OPEN QUESTIONS OF MONETARY INTEGRATION

1. Introduction

The main objective of Slovakia's macro-economic policy is to complete the final stage of transition and to successfully integrate into the European Union. The effort to join the EU is motivated mainly by the advantages of real convergence. As membership of the economic union is a prerequisite for admission to the monetary union, the adoption of the euro will probably be one of the chief priorities of monetary policy.

The proclaimed date of Slovakia's admission to the EU is common knowledge. The Government of the SR declared that the country would be prepared for entry by the beginning of 2004. The timing of the further stage of integration remains an open question, i.e. the date of entry into the European Monetary Union (EMU). The need for an official position on that date arises from the attitude of other candidate countries to this issue (Hungary shows interest in joining the euro area as early as 2006 and expects to fulfil all the Maastricht criteria including inflation, which is currently below 8%; a more sceptical attitude is held by the Czech Republic, where public finances, the fluctuation in interest rates, the state of the economy, and other factors indicate that the adoption of the euro without marked shocks will be possible only after a longer transitional period as from the country's entry into the EU).

The first part of the article is devoted to questions concerning Slovakia's convergence to EU and/or EMU countries from the point of view of structural convergence based on the theory of Optimum Currency Area, the second part is devoted to nominal convergence (fulfilment of the Maastricht criteria) and real convergence (assessment of economic performance on the basis of GDP per capita). Within this part, the date of possible entry into EMU is also discussed. The following two parts are devoted to an analysis of non-standard procedures, including variants of the exchange rate regime within the integration process, which include the unilateral adoption of the euro and the establishment of a currency board[1].

2. Open questions of convergence

Theoretically, entry into EMU is permissible no earlier than two years after entry into the EU. If the Slovak Republic were to become a member of the EU on 1 January 2004, admission to EMU could be gained at the beginning of 2006. The length of this period is given by the Maastricht criterion for exchange rate stability, including the participation of the currency in ERM (currently in ERM II) and its maintenance within the prescribed range at least two years prior to the country's assessment for entry into EMU. However, we assume that Slovakia's entry into EMU is practicable only during the course of 2006 (not on 1 January 2006), because if SKK was included in ERM II on 1 January 2004, the minimum two-year period would last until the end of 2005 and Slovakia could probably meet the conditions for entry into EMU only in the first half of 2006[2]. In the same period, the fulfilment of other convergence criteria would also evaluated.

As the Slovak Republic will probably not be able to meet the criteria for entry into EMU after joining the EU, the country will be granted derogation (exception) for the adoption of the euro. Such status was previously enjoyed by Greece until June 2000 and is currently held by Sweden[3]. The said status will be guaranteed by an accession agreement. Under the EC Treaty (Article 122 (1)), the European Commission and the ECB are to prepare, at least once in two years or at the request of the Member State concerned, convergence reports, on the basis of which the European Council may decide whether the given country meets the conditions for entry into EMU and the derogation may be cancelled. In this connection, we should mention that reports were prepared in November 1996 (according to that report, the majority of EU countries failed to meet the criteria for entry into EMU and therefore the 3rd stage of EMU was not started on 1 January 1997), in March 1998 (on the basis of which, 11 Member States were admitted to EMU with effect from 1 January 1999), and in May 2000 (according to which Greece fulfilled the criteria for entry into EMU and gained admission from 1 January 2001, while Sweden remained outside, since Swedish legislation, including the statute of the central bank, is not compatible with the EC Treaty and the Swedish crown is not included in ERM). On this basis, we assume that the first convergence reports on candidate countries (which are to enter the EU at the beginning of 2004) will be issued as late as 2006.

Regarding the position of the candidate countries on the date of entry into EMU, we should mention the statement of P.

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[1] The article has been written by a group of authors from the Monetary Division of the National Bank of Slovakia.

[2] The convergence report on Greece was elaborated in May 2000, but the period for the evaluation of inflation and long-term interest rates was April 1999 to March 2000, for the exchange rate April 1998 to March 2000 (the Greek drachma was included in ERM on 16 March 1998, an in ERM II on 1 January 1999), and the fiscal position was evaluated as at the end of 1999. In June 2000, ECOFIN approved the entry of Greece into EMU with effect from 1 January 2001.

[3] On the basis of the EC Treaty, Great Britain and Denmark have a special status, which allows them not to participate in the 3rd Stage of EMU. These countries may ask for the cancellation of this exemption at any time.

Solbes, EU commissioner for economic and monetary affairs (September 2001), who appealed to the candidate countries not to focus their economic and budgetary policies on accelerated entry into the euro area, i.e. immediately after joining the EU. Priority should be given to the strengthening of economic structures in general; candidate countries should not attempt to fulfil the convergence criteria prematurely. During the pre-accession process, they should concentrate on the continuation of structural and economic reforms, and strengthening of the competitiveness of their economies.

Due to the ambiguous position of the representatives of candidate countries and the EU on the entry of those countries into EMU, the following sub-chapters are devoted to the evaluation of Slovakia's convergence, in both structural, nominal, and real terms.

2.1. Structural convergence

In analysing the structural convergence of the Slovak economy to the euro area, we applied the theory of Optimum Currency Area (OCA), which was developed in the 60ties by Mundell (1961), McKinnon (1963), and Kenen (1969), but which has only recently become popular (due mainly to the analysis of the pros and cons of monetary integration within the EMU). The basic idea of the OCA theory is that, for countries or areas exposed to symmetric shocks or having a mechanism for the absorption of asymmetric shocks, the adoption of the single currency is an optimum solution.

In general, the OCA theory is based on the following criteria:

1. degree of openness of the economy – a country whose trade within an OCA represents a marked share in GDP, may profit from the OCA;

2. correspondence between shocks and business cycles – the asymmetry of shocks and business cycles in a country requires the adoption of a specific reform policy, which is, however, not possible in the case of a single currency (i.e. single monetary policy);

3. diversification of products – a country exporting a wide range of products is less exposed to specific shocks within a certain sector and is unlikely that, in the case of such a shock, the country would employ the exchange rate for its elimination;

4. international factor of mobility (e.g. labour force) as an alternative to reform policies – in the case of asymmetric shocks, the higher mobility of the labour force facilitates the adoption of reform policies and thus reduces pressure on the exchange rate;

5. fiscal transfers – fiscal transfers may be used in the case of asymmetric shocks.

In the light of the above criteria, it is evident that the stronger the ties between the countries of a currency area are, the more these countries will profit from their participation in the OCA. Closer business relations lead to convergence between the business cycles, which provides a basis for integration and the creation of a currency area. However, there are counter-arguments to this opinion, based on the idea that the higher level of integration is achieved in trade, the more the countries begin to specialise.

In the following section, we analyse the first three criteria of OCA (considered as the most important) for the Slovak economy in comparison with Germany, EMU, and the EU.

Degree of openness of the economy (orientation of foreign trade)

The asymmetric orientation of foreign trade represents a typical source of real shock, since it is foreign trade through which fluctuations may be imported into the economy. Ideally, countries in a monetary union should trade only among themselves with equal intensity. If the orientation of foreign trade differs substantially, the countries may be hit by various shocks at different times.

In contrast with the EU and/or EMU, the Slovak Republic is a small open economy, with a share of exports and imports in GDP increasing from 122% in 1993 to 150% in 2000. The

Table 1 Structure of Slovak exports by territory (%)

	1993	1994	1995	1996	1997	1998	1999	2000	1 – 6/2001
Germany	15.21	17.10	22.37	21.19	28.37	28.80	27.65	26.77	27.58
EMU	27.72	32.50	41.37	38.55	53.07	52.83	56.00	55.47	57.86*
EU	29.63	34.97	44.50	41.27	56.37	55.65	59.38	59.03	61.38
EU+H+P+CR**	77.50	78.18	93.98	78.96	95.19	83.44	83.91	83.58	84.76

Table 2 Structure of Slovak imports by territory (%)

	1993	1994	1995	1996	1997	1998	1999	2000	1 – 6/2001
Germany	11.42	13.43	14.27	14.61	19.69	25.68	26.14	25.05	25.90
EMU	19.07	24.71	31.20	33.92	39.74	46.48	47.97	45.08	46.63*
EU	27.93	33.44	34.76	37.28	43.79	50.13	51.69	48.88	50.22
EU+ H+P+CR**	67.12	67.11	67.49	66.05	69.76	73.46	73.53	68.76	70.05

Note to tables 1 – 2: * Including Greece; ** EU + Hungary, Poland, Czech Republic

Table 3 Share of Slovakia in the exports of selected countries (%)

	1993	1994	1995	1996	1997	1998	1999	2000
Germany	0.22	0.30	0.41	0.47	0.51	0.65	0.55	0.56
EMU	0.15	0.18	0.24	0.27	0.28	0.33	0.29	
EU	0.13	0.16	0.21	0.23	0.25	0.28	0.26	
EU+H+P+CR**	0.34	0.32	0.37	0.41	0.42	0.45	0.39	

Table 4 Share of Slovakia in the imports of selected countries (%)

	1993	1994	1995	1996	1997	1998	1999	2000
Germany	0.26	0.36	0.47	0.50	0.54	0.73	0.72	0.63
EMU	0.14	0.20	0.25	0.24	0.26	0.34	0.36	
EU	0.12	0.17	0.21	0.21	0.22	0.28	0.30	
EU+H+P+CR**	0.30	0.34	0.39	0.38	0.38	0.43	0.43	

Note to tables 3 – 4: ** EU + Hungary, Poland, Czech Republic

Table 5 Variable *TRADE* – average share of bilateral exports in GDP

	1993	1994	1995	1996	1997	1998	1999	1993 – 1997	1998 – 1999	1993 – 1999
Germany	0.044	0.055	0.070	0.076	0.086	0.112		0.066	0.112	0.074
EMU			0.112	0.120	0.140	0.174	0.181	0.124	0.178	0.146
EU	0.076	0.096	0.111	0.119	0.139	0.172	0.182	0.108	0.177	0.128

difference between the Slovak economy and the EU and/or EMU is apparent from the proportions of mutual trade between these regions. While the Member States of the EU and/or EMU account for roughly 60% of Slovak exports, Slovakia has a share of a mere 0.3% in the total exports of the EU and/or EMU. This also applies to imports (See Tables 1, 2, 3, 4)[4].

Under these conditions, a sudden crisis in the region would represent a bigger shock for the Slovak economy than for Germany, the EU or the EMU. Another example may be the problems of liquidity and the outflow of funds from emerging markets. Currency depreciation in these countries could act as a brake on the activities of Slovak exporters, while the impacts on Germany, the EU, and EMU would be negligible.

This indicates that membership of the EMU would make the Slovak Republic more resistant to the risk of shocks within the EU and/or EMU. This statement is supported with the increasing share of mutual trade in GDP. The variable TRADE (Bayoumi and Eichengreen, 1996) expresses the average share of bilateral exports in GDP, e.g. in the case of Germany, the average share of Slovak exports to Germany in Slovakia's GDP and the share of German exports to Slovakia in Germany's GDP (Tab. 5). The individual values of this variable have no information value, but their upward trend is a sign of continued convergence in all regions under analysis.

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[4] For Slovakia, trade relations with other countries also remain important. Exports to Hungary, Poland, and the Czech Republic account for about 28% of total exports, while the share of imports is roughly 20%. Tables 1 and 2 show that, after the integration of V4 into the EU, Slovakia's foreign trade would take place mostly within this grouping.

Convergence of business cycles

During the period of central planning, the most pronounced differences were recorded between the economies of Western and Eastern Europe. The marked divergence, which widened the gap between market-based and centrally planned economies, was one of the main reasons for the introduction of reforms in Central and Eastern Europe.

At present, there are several studies at our disposal about the convergence of business cycles between the EU and the countries of Central and Eastern Europe, confirming the convergence of business cycles mainly to Germany. (Boone and Maurel, 1998, pointed out a high degree of correlation between industrial production in Germany and the candidate countries). This is due probably to the high share of Germany in the exports of these countries.

The degree of correlation between economic cycles is expressed by the variable SDY, which represents the standard deviation of percentage changes between the relative products of Slovakia and Germany, and/or the EU or EMU (Bayoumi and Eichengreen, 1996). In general, the low value of this variable indicates a relative symmetry between the business cycles. The period under analysis was divided into two time sections, i.e. 1993 – 1997 and 1998 – 1999 in respect of Germany and the EU, and in respect of EMU to 1995 – 1997 and 1998 – 1999 with regard to the availability of data for those periods.

The results obtained indicate that increased convergence was achieved during the period 1993 – 1997, while the business cycles began to diverge slightly over the years 1998 – 1999. These results may be attributed partly to the shortness of the time series and partly to the changes in the

Table 6 Variable SDY – standard deviation of percentage changes in real GDP

	1993 – 1997	1998 – 1999	1993 – 1999
SR – Germany	0.012	0.019	0.020
SR – EMU	0.006	0.019	0.024
EU	0.011	0.019	0.021

country's economic policy after 1998 (economic restructuring, consolidation of public finances), which affected the rate of economic growth and probably the character of the SDY variable as well. Despite the above results, we cannot exclude the suitability of monetary union between Slovakia with the said areas.

Structure of foreign trade by commodity

The structure of foreign trade by commodity is another indicator reflecting the structural similarity or dissimilarity between the economy of Slovakia and those of Germany, the EU and EMU. If the ongoing bilateral trade is based on comparative advantages (intersectoral trade), then the tradeable sector of the Slovak economy is forced to specialise and becomes more sensitive to fluctuations than the aforementioned economies. Where, however, trade is based mostly on intrasectoral barter, the economies are converging in terms of structure.

The structural similarity or difference between the Slovak economy and the economies of Germany, the EU, and EMU is expressed in terms of the DISSIM variable (Bayoumi and Eichengreen, 1996), which is defined as the sum of the absolute differences between the weights of agricultural products, mineral raw materials, and industrial goods in total exports (SITC classification). In the case of this variable, it is again true that the absolute values are difficult to interpret, but their downward trend (except 1999) confirms that there is convergence even in this case.

The above variables all indicated the probability that the economies of Slovakia and Germany, and the EU or EMU will be hit by real asymmetric shocks, which would have a negative effect on economic performance in the absence of flexible exchange rates. They represent the costs incurred in connection with the adoption of a fixed exchange rate regime.

On the other hand, the advantages arising from the introduction of a single currency may be assessed according to the relative size of the Slovak economy. The said advantages are expressed in terms of the SIZE variable, which is defined as the arithmetical average logarithms of real GDP in Slovakia and the areas concerned (Bayoumi and Eichengreen, 1996). The absolute values of this variable (Tab. 8) may be interpreted as transaction values for the use of national currencies. The comparison of transaction values for Germany, EMU and the EU shows that the transaction advantages for smaller groupings (SR and Germany) are greater than those for the larger ones (SR and EMU or SR and the EU).

OCA index

In the foregoing part, we tested the basic features of OCA for the economies of Slovakia, Germany, the EU and EMU: the orientation of foreign trade, structure of foreign trade by commodity, and the convergence of business cycles. Within the scope of individual criteria, we obtained ambiguous results. One of the factors casting doubts on the conclusions of this study is the shortness of the time series applied. In the case of the orientation of foreign trade, the study confirmed the persistent asymmetry, which is, however, a sign of an advantage of EMU membership. The correlation between the business cycles does not yet indicate a convergence between the economies, which is connected with the structural changes effected in the Slovak economy in the years 1998 to 1999. On the other hand, the similarity in the structure of foreign trade by commodity indicates a structural convergence between the Slovak economy and the areas under analysis.

Since the results were rather ambiguous, we used the values of individual variables for the calculation of a single variable, i.e. the OCA index, indicating the degree of the country's readiness for the adoption of the single European currency. The definition of this variable has been taken over from a study made by Bayoumi and Eichengreen (1996). These authors concentrate mainly on the conditions set out for OCA and assume that the long-term volatility of bilateral interest rates will reflect the level of fulfilment of these conditions irrespective of the actual exchange rate regime. Thus, countries meeting the OCA criteria are expected to record low

Table 7 Variable DISSIM – Slovak exports and related areas by commodity

	1993	1994	1995	1996	1997	1998	1999	1993 – 1997	1998 – 1999	1993 – 1999
SR – Germany	0.158	0.143	0.151	0.129	0.119	0.089	0.120	0.140	0.105	0.130
SR – EMU			0.109	0.109	0.101	0.077	0.104	0.106	0.090	0.100
SR – EU			0.100	0.101	0.09	0.072	0.094	0.098	0.083	0.092

Table 8 Variable SIZE – relative size of the Slovak economy and related areas

	1993	1994	1995	1996	1997	1998	1999	1993 – 1997	1998 – 1999	1993 – 1999
SR – Germany	5.28	5.32	5.36	5.39	5.43	5.46	5.48	5.36	5.47	5.39
SR – EMU			5.88	5.91	5.96	5.99	6.01	5.92	6.00	5.95
SR – EU	5.82	5.86	5.90	5.94	5.98	6.02	6.04	5.90	6.03	5.93

volatility in bilateral exchange rates. Within the scope of the said analysis, we tested the relationship between the volatility of bilateral exchange rates and the SDY, DISSIM, TRADE, and SIZE variables in several advanced industrial countries and identified the following formula, which is stable in time:

$$OCA = -0.09 + 1.46\ SDY + 0.022\ DISSIM - 0.054\ TRADE + 0.012\ SIZE$$

On the basis of this analysis, we divided the countries of the EU into three groups: countries fully converging, converging, and diverging.

Since the analysis was carried out in 21 countries during the period 1973 – 1992 and the coefficients of the above relationship were stable over that period, we used the equation for testing the preparedness of Slovakia for monetary union with Germany, the EU and EMU. A lower value of the OCA index indicates a higher level of preparedness for the adoption of the single currency. The results shown in Table 9 cannot be interpreted unambiguously: the OCA index should reflect only positive values, which was not confirmed during the years 1993 – 1997. On the other hand, the results for the periods 1998 – 1999 and 1993 – 1999 indicate that the structural convergence continued. (In this respect, however, we should emphasize that, with regard to the inflow of foreign capital into Slovakia in the form of direct investment during the last two years – the analysis of OCA covered only the years 1993 to 1999 – the structural convergence of Slovakia with the tested regions is expected to continue.)

Table 9 OCA index

	1993 – 1997	1998 – 1999	1993 – 1999
SR – Germany	–0.009	0.000	0.002
SR – EMU	–0.015	0.002	0.011
SR – EU	–0.007	0.003	0.006

The analysis of the basic features of OCA leads to the conclusion that the Slovak economy has reached a certain level of structural convergence over the recent period and, despite some differences, the probability of asymmetric shocks has fallen to some extent.

2.2. Nominal convergence

Apart from structural convergence, it is also necessary to evaluate the possibilities of the SR meeting the criteria of nominal convergence (i.e. the Maastricht criteria), and the period of time necessary for the fulfilment of these criteria.

In the fiscal area, the Slovak Republic will probably not meet the criterion for the size of the fiscal deficit (3% of GDP) even in the present year, since the deficit planned for 2001 was 3.9% and that for 2002 amounted to 3.5% (the Ministry of Finance modified the deficit for 2002 to 3.6% as a result of a higher-than-expected valorisation of old-age pensions; this value is, however, above the limit set in the Staff Monitored Programme). In addition, these values are adjusted

for the costs of restructuring in the banking and corporate sectors. With the costs taken into account, the share of the fiscal deficit in GDP would be higher by roughly 1 percentage point in both years. The criterion for government debt in (60% of GDP) is being met by the Slovak Republic (to approximately 30% in 2000, excluding bonds issued for bank restructuring in the amount of roughly Sk 105 billion; with this figure included, government debt would reach 44% as a share of GDP). Despite a moderate deterioration in the value of this indicator in recent years, the SR should fulfil this criterion on condition that receipts from privatisation are employed for reducing the level of national debt.

As yet, the Slovak Republic does not meet even the long-term interest rate criterion (i.e. that for interest rates on 10-year government bonds). However, it is problematical to evaluate the development of long-term interest rates, since the Slovak Republic issued 10-year government bonds for the first time in 2000, when two issues were floated (one of them was made for bank restructuring, but was left out of consideration since the bonds were not sold by auction). The rate of interest on the remaining issue reached 8.42% (the Maastricht criterion for 2000 was 7.4%). In 2001, three issues of 10-year government bonds were floated, one of which was again intended for bank restructuring. Interest rates on the remaining two issues fluctuated above 8.0%. From the point of view of Slovakia, the interest rate criterion seems to be realisable in 5 years on condition that an official proclamation is made of entry into EMU and the other criteria are also met.

The exchange rate criterion requires that the currency be included in ERM II and the rate of exchange maintained within the set range for a period of two years. Since the Slovak currency may be included in ERM II only after the country's entry into the EU, this criterion cannot be evaluated for the time being. According to actual data, the SKK/EUR rate has, since January 1999, been fluctuating within the range of (15%[5], indicating that the Slovak crown can hypothetically meet the said criterion and its future fulfilment is regarded as more or less free of problems.

Inflation is another criterion that is not yet met by the Slovak economy. After disinflation in 1996, the average rate of inflation showed a tendency to rise until the year 2000, up to 12.0% (the Maastricht criterion in 2000 was 2.8%[6]). In the Monetary Programme of the NBS for 2001, the average inflation rate was expected to fall to 7.1 – 8.3%, and the updated figure for the end of 2001 was 7.5 – 7.6%, which is, however, still far from the level of the Maastricht criterion[7]. With regard to the future

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[5] The deviation of the SKK/EUR exchange rate ranged from + 3.8% to – 8.9% from the initial value, i.e. 43.097 (01.01.1999), and/or from + 4.4% to –8.4% from the average for the period January 1999 to September 2001.

[6] The Maastricht criterion for inflation is defined as the average of the three lowest (average) rates of inflation in EU Member States, increased by 1.5 percentage points. For the time being, this value is given by the rates of inflation in France, Great Britain, and Sweden, i.e. the Maastricht criterion is also determined by Member States outside the EMU.

[7] During the years 1999 to 2001, a marked contribution to the rise in inflation was made by adjustments to regulated prices.

Table 10 Fulfilment by Slovakia of the Maastricht criterion for inflation

	1993	1994	1995	1996	1997	1998	1999	2000	8/2000	Estimate 2005
Slovakia*	23.2	13.4	9.9	5.8	6.1	6.7	10.6	12.0	7.9	4.6
Reference value	3.1	3.1	2.7	2.5	2.7	2.2	2.1	2.8	3.3	2.7**

* The rate of inflation is expressed in terms of the harmonised index of consumer prices.
** The reference value of inflation for 2005 is defined as the average of reference values for the period 1993 to August 2001.

course of inflation, two major problems may occur. One of them comprises the modification of regulated prices, the currently unknown deregulation calendar for the next years, and the adjustments to indirect tax rates in connection with entry into the EU. For the year 2002, the Slovak Government approved an increase in the price of gas only for industry and an increase in the maximum price of heating for households, while the direct effect of the adjustment to the price of heat for households on inflation in 2002 will amount to roughly 0.6 of a percentage point. Compared with the originally approved calendar of price adjustments (according to which the impact on inflation would be 3.2 percentage points), this is only a moderate impact. Such a decision will, however, require more extensive adjustments to administratively controlled prices in the period to come. The other problem is the need for an increase in price levels with a view to approximating the level of prices in the EU (in 2000, price levels in the SR reached roughly at 40% of the level in EU 15). With regard to these factors, it is difficult to forecast the time necessary for the fulfilment of the Maastricht criteria. In 2005, the average rate of inflation is expected to reach 4.6%, so it is probable that the SR will not meet the inflation criterion even by that time (Tab. 10). However, it should be emphasized that this value includes the effect of deregulation (according to the assumptions). Since Slovakia requires a transitional period in the area of taxation[8] (e.g. maintenance of reduced VAT rates for heat and electricity, gas, construction work, and minimum excise duties on cigarettes, i.e. less than 57% of the maximum retail price, etc.) and it is not clear what sort of adjustments will be made to these items during the transitional period (one-off adjustment at the end of the transitional period or gradual adjustment spread over the individual years), the average inflation rate in 2006 may be 1 to 2 percentage points lower than in 2005.

The fulfilment of the inflation criterion at the expense of postponement of the deregulation of some administratively controlled prices, does not appear to be the most suitable solution (most regulated prices, e.g. the   to the level of economically justified costs, before the entry of Slovakia into the EU). If the SR meets the inflation criterion in this manner, additional adjustments to administratively controlled prices after entry into the EMU could have an upward effect on inflation. A slowdown in the rate of growth in the euro area and the subsequent cut in the interest rates of ECB may further

accelerate the rate of inflation in the SR.

The convergence of price levels should take place before entry into EMU, when the SR as a potential member of the EU may expect that the inflow of foreign direct investments will continue. Thus the rise in price levels and their convergence with the EU average would be accompanied by dynamic growth in labour productivity and overall economic performance, which would offset, to a significant extent, the impact of increased inflation on the competitiveness of the Slovak economy.

2.3. Real convergence

From the point of view of Slovakia's entry into the monetary union, the question of need for real convergence also arises (in 2000, the SR reached approximately 50% of the average per-capita PPP in the EU).

The integration of the SR into EMU is expected to lead to the consolidation of the fiscal budget (fiscal criterion), which should be maintained even after the country's entry into EMU (Stability and Growth Pact). At the same time, the adoption of the euro is expected to bring about a fall in interest levels with a positive impact on the rate of economic growth and fiscal position, a reduction in transaction costs, elimination of exchange rate volatility, and a fall in the inflation rate (the advantages of the single European currency will be analysed in detail in Chapter 3.1).

The currently non-existing labour mobility, which is a mechanism enabling adaptation to asymmetric shocks, is expected to increase somewhat after the entry of Slovakia into the EU. After the Chapter 'Free Movement of Persons' had been tentatively closed, the Slovak Republic agreed to a 7-year transitional period of restriction on the employment of Slovak citizens (in certain professions) in some of the Member States (Germany, Austria), with the possibility of reciprocal measures on the part of Slovakia. At the same time, the EU accepted the requirements of the Czech Republic for the introduction of a transitional period for the free movement of persons in relation to the present or future Member States, if such restrictions are imposed on the Czech Republic by some of EU Member States. The same system was offered to other candidate countries. The described partial mobility of persons could be replaced as a means for reducing the probability of asymmetric shocks by the provision of pre-accession funds from the budget of the EU (fiscal transfers).

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[8] Chapter 10 'Taxes' has not yet been closed; the European Commission recommends that the transitional periods should be re-considered.

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