POLITICAL ECONOMY OF THE EURO INTRODUCTION IN THE CZECH REPUBLIC

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Abstract

The paper discusses two issues. Firstly: Can the euro also be introduced without an approval of the given country? The paper examines rules for adopting the euro comprised within various EU documents as well as existing experience of the euro area member states. The resulting answer is negative. Secondly: How can we describe the Czech strategy in adopting the euro? The negative position towards the euro is not motivated by economic reasons (nominal and real convergence to the euro area), but rather by political reasons arising in the past. This phenomenon can be described as "euro- hysteresis".

Keywords

Euro, euro area enlargement, National Euro Changeover Plan, euro-hysteresis.

JEL Classification

F 36, F45, G 15

Introduction

As of April 2011, the period of the so-called reduced preparations for the euro introduction has been taking place in the Czech Republic. Discussions on the issue not only continue, but have been recently intensifying. They have been associated with concerns about potential euro imposition, irrespectively of the view and approval of the Czech officials. Discussions have continued, even though no new date has been set following the revocation of the originally foreseen euro adoption date in 2010. The paper focuses on two questions. Firstly: What role does the given country's initiative play in the euro adoption process? Does the euro introduction require an approval of the Czech Government? Secondly: How can we describe the Czech strategy of postponing the euro introduction? Is this strategy common or is our approach of postponing the euro area accession unique? What motivates this strategy?

1. Decision-making process concerning the euro area accession

The Czech Republic committed to adopting the euro Article 4 of the *Act concerning the conditions of accession of the Czech Republic, etc.*: "Each of the new Member States shall participate in Economic and Monetary Union from the date of accession as a Member State with a derogation within the meaning of Article 122 of the EC Treaty."[1]

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[1] *Act concerning the conditions of accession.* The derogation within the meaning of Article 122(1) of *The Treaty Establishing the European Community*: "If the Council has confirmed […] which Member States fulfil the necessary conditions for the adoption of a single currency, those Member States which do not fulfil the conditions shall have a derogation. […] Such Member States shall in this Treaty be referred to as 'Member

1.1 Who decides about the euro introduction?

The specific process of replacing the national currency with the euro with the so-called "Member States with a derogation" is described in the *Treaty on the Functioning of the European Union* (TFEU), specifically in Article 140 (former Articles 121 and 122):

- According to paragraph 1, the European Commission (EC) and the European Central Bank (ECB) shall – at least once every two years (or at the request of a Member State with a derogation) – mainly examine the achievement of a high degree of sustainable convergence (commonly referred to as the Maastricht criteria);
- Paragraph 2 specifies the euro adoption decision-making process: "After consulting the European Parliament and after discussion in the European Council, the Council shall, on a proposal from the Commission, decide which Member States with a derogation fulfil the necessary conditions on the basis of the criteria set out in paragraph 1, and abrogate the derogations of the Member States concerned."[2]

In case the so-called excessive deficit procedure is launched in respect of a Member State, the European Commission must first give its recommendation about the procedure end.

The Treaty of Lisbon (Article 102(b)) resulted in the following amendments: "The Council shall act having received a recommendation of a qualified majority of those among its members representing Member States whose currency is the euro [so-called Eurogroup – note M. H.]. These members shall act within six months of the Council receiving the Commission's proposal."[3]

Furthermore, the ECB also issues its *opinion* on the euro introduction and the conversion rate – upon two requests of the Council.

Subsequently, the Council (ECOFIN) issues:

- Council Decision on the adoption of the euro by the given country;
- Council Regulation on including a new country in the list of the euro area member states;[4]
- Council Regulation on the conversion rate.

This euro introduction process[5] leads to concerns about the fact that the euro introduction may also take place without the given country's approval. According to P. Mach: "[…] The European Union may decide about the accession of the Czech Republic to the euro area even

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States with a derogation'." Moreover, the scope of the derogation is namely expressed in the area of functioning of the national currency and monetary policy of the given country.

[2] *Treaty on the Functioning of the European Union*. The Council of the EU, in its Economic and Financial Affairs configuration (ECOFIN); the European Council consisting of the heads of state or government.

[3] *Treaty of Lisbon*. The Treaty has been in effect since 1 December 2009; therefore, the additional assessment has only been applied to Estonia, Latvia, and Lithuania so far.

[4] The list is enclosed to the *Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro.*

[5] A transparent diagram of the process is shown in an Annex. A similar diagram, in Dědek, 2014, p. 151, contains some differences.

against the country's will. […] In line with applicable treaties, the Economic and Financial Affairs Council will decide about the euro introduction and replacement of the koruna in the Czech Republic […], without any involvement of the Czech Republic. […] The EU may, at any time, decide about our accession to the euro area […]."[6]

1.2 Views of the Czech Government on the decision to adopt the euro

What are the views of the Czech Government about the euro adoption process? The primary document is *The Czech Republic's Updated Euro-area Accession* of 2007. In the document, the Government states that the Czech Republic "has committed itself to introducing the euro and joining the euro area in the future." With regard to the euro area accession date, it states the following:

- "In line with the previous Strategy, the decision to join this system must be based on an assessment of the outlook for the fulfilment of the Maastricht criteria as well as an assessment of the degree of economic alignment with the euro area. To retain the option of deciding flexibly on the adoption of the euro, it would be appropriate to continue conducting these evaluations at yearly intervals using the existing analytical tools.";
- "The euro adoption date will therefore depend on resolving these problem areas in a fundamental reform of public finances and on enhancing the flexibility of the Czech economy."[7]

Therefore, the *Updated Strategy* clearly indicates the Government's intention to determine the accession date at its own discretion, based on its own assessment of the appropriate moment.

Another document that specifies the euro adoption process is the *National Euro Changeover Plan for the Czech Republic* (2007). According to the plan: "Decisions on the timing of the measures[8] that will ultimately lead to euro adoption are the responsibility of the Member State. [9] However, the final examination of whether the conditions for adopting the euro have been satisfied will be made by the EU authorities." Another section of the National Euro Changeover Plan states the following: "After the convergence criteria have been satisfied <u>and the Czech Republic has expressed its will to enter the euro area</u>, the Council of the European Union – acting on the recommendation of the European Commission – will decide on the Czech Republic's entry into the euro area." (underlined by M. H.).[10] Therefore, the *National*

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[6] Mach, 2012, pp. 62-63, 72. A similar statement of P. Mach was published by the server *Zpravy idnes* on 4 August 2011: "The danger consists in the fact that nobody has to ask the Czech Republic, whether it in fact wishes to introduce the euro or not. Once we fulfill the Maastricht criteria, it will simply be imposed." (http://zpravy.idnes.cz/eurozona-nas-vcucne-a-vezme-nam-250-miliard-bez-ptani-varuje-mach-p72-/domaci.aspx?c=A110804_150141_domaci_jw)

[7] The Czech Republic's Updated Euro-area Accession Strategy, 2007, pp. 1, 8, 9.

[8] It (implicitly) concerns measures such as entry to ERM II and request to EC and the ECB to prepare extraordinary Convergence Report.

[9] However, the *National Euro Changeover Plan* does not include any reference to specific EU documents, from which such competence results.

[10] National Coordination Group, 2007, pp. 9, 83.

Euro Changeover Plan unambiguously indicates the Government's intention to make a decision on the euro introduction date on its own as well.

Another important document relating to the accession of the Czech Republic to the euro area is the annual *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. This document, too, explicitly states: "However, setting the date for joining the euro area is within the competence of the Member State and depends on its preparedness."[11]

1.3 Euro introduction in new Member States

The euro adoption process rules, as set out in EU documents, do not regulate the acceding country's initiative within the process at all. How did the euro introduction take place in new Member States?

According to the above mentioned Article 140 of the TFEU, the EC and ECB provide the Council of the EU (ECOFIN) their progress reports achieved by Member States in fulfilling their obligations relating to the their accession to the Economic and Monetary Union. The reports include evaluation of all nonmember states of the euro area, with the exception of Denmark and Great Britain which have a permanent derogation. Some of these reports are dedicated especially to the country acceding to the euro area; in other cases, no separate report is prepared for such country. Let us illustrate this on an example of the two most recent euro area members:

- With regard to Latvia, which adopted the euro as of the start of 2014, the *Convergence Report of the ECB* of 2013 states the following: "This Convergence Report has been prepared following a request for a country examination submitted by Latvia […]." (underlined by M. H.).[12]
- Lithuania, accepted to the euro area at the beginning of 2015, did not apply for such report. The *Convergence Report of the ECB* of 2014 states the following: "In this report, Lithuania is assessed in more depth than the other countries under review, since the Lithuanian authorities have on various occasions announced their intention to adopt the euro as of 1 January 2015." (underlined by M. H.).[13]

The above mentioned "requests" for the preparation of a convergence report or "information on intention" may certainly be viewed as an expression of the given country's interest in the euro introduction.

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[11] Ministry of Finance, 2014, p. 1.

[12] European Central Bank, 2013, p. 5. In addition to the fulfilled convergence criteria, the report also mentions the end of the excessive deficit procedure.

[13] European Central Bank, 2014, p. 5. Similarly, no separate convergence reports were prepared for Slovakia. "In this report, Slovakia is assessed in somewhat more depth than the other countries under review. This is due to the fact that Slovakia submitted a request for a country examination on 4 April 2008 in view of its intention to adopt the euro as of 1 January 2009." (European Central Bank, 2008, p. 5).

Similar interpretation can also be found in other sources. According to Sychra: In March 2006, Lithuania and Slovenia "[…] submitted a request for examination of the degree of their convergence, thereby starting the process of accession to the EMU", or the Slovak Republic "applied for examination of its preparedness for the EMU accession […], thereby launching the official evaluation process within the EU".[14] Similar requests were also submitted by Malta and Cyprus in February 2007.

Therefore, based on the existing practice, there are no reasonable concerns about "forced introduction" of the single European currency against the will of the national political representations. After all, the notion of "forced introduction" of the euro leads to doubts regarding the likelihood of factual implementation of such "forced introduction" of the euro.

2. Euro introduction in the Czech Republic

2.1 Preparations for the euro introduction

Many significant measures have been taken in the Czech Republic in the course of the preparation for the euro adoption. These measures were also officially acknowledged by the European Commission in July 2007. The Czech Republic was identified as a good example of timely preparation even without a set target date.[15]

The main preparations for the euro introduction are as follows:

- *Euro Area Accession Strategy* and *Updated Euro Area Accession Strategy* (2003, 2007);
- *Institutional Arrangements for Introduction of the Euro* (November 2005), which contain the establishment of the National Coordination Group (NCG) and of the national coordinator; in the period of 2007-2014, the NCG submitted nine reports on its activities to the Government;
- *Choice of Scenario for the Introduction of the Euro* (2006) – in the form of a "big-bang" – i.e. one-step introduction of the euro for cash and noncash transaction;
- *National Euro Changeover Plan for the Czech Republic* (2007); in the period of 2008-2010, the NCG prepared three *Reports on the National Plan Fulfillment*;
- In February 2008, a website of the Ministry of Finance dedicated to the euro introduction was launched – *Euro Introduction in the Czech Republic* (www.zavedenieura.cz);
- The Ministry of Finance prepared a draft *General Act on the Introduction of the Euro in the Czech Republic* (2008);

[14] Sychra, 2009, pp. 121-122, 127.
[15] Commission of the EC, Fifth Report, 2007, p. 10.

- *Act on the Czech National Bank* (CNB) that governs activities of the CNB following the euro introduction in the Czech Republic; it was vetoed by President Klaus on 3 June 2010,[16]
- The Ministry of Finance and the Czech National Bank publish their annual *Assessments of the Fulfillment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area;*
- Each year (in the period of 2004-2014), the Government approves the *Convergence Program of the Czech Republic*, which is prepared by the Ministry of Finance and which mainly assesses the situation of public finance;
- In the period of 2007-2009, the NCG prepared six methodology texts (rules for conversion and rounding of monetary amounts, procedures for dual assessment, financial sector preparation, price development monitoring following the euro introduction, estimate of budgetary expenditure, communication strategy[17]) as well as government material *Preparing the legal environment* (March 2009).

As of April 2011, the period of the so-called *reduced preparations* starts, with further preparations only consisting in, for example, monitoring of foreign experience, informing the public through dedicated websites, etc. With regard to new methodology texts, the work has only consisted in the preparation of working versions of new texts, such as the crisis communication plan, adapting individual Ministries to the euro introduction, reference manual for municipal council members, etc.[18]

2.2 Views on the euro introduction in nonmember states of the euro area

Of the ten "original" new Member States of the EU (as of 2004), two thirds have already adopted the euro – specifically Slovenia, Cyprus, Malta, Slovakia, Estonia, Latvia, and Lithuania. What are the views of EU Member States outside of the euro area with respect to the euro introduction? Table no. 1 shows the overview of the euro area nonmember states.

[16] The new CNB Act – i.e. Act no. 227/2013 Coll. – does not deal with the euro; it only eliminates certain incompatibilities of the Act with the EU law and specifies the role of the CNB in terms of the financial stability management.
[17] The last of the specified texts has not been published.
[18] National Coordination Group, 2015, pp. 7-8.

Table No. 1: Planned euro area accession date

Country	Original date	New date	**Preparation stage**
Bulgaria	Not set ("as soon as possible following the fulfillment of the Maastricht criteria")	---	Practical preparations have not commenced
Czech Republic	1. 1. 2010; annulled on 25. 10. 2006	Not determined	National Euro Changeover Plan (2007)
Croatia	Not determined	---	Practical preparations have not commenced
Hungary	1. 1. 2010; annulled on 1. 12. 2006	Not determined	National Euro Changeover Plan (updated in 2009)
Poland	1. 1. 2012; annulled at the end of 2009	Not determined; "as soon as possible following the fulfillment of the accession criteria"	National Euro Changeover Plan (2011)
Romania	2015	1. 1. 2019	Interdepartmental commission established
Sweden	Not determined	---	Preparations discontinued upon rejection of the euro in a referendum of 14. 9. 2003
Denmark	Permanent opt-out with regard to the third stage of the EMU	---	DKK involved in ERM II
Great Britain	Permanent opt-out with regard to the third stage of the EMU	---	

Source: European Commission, 2014 and previous reports

Countries can be divided into several groups based on their attitude towards the euro introduction.

1) The Danish economy is in fact part of the euro area – as a result of its fixed exchange rate to the euro with fluctuation band of ±2.25%, declared as participation in ERM II.
2) Great Britain has been consistently expressing its reserved position towards the integration processes, including the monetary integration. With regard to monetary integration, the situation is identical in Sweden, as the country has not prepared for the euro introduction at all.
3) The three countries in Southern Europe do not show any factual interest in terms of preparing for the euro introduction (with slight exception of activities in Romania).
4) The activities in Hungary and Poland document the countries' efforts aimed at introduction the euro. Both Governments have repeatedly agreed with the euro introduction; however, within an uncertain long-term horizon. At the same time, both countries have been taking preparation measures. The preparations in Hungary are comparable to the situation in the Czech Republic. The National Plan is being updated in Poland.

2.3 Euro introduction date in the Czech Republic

In the Czech Republic, the euro introduction had already been planned; however, it was subsequently annulled.

The Czech Republic's Euro Area Accession Strategy (of September 2003) mentions the "horizon of 2009-2010", later specified in the *Institutional Arrangements for Introduction of the Euro* (2005) to the "working date" of 1. 1. 2010. On 25 October 2006, the Government decided not to pursue the accession to the Exchange Rate Mechanism II (ERM II) in 2007, which resulted in the annulment of the originally planned date for the euro area accession in 2010. A new date has not been determined.

The Updated Euro Area Accession Strategy (of August 2007) confirmed both the annulment of the original 2010 target date, as well as the absence of a new specific date for the planned euro area accession. As of 2006, the annually published *Assessments of the Fulfillment of the Maastricht Convergence Criteria* have contained the same recommendation for the Government – i.e. to not set a date for the accession to the Exchange Rate Mechanism (ERM II) and, consequently, to the euro area.

The Czech Republic is not unique in terms of its position, with Poland and Hungary expressing similar views. On the one hand, it has already completed many of the above mentioned preparations for the euro introduction; on the other hand, it has been postponing the euro introduction on a long-term basis (since 2006). The negative view of the Czech political representation[19] is expressed in the cautious formulation in the Policy Statement of the present Government of January 2014. It does not mention the euro adoption, but only about the fact that "the Government shall actively strive to create conditions conducive to the adoption of the euro“.[20]

The economic conditions for the euro introduction in the Czech Republic – i.e. sufficient nominal and real convergence to the euro area – are a reality (with the exception of formal involvement of the Czech koruna within the ERM II system).[21] The cautious attitude of the political representation towards the euro is motivated by the public opinion – i.e. opinion of voters – in the Czech Republic. According to a poll carried out by the Center for Public Opinion Research in April 2014, the results were as follows in respect of the euro introduction:

- "Definitely against the introduction" - 47% of respondents;
- "Probably against the introduction" - 29% of respondents,

therefore, three fourths of all respondents did not agree with the euro introduction.[22]

[19] The views of the Czech National Bank, one of the most significant opponents of the euro introduction, deserve special attention.
[20] Policy Statement, 2014.
[21] Helísek, 2013, pp. 23-24.
[22] Center for Public Opinion Research, 2014.

What is this public opinion (vies of voters) based on? Does it rely on the study of expert economic analyses or is it rather affected by the views of the previous political representation? If the influence of the second factor prevails, the euro introduction process may be referred to as the "**euro introduction hysteresis".** Hysteresis refers to a situation, where certain value develops under the influence of its own prior developments. The current rejection of the euro introduction results from the past rejection of its introduction.

Conclusion

The legislation of the European Union governing the euro introduction process in a country that is subject to a temporary exception from the euro introduction do not include the requirement for the given country's approval. Is it thus possible to impose the euro introduction even without the consent of the given country's political representation? Based on the existing practice of new Member States of the EU, the euro introduction process has always been initiated by the given country's interest.

Many measures aimed at the euro introduction have already been adopted in the Czech Republic. Moreover, the economic convergence to the euro area makes it possible to replace the koruna with the euro. The negative position reflected in the Czech euro introduction strategy is not motivated by economic reasons, but rather by political reasons arising in the past. This phenomenon can be described as "euro-hysteresis".

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Annex

The approval process for the euro introduction in a Member State with a derogation

Expression of the given country's interest in the euro introduction

- ERM II membership
- Request for examination of the convergence degree
- Another expression of interest in the euro

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Convergence Reports

- Convergence Report of the Commission
- Convergence Report of the European Central Bank

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Proposal of the Commission to the Council (ECOFIN)

- Proposal for revoking the derogation
- Conversion rate proposal
- End of the excessive deficit procedure – if applicable

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Position on the euro introduction in the given country

- Resolution of the European Parliament
- Conclusions of the European Council (heads of state and government)
- Opinion of the European Central Bank
- Recommendation of the Eurogroup

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Conclusions of the Council (ECOFIN)

- Decision on the euro introduction
- Regulation on inclusion among euro area member states
- Regulation on the conversion rate

Source: own elaboration. A similar diagram, in Dědek, 2014, p. 151, contains some differences.