Eugen DIJMĂRESCU
editor

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EUROPE'S NEXUS FOR STABILITY

ROMANIAN ACADEMY
National Institute for Economic Research "Costin C. Kirițescu"

Editura Centrului de Informare și Documentare Economică

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Essays

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Editor: Eugen DIJMĂRESCU

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Bucharest, 2025

CONTENTS

PREAMBLE

There is a season for everything: boldness, madness, breakthroughs, discovery, and other disorders. The third decade of the third millennium marks the course of history by pushing humanity into the claws of evil. The number of victims caused by the COVID-19 pandemic, the Russo-Ukrainian war, the conflict in Gaza, and the immigration crisis exceeded six million in less than five years. New red lines are drawn by those ignoring liberal democracy, by those searching to get rid of institutions and rules internationally agreed, which facilitated their growth. Meanwhile, Europe is caught between Washington's new entente with Moscow and by the far-right supporters and promoters of sovereignism and nationalism. The driving engines of the new order are the imperial powers (the USA, China, and Russia) which subordinate their foreign relations to military capability and extraterritoriality will. How did the World get there? Is this the swan song of the post WWII generation or the outcome of smuggled education by online media?

Since the turn of the century, Europe has enjoyed three decades of the Single Market and 25 years since the Single Currency bestowed its services upon it. Both were born during the longest period of peace that Europe has enjoyed, making it a major economic power with a currency which became the second worldwide asset for settlement and international reserve. All those were made possible by consented unity and openness. Before attempting to challenge the EU, it is prudent to acknowledge the potential immediate and future losses for the young generation who project its future in cultural harmony, beyond geographical boundaries.

Today, Europe is confronted with existential threats. On one hand it is targeted by both US and Russia in the interest of their spheres of influence, a realpolitik which inspire US attitude of indifference and Russia's hostility. Inside Europe, on the other hand, a growing number of those opposed to the idea of staying together, cite both dissatisfaction with Brussels' bureaucratic policies and the encouragement of sovereigntist sentients by extremist groups and foreign powers. None of them can be easily overcome without convergence of national and European policies, to be achieved by rebuilding trust in politics and proof of deeds, as the single market and the common currency have confirmed to every citizen.

This volume is based on the Romanian version of "Euro – liantul stabilității" (edited by Dijmărescu and Moagăr-Poladian, 2024). It can be better understood alongside

"Piața unică la 30 de ani" (Dijmărescu, ed., 2023), both for the premises of the Euro's emergence and the filiation of the authors' ideas. To get more insight, the editors have invited authors from other countries who have not joined the Eurozone, as Romania did. The intriguing question of the book is: "Why aren't they members?" Because they don't want to, or because they aren't capable? Or are they afraid? The volume assumes this challenge under increased stress due to alienation from the European Union and the identity's will to return to an inward retreat. Moreover, it would be hazardous for Europe to emphasize the containment of Trumpism instead of pursuing its own agenda.

Written outside of the Eurozone, the essays do not focus on the strengths and limits of the single currency, born from a unique construction – neither an optimum currency area nor a federation. The authors sought to comprehend the compatibilities of the aspirations of the societies they live in and the Euro offer. We should not take desires for will, especially when they do not belong to the same people. Solidarity has few chances of succeeding in an environment where subconscious pushes to trust other power than the one to which we engaged to add strength. Politicians don't value pro-European discourse, as if Europe's issues only concern technocrats, not the people who elect them.

Current risk and instability should encourage European members to find more effective ways to protect themselves and move forward together. This effort cannot be driven solely by the fear of aggression but must also be rooted in the pursuit of cultural solidarity. After all, what truly endures are not the temporary alliances formed by transient leaders but trust, one of its symbols being the Euro.

Eugen Dijmărescu
February 2025

SAILING EUROPE'S TROUBLED WATERS

Eugen Dijmărescu

The second decade of the twenty-first century marked the end of the world order based on norms and international agreements which followed World War II, the end of colonialism, and the fall of the Iron Curtain. It is, also, the twilight of globalization. Another world emerges, defined by multipolarity, polycrisis, mercantilism, and *imperial powers*. Foes became friends, and politics garnered widespread disapproval. Europe[1] holds a marginal place in this new game, trapped between new masters. Along a slashed Europe, the imperial powers compete into arms race, territorial expansion, and artificial intelligence supremacy. Will Europe's stability and solidarity – that reinforced its foundations – be able to recover its role as a vital actor in international relations, as well as a symbol of human rights and fair trade, containing populism and sovereignism? It took only a month since a conservative-populist entered the White House that Mephisto's whisper echoed across Eastern Europe, predicting the end of the EU.

Europe is the example of goodwill and cooperation achievements (euro included), how they can boost markets and citizens' welfare. The obstacles that the Eurozone has crossed point to construction's uniqueness: neither an optimum currency area, nor federalism, but dependable and durable. Manuel Arias Maldonado of University of Málaga delivered a beautiful synthesis of commitment to Europe, stating that "the existence of the EU is no less than a political miracle made possible by the successive unification of nations boarding a ship already in motion" (Maldonado, 2024).

Confronted with warfare and the ambitions of foreign powers to destabilize Europe, the Eurozone is fragile without the completion of the Economic and Monetary Union, of the Banking Union, and the emergence of the Capital Markets Union. Europe should address, also, the dysfunctions arising from the absence of a fiscal union, of a unified budget, and of the escalating costs associated with the EU enlargement in an environment of prevailing attitude of member states to maximize benefits derived from their membership while opposing any increase in their contributions.

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[1] EU at its core.

Today, we have a European Union stuck between an intergovernmental organization and a federation, derived from fragmented erosion of national policy boundaries in the advance of integration. External shocks, crises, and wars can become vectors for understanding the need to relinquish some national sovereignty pride, but also intensify disputes between national political forces, as well as between member states with respect to their ability to assert in community institutions and in relation to other EU members.

Since Europe itself is shaken by increasing threats, from dealing with immigration to the need for a common defense, hybrid war, and cyber-attacks, it becomes obvious that what it is short of, and not addressed, is a pro-European education (could Erasmus become the chance or the fifth dimension of the single market freedoms, as called by Enrico Letta?[2]), and a neutral but comprehensive consultation and information of European citizens about what should be done to acquire and preserve the common future.

I Designing the Whole

The Euro was not born to meet economic or financial requirements. It was called to strengthen European solidarity confronted with a changing economic landscape, where adversity and the cost of threats would have been higher with individual efforts to properly manage financial crises. Try to measure the size of potential damage in absence of the Eurozone and its mechanisms during the Covid-19 and for the recovery of abruptly stalled economies[3]. To get a better perspective, remember the consequences and casualty numbers of the pandemic following World War I. Currently, with an AAA confidence rating in global markets, Eurozone residents see the Euro as a standard of normalcy, essential for daily life.

"The Single Market at 30" (Dijmărescu, ed., 2023) emphasized two critical aspects of the Eurozone: a) Europe's strength stems from the single market, monetary union, and banking union; and b) the European sustainability is dependent upon the Eurozone's efficient operation and the cohesion of its members. A single market and a single currency are the symbols of the dichotomy of reliance and competition. The countries which have adopted both made national sacrifices for communitarianism,

[2] Letta, 2024

[3] In a decade and a half, Europe has faced a financial blow from the USA, a pandemic outbreak from China and an energy crisis generated by the Russian war against Ukraine. Those events require re-exam of efficiency – security ratio, especially from the specialization process in World trade and weaknesses of supply chains (Pisany-Ferry a.o., 2024).

consistently supported by the political assumption of the costs involved with countries' ambitions to join exclusive clubs. Enrico Letta's report emphasizes that "over thirty years since its inception, the single market remains a fundamental pillar of integration and European values, acting as a significant catalyst for growth, prosperity, and solidarity" (Letta, 2024, p.3), while also promoting innovation in line with significant global transformations.

Is the Eurozone open to new members, including those whose accession treaties specifically provide for the adoption of the single currency? In other words, do these countries wish to join the elites? Numerous Eastern European residents and politicians seek consolation in their insular communities, believing that such a choice protects them better from external concerns, even though this lack of transparency perpetuates past mistakes and encourages unproductive cycles (Bratu, 2007, p.124). It is worth noting that at the end of the Balkan War (1999), a new European order was born, as Bulgaria, Romania, and Hungary prohibited Russian planes from entering their airspace on the way to Kosovo (Tertrais, 2023, p. 10), establishing new security limits on the continent. This has facilitated Eastern European countries' entry to the European Union, a construction distinguished by civilizational diversity, philosophical and theological tolerance, adherence to rights and freedoms, democratic institutions, and a shared cultural history and artistic expression.

In addition to the importance of putting the economies in line with the four economic convergence criteria (which can be achieved through prudent policies), political will is required to achieve legal compliance with the obligations outlined in the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks. This includes guaranteeing the central bank's independence (Article 130 TFEU and Articles 7 and 14.2 of the ESCB Statute), prohibiting monetary financing of public institutions (Article 123 TFEU), and restricting privileged access (Article 124 TFEU). The time proximity of central bank independence with the introduction of the euro raises question about the reasons for passivity of monetary policy institutions in matching their operational legal framework with the convergence requirements.

In 2024, the European currency marked its 25 years, following a period defined by financial crises, a pandemic that shut down the world for two years, consequences of economic sanctions imposed to a major energy supplier, and the inflow of over 11 million immigrants[4]. The ongoing events demonstrate that the conflicts in Ukraine and the Middle East generate significant realignments in international rela-

[4] Compared to 2021, when less than 10 p.c. of world refugees were living in the EU, till the end of 2022, following the beginning of the Russian Ukrainian war, the share of refugees living in the EU rose to more than 20 p.c.

tions, affecting not only the dynamics of power, but also the economic and financial sectors, as well as mobility of individuals, adding pressure to the European currency.

These conditions call for a sensible and clear view of the truth. In a hostile geo-strategic environment that could spark conflict and call for a European defense industry focused on autonomy and interoperability, is Europe ready to smoothly follow an agenda with global ramifications[5] (a.o. education, health, asylum, green economy, climate change, capital market integration, and public goods and policies for European citizens)? Although satisfactory results cannot be expected everywhere, but they are inextricably linked to engagement with democracy and the European concept, all of them supported by the Euro – a currency endorsed by 20 member states but used by citizens and entrepreneurs from all 27 members, as well as international markets. Are those expectations too high in the environment of the rise of sovereigntist forces, and influence of foreign powers? The diverse positions of member states and political entities on European policies have become more obvious, transcending their pro-European or Eurosceptic inclinations. Europe's availability of human capital, technological capability, and financial resources required to accomplish its goals deserve a unified political resolve to succeed.

Over three decades after the establishment of the Single Market and a quarter of a century after the adoption of the common currency, the absence of the authority to develop and implement a meaningful European economic policy is acutely aware. Articles 120 and 121 of the Treaty on the Functioning of the European Union (TFEU) claim that member states call their national economic policies "a matter of common concern," which should be coordinated within the Council "in line with the principle of an open market economy and free competition," and consistent with the European Semester interpretation. The EU's economic policy responses to crises and challenges caused by global upheavals have proved that, while the Union can manage crises, the alternatives are limited and acting fast and effectively necessitate severe political costs. The major cause of the competency gap is the contradiction between member states' devotion to their economic, social, and employment sovereignty with the need to create common chances for action through those policies (Becker, 2024). Furthermore, there is a mismatch between the criteria for determining the adequacy of the single currency with the national economic policies.

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[5] Part of an international system dominated by oligopoly competition where power is shared between few jurisdictions which shape the global relations.

II Architects and Administrators

Is the Euro an economic instrument to strengthen the European economy and increase its competitiveness against the dominance of the US dollar, or just a political asset of Europe's unity and power, perceived solely as a European asset? What role did it play in the context of the 2008–2012 financial crises, which precipitated the West's decline? Did the European currency arise out of need, of voluntarism, or ambition?[6] While it is wrong to claim that the Euro was a quid pro quo secured by François Mitterrand in exchange for Helmut Kohl's desire for German reunification, it is equally correct to understand the establishment of the Euro as a mutual goal of the two leaders to protect Europe from the international monetary upheavals caused by the US dollar (Guillaumin, 2024). The distinctions between European nations' economies and cultures are deeply rooted, and any initiative of greater interest can be understood differently. For example, the Germans viewed the Euro as an upgrade of the Exchange Rate Mechanism (ERM) based on the merits of the German mark, while the French saw the Euro as a global currency in support of Keynesian policy incentives (Brunnermeier et al., 2016, p. 3).

No response would be complete without noting that the brief history of European integration recognizes only three honorary citizens of Europe: Jean Monnet, Helmut Kohl, and Jacques Delors. Their intellectual and political attributes, combined with visionary qualities, made possible the union, stability, and European identity; the last two are also responsible for the Euro and the monetary union[7]. The three people above listed symbolize Europe's *founding generation*, followed by *administrators* of a structure that they do not perceive as their own. This shift outlines the process of contesting the democratic legitimacy of European integration since the people became resistant to the idea of Europe, promoted by a handful of political elites against the backdrop of idle national parliaments. Thus, the censorship against the elites dampened the excitement of European leaders, leading to the failure of the European Constitutional Treaty (2004).

Jean Quatremer and Thomas Klau, keen analysts of the European integration, have meticulously examined the transcripts and memoranda of dialogues and conflicts among the Eurozone founders, beginning with the turbulent year of 1968 through periods of diminished trust caused by the Greek crisis and the global financial crisis

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[6] "I characterized the development of the European Monetary Union as a French endeavor aimed at attaining monetary and economic equivalence with Germany" (Mody, 2018, p. 61).

[7] Some studies on European history contend that the EU embodies the apprehensions of Harry Truman and George F. Kennan, who posited that (1) without reconstruction, Europe risks succumbing to Russian hegemony, and (2) that restoration devoid of European integration may result in German dominance. (Legras, 2024).

of the early twenty-first century (Klau, Quatremer, 1999; Quatremer, 2019). The two authors feel that, despite national pride and institutional hostility, whether at the national level or among leaders from various jurisdictions, the *founders* have been characterized by a distinctive and unifying feature: *the audacity.* Undoubtedly, present leaders are short of, as proven by a confrontational demeanor rather than commitment to resolve and competence to act. Twenty-five years after the Euro's adoption, smart people observe the missing potential of an autonomous authority, which the EU could have become with the euro's support (Todd, 2024, p.161). The fact that during the financial crisis of 2008-2009 and the sovereign debt crisis of 2010-2011, when the discretionary actions of central banks, including the ECB, sparked public outrage, confidence in the Euro remained intact, despite the shift in EU leadership from supranational institutions to the intergovernmental level, resolving, thus, the conflict between state sovereignty and institutional sovereignty.

Americans (who never take European institutions as partners) and the British resolution to either reject the single currency out of a lack of interest in understanding Europe or fostered skepticism out of fear of a challenge to the dollar's dominance, by preaching Euro's failure (Roubini, 2010; Krugman, 2011; Stiglitz, 2018) add to nationalist impulse adopted by far-right movements, already encouraged by Europe's adversaries[8]. Isn't it possible that influencers in the countries that have not adopted the single currency to use narratives like those from across the ocean to discourage adoption of the euro, thereby circumventing the bi-centennial evidence of the economy's dependence on politics?

The euro's architects acknowledged Robert Mundell's theory of optimum currency areas (Mundell, 1961), claiming that the euro's success should have been based on significant economic integration, symmetrical economic cycles, and labor market adaptability. The emphasis was laid on setting fiscal parameters and targets, maintaining price and interest rate stability, promoting economic development and productivity, and converting inequities into complementarities. This demand was answered by enacting the *Stability Pact*.

The Euro did not emerge, as some historians and politicians claim, from a French wish to limit the DM's capacity to become Europe's monetary standard or from Germany's wish to become arbitrator of the viability of less competitive economies. Those "arguments" are regularly revived by proponents of sovereignty and media outlets supporting them. Indeed, significant distinctions have influenced France and Germany in their journey towards establishing the Eurozone, some of which are

[8] Readers are right to wonder why numerous analysts on European topics favor bibliographies in English from non-EU authors, while the focus of European policy lies on both sides of the Rhine, rather than across the Atlantic or the English Channel.

rooted in painful historical deeds. Post-Nazi Germany aimed to constrain arbitrary State intervention in public finance and embraced rule-based liberalism, whereas France, blaming the inadequacies of pre-World War II liberalism for insufficient defense preparedness, turned its expectations towards responsible State engagement in public finance and monetary policy management. In short, Germany restored subsidiarity (suspended during the Nazi era) and established a federal budget to balance the Länder demands, whilst France asserted a centralized unitary state. These examples highlight the frequent lack of convergence between the economies of the member states and their various economic policies. National economic and growth models vary, indeed, including supply and export-oriented policies, competitiveness, and mostly statist and demand-driven approaches.

Politicians freely give their opinions on *economic governance*; but, while under a federal system governance implies convergence towards a common culture of stability, most others perceive it as common initiatives to achieve economic objectives. The European issue is that many governments do not show political stature in the debate about the future of the European Union and rally to one side or the other based on the extent of their sovereign indebtedness (north vs. south; frugal vs. eastern). Various sorts of conflicts and opposition have affected the process of European integration since beginning, most notably between the federal vision and an intergovernmental perspective for Europe, as well as tensions between national and supranational institutions (Coman, 2022). Soon after the Euro birth, member states have proven fatigue and lowered the preoccupations for accomplishing the single market, which paved the way to China to become a mighty power, to BRICS to turn the liberal order upside down; and to US to take profit of a big, unified capital market that pushed forward innovation and technologies.

The Euro's importance in the European economy and its global stature are undeniable, as its political significance, given that Europe is the largest donor of international aid. However, its share of merely 20 percent in global settlement (2022), makes it only a regional currency (Lagarde, 2023). Those who spared no effort to give Europe a monetary identity, who prepared, negotiated, and implemented the Maastricht Treaty (1992), sensed that their work would not be perfect (presuming that price stability would be sufficient to ensure financial stability, and that fiscal policy had no role in price stability). From a political perspective, this was the extent of what could be accomplished by then, relinquishing part of national sovereignty, a situation persistent to the present day[9].

The result is precarious and often belated financial solidarity between the rich and poor states of Europe, Greece being the most obvious example, aside from its do-

[9] Helmut Kohl advocated to put Euro under the aegis of a political European authority.

mestic dysfunctions. The Greek debt crisis and the actions of “so called” friends provide a compelling argument for recognizing the importance of solidarity; in 2001, Greece faced mounting financial difficulties, while the Maastricht Treaty asked Eurozone members to improve their public finances. Goldman Sachs intervened by enabling a clandestine loan of 2.8 billion Euros for Greece disguised as a "currency swap." As a result, Greece's international debt was converted into national currency-denominated bonds at a fake exchange rate, resulting in the apparent reduction of about 2 percent of debt from the national accounts. Goldman Sachs received 600 million Euros for providing the "service" (Reich, 2015). JP Morgan carried out a similar initiative when it "assisted" Italy in disguising its debt at a favorable exchange rate, resulting in payments that were not registered in the national accounts as future liabilities.

When market pressure increased, countries facing balance-of-payments crises called for external finance to cover short-term deficits and introduced austerity measures. While this allowed them to avoid the default, accepting the help required the implementation of harsh budgetary and structural reforms, leading to austerity, increased poverty, unemployment, and disenchantment with politics, including the European policy. (Reinke, Walter, Ray & Redeker, 2023, p. 33).

III The Threats

Any evaluation of Europe's future must consider the long-term consequences of the conflict started by Russia in February 2022 along the Union's frontiers, as well as the (again) unstable situation in the Middle East and Near East. The world has entered a state of permanent hostility, adding new challenges to Europe, fueled by the Trump Administration attitude towards the EU, the proliferation of risk jeopardizing economic growth and sociopolitical cohesion, as well as by increased susceptibility to external interference. Europe must seek methods to coexist with alternative rules and norms of international relations: The 15th BRICS summit (2023) – the intergovernmental coalition comprising all of Europe's foes (Russia, China, India, Iran) – has clearly articulated the objective of "de-Westernizing" (Schnapper, 2024, p.14), primarily targeting the elimination of Western political norms, economic structures, and legal regulations from the Global South (Colosimo, 2024, p. 8; Melvin, 2023). The Euro is directly challenged by the promotion of local currencies in international trade and financial transactions among BRICS members (which collectively account for 45 percent of the global population and hold more than 50 percent of the world's hydrocarbon reserves), as well as with their trading partners, thereby reinforcing the banking networks among BRICS countries and enabling settlements in local currencies (BRICS Leaders, Art.44).

The expansion of conflict areas culminates, as per the Foundation for European Progressive Studies (FEPS, 2023), in a regressive spiral that threatens to reverse the numerous achievements of the post-Cold War era across political, economic, security, and governance, opening gates to political volatility, polarization, economic fragmentation, and human insecurity. Giovanni Crevi, the report's coordinator *(Centre for Security, Diplomacy and Strategy – Brussels School of Governance)*, perceives the scenario not only as prediction but a plausible occurrence, advancing as business as usual, with factors underpinning it stronger, more numerous and acting faster (Foundation for European Progressive Studies, 2023, p.13).

If Europeans are unequivocally aware of the need to address the deficiencies of a common defense and security policy, as per the European treaties, but unfulfilled, partially due to divergences among members regarding alliances, the current geo-economic competition requires strengthening of the single market and monetary union, but also to make significant progress in refining the market for services and capital. The common currency – a unique benchmark widely recognized as reference – stands as pillar of trust to the capital market, the banking union, and safeguard mechanism since it relies on a central bank free of national interests.

This perspective emphasizes the political legitimacy of the monetary union and of assets that make secession impossible, reinforcing faith in federal institutions[10]. The principle of subsidiarity asks for responsibility, decision-making, and creative competence to be entrusted to the smallest viable administrative unit that can address issues independently but effectively, such as a state or federally constituted communities (Stiftung Westfalen Initiative, 2023). The present governance of member states is vulnerable to variances entrenched in national ethos, resulting in less cohesion and weaker alignment of political aims. The Euro cannot serve as a cure for economic inequalities and failures since it lacks the capacity to do so. The Stability Pact, which establishes benchmarks for sound fiscal management, is the result of the rejection of federalism, the lack of a European budget, and the European Parliament's insufficient control of spending. Hence, the euro suffers from the democratic deficit in Europe and, by extension, in the Eurozone, as economic and monetary traditions of member states diverge greatly, resulting in a lack of mutual trust across nations.

[10] Time has come for Europeans to be bold enough to finish the *real Union*, unique, but cohesive.

The threats to the Euro are primarily political rather than economic or financial, as European sovereigntists[11] blame European institutions, including the Euro, for misconduct in home policies, claiming that resolutions can only be achieved within the confines of national competencies. Radicalism, based on a demagogic platform, advocates for the rejection of alienation, defined as the acceptance of communitarianism at the expense of national identity, whereas populism arises from value disparities across generations (Norris et al., 2019). It is equally accurate that several grievances concerning the populace's living conditions (prices, inflation, cost of credit) – some due to Euro technocracy and Brussels bureaucracy – are associated with the limited democratic oversight of citizens over taxation, a situation exacerbated by the passive role of Euro parliamentarians in their engagement with the public. The implications are the proliferation of identity reactions and cessation of models and concept convergence, resulting in a decline in universalism.

In contrast, within any administrative framework, the bureaucratic process fosters a narrow perspective of human collaboration and transforms the political system's dynamics into a hierarchical structure that creates impersonal and authoritarian relationships. Sovereigntists often play the card of the need for administrative dictatorship from the risk that local democratic institutions, dominated by bureaucratic mindsets, make decisions following a technocratic utopia (EC). The lack of information and lack of access to decision-making and organizational processes contributes to alienation (Popoveniuc 2006, p.375)[12]. This situation is exacerbated by proposals to abandon the current voting system in the European Council (based on unanimity), as a qualified majority is likely to be rejected on the supposition that decisions which may relate to any member state's interests cannot be validated without its consent. Resistance to such options bolsters sovereigntist rhetoric while jeopardizing European union. Classic opposition attitudes, based on the confrontation of different public policy options, are gradually replaced by principled opposition, in

[11] Denis de Béchillon: "It would be ridiculous, if not tragic, to see a country that has put itself in the state of failure, self-admiring in sovereignty, ruined and alone on the island" (de Béchillon, 2024)

[12] Striking evidence is offered by Dinu C. Giurescu, member of the Romanian Academy, who told the Q Magazine (2016) that “the gradual erasure of identity, of the consciousness of belonging to the Romanian nation is desired…There is talk of globalization, but I see that the aim is to form a 21st century man interested in material and pseudo-cultural values, without a national identity. In other words, a modern scumbag. The faster you forget the past that belongs to you, the faster your identity will be erased. I think (…) that we have become a colony, that we no longer decide for ourselves. The attitudes of politicians are not encouraging for us as a country, and I see that the trend is towards the weakening and even disintegration of the state and the nation."

which the primary division focusses on the European Union's constitutive values, respect for the rule of law and democratic norms, and geopolitical orientations (Escudier and Leron, 2024).

IV The Difficult Path

In February 1969, the European Commission unveiled *the Barre Plan*, seeking to harmonize economic and monetary policy. In December of the same year, a Committee of European High Officials, chaired by Pierre Werner, was formed. Ten months later, the Committee proposed the transfer of budgetary responsibilities at the community level and establishing an economic policy decision-making center accountable to the European Parliament, implying the formation of an economic government. Furthermore, the Werner Plan advocated that member states establish financial solidarity instruments to alleviate structural and geographical inequities[13]. Economic developments turned against Pierre Werner's team: in 1971, the United States unilaterally suspended the dollar's convertibility into gold, and in 1973, the oil crisis forced nations to take unilateral measures to address unemployment, inflation, and exchange rate volatility, rendering their audacious proposals ineffective.

In 1978, Valéry Giscard d'Estaing and Helmut Schmidt presented the Commission with a draft of the European Monetary System, a framework for coordinating economic policies and maintaining established parities among European currency exchange rates. The proposed mechanism faced seven exchange rate realignments between 1979 and 1983, a second oil crisis (1979-1980), and overt hostility from Great Britain following Margaret Thatcher's arrival in Downing Street, in May 1979.

The concept for a unified Europe with a common currency was renewed at the Fontainebleau summit of June 1984, where Jacques Delors was chosen as the future chairman of the European Commission from 1985 to 1995[14]. He faced a massive challenge: the single currency project had to overcome the markets' reluctance to a currency unsupported by federalism while also cultivating European citizens' trust in it.

[13] In October 1972, the Heads of State and Government of European Communities have endorsed the proposal to create the monetary union by 1980.

[14] On the chair where, according to rotation rule, should sit a German, Helmut Kohl has proposed a Frenchman, a fact that surprised both Mitterrand (who favored Claude Cheysson) and Thatcher (who opposed a left-wing Frenchman). See Jean Quatremer, 2019, p.30.

Between the political vocation of the single currency and the absence of common institutions stronger than national ones, a schism that cannot be erased by the current functioning of European treaties has been dogged. Despite a series of crises that have tainted the public perception of a European Union perpetually fighting for its survival, characterized by inter-member conflicts and insufficient capacity to address challenges, the truth is that the EU's engagement with these crises has catalyzed advancements in integration, fundamentally fostering the Union's development (Bossong, von Ondarza, 2024). The Euro is a cornerstone of European unification, and the current state of conflict at its borders makes it easier to accept another collective security framework that requires transfer of sovereignty to the federal level.

Officials in Brussels frequently emphasize the European Union's unique and novel nature as a diverse entity. Unfortunately, the advent of functional sovereignism has distorted this explanation, as its supporters ignore or fail to admit that BigTech and BigPharma, by their own capabilities, contribute to the erosion and permeability of conventional sovereignty (Mhalla 2024, p.18). As the technopowers have developed into global political entities confronted solely by a European entity above national interests, sovereigntists who reject the new reality are abandoning the search of solutions, moving away from the fundamental truth that democracy relies on common understanding of reality (Arendt, 2023).

On October 18, 2010, shortly before the summit aimed at addressing the Eurozone's instability, French President Nicolas Sarkozy and German Chancellor Angela Merkel met privately in Deauville and reached a bilateral agreement to mitigate the newly implemented sanctions framework for countries that failed to comply with the Eurozone regulations. They agreed to waive automatic consequences for violations of fiscal restrictions, making the sanctions mechanism subject to political negotiations, undermining this way the Stability Pact (Rossi, 2010). The same year, Germany applied *Schuldenbremse* (debt brake rule) for the first time, a measure written in the Federal Constitution in 2009 (Art. 109, para. 3 and Art. 115) to preserve fiscal discipline and limit government borrowing (Federal Ministry of Finance, 2022)[15]. These examples demonstrate the transfer of authority from European institutions to national capitals, whose interests, agreements, and election agendas diverge, leading to long decision-making, frequent interruptions, and the perception of European institutions as bureaucratic. Furthermore, investors' appraisals of Eurozone *individual* members emerged, lessening the Euro's appeal and shifting market focus to nation-states.

[15] The aggressive behaviour of Russia and the disengagement attitude of the USA from the defence of Europe called German MPs to review the self-imposed spending limits.

V Economic Theory vs the Diversity of Unity

Compared to the hypotheses of optimal currency areas (Jager and Hafner, 2013), analysts of the Economic and Monetary Union emphasize that European economic integration is based on an endogeneity hypothesis (Ehrig et al., 2011), which claims that political integration automatically follows the increase in welfare achieved through economic integration. Pessimists, who support the heterogeneity hypothesis, fear that the Economic and Monetary Union (EMU) will exacerbate economic divergences; thus, the introduction of a common currency should have been postponed until the Eurozone has acquired the necessary properties of an optimal currency area (Karras, 2003; Matthes, 2009).

EMU is not an optimal currency area. Member countries' economic performance and structure are different, and the single currency, by encouraging industry specialization, made the Eurozone more vulnerable to asymmetric shocks[16]. EMU's potential is limited by national decision-making and crisis management mechanisms. There are no compensating alternatives, such as labor mobility or fiscal transfer unions, that can mitigate the negative effects of asymmetric shocks. Despite efforts to achieve fiscal harmonization, significant gaps persist in the Eurozone, and factor markets remain insufficiently integrated.

When a group of nations decides to abandon their national currencies and form a monetary union, they frequently envisage a common goal. Twenty-five years after the EMU's inception, member states have yet to agree on a common position on European integration. Discussions about the future evolution of the EMU demonstrate poor decision-making commitment inside the EU. Core members urge for economic integration to achieve a fiscal union, whilst periphery countries support the idea of Eurobonds to consolidate Europe's debts. Divergent viewpoints emerge logically from the distinct aims of fiscal policies. Identification with Europe is limited, and national leaders' preferences differ, resulting in a decentralized decision-making process that impedes the Eurozone's ability to match the characteristics of an optimal currency region (Ludwig, 2012).

Since its formation, the Eurozone has suffered attacks, primarily from domestic corporations such as banks, insurance firms, pension funds, wealth managers, and other financial institutions in charge of managing private investments. Although institutions inside the Eurozone hold most of the European debt, this does not necessarily indicate that they are owned by citizens of the member states. The greater the share of debt held by non-residents, regardless of whether they live within or outside the Eurozone, the greater the vulnerability to attacks. As a result, the Eurozone ap-

[16] Being aware shall not be translated by becoming opposite, but diligent.

pears as "a combination of rapid capital migration with limited labor migration" rather than a well-functioning monetary union (Krugman and Obstfeld, 2009). 587).

Such introspections are welcomed *as post-factum* if decision makers seek to improve the system's operation. The Euro's foundations were not based on Mundell's theory, but rather on political issues stemming from postwar imbalances, the depletion of the Marshall Plan, and the reintegration of economies freed from totalitarian authority. The invitation extended to Ukraine and Moldova to begin EU membership negotiations is primarily a political maneuver, with major economic costs for the EU prior to any anticipated benefits for the candidate countries. We are at the beginning of new sacrifices, gladly made to increase Europe's chances of security, like the sacrifices made to enter the Eurozone by those nations where governments sold the appearance of prosperity with increased public debt[17].

The Euro is equivalent to the US dollar for trade settlements and global payments, but it stays behind USD in global financial markets. The Euro's expanding significance is dependent on capital market confidence and the implementation of the banking union's established common processes. The global financial crisis of 2008, as well as the subsequent sovereign debt crisis in Greece, Ireland, Portugal, Spain, and Cyprus from 2009 to 2010, collectively known as the Euro crisis, revealed the need for strengthening the Eurozone's functional framework through the establishment of the Single Supervisory Mechanism, the Single Resolution Mechanism, the European Stability Mechanism[18], and the Single Resolution Fund, all of which are federal. The well-known expression "do whatever it takes," articulated by former ECB President Mario Draghi, resulted in the implementation of Outright Monetary Transactions (OMT) – the acquisition of government bonds on the secondary market to lower public financing costs – and Quantitative Easing (QE) – the elimination of high-risk government bonds from the financial market, culminating in the accumulation of €2,138 billion in public debt on the ECB's balance sheet, equal to 20 percent of the Eurozone GDP (Quatremer 2019, p.582). The coronavirus epidemic, which forced the cessation of most economic and social activities, spurred the creation of the epidemic Emergency Purchase Program (PEPP), worth 750 billion Euros. These initiatives culminated in the mutualization of public debts, paving the way for a Eurozone's budget "by default". The European Central Bank made what the Eurozone's governments were afraid of. The ECB's policy has significantly enabled the integration of fiscal and monetary policy, improved public debt sustainability, and

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[17] The relationship between the state and the banks is particularly strong in Europe, the banks being the ones that over time have financed public investments and industrial policies, rising a strong banking nationalism, also evidenced by the excessive guarantees offered by the states to the banks.

[18] ESM capital is €80 billion and available lending capacity is €417 billion (2023).

reduced the likelihood of state defaults, all of which are critical to Eurozone stability (Whelan, 2022).

From the core to new entrants, Europeans have recognized that each step towards closer integration is made for long-term gains, even if it requires short-term costs. The detailed history of the Eurozone illustrates it. National interest is defined by economic and geopolitical circumstances, but it is ultimately a social construct. As a result, they are impacted by the discount rate that governments use to future benefits, officials' trust in the new institutions, and governments' perception of the opportunity costs associated with various options (Goldstein & Keohane, 1993). The monetary union brought together states with different cultures, political systems, and economic structures. The monetary union's issues stemmed from institutional differences and structural organization of the member states' economies, rather than the asymmetric shocks predicted by the theory of optimal currency area. The Stability and Growth Pact, which limits state debt and deficits, has met resistance to execute. While some expected that joining a monetary union would gradually eliminate institutional disparities, developments show that historical legacies are resistant to repair.

None of the attempts to transform the European Union or the Eurozone into supranational democracies have proven feasible. Even the most ambitious initiatives for democratizing European institutions give only minimal electoral accountability in the absence of robust competition among truly European (across border) parties. Furthermore, the accumulation of shortcomings affecting various producers and consumers (such as the common agriculture policy) reduces popular support for the delegation of additional powers to Brussels. Most European voters still support the Euro and EU membership, but enthusiasm for further political unity has diminished, and far-right movements opposing European integration are gaining force across Europe. In the foreseeable future, it is difficult to anticipate the source of support for changing European treaties (Hall, 2016).

The entry of new members from the continent's eastern and southern areas into the European Union has begun with steps aimed at narrowing inequities and pushing countries with lower economic growth to match the living standards of wealthy countries. This has boosted investment in those areas, regardless of whether the new members choose to embrace or not the single currency. The rapid evolution of technologies, as well as *imperial powers*' policies to manipulate markets through political strategies (such as embargoes or sanctions), require nations of Europe's southern and eastern peripheries to envisage initiatives aimed at fostering medium- and long-term growth and stability through innovative approaches. That entails shifting to the manufacture of higher value-added products capable of competing in global markets, since the comparative advantages of low-cost production are elsewhere located. These countries will need to adapt to the dynamics of a knowledge-based economy. Looking ahead, the division of Europe into northern and southern regions, or western and eastern parts, will become obsolete, as it will be the case to inflexible restrictions of the Stability and Growth Pact.

The 2021 Communication from the European Commission regarding the European Economic and Financial System (EC, 2021) outlines strategies for the EU to strengthen its autonomy in macroeconomic and financial areas by advancing the international prominence of the Euro, consolidating the financial market infrastructures, refining the execution and enforcement of sanctions regimes, and enhancing the resilience against extraterritoriality. The Commission claimed that a stronger international role for the Euro would protect from currency shocks and reduce reliance on other currencies, while also lowering costs in trading, finance, and risk management. This would make it easier to achieve common global goals, such as the resilience and stability of the international monetary system, as well as providing market participants with a wider range of options, all of which would reduce the global economy's vulnerability. The completion of the banking union and significant progress in the capital markets union, as strategy to improve resilience and the economic and monetary union, are identified as the most important priorities for achieving the stated goals. An important step in this direction is the NextGeneration EU's Recovery and Resilience Facility[19], which provides member states with 723.8 billion Euros in loans and grants to promote reforms and investments.

In the context of few opportunities to reconcile the roles of *homo economicus and homo politicus*, member states are likely to fail in their industrial, technological, and digital sovereignty, as well as ecological transformation, unless private and public finance systems are integrated (Couppey-Soubeyran, 2024). European private financing will only support investments if the public finances remove the barriers that separate national sovereign debt markets. Without a fiscal union, capital market integration will be hampered significantly. It is obvious that heads of state or government are hesitant to sacrifice their political capital by assuming obligations linked with capital market risk. This limit can be overcome by setting up a savings and investment union, which would make it easier to push private money to finance European initiatives like digital transition or green economy (Malingre, 2024; Noyer et al., 2024).

A resilient EU is built on an enhanced integrated internal market, strong economic principles, a reliable and predictable legal framework, and the rule of law. The ma-

[19] Campos Sánchez-Bordona, Advocate General to European Court of Justice: the EU recovery plan "is probably the biggest step forward in the history of the EU in terms of solidarity", (CJEU, 2021))

jor goal of EU geo-economics is to protect and strengthen the single market, which is the foundation of the Euro and the Union's access to global trade and investment. A policy aimed at improving the operation of the single market should provide greater depth and liquidity to financial markets, promote economic growth, and ensure financial and fiscal stability, so strengthening the EU's geo-strategic and economic might.

Jean Monnet's phrase "Europe will be forged in crises and will be the sum of the solutions adopted for those crises" (Monnet, 1978) is well known. The Versailles Declaration of the informal meeting of EU heads of state and government in March 2022, condemned Russia's armed campaign against Ukraine as a "tectonic rupture in European history," with profound implications for the structure and governance of the European economy. It became clearer that the Eurozone confronts a new geo-economic environment and an ongoing geo-strategic crisis. Emmanuel Todd, a historian and anthropologist, describes the present as *the end of Europeans' journey through history as tourists* (Todd, 2024). By foregoing internal fighting, Europeans hoped that *the structural pax europaea could serve as a model for a pax universalis*[20]. Hence, it is critical to reconsider the goal of European unification in the context of a geo-politically structured World, ensuring that the admission of new members serves not only to foster international peace, but also as an essential response to its increasing brutalization (Louis, 2022).

The European Union cannot address a new world with old-fashioned methods, mostly because of lack of public authority and recognition. The conversion of shared interests into public goods, as demonstrated by European collective security, cannot be achieved just through unilateral promises made by governments; it requires a European-level actions. The need for European investments goes beyond the green transition, energy independence or military spending. Europe must increase its investments to accelerate digital transformation, strengthen healthcare, expand R&D activities, boost human capital, and reduce dependency on imported agricultural commodities.

This has a direct impact on the debate around European governance. If individual member states were solely responsible for additional investments and associated expenses, this may result in insufficient investments or a reduction in fiscal capacity. The heterogeneity and financial fragmentation among states will also worsen. Fiscal federalism could promote the appropriate allocation of duties at both the EU and national levels, allowing for economies of scale while incorporating member

[20] If the positive side of the structural state of peace is the political regime of human rights democracy, its negative side is its implicit identity in a wide spectrum of traumatic affections and memories, impregnated over generations in mass culture.

states' various preferences. The EU should provide public goods that cannot be given more effectively or efficiently at the national level, and for which individuals' preferences are sufficiently consistent across Europe. The need for additional but permanent fiscal resources at the European level would lead to significant progress towards building a fiscal union.

Recognizing the restrictions of the EMU's operation in the absence of centralized fiscal control should lead to a strategy to rectify the imbalances within the monetary union's institutional structure, where a unified monetary policy coexists with a fragmented fiscal policy. This is motivated by the need to mitigate the effects of disruptions caused by an unpredictable economic environment fueled by conflict and ambition for supremacy. Advances in this field should allow the Maastricht Treaty's fiscal regulations to be adjusted, as well as improve the ability of national budgetary policies to operate counter-cyclically and address country-specific shocks (Panetta, 2022).

Although the Eurozone's resiliency is visible, vulnerabilities remain. Crisis have occurred repeatedly throughout history. Rather than pursuing a debt-driven expansion, policymakers should create fiscal buffers during successful periods to boost economic resilience.

To improve the resilience, three major initiatives may be considered: completing the banking union with a European deposit guarantee system, building a capital markets union, and strengthening economic governance. Already, the European Stability Mechanism and the Single Resolution Fund enable the systemic restructuring of banks in Eurozone member states without public budget interventions. The formation of a financial market union will boost resilience by reducing barriers, standardizing legislation, and encouraging deeper cooperation across Europe's capital markets which are fragmented and far lower in size than those in the United States. While in the United States the capital market predominantly enables economic financing, in the European Union bank loans account for around 75% of total financing (Gramegna, 2023).

Cessation of economic and social activities during the coronavirus pandemic, coupled with the needs for consumption, led to temporary suspension of budgetary restrictive rules throughout the EU. Soon after, the economic sanctions introduced in the context of the war unleashed by Russia resulted in price increase for energy, food and many others, because of dysfunctions in global supply chains. All of them have unleashed inflation, but their political origin made traditional economic instruments less effective at addressing market disturbances. Restoring equilibrium requires a coordinated effort between monetary and fiscal policies across the entire Eurozone. Regretfully, during the pandemic and the exercise of economic sanctions, the responses of individual member states has shown more self-interest than solidarity, with a vivid preference for sovereign approach. These developments have driven Europe into an unparalleled crisis.

VI Solidarity & Identity

Is the solidarity existential for Europe? Eastern Europeans, especially, give solidarity only a defensive role, and believe that NATO is the arm for it, and it's enough. Peripheral countries have a limited perception of the World dynamics. Their understanding of global markets reflects own factors endowment and industrial tradition. For too long a period their education was based on the paradigm of the near vicinity with their social and economic system in the middle. In 2010, when the EU made the decision to create an ad-hoc fund, set up by Eurozone nations to rescue Greece and other countries from insolvency, Anna Slojewska, a polish correspondent to Brussels, asked for a meeting with European Commissioner Siim Kallas:*" I interviewed the former Estonian prime minister about his perspective on the necessity for his fiscally prudent compatriots to contribute to a fund aimed at saving Greece, which was a victim of its own imprudence. Was it smart to rush into the Eurozone? He responded, "History has taught us that we must never be alone again"* (Slojewska, 2024).

Articles 122, 136 paragraph 3, and 143 of the Treaty on the Functioning of the European Union[21] address the Union's cohesion and stability. Articles 122 and 143 make no distinction between Eurozone members and those that have not adopted the Euro, focusing on economic issues such as balance of payments and natural disasters. These are solidarity clauses (back-to-back loans) approved by the European Financial Stabilization Mechanism, linked to the European budget, and limited to a maximum of 60 billion euros, which the Commission can borrow from international financial markets.

The European Stability Mechanism was established in 2012 to replace the European Financial Stability Facility, a special purpose vehicle created in 2010 by Eurozone member states outside the European Union's legal and financial framework to borrow capital by floating securities guaranteed by its shareholder states[22]. The European Stability Mechanism is an intergovernmental entity created by Eurozone member

[21] Consolidated version, 2020

[22] The European Financial Stability Facility arose because of insufficient resources that the European Financial Stabilization Mechanism could mobilize in the context of the euro area sovereign debt crisis.

states in accordance with Article 136, paragraph 3 of the TFEU. Its mission is to prevent and mitigate financial crises, maintain financial stability, and promote long-term prosperity, thereby ensuring the Eurozone's overall stability.

Peculiar to EU NextGen is the financial contribution defined by Regulation (EU) 2021/241 as "non-repayable financial support under the facility, which is available for allocation to a member state." In contrast to the portion of the facility provided as a loan, which must be repaid, this financial contribution is a significant innovation (Martucci, 2021) in the EU financial legislation. Although the proper wording is missing, the non-repayable financial support is a subsidy paid by the European Union to the requesting state. This is part of a framework of fiscal transfers that enables progress in European economic federalism. Even if it is not exactly a mutualization of public debt, it stands as a new form of budgetary solidarity on the horizon.

On November 27, 2012, the Court of Justice of the European Union ruled that financial stability is a top priority for the European Union, preserving both commercial and public financial institutions (CJEU, 2012). A significant challenge ahead will be to strike a balance between national financial stability concerns and the need for a more cohesive and efficient domestic banking market, all within a strong regulatory and resolution framework that includes unified supervision and resolution within the banking union. Financing member states through NextGeneration EU, with no commitment to repay, renders the EU liable for a debt that must be paid off through alternative sources, as closing the community budget in red is banned. The Commission has already started to add new income sources, such as proportional taxation on unrecycled plastic packaging waste, a border tax on carbon dioxide emissions, a tax on large businesses, and even a tax on digital technology. A rise in European taxation responds to an increase in public debt mutualization, driven by vertical and horizontal solidarity between the Union and its member states.

Expanding fiscal capacity entails both expanding the EU budget and Eurobonds issue, boosting the availability of incentives during deficit periods and withdrawing them in surplus years. This method is viable under the TFEU (Article 311), but it must overcome legal hurdles, including the consent of all member states in accordance with their constitutional mandates, which, for the most part, call for ratification by national parliaments. To motivate member states to reach an agreement, it is necessary to balance the disadvantages with the benefits of resource reallocation at the EU level. Expenditures at the EU level that could yield significant economic benefits relative to the current scenario include (a) synchronized investments in transnational infrastructure and renewable energy sources that value the EU's geographical diversity; (b) an EU industrial policy which does not distort the single market; and (c) a unified defense strategy. A strong governance system is required to ensure that member states' spending corresponds to agreed-upon objectives (Reichlin, Pisani-Ferry, & Zettelmeyer, 2024).

The issue of deepening the European Union inevitably guides us to the dichotomy of solidarity versus national identity. Solidarity, intuitively, denotes a principle that unites individuals, economies, security, and issues, hence connecting the member states, whereas identitarian movement claims for an inward-looking strategy. Solidarity is universal, but identitarians pertain to the specific; the former fortifies the European Union, acting as its adhesive, while the latter undermines it. Along the enlargement of the EU, motivated either by the pursuit of reconciliation "with the rest of the continent" or by the desire to break ties with an unwanted past, the search for what is more advantageous confronts two concepts of the relationship between solidarity and identity: either reconciling the two values within the European Union is unattainable, or achieving a balance of them is essential for the Union's survival.

It can be argued that identity is necessary for solidarity, but only to a certain level; beyond that, it may be destructive (Magnon, 2021). Solidarity gives equilibrium to manage the Union's economic and social spheres, making possible the *a priori* reconciliation of conflicting demands: "economic" and "social," "supranational" and "state sovereignty" (Abderamane, 2010). If left unchecked, the essential binomial might spiral into insurmountable incompatibility, resulting in an irreversible transformation in which the tension between solidarity and identity becomes a conflict between solidarity and sovereignty[23]. Solidarity supports TFEU norms based on the principles of faithful collaboration, such as financial assistance given by the European Stability Mechanism (Article 136). Solidarity distinguishes Europe from all other global actors and regions. It is a fundamental principle enshrined in EU programs and institutions. During crises, it proves extremely important for member states and EU citizens to remain safe. To reap the benefits of all this, the perception of Europe's discretionary nature should be reversed (Delors, 2013).

VII The East: Looking Elsewhere

We have witnessed a long process for the adoption of the single currency and the emergence of the Eurozone, an even longer process for the Eastern European states to join it. Relying just on the premise of longer or shorter timelines for national economies to conform with convergence requirements is simplistic. Undoubtedly, for Easterners, the transition from planned to market economies, from public to

[23] See Wurzel, Hayward, 2012, Van der Walt, Ellsworth, 2015

private ownership, from the Comecon trading system to a free and competitive market, as well as the transition from multiple exchange rates to one set by demand and supply, resulted in often longer transition periods to be ready for the Euro than anticipated. Different views towards the Euro are mostly due to cultural differences, discrepancies in economic structure and governance, and the dialogue between the public and leaders, as well as between leaders and entrepreneurs, commonly described as *climate.* When the Euro option was expressly mentioned, the threat of price inflation was frequently opposed, while political power and its supporters were rejecting budgetary discipline and boosting exports via exchange rate manipulation (rather than competitiveness). Furthermore, they were pushing for fiscal expenditure based on continuous sovereign borrowing. Honest assessment confirms that the Government defends the "autonomy" of monetary policy whenever it is he the main beneficiary of borrowing from the banks, or the political clientele.

Only the Euro adoption is not sufficient to address deficiencies, as proven by the Eurozone's expansion from the core to periphery: ECB monetary policy may lead to disparate effects in smaller economies compared to larger ones, particularly those with lower productivity or sovereign indebtedness beyond the convergence criteria. As a result, some governments opted out the Eurozone to profit of decision-making autonomy: some did so in accordance with national referendums (Denmark – rejection referendum 2000), while others acquired temporary exemptions from the commitments outlined in accession treaties[24].

The single currency has considerably improved the operation of the single market by eliminating the costs connected with foreign exchange transactions, as well as those related to hedging and currency risk. The quasi-simultaneous introduction of the single currency and the accession of Eastern European nations to the EU has downgraded trade creation resulted from an increased number of consumers and exporters to second rank, compared to the benefits derived from Euro adoption, especially since banking rules of the new members have not become homogeneous at the same speed.

An assessment of the Euro's adoption on January 1, 1999, by 11 of the 15 member states, together with existing differences between ECB interest rates and those of non-member states, reveals the possible risk of jeopardizing macroeconomic discipline in specific regions. The Eurozone's monetary policy has initially lowered too quickly the reference rates for countries with fragile institutions. The government of these countries used low interest rates to boost fiscal revenues for politically favored

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[24] Article 116 a (1) – Treaty amending the Treaty on European Union and the Treaty establishing the European Community, Lisbon, 13 December 2007, doc C: 2007:306: TOC (ex-Art III-197 in doc C:2004:310: TOC).

entities rather than investing to increase potential growth rates (Fernandez-Villaverde, Garicano, Santos, 2013). A uniform monetary policy may be stringent for a country with a weak financial infrastructure, reducing short-term economic potential, whereas it will promote growth in a stronger economy (Mody, 2019). Furthermore, low interest rates serve to reduce inflation; but economic history shows that without further incentives economic development stays modest, resulting in a limited job offer. As a result, the recovery from long-date inequalities takes longer, resulting in disparities in productivity and personal income. The economic trajectory of southern and eastern European states stands as proof of it, making some conclude that *the Euro offer is insufficiently appealing.*

The aforementioned factors undermine confidence in the Euro. To be recognized as a force, the Euro must be understood as a common asset that should be entrusted rather than tolerated. Nonetheless, this approach does not appear foreseeable. Significant progress will be difficult to achieve in the absence of European authorities with popular mandates and a willingness to establish a genuine fiscal union. Furthermore, a fiscal union cannot be realized without political unity, since national parliaments reject any subsidiarity. As the President of the Constitutional Court in Karlsruhe[25] has stated, the primacy of order is not based on genuine European originality, as the supremacy of Union law is rooted in national constitutions and hence restricted by them (Lehmann, 2010). Still, the Euro's quarter of century operation highlights two key accomplishments: it addressed the sovereign debt crisis avoiding any nation failure and provided a solution to the costs incurred by the epidemic and conflict that disrupted global value and supply systems.

The answer to the question of some Easterners' desire to adopt the Euro should not be limited to convergence criteria only, but also consider central banks' *benevolent* attitudes towards governments, as opposed to market. Why after about two decade of EU membership, certain countries met the convergence criteria while others have not (Czech Republic, Poland, Romania, Hungary, Bulgaria). Or so they decided? Do they lack trust in solidarity and fear losing access to devaluation to boost exports and employment during a recession? Will they also be unable to lower interest rates to boost domestic consumption and lending (Havlík, 2019)? A prominent example is the steadfast opposition to conditionalities in economic, social, and labor market problems, all of which are within the purview of national governments. Another frequently mentioned "justification" is that a national government is better equipped to protect the local environment from the effects of globalism. No entity with bureaucratic tradition wants to delegate or relinquish authority over decision-making (Gheorghiu, 2023). Because neither the European, nor the accession treaties impose

[25] A source to EU law for those which joined the EU this century.

fines for delays or failure to meet convergence standards to join into ERM II, the Euro never become a political campaign issue, and, hence, politicians were never penalized by voters.

To understand Eastern Europe's political reserves and social perception regarding deeper integration and, ultimately, Eurozone membership, two main factors must be considered: (i) Eastern European nations have, historically, lacked solidarity, frequently undermined by fear; and (ii) their alliances have been ruled by situational circumstances rather than solidarity. Eastern Europe's delayed autonomy, hostage of the Warsaw Pact and CMEA, hampered dialog among Eastern Europeans, even at times when common attitudes and objectives were critical. Individual interests in joining a political-military alliance against Russia drove Eastern Europeans' entrance to NATO, whereas the incentive for entering the European Union was essentially economic, with an emphasis on the single market, its the four freedoms, and access to cohesion funds.

Eastern Europeans are cautious to political recognition of the European Union and, by extension, to any attempt aimed at establishing a governance based on subsidiarity. The new emphasis on revitalizing European foreign and defense strategy, which must incorporate Europe's defensive autonomy, calls for more than just verbal consensus. The countries of Eastern Europe feel, probably violently, the fact that their economic, administrative and cultural systems carry within the seeds of the alienation mechanism, rooted in the long tradition of submission. As a result, their populations perceive the integration process as a potential brake on the ability of politics to respond to society's identity choices, making politics servient to mechanical and impersonal laws of the market. Contrary to societal anticipations the present developments make the function of politics to assume a more bureaucratic nature (Popoveniuc, 2006, p.378-379), reinforced by the subservient journalism.

VIII The Foggy Future

Whereto, Euro? Ashoka Mody, an Ivy League graduate imbued with IMF and World Bank ideas, and notable critic of the European push for a unified currency, claims that European officials were unsure about the direction the Euro would take. Therefore, "when you don't know where you're going, you end up somewhere else," eventually leading to "a euro-tragedy, born of error and weakness" (Mody, 2018, pp. 4-5). Schools of thought across the Atlantic argue that the Eurozone, rather than benefiting from a governance system legitimized by a political superstructure, continues to regress into an inward retreat. A viewpoint shared by Europe's internal adversaries, also.

Faced with pragmatic facts rather than epistemological concerns, Europeans have a unique view on the future of the Euro and the Eurozone, impacted by a variety of economic, political, and social factors. The Eurozone may take the following trajectories:

(i) Reforms and stability: Member states can prioritize structural adjustments to boost competitiveness and economic stability within the Eurozone. This could include efforts to address issues such as unemployment, slow economic growth, and public debt ratios. The common capital market is becoming increasingly necessary.

(ii) Challenges and fractures: Economic disparities between member countries may persist or worsen, causing tensions inside the Eurozone. This may uncover political disagreements over economic choices and challenges to the authority of European institutions.

(iii) External shocks: Events outside the Eurozone, such as global economic downturns, geopolitical tensions, including military conflicts or catastrophic crises (pandemics, cybercrime), have a substantial impact on the Eurozone's future trajectory.

(iv) The evolution of digital currencies, both CBDC and decentralized, will have an impact on the Eurozone's future monetary system and will connect the Euro to the digital economy.

(v) Environmental policy: A greater emphasis on climate change and sustainability will affect Eurozone economic policies, resulting in new legislation, investments in green technologies, and changes in the industrial and energy sectors.

(vi) Demographic shifts: the ageing population in the Eurozone creates long-term economic issues, influencing labor, migration, pension structure, and healthcare spending.

(vii) Geopolitical dynamics: Interactions with other global powers (the United States, China, and Russia) will influence the Eurozone's economic and political decisions. Defense policy, security challenges, and alliances will all have an impact on the Eurozone's future trajectory.

The complex interaction of these and other factors will likely have an impact on the Eurozone's future, needing adaptation and coordination among member states to address potential issues and opportunities. The current geostrategic and economic scenario fuels doubts about the usefulness of *deeper Europe* in tackling important economic and social concerns, especially since fine-tuning of European institutions and processes are ineffective and adds little value. This includes the strict framework of fiscally monitored regulations, as opposed to allowing financial markets to play a larger role in enforcing fiscal discipline.

According to a report submitted to the European Parliament (Reichlin, Pisani-Ferry, Zettelmeyer, 2024) the ECB has demonstrated adaptability and innovation in its policy and instruments since 2012, as well as timely and effective response to threats to the Euro's financial stability. However, political and fiscal fragmentation has delayed monetary policy decisions (such as the January 2015 decision to begin asset purchases, which included sovereign bonds, and the July 2022 decision to raise interest rates). The paper believes that they have created a structural disadvantage for the ECB, resulting in concerns about the distributive consequences of asset purchases and the implications of tighter monetary policy on financial stability. Entrepreneurial organizations of Europe (EURATEX, 2024) advocate for (a) the revival of European integration dynamics by deepening the single market to enhance competitiveness, raise living standards, and augment citizens' incomes, and (b) the setting of a 2030 deadline for completing an ambitious program aimed at overcoming and preventing fragmentation across various sectors, including the environment, energy, digital domain, connectivity, security, health, banking services.

IX In Search for Coherence

Since its foundation, the European Union has confronted economic and financial crises, but never a political one. Technocrats successfully managed financial and economic issues. It's different now, because Europe faces two deep existential crises at the same time: the rupture of permanent peace and the erosion of citizens' belief in universalism, as well as the appropriation of social networks by sovereigntists, nationalists and populists. Collective empathy, the foundation of humanism and shared consciousness, has declined in favor of selective indignation within informational and emotional echo chambers (Glucksmann, 2023). Do elected politicians have the fortitude to leave the lukewarm groups (parties have vanished) where they concoct messages for social networks that pretended to be addressed to everyone? Distrust in politics, stemming from the incompetence of its participants, has become pervasive, resulting in public apathy who cast their votes on the principle of *"let's consider alternatives."* Representative democracy, which has increasingly become a source of discontent, is facing a decline across Europe. Former French Prime Minister Bernard Cazeneuve lamented at the end of 2023 that the current political structure looks like the Acropolis: "a few statues still standing, but without arms, heads, and legs" (Schuck, 2024, p. 14). The efficacy of participatory democracy, which has been welcomed in various jurisdictions, notably at the municipal level, has quickly revealed limitations as result of a dialog with the same few *smart guys*, marginalizing the majority. In none of the recent crisis technocrats aided politicians, and the way the latter might use the specialists' advice deepens public distrust of the elites. This is the environment where politics is called to deliver solutions for the deepening of European integration, enlargement and policies to support cohesion efforts within the Eurozone.

Economic integration had no impact on political integration; a major disappointment is that economic benefits are self-serving, with solidarity searched only for market optimization solutions (Gnesotto, 2022, p.67). Political unity can only be formed by will, which stems from a dynamic and entirely political conditionality. However, seven decades after the founding of the European Coal and Steel Community, the belief that economic unity would generate political solidarity remained a myth. The expansion of the European Union at the turn of the millennium exemplifies the sacralization of the market: from 1994, when the Copenhagen criteria for admitting new members were adopted, to 2004, when ten countries joined it, a vivid debate over enlargement versus deepening the EU has accompanied the process. Prior to the start of negotiations, Germany has unofficially forwarded opinions to EU members about how to improve European institutions, economic integration, and foreign policy to better address emerging issues. But, as in other circumstances, the internal agenda of member countries eclipsed the search for a better functionality of Europe. Europe, as such, runs the risk of viewing a diverted attention of its citizens from future challenges since at least two key institutions of Europe – the Commission and the Council – are not the direct result of citizens' democratic rights. Now, when the agenda of European debate includes the potential enlargement with Ukraine, Moldova, and the Western Balkans, aren't we at the same point as at the beginning of the current Century? (Franco-German Working Group on EU Institutional Reform, 2023).

The single currency is more than just a settlement tool; it is also a strong social asset, a symbol of community, accompanied by a set of norms and institutions that bind people to a common destiny (Pisani-Ferry, 2019). There is a lack of consensus over Europe's political union, leading to a bewildered public image of Europe's paths. Europe lacks military prowess as its members have shown a divide between autonomous defense versus sole NATO reliance – a severely shaken faith by the Trump 2.0 Administration. It is worth noting that, worldwide, no disputes have been resolved through military involvement since 1990. Indeed, Europe is an economic and commercial powerhouse, but it is only united that it may become the fourth global power (after China, India, and the United States). This is the challenge for the generation called to strengthen its unity and solidarity.

Enhancing the EU's strategic autonomy is inextricably connected to the Euro's enlarged global importance. The European treaties identify the Euro as the currency of the entire Union, establishing its fundamental link to the EU's internal market. Furthermore, monetary integration is one of the areas where the EU has achieved a high degree of strategic autonomy. The main barrier to the expansion of the Euro's share in the global financial system is the economic heterogeneity of the Eurozone, coupled with the absence of sovereign support. This heterogeneity is intensified by conflicting economic and political interests that undermine the stability of the single currency, obstruct reforms of the economic and monetary union, and inhibit political integration[26] .

The enhancement of the Euro's international standing is a long way endeavor, contingent not alone upon the stability of the common currency but also on the fiscal stability and sustainability of the economic policies of all Eurozone member nations. The deepening of the single market is also crucial, as there exists a symbiotic relationship with the currency: European financial markets must be harmonized and possess their own financial infrastructure independent of other entities outside the EU. The implementation of the digital Euro will significantly enhance this (de Vauplane, 2024). Despite the significant global significance of the single currency, the EU's strategic autonomy debates avoid often the potential for an augmented international presence of the Euro to bolster those ambitions (Tokarski, 2024). Or the significance of this has greatly increased since international financial relations gained a new dynamic due to geopolitical and technical advances that could undermine the future international standing of the single currency.

The political diversity of the Eurozone distinguishes it from other monetary areas. The Eurozone gathers 20 countries of different sizes, but the absence of a unified sovereign authority for the common currency is a primary factor hindering the establishment of a viable alternative to the dollar. The political cycles within the Eurozone periodically test the cohesion, as the domestic election cycles are non-uniform and frequently result in inadequate timing of achieving supranational agreements on matters concerning the future of monetary integration in Europe. Furthermore, the different statute of EU countries relative to membership to Euro area complicates the operations of European institutions regarding economic policy and raises significant barriers to fiscal union. The distinction between the Eurozone and the EU continues to hinder deeper economic integration and postpone the development of meaningful supranational political representation for the single currency.

The Euro, the Eurozone's unified currency, as well as the European Union, are widely acknowledged to transcend economic theory, whether neoliberal or classical. It is inconsistent to assert that the efficacy of the EU or the Eurozone can alone be

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[26] In nominal terms, three Eurozone members (Germany, France and Italy) cumulate over two-thirds of the entire area’s GDP.

achieved by reverting to theoretical frameworks issued from disparate contexts. According to a recent report by the Centre for Economic Policy Research (Buti, Corsetti, 2024), in the absence of a cooperative framework governing monetary and fiscal authorities' interactions, the ECB's independence would become isolated and vulnerable to public discontent by adopting unpopular decisions. Furthermore, budgetary coherence at the Eurozone level cannot be achieved merely by horizontal coordination of national fiscal policy, especially during recessions. A reform of the EMU's fiscal administration should culminate in the development of a "central" budgetary body at the Union level, ensuring effective (vertical) coordination and complementarity of states’ budgetary programs.

“The "The Euro at 25: Fit for Purpose?" report (Reichlin, Pisani-Ferry, and Zettelmeyer, 2024, p.10) concludes that "a successful monetary union requires a fiscal union" is at least partially correct. A successful monetary union does not call for complete fiscal unity, such as that of a federal state. However, it is necessary to have a liquid and secure bond market, as well as a mechanism to ensure that the joint stabilization efforts of fiscal and monetary authorities are sufficient. In the absence of a comprehensive fiscal union, these objectives can be achieved by integrating: (i) an increased EU budget supported by collective borrowing; (ii) improvements to the ECB's policy instruments to mitigate financial stability risks associated with fiscal fragmentation; and (iii) initiatives to diminish vulnerabilities of fiscal fragmentation, by building budgetary reserves in countries facing sustainability risks of public debt and curtailing banks’ exposure to sovereign debt.

Pretending that 27 (and eventually more than 35) member states will advance consistently is illusory in the absence of political unity or the adoption of a sequential subsidiarity framework; realism calls to a Europe of multiple speeds or concentric circles. The efficacy of Europe's functioning cannot be achieved solely by transitioning from the status of a recognized economic power to that of a feared military power, emphasizing only democracy and civil rights. It must be carefully evaluated the mechanics of Europe's future[27], including the various speeds and concentric circles. Regardless of how sensitive the matter is to the pride of many European chancelleries it must be handled thoroughly. Stiglitz (2018, p.59) acknowledges that the architects of the Euro aimed for a Europe that would bind states via consensus, generate economic prosperity, and ensure peace through economic and political union. However, due to existing socioeconomic disparities, it is impossible for all Union members to pursue identical tactical goals.

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[27] According to the TEU, a condition for becoming an EU member is the state's belonging to the European continent, which stood as the basis for the opening negotiations with Turkey.

Banks, finance, and financial markets contribute all to the EU's goals of economic development, sustainability, and solidarity, also strengthening its worldwide competitiveness. To achieve these goals, the European Banking Federation (2018) calls for a banking and capital markets union that works together at the local, regional, and pan-European levels, creating genuine and effective synergy between economic goals and the needs of collective security.

The European Banking Union is critical for the improvement of financial stability and protection of consumers and the real economy. Its three pillars are: (i) the Single Supervisory Mechanism, entrusted with oversight of significant banks in the Euro area to ensure their robustness and resilience against financial crises; (ii) the Single Resolution Mechanism, designed to facilitate bail-ins, enabling troubled banks to be recapitalized primarily by shareholder and creditor contributions, thereby averting taxpayer-funded bail-outs and mitigating effects on the real economy; (iii) the European Deposit Insurance Scheme (EDIS), still non-operational. Consequently, if deposit insurance is kept at national level, the subordination of banks to national legislation perpetuates fragmentation within the union since the confidence degree in the safety of bank deposits is different among member states. In the event of a crisis, the danger of deposit migration to other member state or non-bank entities grows, intensifying systemic liquidity stress[28].

X Where is the Ideal Solution?

Eurozone membership has both advantages and disadvantages. The benefits include (i) complete transparency of prices and costs for commodities, services, labor, and capital; (ii) exchange rate stability, which promotes more efficient resource allocation; and (iii) monetary stability, which is characterized by low inflation and long-term interest rate convergence. The challenges include: (iv) the loss of control over national monetary policy, as interest rates are determined by the ECB, which may not always adequately address a country's unique economic requirements; (v) the elimination of exchange rate adjustments; (vi) the Stability and Growth Pact limits expansionary fiscal policy during economic downturns; and (vii) the national central bank is no longer the lender of last resort.

The EU Council evaluates a country's eligibility to adopt the Euro based on (i) a proposal from the Commission, (ii) a recommendation from Eurozone member

[28] An imperfect banking union is a significant vulnerability for the EU banking sector and obstructs advancements toward enhanced integration of the financial system (de Guindos, 2023).

states, (iii) consultation with the European Parliament, and (iv) deliberation within the European Council. The final decision is taken by all EU member states. The European legislation calls it – for the non-euro members seeking to become one – the "abolition of derogation" (art. 140 (2) TFEU). The first remark is that opinions expressed by Eurozone member states and the European Parliament regarding a state's request to adopt the Euro are essentially political, while the European Commission and the ECB are the bodies that examine convergence with the Maastricht criteria. In other words, the immeasurable subjective (political opinion) is crucial. The second observation indicates that the correlation between the stipulations for a member state's request to adopt the common currency and the challenges confronting the candidate state's economic and social structure demonstrates that, beyond the economic criteria that must be met and validated, the transition to the Euro also entails a process of political accountability and dedication, encompassing both international ramifications (investments, money laundering) and domestic consequences (accountability to citizens and to political clientele with impact on incentives/tax havens and the public debt resulted from clientelist initiatives). The transition to the Euro looks to be a high political risk for some governments, frequently disguised with the argument that "the adoption of the Euro currency may entail significant interference with the freedom to engage in economic activities" (Dudzik & Brukwicka, 2022).

The non-compliance of domestic legislation with the participation in the Economic and Monetary Union is a clear indication of the choice made by non-Eurozone member states. This situation is both subjective, as human action in the normative framework is impacted by personal (Goffman, 1990) and political will (attribute of the government and parliament), regardless of the conformity with economic convergence standards. For the benefit of whom? Eastern Europeans are not in Denmark's opt-out scenario, which resulted from a referendum; rather, they are bound by commitments imposed in the accession treaties that ask them to join the single currency. Referendums were held in the Czech Republic, Poland, and Hungary after accession negotiations were completed, but before the treaties were implemented. In Romania, the referendum of 2003 amended the Constitution[29] asking for an *a priori* green light to EU accession, the outcome of which were approved by consensus of the Parliament, while citizens were not fully aware of the accession deal.

[29] Title VI, Art. 148: Integration into the European Union – Romania's accession to the Treaties establishing the European Union, for the purpose of transferring certain powers to the Community institutions, as well as of exercising jointly with the other Member States the competences provided for in these Treaties, shall be made by law adopted in the joint sitting of the Chamber of Deputies and the Senate, with a two-thirds majority of the number of Deputies and Senators.

A case study (Novak, 2020) indicates that the Polish government's stance on Eurozone accession illustrates that monetary integration transcends economic and legal considerations, emerging also from the political decisions of successive administrations. This conclusion arises from the examination of collective expectations rooted in voters' values and the domestic interests reflected in the cost-benefit assessments of lobbying groups, also observed in Hungary and the Czech Republic. A report by the Public Opinion Research Centre of the Czech Academy of Sciences reveals that in 2023 merely 22 percent of the Czech populace supported the adoption of the Euro (Čadová, 2023). Numerous analyses performed in Eastern European nations enjoying a temporary exemption from Euro adoption explain their hesitance by the necessity for prompt access monetary policy instruments in the event of financial turmoil and the immediate correlation with fiscal policy, grounded in the notion that *"a less developed economy requires swift and customized intervention to arrest its decline."* While this observation is accurate, it relies on circumstances prior to the establishment of the European Stability Mechanism, the Single Resolution Mechanism, and the Single Resolution Fund. While Poland[30] , the Czech Republic, and Hungary are viewed within the Eurozone as nations whose hesitance towards the Euro stems primarily from their own policy decisions, Romania is assimilated to a not finished transition country, certified by long wait to join the OECD and reliance on other financial institutions for assistance.

The critical necessity for Europe to develop a common defense with weapons manufactured in Europe within a common value system necessitates an immediate examination of the Euro's efficacy for settlement transactions to offset losses from shifting exchange rates. Weapons are expensive, and individual anticipation of spending more than 2 percent of GDP on weapons will have a significant impact on public spending. As a result, differences in interest rates and the cost of currency rate fluctuations must be considered before any further drop in welfare.

The Eurozone is a mature construction 25 years after its creation; yet the conditions of its development have altered dramatically since then. It makes no logic to claim that the initial road map should remain intact. The mechanics of an expanding Europe cannot run smoothly due to significant differences in socioeconomic development and the operation of the rule of law. The same holds true for the Eurozone. Given the escalating budgetary commitment to defense, as well as rising demand from asylum seekers, existing and acquired resources determined by actual criteria appear to be insufficient, necessitating a reimagined approach to the Union's budget, which require increased contributions from member states[31]. Solidarity and sover-

[30] The adoption of Euro requires an amendment to the Constitution, validated by the vote of 2/3 of the members of the Sejm or by popular referendum.

[31] A proposal rejected by the European Council of December 2023

eignism will remain dominant themes in political discourse and electoral decisions across the continent. Moreover, policies across the Atlantic assert that the United States has achieved its primary goal in Europe—preventing any nation from achieving hegemony—time being for restoring the security to its rightful custodians: the Europeans (Logan, Shifrinson, 2024).

The European Union requires the ability to change its model of providing public goods that suit citizens' requirements in areas of democracy, defense and security, education, research and technology, environment, energy, health, agriculture, culture, and immigration. However, none of the Member States have the capacity or resources to deliver on their own (Conclave, 2024). The provision of European public goods in several critical areas (health, energy, the environment, transport, digital security, etc.) should rely on sufficient resource generation and transparent spending methods. Europe must move further than Structural Funds and anti-crisis procedures by establishing permanent financial instruments aimed at achieving common strategic goals and strengthening the development model. Compared to the provisions of the 2021-2027 financial exercise, which limits national contributions from gross national income (GNI) to the European budget to a maximum of 1.4 percent, when the recovery expenses are added, the expenditure reaches the equivalent of 2 percent, demonstrating that old formulas for building the community budget are out of date. The delivery of public goods needs a new European budget pattern, with a projected size at 4.0 percent of gross national GDP (Piketty & Vauchez, 2024).

Despite challenges, the EU's enlargement proved to be the most successful foreign policy initiative since the 1970s. With over 30 countries and a population of over half a billion people, the EU has the potential to become the most democratic, cohesive, multicultural, multilingual, and sustainable body in the world, capable of fostering broad and cordial connections with its partners. Europeans must greatly increase their financial resources to confront the difficulties of ecological transition while also improving civic and military capacities and technologies. The issuance of "European bonds" by the EU treasury should become the norm rather than the exception.

The Euro has a substantial impact on the economies that have adopted it.

(i) It has increased price transparency and competitiveness, notably in cross-border merchandise and financial operations to the advantage of both consumers and businesses.

(ii) Medium-term price stability has been achieved throughout the Eurozone. This provides a firm foundation for future planning.

(iii) Financial market integration: individuals and businesses have more options for risk management.

(iv) Stability and economic growth: exchange rate stability protects consumers and businesses from the high costs of currency fluctuations. This has reduced uncertainty and increased investment, making the use of a single currency easier, more cost-effective, and safer for business and investment within the Eurozone. By reducing uncertainty, the Euro increased employment and enhanced work quality.

(v) The amount of transactions settled in the single currency contributes to Euro's worldwide relevance and quality as a reserve currency, making it appealing to non-EU countries and encouraging trade and investment. The stability of the European currency has generated incentives for worldwide business to accept Euro-denominated prices for international transactions.

The combination of geostrategic and geoeconomic issues has naturally increased concern for solutions whose outcomes and viability should restore faith in pacifism and a clean environment. The debates around the Euro and surrounding institutions develop mainly among technocratic elites and, like common goods, they have neither the capacity nor the concern to reduce the perception gap and interest of the public. This makes public reaction adverse and frequently manipulated by populist policies, "ready to protect ordinary people from the cosmopolitan elite" (Brunnermeier, James, Landau, 2016, p.379). In the multiple exogenous crises that Europe must face, there is an endogenous crisis induced by 27 different national interests that move from the center to the extreme right. For now, the European far right does not share enough common goals to be a real threat to the Union. It has abandoned Euroscepticism and is divided between national-conservatives and national-populists, but it still has enough possibilities to disturb normality and common action, especially by gaining more seats in the national and European Parliament, as well as by joining government with a quasi-democratic platform.

XI The Expensive Future

Will the Euro rise from the regional status to complete international acceptance? What are the conditions, timing, and requirements for its sustainability? To answer these questions, the binomial strength-stability relationship should be investigated, two concepts whose importance has weakened because of Europe's involvement in the Eastern conflict and the member states' ambivalence regarding the situation in the Middle East. The Russian aggression at Europe's borders exposed the vulnerability of European defense, and the lack of a cohesive strategy of all members weakens market confidence in the European economy and the Euro.

With only 9 out of 27 nations net donors to the EU budget (Buchholz, 2023), and 80 percent of contributions coming from just three countries (Germany, France, and the Netherlands), the existing pattern of budget construction becomes unsustainable. Furthermore, the European Union's prosperity is dependent on the economic performance of only two countries, making the rise of far-right, sovereigntist groups across Europe ludicrous[32]. Europe has become a continent of equality only through freedom of vote. Being born with equal rights is insufficient without learning the cultural ability to exercise them. While some accept responsibility, others thrive in controversy. Although observation may lack diplomacy, it is reality that governs our behavior, along with the flaws we like to attribute to it while disguising our impotence.

The European Parliament, the Commission, and member states achieved an agreement in February 2024 to maintain the Stability and Growth Pact requirements, with no indication that its bureaucratic, restrictive, and expensive characteristics will be eliminated. Instead, it resurrects right-wing opponents of European integration to blame and fuel politicians' refrain: "That's what Europe demands" (Giordano, 2024). The neoliberal paradigm of austerity has demonstrated its negative impact on the resilience of societies. Both the Brussels bureaucracy and the advisers of the national cabinets have fallen under the examination of polycrisis. The discrepancy between technocratic rhetoric and facts is worrying. Citizens are on the sidelines thanks to European leaders, disinterested in the project of the Economic and Monetary Union after the introduction of the Euro and its rejection as a political lever for Europe's solidity (Munich, 2024). Political options are supposed to be based on a result of calculated utility, but life stubbornly proves to us that there is no rational actor in the political game, but only pretenders or simulators. Calculated utility works all the time, but there are no plausible reasons to expect it to work for the unit, all the time (Gheorghiu, 2023a).

The statute establishing the new fiscal framework makes several references to social partners' engagement in the European Pillar of Social Rights. Countries should outline in their fiscal-structural plans the steps they intend to take to comply with the pillar's requirements. However, they must explain how the EC ideas will be implemented within the context of the European Semester, which is commonly used to deregulate economies. References to social aspects may be considered "non-binding legal instruments," giving the EC significant latitude in their interpretation; nonetheless, net expenditures must be adopted as "binding legislation" to avoid potential consequences (Schuberth, 2024).

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[32] Emil Cioran: "Stupidity is a painless affliction of intelligence" (Cioran, 2017)

2024 McKinsey research (Giordano et al., 2024) identifies Europe as a key area for sustainability and inclusivity. The new geoeconomic phase increases the urgency and complexity of competitiveness for Europe in important areas for ensuring the future, such as energy, technology, and supply chains. To thrive in this new era, it requires a unified competitiveness agenda in which corporate leaders and government work together to achieve ambitious goals through critical decisions and necessary concessions. Mario Draghi, the author of the European Competitiveness Report, conveyed an identical message. To close the competitiveness gap, the analysis suggests that the EU should invest an extra 500 billion euros beyond the NGEU, either through new loans or increases in national contributions. According to the European Commission (Lauer, 2024), the investment required for the green transition is 620 billion Euros per year until 2030, with the digital transition costing around 125 billion Euros per year during the same period. How will the additional annual investments surpassing 1 trillion Euros be funded without the 35 trillion Euro savings of Europeans (Noyer et al., 2024, p.4-5)? The answer could come from a systematic and transparent merger of capital markets (which is still being resisted). Possessing resources without the ability to leverage them is a deficit, particularly as Europe's share of global financial markets has decreased from 17.1 percent to 11.4 percent over the last 16 years (Demarigny, 2024).

According to McKinsey, European corporate investments must increase by around 400 billion euros per year relative to the 2022 benchmark (+60%) to match the competitiveness of American corporations. To make it feasible, the Europe’s capital market must rise to a level that provides appropriate resources to satisfy the burden and risk of long-term investments by hastening the implementation of the capital markets union. Delays or failures to ensure economic stability at this level endanger the labor market and increase mistrust in politicians and European institutions.

The Recovery and Resilience Facility of Europe, revisited under geo-economic and geostrategic changed realities, necessitates a thorough re-evaluation of previous European financial arrangements. We are on the brink of critical decisions regarding the cohesion of Europe, particularly concerning the democratic legitimacy of political choices. This implies the acknowledgement of the obsolescence of the near neighbor strategy, which has conveyed to all former Soviet countries the message that their destiny is part of Moscow's sphere of influence (de Waal, 2024). The primary challenge is to alleviate the opposing inclinations, specifically the reluctance of some governments to enhance collaboration and relay additional authority at the supranational level, juxtaposed with the aspiration of others to intensify integration. How can it be guaranteed that no member state or faction can obstruct enhanced collaboration among interested governments, while not forcing it on those who are hesitant? (Pacześniak, 2024). The solution lies in shifting from intergovernmental cooperation towards enhanced role of democratically elected European institutions, (along with the European Parliament). The absence of "significant efforts to be made in a brief period" (Draghi), will jeopardize European sustainability and its internal political dynamics.

The discussion of strengthening the Euro's international significance cannot be limited to economic considerations. The relationship between the international use of the Euro and the influence of the European economy is not the main issue here; rather, the changing global context and the broader geopolitical benefits (as well as an honest assessment of the cost) of the European currency's stronger international role will determine both the future direction and the outcome. Foreign policy and geopolitical issues must be considered in this debate, and generic assertions of commitment to strengthening the Euro's international role will only be trusted if backed by a genuine desire to take the appropriate steps to achieve the goal. Because economic fundamentals differ between member states, without a general risk-sharing mechanism, idiosyncratic economic and political risks (political instability, legislative changes, social tensions and internal conflicts, corruption, and nepotism) will have a different effect on European markets. Funding from the NextGeneration EU initiative helps to recover from the pandemic shock, but there is no permanent system in place to share risk in case of asymmetric shocks. Capital markets are insufficiently connected, and legislative and informational hurdles continue to give preference to national markets (Hudecz, Moshammer, Raabe, & Cheng, 2021). The difference between the market capitalization of the Eurozone and its American counterpart is striking with market capitalization in Europe representing roughly two-thirds of its aggregate GDP, while in the United States it nearly doubles the GDP.

The development of private and public digital currencies will result in greater diversification of currencies used in international transactions, making urgent a digital Euro market. That requires more efforts to give solutions to the incompleteness of the Economic and Monetary Union, the unfinished banking union, the intermittent progress towards a capital markets union, and the absence of a central fiscal capability. Furthermore, there exists a limited range of premium Euro-denominated assets and a lack of unity in the EU and Euro area shown in international financial institutions (ART, 2021).

While the Euro was created primarily to address the EU's internal requirements, particularly to facilitate the completion of the single market by mitigating the risks of exchange rate volatility and associated costs for SMEs, the strengthening of the European currency serves political objectives that are just as important, if not more so, than economic ones. The Euro delivers economic benefits associated with a strong currency. Reaching the status of a dominant global currency would provide even more benefits; yet, because this is a long-term goal, the willingness to invest the required political capital to achieve it remains unknown. If all EU members were more convinced that the Euro's international significance should be increased to advance the Union's geopolitical interests, identifying and implementing the necessary measures to achieve this goal would be easier.

Supporters of staying out of the Eurozone (while acknowledging Euroscepticism) must not overlook the "political barter hypothesis," which explains the relationship between a country's geopolitical might and the worldwide effect of its currency (Pittaluga, Seghezza, 2012). In political and economic assessments, nations weigh the comparative advantages obtained by the issuer of an international currency (which shifts the global political equilibrium in his favor) against the tangible benefits received from a public good that reduces transaction costs in exchanges. In a multipolar system marked by competition and rivalry, it is unlikely that a specific country's currency will gain acceptance as an international currency; historically, the most likely outcomes have been the use of merchandise money for settlement, or the formation of monetary blocks centered on regional hegemons. The presence of strong security alliances reduces the influence of relative gain while increasing trust and promoting the use of an international fiat currency.

The revival of liberal nationalism after WWII, and its acceleration after the Cold War, explains why European integration brought forward the question of national borders and why governments have increased their collective focus on addressing cross-border issues such as post-socialist and post-conflict liberal transitions, environmental setbacks, global economic and financial crises, and pandemics. The steady transfer of national sovereignty across an increasingly diverse range of policies has transformed the EU into a form of supranational and liberal regionalism. European nations experienced the Second World War and its aftermath differently, drawing diverse lessons. In contrast to Western Europe, which quickly reclaimed the liberties and privileges that existed before the war, it was only the conclusion of the Cold War that restored sovereignty to the states of Central and Eastern Europe, which had been forfeited to the former Soviet Union. The discrepancies are noteworthy because the elites involved in the (re)construction of the regions are primarily motivated by identity options that link their national experiences to the respective locations. These policies must resonate with citizens to generate widespread support for regional integration. The pioneers of the European integration project all saw the two world wars and the Holocaust as a common history of destruction that needed to be overcome (Börzel, 2024). For a certain period, the identity construction produced a consensus on European integration, which many citizens with a Europeanized national identity embraced. In contrast, despite preserving a European cultural identity behind the Iron Curtain, the populations of Central and Eastern Europe have only lately institutionalized the European identity in their societies, already being contested by extremists and sovereigntists.

Since the beginning of the twenty-first century, European integration has gained significance, but it has also witnessed greater competition among member countries. Eurosceptic populist movements have galvanized people with narrow nationalist identities, impeding the construction of a coordinated response to the Euro crisis and the concerns of mass migration. This identity politics is based on a realignment of political forces in connection with a transnational cultural gap in Europe, but also elsewhere (Börzel, Risse, 2020). Regardless of the terminology used to describe the gap, all positions fall along a spectrum counting internationalism and cosmopolitanism at one extreme, containment and exclusive nationalism at the other (Hooghe, Marks, 2017). Liberal nationalism can be more inclusive by allowing secondary regional identities, resulting in a shared interest among elites and a permissive consensus for supranational integration. Nonetheless, it does not eliminate exclusive national identity initiatives (as political groups do in Hungary, Poland or Romania). They endure, albeit among a small proportion of the population, but can be mobilized to oppose liberal regionalism. The shift from procedural liberal internationalism to substantive supranational liberalism has exacerbated the tensions between collective and individual self-determination, as well as the support for open borders and national sovereignty. The change has exacerbated nationalist elements' challenge to Europe's supranational and liberal regionalism, undermining the European order's consensus.

XII The Need for Change

The extent of freedom and democracy is proportional to the degree to which their citizens exercise them. Supported by a referendum, this would explain why some European Union nations have chosen to remain outside the Eurozone. Otherwise, their choices are purely political and identitarian. This reality is implicitly acknowledged in France and Germany's proposals for updating European treaties, which emphasize the need to address the implications and costs associated with potential enlargement while prioritizing issues arising from external emergencies such as defense, asylum seeking, environment, education, and health (Franco-German Working Group on EU Institutional Reform, 2023; Macek, 2023).

The support papers produced to open EU accession discussions for Moldova and Ukraine are an upgrade of the French Government's 2019 non-paper (Enlargement

Non-Paper, 2019), made for the preparatory dialogue with Western Balkan nations. This document provided "opportunities for candidates to engage in EU programs, participate in specific sectoral policies, and, where applicable, receive targeted funding". It is hazardous to assume that a significantly expanded Europe can be conceived as "erga omnes." While it will share the internal market and uphold fundamental rights as core EU principles, it will allow for integration at different speeds and through various pathways, like the Euro accession process. The likelihood of progressing towards a commercially orientated Europe, defined by market-driven objectives and constrained aspirations, grows along with the rising national interests. Furthermore, the EU is affected by a heterogenous European Council, which gathers heads of state or government elected at the national level, attached to national interests than European values. The appeal of two former European deputies, whose political experience can serve as a compendium for most of today's European leaders, reveals that *"if those claim to be the apex of representative democracy, they should be able to understand what it means to strengthen nations through the effort of all, compared to the risks of perishing everyone in their own language"* (Cohn-Bendit, Goulard, 2024).

Historically, the Euro has called for a regulatory structure within the member states that have adopted it, as well as measures of support, when necessary, whether due to noncompliance with established criteria or external threats. Except for Denmark, the states that remained outside the Eurozone have clearly eschewed that discipline, either due to trivial political motivations (such as votes, clientelism, and conditionalities), or out of self-interest (refusing to pool resources to correct the errors of others, as evidenced by EDIS), or by abusing the derogation clause to arbitrary refuse to implement European policies. Over three decades of "labs experience" (Hampl, 2023) in Central and Eastern Europe, characterized by competing exchange rate regimes and separate monetary policies, various levels of trust in macroeconomic anchor management have emerged. All these governments opted to disregard solidarity, either assuming they would not require external support or acquiescing to Bretton Woods institutions, thereby demonstrating their preference for other powers over the ones they were intended to align with upon admission. Is this a decision made by technocrats, politicians, or citizens? Existing constitutions limit the ability to discover it, but the solidarity of Europe extends beyond political stalemate.

Politics creates the fundamental conditions for constructive interaction, with a Europe which is more than one political entity. It is a complex—called a *"culture"*—that includes institutions, ideas, expectations, habits, emotions, attitudes, memories, and opinions that build connections among Europeans; all these factors serve as the foundation for political construction (European Commission, 2005, p.10). In contrast, the subconscious part of politics reveals national identity, failed goals, and individual private interests (Gheorghiu, 2023a, p. 7). The distinction between nations, in addition to their historical development, lies in the form and intensity of the adoption of norms within European democracy, which are more limited in ethnically driven (Eastern) societies than in the more proactive and organized approaches of (Western) nations that grew through civic participation (Schnapper, 2024, p.43-44). European harmonization arose among societies with similar characteristics, such as living standards, solidarity systems, and equivalent tax structures, with little negative impact from rivalry across national systems. The introduction of aggressive liberal policies (Thatcherism) into the European market disrupted socially integrated systems, undermining this benefit. As a result, both the expansion into jurisdictions based on ethnic identity and globalization have increased heterogeneity (Thibaud, 2014).

The updating of EU treaties will happen eventually. Internal Europe is currently characterized by variety rather than unity. An essential factor in ensuring a functional and satisfactory Europe for most of its population is the participants' awareness of the proposed modifications in any future referendum. Leaving the negotiations solely to politicians and technocrats is neither a benefit nor a step towards greater confidence. The four concentric rings envisioned by the Franco-German idea are unlikely to form the basis of Europe's future architecture. Although judged with the intention to improve the operation of the unique political body in the modern world, diplomatically speaking, the suggestion of four concentric circles is generous but difficult to implement for practical reasons. Over the past century, the decisions made by European leaders have been shaped by strategic alliances and individual considerations. History never stops. It is improbable that national leaders will ever acquiesce to a two-tier status, any tentative resulting in a separation of actively engaged states from those bound to sovereignism.

Do Eastern European countries share similar motives for staying out of the Eurozone? The convergence reports simply show the persistence of differences with the technical requirements. Eastern European countries lack a shared history, and it wasn't until they joined the EU that they started common projects benefiting the region and reducing the gap from Western Europe. The arguments for nationalism differ. Poland, a supporter of national sovereignty and identity, aspires to become a significant emerging power in Europe and a privileged partner of the United States, whereas Hungary, led by the architect of contemporary populism (Sapin, 2024, p.88), prioritizes ethnic considerations and the preservation of crony capitalism. Needs of significant financial resources to meet aspirations can be more effectively managed with government oversight of monetary policy. In the Czech Republic, there is little public, institutional, and governmental interest, whereas in Romania, governance inadequacies and the lack of viable economic strategies have hampered the pursuit of long-term goals, including the Euro adoption[33]. Economic performance, fiscal stability, and budget deficits are all heavily influenced by corruption. Why, among all EU member states, only Bulgaria and Romania were subject to CVM (Cooperation and Verification Mechanism) for 16 years? Why did it take so long to implement judicial reform, anti-corruption and fight organized crime (Bulgaria only)? Wasn't the delay due to soveregnists' reaction, who found the curtail of their illegal deeds the source to blame the EU for seeking equality among all nations of Europe? In substance, if the objective is to abandon the temporary derogation provision and pursue Euro adoption, the first step must be political: cut the ties with corruption and bring central bank law in line with European standards[34].

Embracing the Euro means joining a club whose members share the same values, understood not only as a means of achieving their own economic goals, but also as a power hub in which investors, entrepreneurs, and consumers from Europe and beyond may lay their trust[35].

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[33] If the corruption perception index for a state governed by Articles 139 (1) and 140 of the TFEU improved only marginally over a decade (2012-2023) from 66th to 63rd place (Transparency International, 2023), it is unlikely that Eurozone nations in charge of approving new member admissions will find a positive correlation between political rhetoric and actual conditions.

[34] Surprisingly(?) the National Plan for the Adoption of the Euro (Government of Romania, 2018) is short of proposed action to political and legislative sectors.

[35] Sven Giegold, a member of the European Parliament from the Green Party, stated, "Bulgaria is certainly welcome to adopt the Euro; however, it must first resolve its issues with money laundering and corruption." He made this remark during his visit to Bulgaria with his colleague Daniel Freund to evaluate the nation's preparedness for the common currency. According to Giegold, the EU must avert the emergence of a member state as a significant money laundering hub, as previously occurred in Cyprus or the Baltic states." (Neukirch, R., Sauga, 2021).

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THE EURO CURRENCY – SYMBOL AND COUNTER-SYMBOL

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The project of a united Europe represents a species of the Platonic Ideas. These Ideas exist but "they aren't", while the material reality, "is, but does not exist". More precisely, the Ideas transcend the time and our so precious opinions but cannot be sensorially perceived, cannot be understood other way than through the work of our intellect. They will never be materialized except in approximate, partial and, inevitably, transient variants. Such entities are the present political states, so as all forms of social or political organization have been or any "thing" created by human being. Therefore, things "are", we perceive them, we can modify them, we can compare them but they "do not exist" because their passage through the world is ephemeral. "The first to write the name Europe was Hesiod, 900 years before our era. The first to describe it and compare it with Asia was Hippocrates."[2] And since then, this Europe has remained as a name under which geographies and sculptures, political treatises, musical pieces or sophisticated legal documents have been placed. Europe has reached us like a gust of wind curious to see what will we charge her with, what will we understand out of its essence, how far we will venture to imagine her borders. All the drama and all the convulsions of the old continent are hidden

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[2] Denis de Rougemont, 1961, *Vingt-Huit Siècles d'Europe. La Conscience Européenne à Travers les Textes D'Hésiode à Nos Jours,* Paris : Payot, p.9.

here, within the limits of our world, in the cave from which we imagine the content that we attach to “Europe”.

The euro currency could be one of the languages “used” in this imaginary realm, it could be the password by which we recognize each other and by which we promise ourselves that we will protect the castle built with so much scrupulousness. But, just like the castle, the currency also plays tricks on us: it is the symbol of a dream and exists only for those who venture to believe in this dream. To the others, it only appears as what it’s negation: the substitute for an identity, of an entrustment, a legitimation. The euro currency only materializes as a result of a conscious act of assumption, of understanding and integration. In this sense, it is a counter-symbol, emphasizing the absence, the helplessness and the frustration.

Having become through legal and political force, the binder of a world, the euro currency was supposed to bring under its umbrella the 27 member states of the European Union. Beyond the “obligation to join”, there ought to have existed a sense of belonging, a search for an identity, a genuine need to overcome the local, the particular status and to find ourselves in a common, transnational, *essential* formula (formula which endures because “it is”, namely *esse*). Today, a quarter of a century later, only 20 states of the Union are part of the eurozone alongside other small entities, even non-EU members. For these, due to various reasons, the symbol is active and attractive. In contrast, for seven member states, the euro and the benefits of the eurozone might be placed in parentheses for particular reasons. The question from which I started to structure this essay was, of course, the one regarding the roots of these reservations or attitudes, the real roots and not any superficial excuses that can be quickly categorized as “sovereignist” for the simple reason that this has become the umbrella concept under which, politicians crowd together contemporary grievances and prides. We believe that this is a weightless excuse and that, beyond it, something older, more credible, more consistent must be found to justify the decision to stay aside. In Platonic terms, the question would be formulated as follows: what name would determine the refusal to participate in the European Idea, choosing to remain in the private, in the material, therefore in the ephemeral?

In this reading, the euro is not, primarily, an economic nor a political instrument, but an identitarian one. We set out to delve into the depths of the euro’s anatomy, seeking to understand how it reached us, what message brings to us, in order to then, be able to "interrogate" the states that are not part of the eurozone, as well as those that, without being part of the community club, have opted for a shelter under this symbol. We seek for an explanation that is as a-political as possible and as close as possible to the unspoken reasons of the said decisions. After all, living outside the eurozone has a price, and this price must be attractive enough to justify avoiding the more significant price of integration. We start from the hypothesis according to which the primary fault would belong to the way in which the community-European pattern was structured from the very beginning, namely with a hidden federalist thought, concocted under the cloak of a functionalist-economic cooperation. The functionalist compromise had no room for manufacturing defects, but the double game practiced for decades had its say as soon as the politicians decided that it was the right time to move from communities to political unity. Somewhere, there, we must identify the virus that does not give Europe peace and calls it to follow a difficult path among fears, vanities and helplessness. Once there, we will revisit the reasoning of the German Federal Court included in the Decision on the Maastricht Treaty and after that, with all these tools on the table, we will return to the EU member states and, respectively, to the euro-zone. We seek to identify what unites some member states and what holds back the others, namely, what would probably be one of the critical spots of the European construction. By looking for the reason behind the diplomatic declarations, we will avoid statistics, economic reports or the national legislation that is changing too easily and too quickly. We will seek to penetrate beyond what politicians want us to see, suspecting that the answer is buried in better guarded places.

I The gap between federalists and nationalists

No Idea, universal by its nature, may take shape in particular forms, in fragments of the world, incomplete and ephemeral as we know them. "Europe is much older than its nations. It risks perishing due to their discord and their increasingly illusory claims to absolute sovereignty. On the contrary, their union would reign over Europe, saving in the same time what remains valid from our decades of diversity."[3]

The zero moment of the European consciousness was 1945. Some had lost the war and were striving to understand why; others were seeking revenge, but most actors understood the advantages of cooperation and were looking for formulas to preserve it over time. Between the former, rigid nationalists, and the latter, a huge gap was opening up! It could no longer be just about vanity and the need for power, but, above all, about the need for safety, peace, and security. A high price was being asked for freedom, though its preservation made no deal demanding enough. "If Europe is to be saved from infinite misery and, indeed, from the final doom, there must be this act of faith in the European Family and this act of oblivion against all the crimes and follies of the past."[4] Nationalism had gone out of its usual rhetorics, turning into extremism, and came to work against the nations it claimed to support

[3] D. Rougemont, 1961, p. 1.

[4] Winston Churchill, „Speech to the academic youth", Zurich, 19.09.1946.

and promote. The borders between these nations turned out to be more than lines on a map, more than constitutional details: they become, in some cases, signs of the final breath before death and in most others, had disappeared under the tanks of the aggressor. Their uselessness, volatility and even absurdity had been proven beyond measure. "The question which must be resolved first, failing which progress is no more than mere appearance, is the definitive abolition of the division of Europe into national, sovereign States. The collapse of the majority of the States on the continent under the German steam-roller has already given the people of Europe a common destiny"[5]. What emerged from these more than desperate appeals were (at least) two Europes camouflaged in frozen belligerent camps, behind which each nation worked discreetly but continuously to reformulate its identity, waiting for the right moment to assert it. The fall of the Berlin Wall proved to be exactly what they had been waiting for. Germany had practically frozen their self-adulation, but now, it was precisely from Germany where the consent to manifest themselves came from – even if, we must say, this had not been Helmut Kohl's intention! The moment announced in the Ventotene Manifesto had arrived: "The point they will seek to exploit is the restoration of the nation State. Thus, they will be able to latch on what is, by far the most widespread of popular feelings, so deeply offended by recent events and so easily manipulated to reactionary ends: to patriotic feeling"[6]. We will answer very simply: even the populist episode has already been overcome in Europe, the elections of recent years bringing to power downright extremist parties, with declarations, actions and agendas that should rather push them outside the (democratic) law, not to accept them into the governance. It is clear that, back in 1945, something did not properly work! It is clear that the freedom, so hard obtained, was not attractive enough to keep at a distance, in the minority or even in silence, the ambitions of restoring nationalist movements and discourse, all this time! Something deeper, more incurable opposed.

"Time may be short. At present, there is a breathing space. The cannons have ceased firing. The fighting has stopped, but the dangers have not stopped. If we are to form the United States of Europe, or whatever name it may take, we must begin now"[7]– warned Winston Churchill. Still, making the long story, short, the entire program resulted in "only" the Council of Europe, that is, an organization of (nation-)states and later, the timid ECSC, Euratom and the European Economic Community. Approximations, roads not taken to the end. Fear. Freedom has not managed to cure politicians of fear; on the contrary, it seems to have advised them to erect even more

[5] "The Ventotene Manifesto. Towards a free and united Europe", 1941.
[6] "The Ventotene Manifesto. Towards a free and united Europe", 1941.
[7] Winston Churchill, „Speech to the academic youth", Zurich, 19.09.1946.

defensive fences around nations! The fact that historical and, especially, interwar efforts to promote the federalist project were not enough to convince had repercussions throughout the continent's post-war Odyssey. "It was obsolete state structures and the selfish, anachronistic values of the states' elites and interests which impeded this natural movement."[8] And by now, we are aware that everything that was achieved, in the meantime, was the effect of a gradual, cautious, sometimes too patient snatching of competences from nation-states to "Europe", offering, perhaps too little in return, as scepticism and extremism have already reached the negotiating table. But in such a context, no single currency has its place, nor even its usefulness, because the measures that could endanger its existence are within reach of its too numerous opponents.

Federalism is both inviting and threatening. It brings together what seems to have much in common and, at the same time, discourages slippage, double play, and disguise. It can be a "centralist, decentralized or balanced"[9] federalism. But what goes against nationalists is the sharing of power and, implicitly, of authority. Of the aura of mastery. Federalism is, in this regard, a one-way street, in which security and stability are gained through the transfer of power. "The federalist position is, certainly, the position of maximum scepticism about human nature and about the potential for good will and cooperation between states"[10] The promise already made by Immanuel Kant regarding the eternal peace could not convince; the legal provision of distributing power in such a way that decisions are made as close as possible to their recipients was, belatedly, replaced by subsidiarity (1992) and then, almost emptied of content by the multiplication of decision-making centres; and the "simple" centralization of government in a single place, even with the presence of representatives of all states, ultimately led to Brexit and the proliferation of gestures con-

[8] Michael Burgess, 1989, *Federalism and European Union. Political Ideas, Influences and Strategies in the European Community, 1972-1987,* Routledge, London and New York, p. 30. The same idea might be found in Count Richard Coudenhove-Kalergi's essay:" Not the European peoples are stricken with senility, but only their political system. Its radical change might and has to lead to the complete healing of this suffering part of the world." *Pan-Europe*, Ed. Pro Europa, 1997, (Pan-Europa Verlag, Wien, 1923). Many years after the publishing of this manifesto-essay, Edgar Morin reiterated the same risk: "Going towards the past means a return to the Nation-States, with the risk of generalized balkanization, with arbitrary borders, with oppressed or persecuted minorities and with frenetic and blind nationalisms... Going towards the future means the development and multiplication of confederations and federations where the imperative of respecting nations is associated with the imperative of overcoming the Nation-State.", E. Morin, 1990, *Penser l'Europe,* Gallimard, (Gândind Europa, 2002, Ed. Trei, p. 176).

[9] Ben Rosamond, 2000, *Theories of European Integration,* Palgrave, p. 24.

[10] Reginald Harrison, 1974 apud B. Rosamond, 2000, p. 26.

testing the centre. Although, at this time, most of the world's population lives in federations or various confederative variants, this bet has not taken root in Europe. Somewhere, this fact must be the ground for the rejection or postponement of the adoption of the euro in certain EU member-states.

But then, "can we have a single market without a monetary union?"[11] "The EC's single market is something very different from a free trade area. In the single market, nationality cannot be the basis for distinctions between economic agents, products and services... The EC's rules on the free circulation of goods, services, capital and persons have constitutional status for the member states; they thus have priority over national legislation."[12]Thus, the nationalists' attempt to hide under the provisions of the accession treaties is exposed by the exchange rates and the covert or overt protectionism that these politicians intend to practice freely. The trade and fiscal policy over which they reserve, for themselves, a margin of influence may undergo mandatory fluctuations in order to comply with the political agenda of the countries concerned, but will entail the additional costs of the lack of stability of the exchange rate and, automatically, the cost of a decrease in the level of economic partners' trust. On the other hand, the above approach betrays the purely nominal accession of some countries to the single market, as they cannot benefit from either its advantages or the consequences of the four freedoms. Since these are not subject to any optional acceptance, their partial adoption turns it into an issue of unconstitutionality. It was clear from the beginning that certain capitals would have looked only for the economic advantages, that is for a simple accession to the free-trade area. But they agreed to some of the single market's conditionalities wishing that, at least in part, this double game could produce profit. It is, of course, a contradiction in terms the affiliation to the single market without participating in the single currency, just as joining "Europe" without having the feeling of belonging to the club leaves room for speculation. Somewhere, behind the signatures and handshakes, there is an unspoken residue, and this comes to light whenever the demands go beyond a line of acceptable diplomatic duplicity. We have, without any doubt, a Europe with (radical) nationalists all over it, a Europe that cannot become federal even though, it has developed, over time, a series of federal instruments and institutions, shaped quite against the "separatists", The effects can be plainly seen whenever the Commission's decisions risk taking a "centralizing" tone or, more clearly, in numerous decisions of the European Court of Justice. The latter is obliged to be the "guardian of the treaties" but no one says – and cannot do it legally correct- whether

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[11] Tommaso Padoa-Schioppa," Key Questions on Economic and Monetary Union", in W. Adams, 1994, ed., *Economy and Polity of the European Community after 1992*, The University of Michigan Press, p. 55-56.

[12] T. Padoa-Schioppa, 1994, p. 56

we are talking about treaties in their literal meaning (as the nationalists would like) or in the spirit of the law (as is natural, customary, doctrinal). And the spirit of the treaties refers, very often, to interpretations which are federalist in their essence – hence the revolt of the sovereigntists against the principle of the pre-eminence of community law.

Up to this point, we can summarize by saying that the European Union developed from a federalist project rejected by some and tacitly assumed by others, that this project closely follows the institutional evolution of the community club and symmetrically entails the refusal of some politicians (or countries) who have not honestly adhered to all the conditionalities and limitations they face. We will further narrow the theoretical framework, trying to find the portrait of typical Eurosceptics.

II The functionalist compromise

The tragic lessons of the First World War led David Mitrany to sharpen his criticism against the (national) states. These had been, he said, "essentially a means to human fulfilment – (but, n.n.) they had become an end in itself."[13]. "The state has almost became an organization for the prevention of free international intercourse and the growth of a normal human society"[14]. Therefore, even the construction of Europe on a statist model – as many voices demanded by that time – would have only repeated the shortcomings of states and would have had an unhappy ending. In the 30s, the state – Mitrany claimed – was becoming "hybridized", confronting "the welfare system with the old image of the state as essentially a guardian of peace and order"[15]. The alternative he proposed was functionalism, based on the principle that the form of an institution follows the function and not some abstract bureaucratic decision. "The design of institutional solutions has to be an open-minded and flexible process."[16] Hence, there is not the territoriality that draws borders and separates people into citizens and foreigners; nor some cultural traditions which, in their own way, also impose some sort of map; but a dynamic approach, capable of keeping pace with changing in human needs and the possibilities to meet these demands. In essence, functionalism transcends borders, "without offending against the sentiment of nationality or the pride of sovereignty. Instead of a fictitious formal equality, it

[13] David Mitrany, 1933, *The Progress of International Government,* in Ben Rosamond, 2000, p. 34.

[14] David Mitrany, 1965," The Prospect of Integration. Federal or Functional", *Journal of Common Market Studies*, vol. 31, p. 136.

[15] D. Mitrany, 1933/ 2000, p. 35.

[16] B. Rosamond, 2000, p. 34.

offers even to the weakest states the assurance of non-domination and of an equality of opportunity."[17] The failure of states to offer their people what they need so as to live according to the requirements of the times, as well as the doubling number of sovereign states, were, according to Mitrany, solid arguments for choosing a different type of government. Basically, he proposed a technocracy, in which every field considered necessary was to be placed under cross-border cooperation and under the authority of experts. "Government by politicians implies that the prevailing motive of politics is the acquisition and retention of power rather than the pursuit of the common good."[18] In this context, Mitrany believed, the Euroatom and the ECSC were organized on functionalist bases, while the European Economic Community "is by comparison diffuse, and subject to a continuous temptation to self-inflation (which the 'Europeans' deem a virtue); with a bureaucratic tendency because it is diffuse; and an expansionist tendency because it is bureaucratic)."[19] We would add that the said expansion allowed for both the acceptation of new member states and the acquiring of new competences, new areas of application, even without (functional) connection to those that already existed. The bureaucratic character was considered by Mitrany as an anti-technocratic element likely to disrupt the strict functioning and turn the institutional structure towards areas and requirements for which it is not properly shaped. In this regard, it is necessary to say that the "expansion" towards the Common Market, then towards the Single Market and towards the EMU constituted a violation of classical functionalism and a development towards an implicit federalism; an undeclared one but assumed by the promoters of these innovations, even at the risk that the opponents of the "ever closer union" would react with a paralyzing potential. Mitrany's guiding idea was precisely to avoid the typical federalist "closure" in overly rigid constitutional frameworks, while functionalism allowed the inclusion of new members or competences while and the way in which they were required by the societal market, and not as a result of any political decision. His functionalism was a reflection of a kind of classical liberalism, *laissez faire, laissez passer* meant to bypass the traditional dynamic of creating certain structures destined to certain functions as the ones established through the constitutive act were too little receptive to the dynamics of reality. Between the states' vanity to protect the game of power and the constitutional confinement of federalism, functionalism was a process, a fluid reality. For the early times, especially between 1945-1955, functionalism was even put in practice, including as a form of delusion, a siren song meant to lull nationalist vigilance and put everyone in front of a fulfilled situation. But real ambitions and interests do not sleep forever!

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[17] D. Mitrany, 1965, p. 139.
[18] Ben Rosamond, 2000, p. 33.
[19] D. Mitrany, 1965, p. 142.

This case determines us to bring up a theory, apparently from a field foreign to the present discussion, but extremely useful in the context. It is an explanation taken from the description of transition and democratization. Analysing the main actors involved in the transfer of power as well as the location of the major battles involved, László Bruszt and David Stark staged four groups of combatants: conservatives (hard-liners), reformers (soft liners – "from within the regime"), respectively "moderates and radicals (from the opposition)"[20]. Mutatis mutandis, we consider that, with regard to the European construction, *l'ancienne regime* is represented by the world of nation states, the interwar world and the dominant one immediately after the end of the Second World War. Thus, the part of the conservatives (HL) is clearly played by the most ardent nationalists, by those who had lost the war or had been marginalized in the course of EEC development. The reformers (SL) would be those who wanted their countries to be included in international organizations without too many obligations, at least on short term, including all those who preferred the Council of Europe instead of the European Communities. The moderates' chair is obviously occupied by David Mitrany with his functionalism, and the radicals' space is populated by federalists. According to the aforementioned analysts, political transition occurs when the reformers (SL) reach a consensus with the moderates. And, we believe that this was the initial situation, in which the European Economic Community – EEC was born, on functionalist principles, with limited competences, in specific areas. The extremes of the spectrum, namely the conservatives and the federalists, could not have any possible dialogue.

I hereby claim that the federalists (the radicals in the above scheme) skilfully disguised themselves as moderates precisely in order to see the unification process started. They aimed, from the beginning, to take over the initiative at a proper time considered safe enough not to allow a reversal shift and, at the same time, advanced enough to have a good part of the reforms already implemented. The proof lies in the original texts of the 1953 Treaties, in the way in which the main European institutions were structured: the Court of Justice in particular, the relations between these institutions, the role of the community parliament – relieved of the sectoral public policies of the national parliaments but charged, especially with “federal” aspects. All started with the compromise represented by the EEC to which the reformists were ready to agree and, then, on the functionalist recipe, everything was expanded, step by step. Could everything be blocked at this stage? Of course not, in case of cautious operation and in the absence of substantial international convulsions. Could it be less? Yes, but it was not in anyone's interest, especially since the

[20] László Bruszt, David Stark, 1992,” Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition”, in Ivo Banac, ed., *Eastern Europe in Revolution,* Ithaca – London: Cornell University Press, p. 15.

world of the six founding states felt good in the exotic clothes it had put on. Was there room for a single currency? Of course, but the price would have been much too high, namely the risk of contestation from the hard-liners still active in all the member states. The EEC as a "simple" form of economic cooperation was an unexpected gift that also ensured mutual control and a sense of security, amid economic recovery.

The year 1973 not only brought three new members, Denmark, Ireland and Great Britain, but also changed the consensus of the six. By now, we already know it well enough, that only Ireland pursued actual integration, being open to a union no matter how close, while the other two states preferred the HL – conservative position. Even if London was more vocal, the single currency was not agreed in Copenhagen, although it is difficult to consider a possible economic decline that it would have caused. So, from six states dominated by the reformist-moderate consensus, we now had 7 + 2 (moderates + HL). How did they act, what did the hard-liners analysed by László Bruszt and David Stark try to do? Initially to eliminate the opposition (accusing it of treason), then to neutralize it and, finally, to constrain it by inserting new legal measures designed to ensure the conservatives a relative control over the new power. What did the two hard-liners in the European Community do? Britain first formed EFTA, the Economic Free Trade Association, with the aim of competing and removing the EEC from the market, then entered the European Community where, together with Denmark, it categorically rejected the federal idea, continuously demanded economic cooperation devoid of political factors, respectively inserted amendments into the annexes to the Treaties meant to keep these two countries away from any obligations that would have facilitated the transition to political union. Practically, between the promise/compromise of the EEC and the target of political union there was the entire confrontation that started with the first attempts of London's accession and continued until the entry into force of the Maastricht Treaty. A confrontation between hard-liners and federalists, both benefiting from the patience and institutional imagination of the moderate-reformists. As the next two enlargements brought into "Europe" countries that were in desperate need of integration: Greece (1980), respectively Portugal and Spain (1985) even if they did not really want to be part of the EMS – the European Monetary System, we may say that until the fall of the Berlin Wall, the internal balance was protected: 7 + 3 moderates + 2 hard-liners. With the exception of Mrs. Thatcher[21], the objections were related to the daily running of business, not to questioning the foundations of the

[21] "To try to suppress nationhood and concentrate power at the centre of a European conglomerate would be highly damaging and would jeopardise the objectives we seek to achieve.", *Britain and Europe,* Text of the speech delivered by The Rt. Hon. Mrs Margaret Thatcher, FRS, on 20th September 1988, Bruges.

European construction. Not even the "1995 wave" (Austria, Finland and Sweden[22]) foretold anything radical, although Austria, until then silenced by its own history, could hide deep dissatisfactions. By then, it was not the proper time to voice them precisely in opposition to the increasingly vocal German Federal Court. We believe that the Court's comments on the Maastricht Treaty represented the moment of hard liners' awakening all around the continent, while they were learning that the federalist attempts could be and were being challenged on the open stage precisely by a founding member. It is very possible that the debates that accompanied the ratification of the Maastricht Treaty sent the conservatives the signal to come back to political activism. That is, precisely the moment when, against the backdrop of a major political and security risk – the unification of Germany – the EEC was transforming into a political actor. In other words, as long as the federalists operated discreetly, under the functionalist cloak, the conservatives allowed themselves to be deceived by the matrix of strictly economic cooperation. The EEC could remain an international organization, more or less integrated, from which there were some possible exit options, inside of which there were possibilities of rebellion, disobedience, contestation, and return. The trap of political union was in the closet but the conservatives felt safe. Once, the EPU (European Political Union) was brought to the table and imposed by the Maastricht Treaty, it led them to go on the attack. A single currency presupposes or leads to a political union which, sooner or later, may lead to the fiscal union[23]. But here we have everything that contradicts the nationalists' reason to exist, everything that may contradict the illusion of the absolutely sovereign[24] nation-state and the entire propagandistic, emotional and mobilizing plethora behind it.

In conclusion, regardless of its economic or political value, the euro topic has changed the internal balance of the EEC. As a tool of those supporting the EPU – European Political Union, "extremists" as read through Bruszt – Stark lens, the eu-

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[22] Sweden is not part of the euro-zone and did not ask for any such declaration to be inserted in the EU official documents. A referendum was organised, got negative results but their validity already expired.

[23] Cf. T. Padoa-Schioppa, 1994, pp. 59-66.

[24] "Only for highly centralized and tightly organized European nation-states, whose cultural and constitutional identity and structure have been built up over centuries, is political union a comprehensive reality, in which "the state" tends to monopolize all the functions of government. But even in Europe, not to say in the world, very few nation-states conform to this particular model. For the others, the functions "affecting the state or its government" are divided among many agencies, levels of government, and institutions. If EPU is taken to mean that the Community should give itself a governmental structure similar to France or Britain, this is clearly not on the agenda, and will not be in any foreseeable future. With *this* particular type of EPU, the single market and the EMU have no necessary link. Subsidiarity, not *Leviathan*, is the essence of European *political union.*" T. Padoa-Schioppa, 1994, p 66.

ro's entry into circulation allowed the other "extremists" – nationalists (sovereignists[25], as they call themselves) to enter the game precisely on the path open by the conservatives: by ignoring the euro file, by delaying, by finding or formulating legal amendments. In this sense, functionalism constituted a formidable compromise, keeping the "extremes" away from the European agenda, protecting its integration and consolidation. At present, the list of countries that have not joined the euro area includes: Denmark, Sweden, Poland, the Czech Republic, Hungary, Bulgaria and Romania. If the Danish monarchy rejected it from the beginning, the other countries neither explicitly refused, nor did they take any credible steps towards adopting the currency. Since the argument of a sufficiently strong national economy does not apply, we certainly need another set of narratives from the panoply of nationalist hardliners, a kind of financial-fiscal nationalism if not something more, especially in Hungary and Poland. Before that, we will stop for a moment at the "birth" of euro, a moment that cannot be completely innocent with regard to at least five of the "dissident" states.

III The Euro bet

At least theoretically, each EU member state has, through the accession treaty, the duty to prepare its entry into the euro area, fulfilling within a reasonable time, the five convergence criteria. With the exception of the two Nordic monarchies – Denmark and Sweden – which were already EC's members by the time of signing the Maastricht Treaty, all the other countries that had not yet adopted the single currency were aware, even before their accession, that they would have to fulfil this obligation. And yet, we see how the five capitals do not seem too concerned about their non-membership in this club and Brussels has not taken any action to determine them to hurry up. While politicians rejoice and hide under financial details, we cannot help but wonder whether this unanimously accepted silence does not hide other considerations. It is difficult to say whether the five Central European economies that are not included in the euro area are the least performing in the Union and therefore, Brussels consciously postpone their accession. It is also true that the Maastricht Treaty does not contain provisions under which these countries can be summoned, sanctioned or, in any case, determined to accelerate the fulfilment of the

[25] "There are no perfectly sovereign states, but only states that are servants to each other, while equal and independent, aware that their very existence, their evolution would not be possible if they would not be ready to do each other, services.", Luigi Einaudi, 1918, cf. Ștefan Delureanu, 1999, *Geneza Europei comunitare. Mesajul democrației de inspirație creștină,* Paideia, Bucharest, p. 31. (*The Genesis of European Community. The Message of Christian Inspired Democracy*)

criteria. We can only note that all the actors involved feel good in this duality, some offering to their home nationalists good topics for political discourses while others happy to get away with fewer problems. Is this a professional attitude? Are we talking here about technocratic – functionalist decisions, if we could still use this term today? Of course not; of course, everything is locked in political offices. Does the economy of the countries in question benefit? It is enough to remember exchange rates and fiscal uncertainty to get out of any niche discussion.

Equally, however, we recall the above conclusion regarding the transition from an economic community to a political union. And we cannot help but recall the fact that the “return to Europe” of the Central European countries did not refer to any political union but to a type of civilization, to a certain cultural elevation, to a way of life. The Central and Eastern European elites who made efforts in favour of European integration did not have in their speeches issues like any financial-fiscal discipline, exchange rates or public debt! On the contrary, they talked about freedom, dignity, human rights, property or free information. We detect here a new possible interpretation of the role of the four actors involved in the political transition: instead of federalists (existing in Central European literature but quasi-unknown to the general public), we should have known Europeanists capable and willing to tell us about the complexity of the community acquis, about the criteria for financial convergence or about the pre-eminence of European norms. They were absent from the public discourse! Rather, we heard humanists talking about culture and values, about historical roots and elements of civilization. We are not saying, in any way, that these lessons were useless, but only that they were not complemented, in the public space, by the presence of specialists in fields that, even today, cause us troubles. Wherever they made themselves heard, especially in Poland, Hungary or the Czech Republic, they did not have an audience sufficiently prepared to assume the adaptation efforts and constitute a sufficiently resounding voice to determine public decisions. It is true that Slovenia or the Baltic countries thought less and forced the "burning of the stages" but we suspect that there, probably also in Slovakia, the despair of those who came out of an unfavourable regime had more success than the rational passage of each stage alongside a proper democratic debate. In other words, where fear was predominant, the leap into the eurozone preceded the societal education on this topic, while in countries where the list of dilemmas was long enough, the hard-line position won. It is not difficult to go through the list of the five Central European countries that do not use the euro to read the political strength of nationalist conservatives and a certain sceptical attitude towards the European Union, combined with a complicated need for identity reformulation. Economic cooperation is welcome, investments, freedoms, opportunities too, but, again, the leap to monetary union, as a stage towards an increasingly complex integration is perceived as endangering a certain national identity wounded by the times, the feeling of self-definition and, above all, the joy of exercising a supposed national sovereignty. The figures we keep hearing about the economies of these countries, especially Poland, the Czech Republic or Romania, do not justify us in placing the entire blame on economic agents or institutions who, despite traditional inertia, could have done more. We believe that it is something, beyond the performance reflected or reflect able in figures! And it is appropriate to say it bluntly that in proportion to a low trust in the community institutions, we will have a consistent support for the national currency, respectively, of a cautious position towards full integration into the EU. Nationalist forces, hard-liners of all kinds are more active and, therefore, more dangerous than postponing an actual integration, because their capacity to use the good faith of the population, to manipulate the options and, ultimately, even to re-win the elections is high enough for those in the European camp to be content with a moderate, almost "functionalist" position. Conservatives in these countries, of whatever kind they may be, still have enough to lose so that, in the event of the adoption of a too "radical" European stance, to do everything in their power to undermine it. As a result, maintaining a social balance in the medium term explains, at least, the reluctance of these capitals to undertake the legal steps to adopt the single currency. At this point, we must stress that not only the financial convergence criteria must be met – as provided for in the Union documents – but, above all, the mental convergence criterion, (unwritten but implicit), understanding the role of the single currency, of the EMU in the progress of the home economy, accepting the fact that the advantages of European integration come with conditionalities and that this double game of having one foot in the EU and the other, respectively with one mind outside, will only delay the evolution of the home society, be it Romanian, Polish, Bulgarian. We did not arrive at the gates of the EU as societies prepared to pass all the integration tests, but hoping that some could be circumvented or postponed sine die. In each of the five countries, conservatives have a lot of reasons to keep things in place, and the real reformers, the active economic agents, who would immediately gain from adopting the euro no longer have dialogue partners in moderate politicians. Societies have swallowed them up during these two decades since integration, either in dull and boring political formations, or in non-decision-making positions.

The euro bet was the most consistent barrier between the aristocracy of the EEC and the rigors of a political union still in formation. The Maastricht Treaty promised a lot and convinced only a small part of those in decision-making positions. Since too few of them were/are risk-lovers, politicians preferred to retreat to defensive positions, well supported by the populations anyway accustomed to finding compromise solutions, as well as by that segment of the political class that, all these years, rejected reform, competition, legality or institutional discipline. We will now delve deeper into the discussion of the Maastricht mechanism, hoping that it will outline new elements to explain why certain Central European countries still stand by the euro even though they would have all the reasons and criteria to be full members. And when we say the Maastricht Treaty, we are not limited to the dry letter of a legal document, but we look at the context that made it possible if not inevitable. We will scrutinize the year 1989 from the virtual proximity of Helmut Kohl, we will read from the Treaty to then "listen" to the opinions of the German Federal Court in what was called the "Maastricht Urteil".

IV The Maastricht Treaty and constitutional realism

The fall of the Berlin Wall was not simply a German problem, nor even one of the Soviet Union and its European sphere of influence. The GDR was far from being a self-sustaining state. Chancellor Kohl understood that in the general confusion, fuelled by the Westerners' fear of Germany and Moscow's reluctance, it was precisely the moment to demand the maximum of profit: the liberation of "democratic" Germany, the unification of the country and the integration/maintenance of the new state in the EEC and NATO. He was willing to "pay" anything – and the payment was precisely the disappearance of the German mark. But he saw Germany unified, liberated by Soviet troops and accepted – with reluctance, with amendments – in the Western world. For Bonn, it was an absolute victory. For the rest of Europe (perhaps the world) it was only the beginning of a series of problems for which it was not prepared.

The Fear of a United Germany

Europe – in its EEC form – was preparing to rethink its internal structure and functioning when Helmut Kohl brought in an uninvited guest: the GDR included in a greater Germany, that is, unforgivable, unpunishable for economic backwardness, for general instability. The chancellor's decision to equate the West German mark with the Eastern one, against the Bundesbank's warnings, weakened the German currency precisely at the moment when the EMS called for its strengthening. Nothing in the functioning of the German currency up to that point corresponded to the new parameters, nothing could fit into the agreed exchange rates. "Due to the German mark's position within the EEC, it was necessary to raise the interest rate and thus, the other EEC members had to pay, in the form of higher interest rates, part of the cost of East Germany's recovery, when they actually needed more devalued money to achieve their own development."[26] Instead of consolidating the EEC,

[26] Peter Calvocoressi, 2000, *Politica mondială după 1945,* CEU – ALLFA, București, (1996, Addison Wesley Longman, London), VII th ed., p. 239. (*The World's Politics after 1945*).

Kohl choose the unification of Germany, that is, the rewriting of all existing scenarios. Suddenly, it was not the hard-liners to represent the greatest danger, but precisely the (too) large Germany, unpredictable and threatening in its potential. "Even if the Germans should in no way aspire to a position of dominance in Europe, they will be suspected of doing so, and the other countries will want to protect themselves against that eventuality"[27]. As I said, the "German problem" was not a local or localizable one, the wave of GDR's liberation generated consequences in the "East": "the rush of aspirants for full or limited membership of the EC"[28]. A number of states were leaving the stricter or more moderate tutelage of the USSR with the clear intention of gaining a rapid accession to a Europe they had been yearning for decades. It was the famous "return to Europe", without further ado, without conditionalities or delays in detail. The bourgeois peace of the Western EEC was suddenly blown up, along with EMS' years of work meant to coordinate the national currencies, preparing the transition to a single, common one. The very events that Mitrany had feared were taking place: the political enlargement of a functionalist created body, beyond the precautions of the technocrats, beyond the intrinsic capacity of the system to absorb the new. The integration of the GDR, completely unprepared for the Western world, was already unquestionable, as it was already united with Federal Germany. And through this, a precedent was created, a door was opened wide while few politicians of the time hardly dreamt of. How to raise conditions and criteria in front of some (Eastern) countries that were in any case more developed than the GDR, which was already automatically accepted? How to postpone their access to "Europe" even though each one was more qualified than the East German state? If we look at the chronology, we will see that the difference was 15 years between the unification of Germany and the accession of the first wave of Central European countries. Surely this delay – desired by no one in the "East" – as well as the effects of the shock therapy imposed by Bonn in the new *Landen* would give harsh lessons to the Central European countries, along with serious reasons to be cautious, to weigh radical decisions several times, to value their independence and regained identity. We see that today, more than three decades after German unification, it is precisely in these new states that nationalist hard-liners are winning, a sign that this leap was neither prepared nor reasonably implemented. We also discover how, precisely in the countries that were, by then, most economically advanced, reluctance to adopt the common currency. In his own way, Helmut Kohl was right to rush things. But his impulse was not followed by a commensurate implementation. In Kohl's wake, the conservative hard-liners have learned their les-

[27] Fritz W. Scharff, 1996," Can there be a Stable Federal Balance in Europe?", in Joachim Jens Hesse, Vincent Wright, eds., 1996, *Federalizing Europe? The Costs, Benefits and Preconditions of Federal Political Systems,* Oxford University Press, p. 363.

[28] P. Calvocoressi, 2000, p. 239.

sons, preventing accelerated reforms as well as the real preparation of the countries in question for accession to the EU and the eurozone[29].

As if all this were not enough cause for concern, "German unification has added political urgency to the constitutional development of a European state."[30] Less disturbing aspects on a daily basis became pressing: the representation of the new German state in European institutions, its weight in decision-making process, the capacity of such a state to influence the votes of other states, and consequently, the role of the European Commission and the European Parliament. "The system of flexible alliances (within the EEC, n.n.) has been unbalanced by German unification. By the size of her population and of her economic potential, the Federal Republic was now clearly the largest member of the Union and it is most likely that this will also change the character of Franco-German relations, which hitherto depended on the fundamental equality of status and influence between both countries."[31]

The transition from economic cooperation, accompanied or not by the EMS's requirements to a political union, already demanded a revision of internal procedures. But through the cavalcade of events that all Western leaders had feared, all of them naturally arouse and accelerated by the fall of the Berlin Wall, the institutional agenda had become overcrowded and risked turning into a political one. It was precisely the transition that the hard-liners did not want, be they communists or nationalists, British conservatives or right-wing extremists. A political entity built in Europe instead of an overall useful economic cooperation was ready to rewrite the anatomy and physiology of the continent. It was definitely a leaving of the middle arena, of the compromise of reformists with moderates which was to satisfy the federalists. Following the adoption of the Maastricht Treaty, "The European Union was a federation, without calling itself (as such). The draft treaty made this known, but the word "federal" was eliminated out of respect for the British sensitivities."[32] Beyond the language, the reformed procedures were leading the Community towards the shape of a state. There was much discussion about whether it should have

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[29] Otmar Issing, 2008, The Birth of the Euro, Cambridge: Cambridge University Press: "We cannot repeat it often enough. Political union is the indispensable complement to economic and monetary union", Helmut Kohl, 6 November 1991, Statement in the government; cf. Issing, 2008, p. 229; or "If it comes to foreign policy, this will only be done through monetary union. Of course, monetary union will take time to consolidate. And it will not be cheap. If the currencies of areas at different stages of economic development are no longer to fluctuate against each other, equalization of payments will be necessary. Getting people used to the idea of monetary union is the only way I see to finally achieve a common foreign policy.", former German President Richard von Weizsäcker, Focus, 28 November 1994; cf. Issing, 2008, p. 230.

[30] Fritz W. Scharff, 1996, p. 362.

[31] Fritz W. Scharff, 1996, pp. 362-3.

[32] P. Calvocoressi, 2000, p. 241.

followed the federal formula of Germany, that of the United States or the more relaxed version of the Swiss confederation. We will not go into such details here. But the introduction of the notion of European citizenship added to the national one was already an important step towards unification. The specification of the relationship between the Commission and the Council, respectively between the Parliament and the Council suggested the relationship between an (active, real) executive and a bicameral legislature. And the addition of subsidiarity meant the ultimate signal of danger for the hard-liners. Suddenly, the functionalist narrative evaporated, revealing the true founding intentions of the whole: the federalization of Europe – gradual, consistent but certain. As in every such scenario, the centrist position may always be accepted – sometimes naturally, sometimes with amendments, but a radical turn towards constitutional unification was unacceptable. Brexit happened as these hard-liners were stronger and more convincing in the UK. In countries in which they came later, creating populist, Eurosceptic movements, they postponed the adoption of the single currency, irrespective of purely budgetary considerations. Today, the EU exit option is on their table, more than any possible constitutional reform.

The Stateless Currency

As a rule, any currency represents the symbol of a statehood and comes to round off its insignia. It is a source of pride and a clearly expressed difference from all other states. This time, we do not have a state, the very discussion regarding the European political union being more than heated. "Since the start of monetary union, the question has been: is this institutional arrangement sustainable? Can *monetary union* survive without *political union*? To judge by the number of warning voices, the euro's chances of survival are, rather, poor."[33]

Much has been written and debated on possible alternative options to maintain relatively fixed exchange rates without involving the entire constitutional apparatus of the political union. Wayne Sandholz (1993), for instance, wondered whether it was necessary to "sacrifice the sovereignty" of the member states, knowing that the national currency was an unreplaceable symbol of it, along with the autonomy in the field of monetary policies. "Monetary union requires a far-reaching surrender of sovereignty; monetary policy would be set by a supranational central bank and national currencies could eventually disappear. National leaders could therefore be expected to dismiss the idea out of hand. The political logic of monetary union, in short, is not obvious."[34] As an alternative, he proposed having the national govern-

[33] O. Issing, 2008, p. 228.

[34] Wayne Sandholtz, 1993," Choosing union: monetary politics and Maastricht", in *International Organisation,* 47, 1, p. 11.

ments to maintain the objective of macroeconomic discipline, even if giving up the fixed exchange rate regime. Although acknowledges that some governments involved have so far failed to ensure this macroeconomic discipline – and gives the example of the French one – the author insists that they should be ordered to do so, by law. He also mentions the EMS and the possibility of adjustable exchange rates and, actually, he lists all the attempts that had already been made within the EEC. The simple idea of completing the monetary union with a political umbrella gave the academic world a shiver, especially since it was, for the first time, when a "state" was being born under its eyes, without being based on the classic elements: a people, a territory. One could object to the territorial aspect, but since the EEC – the European Union was already on the verge of expansion and not only to the east, but also with Western states that had by then entered the European Economic Area, the very criterion of territory was undermined. As a result, Europe was preparing for a constitutional reform against the classic provisions of a Constitution with respect to the classical elements of statehood. The uncertainty was becoming unbearable, consisting, in fact, of a series of overlapping uncertainties: the transfer of sovereignty, the functioning of a supranational Central Bank, enlargement, Central Europe, a united Germany. Legally speaking, it was clear that the Central Bank would take over the power to decide monetary policies, but on everyone's lips was the question with nationalist origins: should the nation states accept such a thing? At what price? And if not? "A central bank does not make a state, but every state has a central bank. This is the normal state of affairs. In the context of the EMU (the European Monetary Union), the ECB (European Central Bank) is an important element in the formation of the state – no less, but also no more."[35] Therefore, the unification of Germany did not solve a "simple" historical problem of the two states, but complicated the political and economic equation of (at least) an entire continent. States that had been belligerent for hundreds of years were now called upon to accept the sovereignty of supranational institutions or return to the political stagnation of the interwar period. While economists continually stress the advantages of removing customs barriers and opening up markets, historians warn: "The history of Europe is that of her borders. And that it is the history of what was inside those borders, imposed on her by words and deeds and. It is therefore a history of the forces which, consciously or not, have acted to produce the unification of a space which was initially fragmented; it is also a history of those forces which have pulled in the opposite direction and undone everything which the first had produced. It is, thus, the history of conflicts."[36] So, could a monetary institution "without a state," a John

[35] O. Issing, 2008, p. 230.

[36] Krrzysztof Pamian, 1990, *L'Europe et ses nations, Paris: Gallimard,* in Bronislaw Geremek, 1996, *The Common Roots of Europe*, Polity Press, p. 10.

without a country, survive in the midst of these political convulsions with ancient origins? Was the technocratic genesis of the single currency enough to guarantee and maintain its immunity, or was it to become, at a disastrous moment in history, the favourite target of politicians precisely because it was not the product of their negotiations? The course of events also provided us with the answer: during the sovereign debt crisis, politics did not stand aside but the currency and the entire institutional machinery behind it survived. It was a gamble it was a test not to be missed – but how many such tests can stand in the way of a political class determined to take back what it perceives to have been technocratically stolen from it at some point?

On the other hand, if we check the contemporary euro-map, we will identify islands of circulation that do not belong to the actual European "territory", whether we consider the four micro-states that use this currency without being EU members: Andorra, Monaco, San Marino and the Vatican, or whether we look far, across the world's oceans, islands – French overseas departments, former Spanish or Portuguese colonies, so that, symbolically or not, we can say that the euro has drawn its own territory and statehood. Adding the attraction it also exerts in the Western Balkans we may see an "expansion" of the European Union far beyond political enlargement. At the same time, we have EU member states who, diplomatically speaking, are postponing the adoption of the euro. The charm of the single currency, its stability and the aura of victory, has not convinced these countries, a sign that for it, still considering the transition from cooperation to union not acceptable.

Legal Aspects Raised by the German Federal Court

The ratification process has not gone without stumbling either. As expected, the two hard-liners played their cards by obtaining a series of options for non-compliance with the provisions of the Treaty on European Union – TEU. They were joined by the very ones who should have been the engines of ratification, France and Germany. The ambitions of political union proved to be difficult to digest: European citizenship, the redefinition of the roles of the main European institutions, the single currency, the European Central Bank, the three-pillar structure, the expansion of qualified majority voting. The emergence of the CFSP and JHA pillars (Common Foreign and Security Policy, and Justice and Home Affairs, respectively), even with an important role reserved for the ministers of the member states, brought too much of a huge transfer of sovereignty. Europe had lost the slow rhythm of functionalist reforms and was betting everything on a Treaty that would change it from the ground up.

If politicians or even electors who voted in referendums could have somehow been seduced, convinced, or deceived, the German discipline pushed the TEU text onto the analytical table of the Federal Constitutional Court, based in Karlsruhe. The Court delivered a historic ruling that redefined the way in which the institutional architecture and functioning of the Union is to be understood. Ten months passed from the ratification, without problems in both chambers of the federal parliament, until the Court's decision. Referred to by a group of political parties and individuals on their own behalf, alerted by the possible decline in the degree of democracy in Germany following the adoption of the TEU, the Court decided the following[37]: the ultimate goal of the TEU was not to build a federation like the United States of Europe, but to consolidate an international organization (Brunner, 90); Germany should not fear that, through the Treaty, the European Court of Justice or any other Community institution would obtain the right to assume powers not provided for in the Treaty, in other words, it would not acquire *Kompetenz-Kompetenz* beyond the letter of the ratified document (Brunner, 94); Economic union was not inevitable, and if such a case were brought before it, the Federal Court was ready to analyse the implications of Germany's entry into this union; respectively, ratification of the TEU did not equate to Germany's automatic entry into the monetary union, without any possible stages being subject to internal constitutional analysis (Brunner, 101-103).

Of course, there were several voices who immediately added that the judges would have been convinced in advance to accept the TEU without too much additional requirements. However, two aspects directly interest us in the euro issue, with a third coming implicitly, on a legal path. First of all, it surprises the idea that the achievement of the economic union was not inevitable – when, in fact, in 1993, it was a relatively accomplished fact, the TEU eventually going to legally legitimize the *de facto* reality. At that time, we were already talking about four decades of the EEC, with the – even – inevitable expansions and developments imposed by the market. The entry of the EEC into the European Union practically granted the EU a single market and added the mechanisms of the monetary union: the currency and the Central Bank, as well as the European Monetary Institute. The Court, however, was careful to note that “whether full economic union is the only way to complete the monetary union successfully is a political question and should be decided by the proper legislative bodies.” (Brunner, 103) Therefore, neither the currency – with its sovereign component, nor the monetary union represented, in the Court’s view, any impediment, but the economic union – already accomplished to a considerable extent. Let us say that the referral to the Court could only be made on the basis of an alleged violation of individual rights, these components of sovereignty not falling

[37] Cf. Kevin D. Makowski, 1995, ”Solange III: The German Federal Constitutional Court's Decision on Accession to the Maastricht Treaty on European Union”, *U.Pa.J. Int.l Bus.L*, 16:1. In the following, we will indicate by Brunner, xx, the paragraphs in which the ideas we present here, are discussed. The decision is also known as the Brunner Decision.

within the scope of individual rights, "actively and directly violated" (Brunner, 76). This is where a good part of the dissatisfaction of the hard-liners stems from, because the Federal Court does not admit political causes, and beyond individual rights one enters the political sphere. We note, for our topic here, that by translating this way the question, the Karlsruhe Court practically separated the justifiable issues under the spectrum of internal democracy from the political aspects involved and implicit in the TEU. Clearly, the issue of sovereignty could not fall under its jurisdiction, despite all the efforts of its opponents.

Consequently, and by placing Germany's exit from the EU as the ultimate sanction against the Union in the event that the procedures provided for in the Treaty were to be violated in practice and the countries would have seen themselves automatically integrated into formulas beyond the acceptance of national legislatures, so in such a reading, the Court declared the ratification and implementation of the Treaty constitutional. It was rather a literal-originalist interpretation of the Treaty than an intentionalist one. But, by emphasizing in two of the four key questions – economic union and monetary union – the need for each stage to be nationally approved, it practically added to the Treaty and offered a guide to good practices. It removed the burning issues from the agenda and from the options of the hard-liners of the time, demanding, in return, a clear division and regulation of competences. The *Kompetenz-Kompetenz* clause did not remain without echo. Solved apparently naively, by specifying that it was not the intention of the legislators to leave the granting or extension of their own competences to the discretion of the European institutions (Brunner, 94-95), it practically opened a Pandora's box that still haunts us today, with respect to community law. The increase in the complexity of the files submitted to trial before the European Court of Justice, as well as the accumulation of precedents with serious effects in the EU economy or administration, transformed the European Court into such an active body that it is suspected of creating norms, that is, of clearly exceeding the competences provided for in the Treaties. Moreover, the Commission – accused by all the hard-liners of the Union of not being democratically constituted, but by nominations of national governments – seems to be the main actor responsible for increasing its own competences. We will not develop the *Kompetenz-Kompetenz* problem here, but it is necessary to emphasize that since the Karlsruhe Court considered the relationship between the economic and monetary union to be a political issue and politics escapes, in any case, the precautions of competence, we practically have to look for solutions to the relationship between the two unions in the statements and agendas of politicians, and not in judicial interpretations. Perhaps, the answer to the first objection, the one concerning the construction of a European federation under the deceptive umbrella of the "ever closer union", would also remain in the hands of politics.

Beyond these topics on which we should focus on every time something seems suspicious in European law: constitutionality, the relationship between individual and political rights, respectively the allocation of competences, the Court has inserted a mention almost neglected in Western countries but increasingly important in the arsenal of Eurosceptic populists, such as Viktor Orbán or Mateusz Morawiecki (Jaroslaw Kaczynski). The text goes like this: "any expansion of the Treaty – including expansion via judicial interpretation – will not be binding in Germany because such an expansion would not be sanctioned by the law implementing the TEU and will be unconstitutional" (Brunner, 108). It is worth saying that, while the contemporary world contemplates with satisfaction the activity of "active" judges, creators of norms in Europe, the Decision pronounced by the German Constitutional Court is in force and can sanction such novelties at any time together with their legal effects. Politicians from Hungary, Poland, Bulgaria or Romania rely on such lines whenever the problem arises of finding plausible explanations for their inactivity, for the way they postpone decisions or reforms. If in legal theory, the battle takes place between the literal reading of the law and the reading of its spirit, and has been developed towards the opposition between the mechanical, textualist reading and the pragmatic, utilitarian or even institutionalist one, in EU practice we have these levers through which political leaders can evade certain obligations, covering their nationalist games with legal arguments. On this point, they call themselves sovereignists, not because they possess the instruments of any authentic sovereignty, but just to cover their actions of undermining participation in the economic, monetary or other kind of unions.

Moreover, one delicate aspect arises from the way in which the Court has addressed the issue of EU statehood. Some commentators have underlined the influences of the German constitutionalism tradition, which, through the Karlsruhe Court's Judgment, have penetrated the way in which Europeans began to understand the internal spheres of the Union. For example, Paul Kirchhof, the Court's rapporteur in the TEU case, had declared in a conference held just three years before the Judgment: "The Federal Republic of Germany is a State; the EEC is a community of States and should not become a State."[38]It seems that the reply from Ulrich Everling, then a judge of the ECJ, contradicts more than all the philosophies in the world, saying that "he would rather leave the decision on whether the Community should become a State or not, to his children, that in any event, the State is no longer what it was a century ago."[39] Are we, after following this exchange of replies, obliged to review the relevance of the concepts we operate with? In such a case, the entire discussion

[38] Paul Kirchhof, 1991 cf. Julio Baquero Cruz, *The Legacy of the Maastricht-Urteil and the Pluralist Movement,* EUI Working Papers, RSCAS 2007/13, p. 20.

[39] J.B.Cruz, 2007, p. 21.

about monetary and economic union would move to completely different dictionaries! As the quoted author, Julio Baquero Cruz takes from the writings of both aforementioned judges as well as from the "eternal" clause of the German Constitution regarding the existence of the state, he practically calls us to look into our own Constitutions, especially towards the "eternal" clauses that can, whenever the hardliners decide, generate situations of incompatibility with the EU Accession Agreements.

And last but not least, it is necessary to recall the remark in the Court's argument that there are no "European people", but will coagulate through integration. As a result, for the time being, European citizenship is devoid of substance and in no way generating individual rights, such as the right to vote in local elections where one resides. In fact, the Court stated, democracy was to develop in parallel and by virtue of the integration process. Moreover, since the European people do not exist, the TEU cannot be a constitutional text of the EU, but, at most, an international treaty, the authors of which were the member states. Of course, constitutionalists had time and energy to debate these aspects on all sides – and they did so with excessive force. What interests us is that, raised at the level of the Constitutional Court, these notifications influenced the entire legal narrative on the continent and, as we noted above, gave working tools precisely to those challenging the European constitutional order. Because, a simple focus on the "detail" that the states are the authors of the Treaties – and even of the legal norms, the Parliament not having exclusive powers – can divert the meaning and applicability of any normative act. And, we have seen in recent years how all the populist leaders, so-called nationalists, with or without their own agenda, have based their challenge to the European order. The topic of the democratic deficit has taken root and no longer needed rigorous explanations, compliance with the Treaties or with reality itself. Every national electoral campaign has this mantra of the Union that functions precariously compared to sound national principles of governance. Last but not least, "one must not forget that the obligation of Courts of last resort, including constitutional courts, to refer issues on Union law to the European Court is not always strictly observed. In some Member States it is actually seldom respected. The consequences of this disregard for an essential element of the system are grave: the rule of law is only imperfectly ensured in the Union; the position of the Court within the judicial system is not as strong and central as it is supposed to be; Community rights are not always enforced; national courts often decide cases in breach of European Union law as interpreted by the Court, not because of a rebellious attitude, but because of ignorance."[40] Actually, through their attitude, natural or politically-administratively induced, these institutions themselves determine the emergence of the democratic deficit in the Union. Part of this non-

[40] J.B. Cruz, 2007, p. 31

reporting to EU rules is the avoidance of the obligation to adopt the euro, pursued precisely in order to retain some instruments of control, diversion or distortion of the natural functioning of the Monetary Union. Before naming the “perpetrators”, we will say a few words about an extremely active mechanism in political life, namely the symbol. In the modern era, it has taken the place of myths and numerous religious commandments, but the way in which it is used reminds us of the functions of its predecessors.

V The political symbols

At the level of general culture, it is well-known that any currency represents a symbol of the country's sovereignty, of imperial or royal majesty – where applicable – an almost sacred object in the national imaginary. Thus, it would be easy to say that, at the level of the European Union, the euro represents, for 20 states, the sign of membership in the community club, in a democratic region, protective of fundamental rights and freedoms. In the same logic, the seven states who did not adopt the single currency would be the opponents, the dissatisfied, the dissidents. And here we would stop at the most banal repetitions possible. There are, we know from school, proper meanings of words (dictionary meanings, as Umberto Eco called them) and figurative meanings (encyclopaedic, in the vocabulary of the same Umberto Eco). What I have outlined above, would naturally fall within the field of the proper meaning of the term symbol, respectively of the euro, as perceived by politicians. The question is what exactly is hidden in the labyrinth of multiple, deep meanings, what motivates them to pay the price of postponement or of living outside the eurozone. Of course, it is mainly about the perceptions of the electorate, about what they want to believe and receive insatiably from official propaganda.

“Politics is the process through which the irrational foundations of society are revealed.”[41] The more complex the real situation is, requiring more information and critical thinking to understand it, the more an abstract explanation is preferred, ready-made to be accepted and promoted. No matter how undemocratic, arrogant or even medieval it may sound, we must say that the vast majority of the electorate does not want to take up the details of reality and analyse them independently. On the contrary, “signs and symbols … constitute the only means by which groups, who are not in a position to rationally analyse a complex situation, can adapt to it through stereotyping, oversimplification and the instillation of a sense of securi-

[41] Harold Lasswell, 1999, cf. Murray Edelman, *Politica și utilizarea simbolurilor,* 1999, Iași: Polirom, (1985, Illinois), p. 35. (*Politics and the Use of Symbols*)

ty."[42] The more difficult the situations to which we are exposed have become to understand, the more the mass of people have turned to easily accessible forms in which they escape and, through the simplicity of which, they obtain the hope that they have an acceptable explanation of the events around them. Let us take the European Monetary Union and the functioning of the euro. Few people have the knowledge through which to explain the physiology of a national currency. Then, just as few, especially in certain regions of Europe, have the ability to explain the need for European unification, the emergence and usefulness of certain institutions, and thus, they have no way of relating rationally to them. Getting a clearly argued option in favour of or against the euro would imply an economic culture that rarely goes beyond the narrow framework of specialists. How to express oneself in a referendum related to the adoption of the TEU/the euro[43]? How to constitute an active civil society that questions the political class when it delays the set of mandatory reforms? Who will "control" the rulers from among the electorate that gives them votes and support? For this majority, critical interrogation is not the priority, much less rational penetration into the bowels of economic or political problems. Essential proves to be the "social adjustment"[44], the feeling of comfort, of assuming a reality, even if abstract, illusory. "For the majority, politics is a parade of abstractions."[45] The state is abstract, political power is a news character, the controversies of the government are just episodes in a series that they watch not to detect the truth from the pile of propaganda, but to breathe with satisfaction the feeling that they part of the ritual. Even after so many years in which the mobility of people within the EU has brought many people into direct contact with the single currency and its advantages, euro plays, in the collective imagination, only the role of another reality, a scenario that begins beyond the national border and eventually stops there. It does not have the impact of a necessity, of an emergency! It is an alterity, another film that may be optionally, watched from time to time. Reality is fractured into "them" and "us", "here" and "there" without these people asking themselves the question of cancelling such a border. Accustomed to a life with borders, to crossing or ignoring them, they do not have – yet? – the feeling that they should break the chains, nor the fervour to imperatively demand that politicians do something. And these, stay happy when acknowledging that they can maintain control over their petty, personal, interests without being fundamentally disturbed.

"Politics is, for most of us a continuous unfolding of abstract symbols, but one, as our experience teaches us, that can be a force for good or evil, sometimes bordering

[42] M. Edelman, 1999, p. 45

[43] We refer here, on the referendums held in Denmark and France.

[44] M. Edelman, 1999, p. 18

[45] M. Edelman, 1999, p. 19.

on omnipotence."[46] For many years, perhaps too many, Europe was, East of the Iron Curtain, just a symbol. A great unknown issue, populated by each of us with the little knowledge we possessed: a list of novels, a few names of composers, a few football or rugby teams, a number of politicians about whose activities, we knew only very little. And we felt abandoned, isolated, frustrated. We see nowadays how societies in Western Europe do not have more information about us, not even now, even if the umbrella of censorship has not acted in their countries. For each of them, as for each of us, the Other is a symbol, a stereotype, a mental construct. As positive entities dominate or not this list, we operate with a positive or negative image of Europe, of the European Union, of the currency, of the institutions or even of the norms regarding fundamental freedoms[47]. In the end, Europe is a sum of symbols; it depends on how each of us understands to decrypt them positively or negatively, to adhere to or refuse, it depends on the narratives we trust or on those we need to better adapt to the reality we live in. For politics, "essential to its power as a symbol is that it exists somewhere far away, singularized, omnipresent, as the ultimate threat or means of salvation, and yet impossible to effectively be influenced by any act that we, as individuals, would perform".[48] This observation, however valid in terms of social psychology, shatters everything on which the theory of civil society was built while fully feeds the masses (of an Ortega or a Canetti) and gives broad wings to politicians. Being far away, singularized, everyone seems to have the freedom to "fill" it with whatever content, whatever meaning at hand, to interpret and use (even abuse) it as it serves best. What can the average person understand from the entire mechanism of the establishment and functioning of a single currency that is "far away" since he finds something else for daily living in his pockets? Rather, those who promote the urgency of adopting the euro become suspicious and cautious distancing from them is demanded! Politics is a symbol, without a doubt, and if, through its metabolism, it takes us out of our psychological comfort zone, it becomes negative towards toxicity. This is how negative symbols appear, those that describe nefarious realms on the edge of the known world, spaces beyond borders whose passage itself is optional if not contraindicated – in the view of many people unaccustomed to traveling beyond their county of birth. Or, accustomed and returning home after a series of negative experiences. So, the symbol is the one that guides us through the darkness. Around the symbol, not the world as such is built, but our world, our acceptable, habitable, breathable world.

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[46] M. Edelman, 1999, p. 15.

[47] See the ease with which populist leaders have created extremely negative images of European Others, be they from the West or the East, as demanded by "national" morality, public fear, or their own political agenda.

[48] M. Edelman, 1999, p. 15.

Of all the types of symbols analysed in the specialized literature, the ones that interest us here are the “condensation symbols”. These “evoke the emotions associated with a certain situation. They condense into a situation, sign or patriotic act, patriotic pride, anguish, memories of a past glory or of a humiliation, promises of a future greatness: some of these or all of them together”[49]. So, emotions! Decisions made on the basis of emotions, adhesions or rejections on irrational grounds, histories interpreted, distorted, used. And, what better characterizes Central and Eastern Europe than the politics of emotions, of subjective history rewritten with each generation, the politics of signs and stereotypes? In these symbols of condensation, "the constant confrontation with the environment is missing"[50] precisely because, at the level of the masses, it is not reality[51] that matters, but the opinions." The mass man considers himself perfect. In order to feel perfect, a superior man must be particularly conceited. on the other hand, the mediocre man of our time does not even think of doubting his own perfection. The innate hermeticism of the human soul forbids him what would be the prerequisite for discovering his insufficiency: the comparison with others."[52]

As a consequence, we believe that it is mandatory to give up looking for rational, budgetary, monetary arguments in favour or against the adoption of a single currency. The mass man, along with his favourite leaders who "know" what is good and what is wrong for us, will do their best to convince as many people as possible of the toxicity of joining the Monetary Union. The Other guy, who, by chance or due to good social placement understood the advantages of the single currency, will "know", in turn, that it is no better alternative and will try to convince everyone to vote in favour of adopting the euro. Political leaders know this and, with good advice, understand that they are the last stage in the alleged social dialogue on such a complex and abstract topic. As a result, the party press has a lot of work to do, the sympathizing youth, the people around, as well. In both situations. When the (mass) man comes to vote, he already knows the lesson precisely in the form of a symbol that he will accept or not. "Practically, each controversial or truly considered important political act is meant to serve somehow, as a condensation symbol. It evokes

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[49] Edward Sapir, 1934,” Symbolism”, in M. Edelman, 1999, p. 15.

[50] M. Edelman, 1999, p. 16.

[51] “The democratic project depends on the decision to explain people's otherness differently – namely to condemn the differences found and replace them with differences made... From now on, there are no more real facts, from now on there are only interpretations", Peter Sloterdijk, 2002, *Disprețuirea maselor*, Cluj: Ideea Design si Print, pp. 64-65. (*The Contempt for the Masses*)

[52] Jose Ortega y Gasset, 1994, *Revolta maselor,* București: Humanitas, p. 95. (*The Masses Revolt*).

a response of consent or revolt from the masses, as it symbolizes a threat or a state of security… its meaning can only result from the psychological necessities of objective consequences."[53]

The main lesson we have to take from the socio-psychological theories consists of a few key words: threat, psychological necessity, the need for comfort, for security, constructed reality and emotions. Any political symbol is defined by these elements when it reaches either the electorate or the arsenal of hard-liner leaders, of whatever colour they may be. If, the ingenuity of politicians manages to accumulate under the letters of a concept, a political instrument, motivation enough, positive speculation, impetus towards progress and well-being or, at least, motivation for respecting a discipline, the cause is won. In all other situations, a negative memory, a trauma, a fear of failure is enough and the whole scaffolding collapses. As the labyrinth of the creation of the EU was not without risks, sacrifices or even ambiguities when the real goal had to be presented in more attractive clothes, it is not surprising that the transition from the well-being of economic cooperation to the political bet stumbles in the stereotypes "condensed" behind history. Now, with these tools ready, we will turn our attention to the seven countries who still prefer to stay at the gates of eurozone.

VI The apparent sovereignism and the historical traumas

Rationally speaking, the map of the eurozone hides (or betrays) a series of traumas transposed into economic policies; we have a compact group of countries, mainly Catholic, who have joined the eurozone and thus confirm the decision to belong to the community club; we also have some small countries or smaller areas who, without being constitutionally EU members, participate in the eurozone; and, above all, we have five countries from Central and Eastern Europe who, after two decades of European affiliation, sit quietly in the cradle of national currencies, with slight simulations of interest for the euro, when the narrative requires it. Of course, the question seeks the reasons for this attitude and, as we showed above, these are difficult to identify in the world of professional economists. They may find pretexts to display, may compare figures and explanations. Many of these explanations sound attractive but they are always placed against a political double-game background. This is where the sociological interpretation of politics, historians, social philosophy come in, because if the situation had the right answer elsewhere, the technocrats would have brought it to life. In this last part of our essay, we will try to say a few words

[53] M. Edelman, 1999, p. 16.

about what exactly is "condensed" behind this "no" which, otherwise, implies social costs, complications in the business world, exchange rates, monetary policies and, above all, "sovereign" decisions where there could have been European cooperation.

The Apparent and the Real Sovereignism

The passéist obsession with sovereignty is honourable as long as it does not turn into barrier. The currency with all what it implies: design, policies, exchange rates with other currencies is, traditionally, considered one main component. But just as in the legislative sphere, today's sovereignty is, more and more, a nominal one, each country's membership in multiple forms of international cooperation generating criteria and conditionalities, beyond the immediate national legislative agenda. The states are integrated into multiple forms of international cooperation, in multiple political games without which their entire contemporary development would collapse. Interdependence at the macro-regional or international level has pushed us all into areas where real sovereignty is no longer feasible. In today's Europe, especially in the EU, the so-called sovereignists are miming an old story and, indeed, enjoy the support of a chorus of nostalgic persons. But their power is limited to that: to be sovereign and have powers shared with transnational bodies; to have domestic policy decisions largely imposed by multinational forms precisely for their functioning; to have parties financed from abroad and foreign policy interests coordinated if not distorted by foreign partners; these and many others contradict the most elementary textbooks of constitutional law. But "political constitutions are so irrational in terms of their genesis and impact."[54] In practice, constitutions arise precisely out of fear and the need to set barriers. Even so, today's sovereignism of EU populists is a parody of the classical sovereignty, the one favoured by the public law jurists, the "real sovereignty". Populists pretend to protect sovereignty but they, themselves have no real power behind them; it is, on the contrary, their lack of effective power is the one to drive their declarations and frustrations altogether. Politicians who are not really eager to follow either the domestic laws or the international documents, make noise in order to be allowed to break them and pretend to seek a general societal reform. We may find "sovereignists" both in the eurozone and in the EU without the euro. In the same time, we see how the French Overseas Departments, where they could hardly be bothered by the political arrangements on the continent, participate in the eurozone beyond anti-colonial rhetoric, beyond any claim for false sovereignty. Likewise, the small islands that were former Spanish or Portuguese colonies see in the EU single currency the symbol of their belonging to a world that has most likely relaxed its colonial norms and offers them dignity and the pride of a civiliza-

[54] M. Edelman, 1999, p. 26.

tion. Notably, important pro-euro options are to be found in the four European micro-states that are not EU members: Andorra, Monaco, San Marino and the Vatican, where rationality (political? economic? both?) has prevailed and pragmatism has outclassed possible parlour sovereignisms. Also relevant, although the Western world is not always happy to remember them, are the unilateral options of Montenegro and Kosovo to use the euro. We only need to read their recent history to understand the cage they are in. Montenegro – a small country with an economy based mainly on tourism – was in great need of a point of stability since the moment of leaving the union with Serbia. At its size, creating a national currency would have been a reckless gesture, difficult to sustain, and the imperative of independence demanded the abandonment of the Serbian currency. Therefore, euro looked as the optimum solution. As for Kosovo, with its ambiguous status, it had almost no alternative. While Montenegro has had EU candidate status since 2010 and the National Bank is openly pursuing the achievement of the EMU criteria, for Kosovo the future goes through many other files until we find out whether the euro will remain, legally, the currency in use, whether it will stay as independent state or will adopt another status.

In any case, for all these micro-states, the euro is the symbol of the culture to which they want to belong at present and, especially, in the future, the need for affiliation and protection. Without being able to cope with all EU regulations, the status of these countries offers them, for now, a possible maximum. "Condensed" in a hope and an anchor of budgetary security.

The Non-euro Monarchies

At this point we are talking about two Western EU member states who do not belong to the euro area, Denmark and Sweden. And, as mentioned above, it is difficult to assume that the impact on the economy or domestic welfare would be an impediment to the adoption of the single currency. Denmark, a member of the EEC since 1974, requested and obtained the agreement not to participate in the single currency since 1992, following a referendum organized in September 2000 and concluded with discouraging results (53% of the population spoke out against the adoption of the ounce currency). Time has passed over this country as well, and the fact that, beyond everything that has happened in the EU, it has remained reluctant to this project – as well as to the pillars of the EU, despite their entire national burden in the matter of most decisions, indicates that something of a “condensed” sovereignty must be responsible for such an attitude.

Sweden, for its part, joined the EU in 1995 but is hiding behind a failed referendum held in 2003 on the adoption of the euro (with 56% of the population voting “no”).

However, at the time of the popular test it was said that its effects extended over a period of five years, already long expired, without the government having made any gesture in favour of or against the euro.

It is not even the status as monarchies to constitute a plausible excuse for Denmark or Sweden, since we have numerous monarchies in the euro area. Since both countries are constitutional monarchies, there is no consistent reason to invoke any "royal sovereignty" possibly broken by the adoption of euro. What, however, caught our attention was their option for Protestantism – more radical in Denmark, where we are dealing with the Danish Church – more moderate but with old roots, in Sweden. All the other EU – Euro monarchies are Catholic. "The Catholic ... is calmer; having less industrial spirit, he prefers a life as secure as possible, even if the income is lower, to a life full of risks, restless, but perhaps offering honours and wealth. People use to joke: you either eat well or sleep peacefully. In this case, the Protestant likes to eat well, while the Catholic wants to sleep peacefully."[55] Mrs. Thatcher's acid comments on the authoritarianism imposed by Berlin and Paris are notorious, so it is likely that the world of Northern Protestantism felt constricted by the austerity or at least by the financial discipline demanded by the Frankfurt Bank. It is quite possible that the free capitalist initiative would refuse the "continental" rhythm and common denominator and would seek, in addition to economic cooperation, free rein for the investments and creativity to which they have become accustomed, in time. As a consequence, we may see in their national currencies the "profile" of national royalty symbolizing a certain degree of freedom and appreciation of individuality. That is, their currency would become a symbol only as an appreciation for the mode of government that made the well-being and wealth of the two monarchies, possible. The process would be exactly reversed in Europe, where the currency would appear first and only in time, gain moral or cultural-historical content. Certainly, the British reasoning had been the same, completed with amendments related to cooperation within the Commonwealth. But what is shown to any one searching these paths is the fact that economic considerations did not prevail and even today, statistical figures are not responsible for the absence of the two monarchies from the euro table. Symbolically speaking, we could "accuse" them of an axiological sovereignty, of defending a certain lifestyle, of principles and values achieved over time but not of any political reason, hidden under the curtains of some statistical reports or convergence criteria.

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[55] Weber, Max, 1993, *Etica protestantă și spiritul capitalismului,* București: Humanitas, p. 26. (1934, Tubingen, *The Protestant Ethics and the Spirit of Capitalism*).

Central and Eastern Europe

We came close to the five most attractive non-euro states, all located east of Berlin. They are neither monarchies nor do they lead the economic charts. Only one is Protestant. And yet, they stubbornly remain outside the game: the Czech Republic, Poland and Hungary, and Bulgaria and Romania. Poland and Hungary were the first beneficiaries of PHARE pre-accession funds, while Bulgaria and Romania had their accession postponed by three years. Apart from their geographical position, almost nothing explains why these countries are together on this list, while Slovakia or Slovenia is not. We suspect that the latter two countries have accelerated the procedures precisely for fear of falling back into the void of history, either as a somewhat secondary subject compared to Prague, or to fellows from former Yugoslavia.

The post-communist transition in Central and Eastern Europe was expected to be much more complex than that of the "second wave": Spain and Portugal, involving both the economic and political dimensions. At least! The (possible) accession of ten new states to the Monetary Union was expected to be a potentially devastating shock. All the more so since each of them had to go through its own unpredictable transition in multiple aspects: inflation, economic restructuring, foreign investments, institutional and managerial culture. Although the cumulative impact of the ten economies would not have been too consistent[56], the fragile balance between the existing currencies risked to be broken, at least in the opinion of some Western analysts. They were betting not so much on the immediate situation, but on the unpredictable effects of the structural transformations and investments that were to be made in these new countries, certainly entailing new taxes and a reset of the tax system, medium or high inflation figures and the considerable depreciation of their national currencies, defying the very convergence criteria. While, fearing the imbalances that were to come, some economists suggested that a rapid integration into the EMU/EMU would protect these countries, forcing them to respect financial discipline even during the transition, others warned that this was too heavy a task, demanding that, first, these countries adjust their internal mechanisms and reach a GDP per capita of at least 70% of the European average[57]. In the meantime, the countries that had already begun preparing for the single currency – Estonia, Lithuania and Slovenia – crossed the line, others went through the mandatory reforms at

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[56] "Six of the new members are very small economies which can expect to becoming increasingly open as they integrate, three are medium-sized, while Poland has a population comparable to Spain of 39 million. However, collectively, the GDP of the new members, measured in purchasing power terms, is barely 5%of the EU25 total.", Brian Ardy, Iain Begg, Dermot Hodson, Imelda Maher, David G. Mayes, 2006, *Adjusting to EMU,* Palgrave, p. 265.

[57] Franz Christoph Zeitler, member in Bundesbank Board, cf. Marek Dabrowski, Jacek Rostowski*, 2006, The Eastern Enlargement of the Eurozone,* Springer, p. 6.

different paces, eventually reaching the third stage of euro adoption. The two "90s prize-winners", Hungary and Poland, have ended up either in large budget deficits, or in populist dissensions that followed the change of power, or in both. We find them today, on the list of non-euro countries, with Hungary waiting, rather, for the EU to return to the structure of an international organization between relatively sovereign states, and with Poland which, after eight years of populist governance, is trying to repair the boat while sailing and having a vocal opposition against all of its reforms. We are not talking only about more or less popular economic measures, but, above all, about the diversion of support for full European integration, the diversion of institutional culture and the willingness of the population to support harsher reforms in the first instance. Close to them, there is the Czech Republic, which has witnessed the parallel existence of two societies – the real and contesting one and, respectively, the one subordinated and supporting the former Prime Minister Andrej Babis. Yet, Czechia has to reinvent itself on the fly not necessarily to meet all of the expectations of the Velvet Revolution, but to find her way in the turbulent world find ourselves in. Then Bulgaria, who began the path of reforms with her national currency tied to the German mark, later to the euro, lost its rhythm, swinging for three decades between two political options, without being able to decide where it wants to go. And Romania, accustomed to "managing things", announcing from time to time the noble goal of preparing for the euro currency but probably never starting, in the deep sense of the word. It is known, "*Nous somme ici au portes de l'Orient...*" and we do not deny it.

There is, however, a "small detail" that should be added to the description of the current regional context. If in early hours of the transition, the liberal option was the order of the day, now, with the rise of the radical right in all these countries, nostalgia and revolt have returned in almost all the speeches of their political leaders. And even if, for example, Petr Pavel, the current president of the Czech Republic, has a more pronounced international agenda, ANO, Babis's party is lurking, counter-attacking precisely with the well-known slogans. At the level of liberal discourse, the echoes of history can be ignored or, in any case, separated from the economic program. It's just that those times seem to be over, at least for now! The meetings of the Visegrad Group (before the return of Donald Tusk) ensured consensus around the idea of neglected countries, abandoned but aware of their task to "protect Europe". I have heard all the leaders in question with this refrain. In Romania, the nostalgia for the heroic times, as they were, presented in the history books ignites the imagination of the hard-liners who are still active, still having the potential to mobilize, persuade, and divert any attempt to rationalize the public discourse. They are supported by “professional nationalists”, never silent, never missing any opportunity to draw new borders and rewrite the list of acceptable or unacceptable values. Without getting lost in too many details, we will take a look at this topic of historical traumas, just to extract from it the major issues and arguments and then see how much of them has been "condensed" to the point of making the euro a negative symbol and how much is the contribution of our contemporaries.

The Historical Traumas

In this short excursion we will follow the thoughts of the historian István Bibó[58], taken up and commented on by numerous academics, precisely because he managed, in succinct presentations, to synthesize those moments of Central European history that are responsible for the feeling that Europe is indebted to it, that the troubles of Central European history must somehow be paid for by this Europe which must offer more, help and understand. Perhaps today, these words would seem detached from Viktor Orbán's speeches, but the truth is a chronologically reversed one: Orbán read Bibó – how else? – and quotes his writings whenever they serve his nationalist discourse. Was Bibó a nationalist historian? Not at all. But in the way he argued, the emergence and strength of Polish, Czech, Hungarian anti-democratic nationalism his writings represent an excellent source of contemporary legitimization of political pleas in the region. And also a good explanation of why precisely these countries, the champions of the first years of democratization, are today reluctant to move forward on the path of European integration and why, somehow against the logic of history, they maintain a line of caution, of self-protection, of separating cultural-national identity from the projects of a community club. Even though Bibo speaks of Central and Eastern Europe, practically his attention is focused on "the three historical states", namely Poland, Hungary and Bohemia. For each case, he briefly presented the shocks of last two or three centuries history in order to explain the moments when, beyond the inherent local problems, the neighbours of these countries and/or the Great European Powers acted violently, unbalanced and, often, unnecessarily insistently, generating the feeling of a continuously besieged fortress. "The characteristic feature of the unbalanced Central-East European political mentality is the *existential* anxiety for the community. East European nations were always overshadowed by alien, rootless state powers either bearing European forms or wielding unbearable pressure, whether they were called emperor, tsar or sultan.[59] This statement reminds us of an almost identical one made half a century later by Milan Kundera in his famous essay "The Tragedy of Central Europe". Starting from the Soviet invasion of November 1956, Kundera noted: "Actually, in France, in America, one is accustomed to thinking that what was at stake during the invasion was neither Hungary nor Europe but a political regime. One

[58] István Bibó, 1946," The Miseries of East European Small States", in *The Art of Peacemaking,* 2015, New Haven, London: Yale University Press, pp. 130-180.

[59] I. Bibo, 1946, p. 149.

would never have said that Hungary as such had been threatened… <To die for one's country and for Europe> – that is a phrase that could not be thought in Moscow or Leningrad; it is precisely the phrase that could be thought in Budapest or Warsaw."[60] "The fact of seeing your country divided between neighbouring Great Powers and erased from the map (Poland), invaded and fragmented (Czechoslovakia or Hungary), at the mercy of others for various reasons and especially pretexts, generated in the region a widespread feeling of distrust in democratic values, in European dialogue and in any political project that transcends the region. "In Central-East Europe, however, everything was disputed, first dynastic, then national frameworks fought battles for every single soul."[61] Thus, a symbol of condensation was created. The negative emotions that these countries' populations have accumulated in time did not need the political elite to direct them, nor the intelligentsia to interpret them. The experiences lived alongside or, rather, against neighbours on the street or from the neighbouring town, the fluid borders and, even, the alternation of occupations reinforced the need for a well-defined, consolidated and protected national identity. One could notice the reaction of these countries in 2015, in the midst of the migrant crisis, the politicians' outbursts against the pre-eminence of community law over national law, their reluctance to take on the requirements of international bodies[62] to which they belong. It was not always a matter of private interests, companies or about the families of politicians. It is easy to place yourself in continuously moralizing[63] positions just to push the "Central European problem" off the public agenda. And attempts to explain the situation objectively are often classified as lobbying in favour of nationalists, tertium non datum.

"*To be a democrat means, is first and foremost, not to be afraid* – not to be afraid of those who have a different opinion, speak a different language, and are of another race; not to be afraid of revolutions, conspiracies, the unknown evil intentions of the

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[60] Milan Kundera, *The Tragedy of Central Europe*, "New York Review of Books", vol. 31, no 7, April 26, 1984, translated from French by Edmund White. The same idea might be read in I. Bibo's work: "<The death of a nation> or the <annihilation of a nation> rings empty in West European ears. Westerners can imagine extermination, subjection, or slowly going native, but political <annihilation> over night is sheer bombast to them, yet it is a *palpable reality* for the nations of Central Europe". Bibo, 1946, p. 150.

[61] I. Bibo, 1946, p. 150.

[62] " Under the shocks befalling them, all three nations fell into a mental state wherein they felt they had only claims on the *world* and no obligations or responsibilities toward it.", I. Bibo, 1946, p. 146.

[63] "It is common today to hold that the political culture of Central and Eastern Europe – that is, the area east of France, between the Rhine and Russia – suffers from an original backwardness. And observers refer to the underdeveloped and antidemocratic social relations; and the narrow, small-minded and aggressive nationalisms of the area.", I. Bibo, 1946, p. 147.

enemy, hostile propaganda, disdain, and generally all those imaginary dangers that become real because we are afraid of them. The countries of Central-East Europe have been afraid because they were not full-fledged and mature democracies, and being afraid, they were unable to become democracies."[64] The autocrats do not need cooperation, they find each other and support each other to the extent that each has a guaranteed gain. A possible adoption of a single European currency would imply so many constraints, limits, external control and spheres in which the leader no longer has control that, beyond the "common good", they find no way for personal gains. Not even at the level of public image can they obtain anything good as this is "censored" by the convergence norms which are mandatory throughout the entire eurozone. And with this, the vicious circle has closed. Then, history is brought back into the picture to explain the negative attitude. "The fall of all three nations -precisely the fivefold partitioning of Poland, the crushing of Hungary in 1849 and its dismemberment in 1919, and Czechoslovakia's tragedy in 1938-1939 – occurred amid brutal violence and blatant injustice, and none of them were in a mental state to realize the part historical logic had had behind the brutal aggression at the hands of the powers that be. All three nations justly felt that Europe had shamefully left them in the lurch."[65]

The euro, at least, here, is not the symbol, nor the instrument of any pragmatic policy/approach, but of an identity-symbolic tool. What does the "euro" represent? Precisely this indifferent Europe, eternally indebted, never in solidarity with the challenges to which the countries of Central Europe are subjected, even on a permanent basis. The single currency has condensed a past full of troubles, usurpations and even cancellations of the identity of one or more of the three countries in question, having no way of being the herald of a club perhaps richer, perhaps with more economic options, certainly having a more inclusive market. The criticisms, penalties, sanctioning policies of Europe towards these three countries, add, from the perspective of the three capitals, even more aversion, suspicion, desire to stay away.

An aspect that must be added immediately is the fact that, although Bibo analysed only the three states, he mentioned, each time, "Central and Eastern Europe", allowing us to say, without adding anything impermissible to his assertions, that this situation of frustration, the feeling that "we were left behind during hard times", also dominates in the Romanian or Bulgarian political culture. In this entire region – probably including Serbia, even if, for the time being, it cannot enter the "euro file". All around this space, Europe has a negative connotation for a good part of the political class, for the media and, implicitly, for the population. Trying to determine the

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[64] I. Bibo, 1946, p. 152.
[65] I. Bibo, 1946, p. 145.

opening of the procedures for adopting the single currency is equivalent to an implicit betrayal, hidden under the alleged right to free expression. The primary objective should be to get out of this vicious circle and, only then, start the engines in the direction of moving towards Europe. The West does not really have the energy for such a thing, moreover, it should recognize a good part of its “contribution”; meanwhile, the local political leaders are content to rest in this situation that benefits them both personally and as political forces. And the European currency would be good, most of the reluctant people think, it would be good for it to stay there, far away, “with them”, so that no one comes looking for us, at home, how much we spend and how.

What should be emphasized is that the contemporary situation cannot be changed by "successful and fair" elections, as many people in the West declare. The change of a leader or even of a ruling party will not automatically entail a change in the way the electorate thinks and interprets things – with fear, with resentment, with stereotypes, that the elections so far, even contested by the opposition at the level of legislative details, have not falsified the results considerably beyond the social reality; that Europe as an entity in which to get lost or become a secondary actor, is not attractive, it does not coincide with the common market and will not have any consistent legitimacy before the arrears of history are, somehow, digested.

Hungary

“Twenty-seven years ago, we thought that our future was Europe,” Viktor Orbán said. Now, we are Europe’s future.”[66] From this point on, any discussion about the euro currency goes beyond any foreseeable horizon. In the view of Viktor Orbán, of those who follow him and, especially, of those who do not challenge him, the present Europe, the European Union, has no connection to the Europe where three decades ago, Hungary was trying to “enter”. That Europe of civilization, as opposed to totalitarianism, a Europe of culture, opposed to censorship and absurd limits, a Europe of normality seems today an ephemeral entity in complete contrast to the way these people perceive reality. Ultimately, there is no political reality defined and definable in absolute terms, because, like any “reality”, a large part of its constitutive elements come from our perception, from the way we relate to that reality, from the relationship between our expectations and fears. Or, for a large part of Hungarian society that not only votes for Viktor Orbán, but is unable to create a credible opposition to win the elections with a rigorous program, thus, for this part of Hungarian society, the real Europe does not resemble the one in the dreams of the gen-

[66] Viktor Orbán, Discourse delivered at the 28th edition of the summer school and student’s camp in Tusnadfürdö, 2017

eration of transition. The financial crisis of 2008 forced many Hungarians to repatriate as a result of the closure of the Western companies they worked for, without finding a viable alternative in the country; the information isolation in which many Hungarians find themselves is no longer felt as a gap to be solved, but as a protective veil against false information and the effort to select information; the EU has sanctioned and penalized Hungary several times but remedies are not visible on the horizon. In addition, the country is surrounded by several other states whose societies share its pessimism regarding the evolution of the European Union. In his speech at the first Balvanyos Summer School, Viktor Orbán lamented the following: "I thought that we, the freedom fighters from beyond the Iron Curtain, would have something important to say to Europe that had lived in prosperity for 40 years."[67] It is enough to recall the famous saying of French President Jacques Chirac regarding the "Eastern European" leaders who "lost the chance to remain silent" (2004) in order to suppress our instinct to immediately contradict Viktor Orbán. He is a leader who talks a lot, poses as a regional hero, often risks assertions with fluid coverage, but there are occasions when he verbalizes beliefs widespread in the region, even if they are classified as politically incorrect! Certainly, the Europe to which the "East of the continent" dreamed to join was not one in which to keep quiet and learn imposed lessons. It was, yes, a Europe of diversity, pluralism, equality between states and between individuals! And the Central European countries already had the status of member states when they forgot to keep quiet!

As proof of the violation of equality between states and pluralism of opinions, it is enough to remember the immigrant crisis of 2015. At that time, several Central and Eastern European states raised various questions such as the protection of the EU's external borders, the selection of those entering "Europe", their registration, a payment proportional to their number for the countries that host them. After less than a decade, the Western countries have reached the radicalism of the extreme right to solve the problem at home, but they naturally forget to say anything about their attitude and the sanctions that, at that time, they dictated against those in the "East" who opposed the project. Similarly, on the issue of the correct relationship between Europe and Russia, it took the invasion of Ukraine and the failure of any political dialogue with Moscow for President Macron to declare, in 2023 in Bratislava, that the West was wrong when it did not follow the warnings of Central Europe regarding the Russian Federation. We do not make any *laudatio* for Orbán, nor would we want to list his absolutely haphazard opinions in multiple areas. But the Central European frustration that Bibo spoke about half a century ago cannot be cured by continuing hostile attitudes or total ignorance towards these countries! On the con-

[67] V. Orbán, 2017. The first editions of the summer school were held in Balvanyos and later, all was moved to Tușnad Baths, but it is all about the same event, held every single year.

trary, they contribute to the withdrawal of the societies in question, into their nationalist shell, at all costs. In the end, the costs calculated by economists pale in comparison to the moral ones, those that target identity, dignity, the right to exist with full status. "The West is irrational, while the Central European vision of the world is based on the concept of nation-states. The West believes that these no longer exist."[68] Of course it is an exaggeration. Or maybe it's not? In fact, beyond any typology of states lies the idea of identity. The more this is minimized, cornered, ridiculed, the more you are encouraged to affirm it! The volatile political culture in the region cannot create a targeted societal reaction against the source of evil while skilful politicians like Orbán capitalize on it in their own discourse. You cannot talk successfully about any trans-national political formula in a traumatized region. Let us remember how many federalization projects have existed, since the time of the Austro-Hungarian Empire, but they have not been successful! No one read them through the constitutionalist magnifying glass, but through the identity lens, i.e. no one was willing to cede prerogatives for a promise of stability and well-being. And after 1990, numerous cooperation formulas emerged, but none crossed this national "border", precisely because suspicions, fears, mutual stereotypes and more are still extremely active.[69]

In this political framework, is Orbán's demand for the consolidation of nation-states in Europe to the detriment of supranational projects an exaggeration? Constitutionally, yes. From the point of view of the philosophy of the European idea, it is a defiance. But from the perspective of protecting or promoting wounded identities, it is, for now, the only realistic approach. "For Europe to be able to resist... the European Commission will have to be reformed and depoliticized to the level prescribed by the Treaties. National states must protect Europe's borders"[70] There are two ideas to be taken out of this deliberate conceptual chaos: the need to return to the pre-Maastricht European Communities, i.e. purely economic cooperation with no political or monetary constraints. And, second, the issue of EU borders. That is, we return to the moment of 2015. If Hungary and other states in the region had felt, by that time, n effective EU support, that is understanding, perhaps the Central European nationalists would not have been so vocal today. Giving up on political union is, theoretically, feasible at any time and in practice it would be the beginning of an infernal collapse in Europe. Is Hungary looking for something like that? Not sure,

[68] V. Orbán, 2024, Discourse delivered at the Tusnad summer school.

[69] The best example being the Three Seas Initiative, an extremely attractive and promising cooperation formula, which was not and is not free of suspicions and accusations of premeditated hegemony, thus of attempts to impose projects which are favourable to some parties and only tangentially to the others.

[70] V. Orbán,2024.

Orbán is talking about reforming European institutions. And our task is to order the conceptual labyrinth that he throws out, each time, with immense pleasure, and to read beyond the vaguely packaged symbols. A political Europe can only be thought of after it becomes or re-becomes a pluralistic Europe, in which more voices are listened to and their objections or proposals are taken into account. Only then will this Europe be able to raise the issue of deepening integration, legitimizing a monetary union or a single market, because it will have consolidated trust in common decisions. This trust is, for now, shaky, being undermined by numerous clear cases of double standards operation. Orbán exaggerates almost all the time, trying to test the others' opinions. Who, however, have left him to his own devices, without reserving time to look beyond his rhetorical parade. He is not a guide, nor a hero in the EU, but definitely, his remarks are to be read as warnings and as negative symbols. For instance, his critiques of the European culture, his position about the collapse[71] of Europe's traditional-historical civilization, and the like. There must be some truth behind his words and by simply ignoring him we would not get a deeper insight into the European state of affairs.

In conclusion, the euro cannot be on the agenda of the present Budapest government because this currency, through the constraints and supranational decisions it implies, activates precisely the Hungarian negative symbols related to foreign powers, to the Other, to the one who comes to demand, to impose without dialogue. This does not mean that Orbán would not have been without multiple slippages from the functioning of a viable democracy. He himself is not a champion of democracy, on the contrary, he often reiterates the idea that democracy is not the path to desirable governance in times of crisis.[72] It is enough to remind his electorate of the "debt of Europe" for the injustice done to Hungary, for a series of stereotypes to be activated and put into play. We know well and Orbán knows it too, it is not just about Trianon! Much more serious are moments like 1956, the postponement of accession, 2008-2010, the 2015 crisis and, above all, the long-established feeling of secondary status of the country, unable to offer any relevant opinion. Somewhere, we are not wrong if we say that Hungary does not feel integrated into the EU, but only attached, sometimes swallowed. The euro currency will reach the political and economic agenda in Budapest, not only after the changing the political regime, but after offering signs that historical traumas can and deserve to be healed at a societal level.

[71] We cannot be in solidarity with groups and ideals opposed to European existence and culture, because the end will be a collapse", V. Orbán, 2024.

[72] See Viktor Orbán's 2014 Discourse in Tusnad summer school, in which he defined the illiberal democracy, as well as all subsequent occasions when he used the same political language.

Poland

In the case of Poland, it is enough to mentally return to the early 90s. At that time, being in a situation of (re)defining its diplomatic relations with Germany, this time unified, Warsaw was extremely aggressive in the matter of recognizing the common border. If we only recall the series of partitions, of borders moved, truncated and then annulled, can we will understand the ferocity and fear. More or less legally founded claims followed, through which Poland requested huge amounts of war reparations from Germany. They were morally founded. "By the end of World War II, Poland was itself in the mental condition that <Europe was indebted to it>"[73] And if, during the Civic Platform government, the subject was blurred, as soon as PiS (the Law and Justice Party of the conservatives led by Jaroslaw Kaczynski) returned to power in 2015, the topic of the debts of Germany, of Europe, of all those who brutally intervened not only in Poland's history, but in its very existence on the map, was resumed. The existential fear has not disappeared, and PiS, even though it is no longer in government, did not actually lose the 2022 general elections! It is still the party with the largest number of deputies, but, getting just 35% of the votes, it was unable to form a government and pass it through the Parliament. Therefore, it still enjoys popularity and a good part of the population recognizes itself in its demands. On the other hand, the Civic Coalition obtained only 30.70% and, assuming that all its voters would be ready to support the adoption of the euro, Poland is left with almost 70% of the population Eurosceptic, reluctant or undecided. In principle, it is the population that lost in the 90s, after the implementation of the Transition Plan of Professor Leszek Balcerowicz, a population that seeks, through one variant or another of conservatism, to save what it can of the hope for a better life. After all, the “shock therapy” was a hard-line policy, which at some point had to show its social limits. The traumas of those years were not healed yet.

Understanding these societal deficiencies, PiS and President Andrzej Duda built their political message precisely on this idea of salvation through mythologizing or through a symbolic recovery of the past. Since the most numerous conflicts that these rulers had with “Europe” focused on the justice reform, we will invoke two responses offered by the Polish political class to the warnings or sanctions received. Immediately after taking power, in 2015, PiS moved to a structural and functional adaptation of the national justice system to the interests and working mechanisms of the party: they appointed certain people to certain key positions; they amended justice laws; they created the Disciplinary Chamber for magistrates in order to politicize their activity and political control. On December 5, 2019, the Supreme Court in Warsaw declared the Disciplinary Chamber illegal. Naturally, the EU institutions

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[73] I.Bibo, 1946, p. 140.

reacted by demanding that the situation be remedied. In a speech on January 17, 2020, President Andrzej Duda categorized the messages coming from Brussels as "their attempt to deprive us of our right to have a good and honest justice system, to reform it. We will not let others decide for us. We, Poles, have the right to decide for our country, for our laws – that is why we fought for democracy."[74] As the Venice Commission supported the decision of the Polish Supreme Court and, in addition, had its own dissatisfaction with the reform promoted by PiS, President Duda decided to send them, indirectly, his opinion: "They will not come here to impose on us in foreign languages, what political system we should have in Poland, or to tell us how to solve Polish problems. Yes, we are in the European Union, and we are very happy about it, but above all, we are in Poland."[75]

President Duda is certainly not a hard-liner. He won two presidential terms by direct vote so, whether we like it or not, he speaks the "language" that the electorate wants to hear. The euro would come with limitations and rules to follow. For those over 70% of Poles who did not vote for the Civic Coalition, the overly strict rules, in the medium and long term, fall into the category of those "rightly" rejected by President Duda. Poland has reborn from the ashes several times, but it has not forgotten who threw it there, who sought to "burn" its identity in order to use all that was best extracted from this identity. External statements or requests are received not only with reluctance, but with the violent memory of the past. This is the weapon with which President Duda has attracted votes, support, a certain social attitude and, correlatively, sufficient restraint in adopting any change proposed or imposed from the outside, especially from Brussels. Or, we can say without getting error that, as long as the percentage of those who recognize themselves in this type of rhetoric, reaction, and political positioning remains high, the euro file can sit in the library window without being disturbed by anyone. It is true, we have a new executive power, an indisputably pro-European prime minister, but with a minister or a cabinet such a radical transition cannot be made! Nominal changes that are not based on profound ones that would give them substance and stability, risk bringing more harm than facilitating reform. And the group of experts around Donald Tusk seems to know this banal truth!

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[74] President Andrzej Duda, 2020, Speech delivered on January 17 in Zwolen, as part of the election campaign and repeated on January 18 at a meeting with members of the Solidarity trade union in Katowice, cf. https://ruleoflaw.pl/duda-shocks-with-hate-speech-attack-on-polish-judges/, accessed 11.02.2020.

[75] President Andrzej Duda, 2020

The Czech Republic

After the catastrophe of World War II, "the Czechs simply and justly felt that Europe *had forsaken them, the nationalities had stabbed them in the back* and Europe owed them the restoration of their free state."[76] In the meantime, they separated from Slovakia, restored democracy to Prague, but there they also encountered two story characters: Milos Zeman and Andrej Babis. Zeman, a former and current communist by conviction, who became the country's president (2013-2023), has always had an oscillating position in foreign policy: usually pro-Russian and pro-Chinese, he vehemently opposed Russia's invasion of Ukraine, just as, in his youth, he had criticized, from the position of a member of the communist party, the invasion of Czechoslovakia by the Warsaw Pact troops. He had the same sharp position regarding the occupation of Crimea, saying; "The moment Russia decides to widen its territory expansion to the eastern part of Ukraine, that is where the fun ends, Zeman said in a broadcast on Czech public radio. There I would plead not only for the strictest EU sanctions but even for the military readiness of the North Atlantic Alliance, like for example NATO forces entering Ukrainian territory."[77] But none of the invasions convinced him to be fully pro-European, pro-Western, remaining a critic of these whenever the opportunity arose. However, a convinced federalist, he raised the European flag on Prague Castle on the first day of his presidential term and ratified the Treaty on the European Stability Mechanism, a Treaty that his predecessor, Václav Klaus, did not even wanted to hear about. It was an attempt to boost the approach to the euro without, in the next ten years of his term, taking another step. "People in the Czech Republic are irrationally afraid of adoption of the euro, president Milos Zeman said, and added that the euro would only bring a change of the instrument measuring economic phenomena and that it would not affect Czech sovereignty either."[78]Aware or not of the implications of this fear, he appointed prime ministers who had no interest in fulfilling the convergence criteria, either for ideological reasons or for purely economic ones. His favourite one, Andrej Babis, a businessman accused of using structural funds in his private companies, former state-owned companies, privatized more or less transparently. Good friends with Viktor Orbán and Robert Fico, Babis made a habit of criticizing regulations and directives from Brussels, precisely because he himself was being investigated

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[76] I. Bibo, 1946, p. 144.

[77] Milos Zeman, 2014, "Czech leader says NATO could offer troops to Ukraine is Russia goes beyond Crimea", 6 April 2014, https://www.reuters.com/article/us-ukraine-crisis-nato-czech-idUSBREA350LY20140406, accessed July, 1st, 2017.

[78] Milos Zeman, 2017, "Prague Daily Monitor", June, 23rd, 2018, accessed in January, 29th 2018; http://praguemonitor.com/2017/06/23/zeman-says-czechs-are-irrationally-afraid-euro-adoption

by both the Czech Police and OLAF for conflicts of interest. He acted simultaneously as prime minister and owner of a company that received over 2 billion euros in European funds. He was acquitted, but the charges still hang over him. Added to this is the management of funds during the pandemic as well as the financing of offshore companies from public funds. So, during his government, the very topic of the euro currency was devoid of any consistency in the Czech Republic. The trouble was that even the opposition, with all the street demonstrations, did not manage to coagulate a party strong enough to take power and at least start the procedures for entering the convergence mechanism. On the contrary, the opposition created a fragmented government, with accusations of corruption and money laundering, therefore, without any legitimacy to propose, adopt measures or to force the market to enter the reasonable indicators of such a target. At this time, the government led by Petr Fialla is formed by five parties, of which the ODS (Civic Democratic Party) is radically Eurosceptic and the other four consider that the adoption of the single currency makes no sense in the current decade. As in the opposition we find Babis with his ANO party clearly opposed to such a step and, respectively, the extreme right. In the Parliament, the situation is similar: "An analysis carried out by Seznam Zpravy in January this year showed that, in the lower house of the legislature, out of the 200 deputies, more than 70 spoke out against the adoption of the single currency and only 55 in favour of it, the others being undecided or preferring not to respond."[79] Beyond the initial enthusiasm of the Czechs at the time of EU accession, the loss of numerous jobs, the pandemic and much ignorance related to the functioning of the European institutions translated into caution, restraint, indefinite postponement of any steps towards the adoption of the single currency. "The Czech Republic follows the National Plan for the Adoption of the Euro,approved in 2007, which planned for an "earliest possible date" of adoption (January, 1, 2010) but set no deadline… Instead, public debate would benefit from addressing widespread and deeply embedded worries linked to the euro – including the ever-present fear of rising prices and concerns regarding the country's loss of monetary and discal autonomy in dealing with potential crises."[80]

With a divided society, lacking a pro-European force strong enough to determine a change of attitude and, based on such support, a legislative change, the Czech Republic stands, for now, with the conviction that the national currency is still desirable and necessary to be preserved, even though the bulk of trade is with countries within the European Union. A mixture, yes, of irrational, of fear, of caution and

[79] Jules Eisenchteter, 2024, "Czechia and the the Single Currency: Euro-Division", https://balkaninsight.com/2024/02/13/czechia-and-the-single-currency-euro-division/, accessed July 12th, 2024.

[80] J. Eisenchteter, 2024.

conformity blocks risk-taking and keeps the Czech Republic, along with Poland and Hungary, in the warm, traditional-defensive cocoon.

Bulgaria and Romania

These two countries shared the postponement of accession by two and a half years, respectively a series of criticisms, sanctions and requests to revisit many of their public policies. We do not intend to go into the details of the history of accession or the post-accession metabolism, but only to emphasize, now, with the lessons of Central Europe covered in step, a serious aspect that holds the two countries in place. It is about the conflict, not yet over, between hard-liners and soft-liners, between conservative post-communists, Eurosceptics if not radical nationalists and, respectively, pro-Europeans of all political colours, reformers, innovators or, at least, those favourable to transition. If in neighbouring Bulgaria, 19 governments were installed and dismissed in 30 years, some with extremely short periods of government, as interim governments (under 100 days)[81], in Romania the art of backstage negotiations and cohabitation beyond the convergence (at least virtual) of ideas and programs made everything seem more stable and coherent. Beyond appearances, however, beyond declarations with an academic amphitheatre flavour, the geographical distance from Brussels metamorphosed, over time, into euroscepticism, disinterest and even fear. The famous line "better being the best in your village than the last in the city" works fully within these societies with a precarious political and institutional culture, societies that modernized late and incompletely, with a strong medieval Ottoman legacy and, until communist times, with a predominantly rural population. It is not difficult to convince such societies that the transition to the single currency is hard to be done or that criteria beyond the current powers of the society, would have to be met. Even a good part of the urban population is willing to believe and not just out of ignorance: we may read here, the need for personal security, the phenomenon of migration to the West through which each individual/family has tried to solve on their own, the disparities between these countries and those in the Western Europe; a certain convenience, the fear of risks as well as a political class satisfied with the current state of affairs. Neither the media nor the list of academic conferences reserves space to debate the need for euro, nor even the European legislation or the functioning of community institutions. For a good part of the population, both urban and rural, Europe is somewhere far away, where they go on vacation or to relatives, where the single currency is used, while "at home" we return to business as usual. Rigor and methodology have never been strong points in the Balkans, and the assumption of a project as large as the adoption of the euro

[81] List_of_heads_of_government_of_Bulgaria.pdf

could be postponed indefinitely without such an attitude being challenged, sanctioned or even endangered by civil society pressures. The centuries of foreign domination over which the totalitarian era overlapped gave the population the basic lesson of breaking with the political class and finding remedies on their own. Each of these two countries had, at some point, solid arguments – the connection with the German currency (Bulgaria), respectively a sustained economic growth for several years (Romania) but all that native mixture of fear, ignorance and a political class more interested in its own accumulation than in completing European integration demands, blocked things in the open field. Let us not forget that modernization, when and the way it unfolded, involved rather leaps than slow transformations, overlapping and "burning" stages and more rarely or not at all, a smooth evolution, from one objective to another. It is much more reasonable to suspect some hidden interests that show up during any kind of dialogue between some engaged intellectuals, between those who understand and want and the great mass of "the others" who, like Viktor Orbán, would be very satisfied if Europe returned to the minimalism of the Economic Communities. It is hard to believe that, in almost twenty years, at least minimal steps could not have been taken in the direction of the necessary reforms! But we should not always ignore the hardliners: they are active, in public institutions, where public money comes from, where decisions are made, many occupy chairs in public education and "forget to explain" the mechanisms of the euro or if they do, they use the language of their own communist youth. Therefore, with respect to these two "cases" we would say that the traumas of history translate more into conformity to foreign masters, conformity that does not involve questions but only satisfaction with what one can individually obtain.

And yet, Bulgaria comes with great news, namely the possibility to join the euro-zone as soon as January 1st, next year[82]. The same little detail works here as in all the other "problematic" countries: the political impact of the single currency. Since the governor of the National Bank, Dimitar Radev claims that all the mechanisms are ready for this huge step, it could only be the political hard liners to intervene and prevent the euro-adoption. It would not be the first time when politics interfere and keep development on the spot. With Romania in still an uncertain and, anyway, disobedient position, regional hard liners might be very interested in Bulgaria. On the other hand, if they will fall in their endeavours, Romania will remain in a complete uncomfortable position, not just out of the euro-zone but with its public deficit

[82] Razvan Diaconu, "Banca Natională a Bulgariei anunță că țara va fi pregătită până în ianuarie pentru adoptarea euro", https://cursdeguvernare.ro/banca-nationala-a-bulgariei-anunta-ca-tara-va-fi-pregatita-pana-in-ianuarie-pentru-adoptarea-euro.html#google_vignette , accessed January, 7th, 2025. (The National Bank of Bulgaria announced that the country will be prepared to adopt euro next January)

far from allowing any serious step towards monetary integration. But for now, all these are just action in progress and we may only hope it will all end well for both countries.

VII Conclusions

"To rebuild Europe from its ruins and to make its light shine forth again upon the world, we must first of all, conquer ourselves."[83] The WWII did not convince Europeans that they must live in a common political project; on the contrary, for many, it amplified or legitimized nationalist, arrogant, xenophobic separation. It was not a united Europe that emerged from the tumult of the 1940s, but fragments of Europe: The European Communities, the Council of Europe, some organizations created on the functionalist principle. But not Europe! Fear, mutual stereotypes, real or imagined frustrations coagulated into symbols with a heavy semantic load, symbols that today's politicians not only fail to deactivate, but use in disputes between their weaknesses and political rationality, between themselves and themselves. The fall of the Iron Curtain could have been a moment of resetting the way we perceive Europe. Because, ultimately, the greatest test is precisely this of the European identity: a conglomerate, an organization, a union not always desired but arising from the ironies of geopolitics, a nominally ideal federation but unachievable, at least in the medium term. The fall of the Iron Curtain resuscitated the mutual complexes, the tendencies to dominate, the memory of the glorious days but also the need for dialogue and diplomatic substance. After three decades, these needs are not just unmet or undone! The accession of the Central and Eastern European countries to the community club determined the European capitals to calculate the moral profit instead of naturally discovering it and on its ground, to strive to reformulate Europe's identity. It is clear, by now, that the initial fears that blocked the European project in Communities of sovereign states, these fears were better rooted than the fathers of a united Europe would have imagined. We may witness today how borders, taxes, doubts reappear; we may see how deeply rooted the mutual fears are and how, Western Europe does not find – perhaps not even seek – remedies for the traumas of its new neighbours, just as it does not find any treatment for its own vices. Each part stands stuck in its ontological symbolism and waits for the other to initiate the dialogue, the re-evaluation, to extend a hand. Which seems to be the most difficult gesture, ever!

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[83] Winston S.Churchill, 1947, *Europe unite. Speeches 1947 and 1948, ed by Randolph S Churchill, 1950, Houghton Mifflin Company, Boston,* The Riverside Press, Cambridge, 1948, p. 313.

The past and present radical nationalists are nobody else than the hard liners who opposed the European project and who seek, through the fence, the weakening of any of its functional aspects. They may be some reformists in the room, but their voice is increasingly ridiculed, they are isolated in their dream precisely because, beyond the barrier, there are even fewer Europeans committed to change things. Even the discussions about the EU reform have been conducted in national terms or with a suspicious condescension towards the nation-state. Which is such a contradiction in terms: you cannot support the nation state beyond any possible rationale while claiming to be eager to push for reform towards for integrated Europe. The project of this Europe, appreciated more outside the continent than by its potential beneficiaries, has lost its attractiveness and has become a banality for some, a realm too distant for others, an almost impossible target for a third group.

The non-euro countries are not staying outside the single currency zone because they could not meet the conditions or it would be impossible for them to make such an effort. They are mentally staying; they are remaining in their negative perception of Europe or of the cost-benefit ratio of such integration. Identity, dignity, a voice that counts are more precious than any economic advantage. Profit can also be obtained through alternative mechanisms; free trade can be replaced by other forms of free trade or avoidance of conditionality, and Hungary is a winner in this regard, with interesting political illusions. But the leap from Economic Communities to Political Union presupposed – as the German Federal Court has rightly pointed out – the existence or creation of a European society. You cannot be part of a group as long as your vision has no effect on the group's decisions, as long as you do not recognize yourself there and, if possible, are not even properly recognized as an equal partner.

The traumas of Central and Eastern Europe – not only those analysed by Istvan Bibo but also those that occurred after he was no longer among us – are responsible for many of the strange reactions of the countries in the region. The fact that Europe's position towards totalitarianism has not been firmly established has allowed the hardliners to still be on the scene with an aberrantly high share. The fact that the transition from economic to political occurred, somehow, forcedly, has fuelled another group of hardliners. Europe's repeated failures – especially towards the Eastern countries and the candidate countries – have raised numerous questions and justified the diminishing fascination with the EU and, implicitly, with the euro. Because the currency, as everyone knows, is a symbol: it can attract like a magnet or brutally repel. Yes, it is a symbol of sovereignty, power and independence. And when these are felt to be alien, representing a different political entity, the currency in question is the "face" of undesirable, of evil, of everything that can cause new trauma. Therefore, it is rejected.

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ON COMPROMISES AND POLITICAL CONSENSU THAT WOULD BRING US CLOSER TO THE EUROZONE

Gabriela Mihailovici

Exhortation

When European leaders convened in Maastricht to negotiate the new treaty, each member brought forth national concerns alongside a commitment to finding common solutions for advancing the European Project. Compromising was essential whenever (and this happened often) there was a need to reconcile the positions of member states and/or to mediate between them and European institutions, regardless of their ideological or political affiliations[1]. The political will to collaborate and enhance European integration, which first took root in the 1950s and was rejuvenated in the early 1990s, energised the process.

The vision of the Founding Fathers was firmly rooted in the principles of cooperation and mutual understanding, emphasising tolerance and political compromise as essential for a conflict-free future on the European continent, particularly after two devastating world wars. It is no coincidence that the opening sentence of the Schuman Declaration calls for peace and stability in Europe[2]. As the years went by, promoting these values went far beyond mere political, economic and commercial cooperation. It gradually became a system of multi-layered, vertical and horizontal

[1] Reh, C. (2012). "European Integration as Compromise: Recognition, Concessions and the Limits of Cooperation". *Government and Opposition* 47(3), pp. 414–440. doi:10.1111/j.1477-7053.2012.01369.x.

[2] "World peace cannot be safeguarded without the making of creative efforts proportionate to the dangers which threaten it". Schuman Declaration, 9 May 1950. URL https://european-union.europa.eu/principles-countries-history/history-eu/1945-59/schuman-declaration-may-1950_en

governance unique in the modern world, bringing together European institutions and member states with different governments and policies[3]. This form of governance, created by voluntary and reciprocal divestment by member states, although operating based on a common legal system (*acquis-cummunautaire*), nonetheless separates the primacy of national law from the primacy of European law[4] in a certain way by giving precedence to European law only partially and only in areas where the member State voluntarily ceded sovereignty to the EU (single market, environment, transport, etc.).

In such a cross-party European construction, the adjustment of the balance between legislative power (the European Parliament (EP)) and executive power (the European Commission (EC) and the European Council (Council)), as well as the distribution of these two powers, are achieved through a combination of formal means, which call upon institutional and legal prerogatives and competences, with informal means, involving political levers based on concessions and compromises specific to a political Union[5]. However, fear may arise that using the practice of compromise too frequently may lead to a prevalence of state interventionism. This sentiment was present before, but also after, the global crisis of 2008[6], and has continued through the pandemic and is now tending to grow at the start of the new European political cycle, when European institutions define their priorities and mandates. During the last two and a half years of war at the EU border, there has been a greater European appetite for cooperation in areas such as foreign policy, security and defence, which means extending Community legislative powers, including the co-decision process. The result is a paradox: whenever global uncertainties and insecurity on the European continent increase, there is a greater willingness to cooperate, take joint action

[3] Von Ondarza N. and Stürzer I. (2024). "The State of Consensus in the EU.What Is the Way Forward in the Debate about Expanding Qualified Majority Decisions?". *Stiftung Wissenschaft und Politik Publikationen* 2024/C 16, 19.04.2024, DOI:10.18449/2024C16

[4] Member states retain the primacy of national law in areas such as national security and security, foreign and defence policy, education, culture, tourism, etc. For details please see the section "Primacy of EU law". URL: https://eur-lex.europa.eu/RO/legal-content/glossary/ primacy-of-eu-law-precedence-supremacy.html#:~:text=De%20re%C8%9Binut%20c%C4%83%20suprema%C8%9Bia%20dreptului,precum%20educa%C8%9Bia%2C%20cultura%20sau%20turismul.

[5] Bellamy, R., Castiglione, D. (1997). "Building the Union: The Nature of Sovereignty in the Political Architecture of Europe". *Law and Philosophy Journal*, 16(4), 421-445. URL: http://www.jstor.org/stable/3504983

[6] Riddervold M. and Guri, R. (2016). "Trick and treat: how the Commission and the European Parliament have influence in EU foreign and security policies". *Journal of European Integration*, 38. 1-16. DOI: 10.1080/07036337.2016.1178737

and make collective decisions, which inevitably leads to the deepening of European political integration[7] .

Historically speaking, in the political construction of the European Project, the concept of political compromise is seen as a European way of collaboration and cooperation, but also as an exercise in reconciling differences in ideas and perspectives, which can sometimes result in gains, and sometimes in losses, on both sides, in exchange for a satisfactory agreement for both sides (*win-win*). The flexibility with which European decision-makers still use this type of exercise is remarkable. Over the last eight decades, this has formed a culture of compromise that has included leniencies and voluntary surrenders, and this has evolved as the Union has expanded and deepened. Compromise culture functions in Brussels comitology now as a *soft-power*[8] instrument, serving as a political lever that **links concession to compromise in order to generate consensus**.

The European project also needs political consensus in the future to achieve the three ambitious objectives set out in the New Strategic Agenda decided by the Council on 27 June 2024 for the period 2024-2029: „a free and democratic Europe, a strong and secure Europe, and a prosperous and competitive Europe”[9]. However, it will not be easy with an EP that is more fragmented than previous legislatures and has a tumultuous political life in many member states, even with long democratic traditions. It will take more wisdom and political versatility to negotiate the compromises that give a higher profile to the balance of power in the Union. *Therefore, the call for consensus-building concessions* becomes part of the solution to reconcile political differences within the Union. Progress and continuity of the European Project depend on the capacity for compromise.

Romania can play a more active role in the current extraordinary geopolitical context in negotiating its contribution to the implementation of the Union's objectives

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[7] Nuttall, S. (2005). "Coherence and Consistency" in *C. Hill, M. Smith (eds) International Relations and the European Union.* Oxford University Press.

[8] In the 1980s, political scientist Joseph Nye Jr. coined the term soft power, defining it as a country's ability to influence others without resorting to coercive pressure. In practice, this process implies that countries project their values, ideals and culture across borders to boost good will and strengthen partnerships." (Source: Foreign Policy (2023). "*What Is Soft Power?"*. Article. 16 May, p.73).

For illustration, one can see the case of the political consensus achieved in the European Semester: Eeva, K. (2024). "Governing through consensus? The European Semester, soft power and education governance in the EU". *European Educational Research Journal*, 23(2), 178-197. https://doi.org/10.1177/14749041211055601

[9] European Council. (2024). "EU strategic agenda 2024-2029". 27 June, URL: https://www.consilium.europa.eu/en/policies/strategic-agenda-2024-2029/

and priorities. It depends on how it decides to act: by aligning and coordinating national economic goals and policies with European political and economic priorities as part of the Union's common effort to make progress or, on the contrary, it can tilt towards the primacy of national interest. In the former, European history shows that the member states with the capacity and ability to contribute to the construction of the European Project integrated more quickly into the EU and had a smoother (*smooth*) path towards acceding to the Eurozone. However, the member states that have hesitated in moving closer to the Eurozone have either targeted objectives of regional power or have chosen the path of isolation from European values rather than accepting concessions and European compromises[10].

The analysis in Chapter 2 has only one objective: *to urge* that political compromise be seen as a key to opening the window of opportunity for preparing accession to the Eurozone. This window is two-sided. The „European side" warns of the limitations and effectiveness of political compromise when seeking quick accession to the Eurozone under all circumstances. The „national side" *urges* decision-makers to use political compromise to negotiate the approaching euro and to consider that simply achieving the convergence criteria is not the ultimate argument guaranteeing European institutions that the Romanian economy is and will remain competitive post-accession and will not become a problem for the Eurosystem. At present, Romania cannot consider the rapid adoption of the euro without a „formal commitment" being accompanied by a detailed action plan with explicit support"[11], "an institutional capacity and convergence plan towards a common culture of stability"[12] and "with severe macroeconomic imbalances which can be adjusted within the Eurozone at high social costs and with a slower economic recovery than if it would remain outside the Eurozone"[13].

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[10] Roderick, M. (2013). "*Poland, the Czech Republic, Hungary, and Romania: political and economic contexts. Constructing Capitalisms: Transforming Business Systems in Central and Eastern Europe"*. Oxford Academic URL: https://doi.org/10.1093/acprof:oso/9780199657667.003.0003

[11] M. Isarescu. (2013). "Romania and the euro area". *Presentation of the Espera Conference.* Romanian Academy, December 11. URL: http://www.bnro.ro/PublicationDocuments.aspx?icid=6885

[12] Dijmarescu, E. (2018). "Enlargement of the European Union: strengthening Romania's candidate capacity". *Romanian Journal of European Affairs,* Vol. 1/nr. 1. URL: http://rjea.ier.gov.ro/wp-content/uploads/articole/RJEA_vol1_no1_Largirea_Uniunii_Europene_intarirea_capacitatii_de_candidat_a_Romaniei.pdf

[13] Dăianu D. (Ed.). (2014). "*The Eurozone Crisis and the Future of Europe — The Political Economy of Further Integration and Governance"*. Palgrave – Macmillan.

Such an approach intends to gather ideas and find political compromises that would foster a consensus for rapprochement with the Eurozone. This angle has been little explored in the papers written so far in Romania on the issue of joining the Eurozone.

I Methodological clarifications

When it comes to preparing for joining the Eurozone, the overriding need for an *ex-ante* political will is invoked, not only in Romania but also in other member states outside the Eurozone, to build a *political* consensus as a catalyst without which no progress can be made on the path to joining the Eurozone. Although so often invoked, it was rarely discussed as a conceptual, analytical and normative topic.

So, what is a political consensus? And, above all, can there be a definition of a political consensus for joining the Eurozone? Four theories of political literature (*politics*) were briefly analysed in order to extract some ideas that would help to outline a methodological delimitation of the concept of political compromise[14].

The first of these is the theory of deliberative democracy (combining Jürgen Habermas's critical theory with John Rawls's political philosophy[15]), which provides arguments and mechanisms for civic dialogue and inclusive debate that facilitate the creation of a deliberative flow and a critical mass that democratically legitimises this current opinion (in this case, joining the Eurozone).

The classical theory of the social contract, even though it was proposed more than 300 years ago by Thomas Hobbes, John Locke, Jean-Jacques Rousseau etc., complements this reasoning with the idea that political legitimacy results from implementing decisions that are of mutual benefit to a community, civil society, the state in general and not just to one person. The transition from individual to collective

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[14] An analytical assessment of the theory of compromise is outside the scope of the analysis in this chapter. Box 1, however, provides a brief perspective. If, however, further thought is needed on this subject, here are some suggestions: Fordham B. (1998). "*Building the cold war consensus: the political economy of US National Security Policy", 1949-1951.* University of Michigan Press; Marsonet, M. (2015) Pragmatism and Political Pluralism-Consensus and Pluralism. *Academicus International Scientific Journal* 12, pp. 47-58; Gamble A. and Lane D. (2009) "*The European Union and World Politics: Consensus and Division".* Palgrave Macmillan.

[15] Țuțui, V. (2011) Democrația deliberativă. O analiză critică în *Huzum E. (coord). (2011)."Concepte şi teorii social-politice".* Editura Institutul European, Iaşi și Atanasescu A. (2010). "Democrația Deliberativă". *Pretext. Revista de culturală social-politică.* URL: https://pretext.wordpress.com/eseuri-academice/democratia-deliberativa-adrian-atanasescu/

interests raises fundamental questions about competing epistemological frameworks, wherein multiple perspectives and theoretical paradigms inevitably emerge, often leading to contested rather than consensual outcomes.

Michael Sandel, Charles Taylor, and Alasdair MacIntyre acknowledge this diversity of values and, as a means of mitigation, advocate—through communitarian theory—for a series of concessions and compromises aimed at assessing objectives and priorities while guiding towards a communion of ideas upon which consensus can be built. However, this consensus is not fixed; it must be adapted to reflect the set of values that unite those communities.

In cases where there are diverging and competing interests between communities and consensus is difficult to obtain, thinkers like Alexis de Tocqueville, Alasdair MacIver, Robert Dahl, Isaiah Berlin, etc. propose the theory of political pluralism in several steps: it starts with the acceptance that the real protagonists of a political process are several interest groups and communities; once diversity is accepted, a common goal will be assumed, which offers common *win-win* benefits for as many interest groups as possible and where implementation coalitions and agreements negotiated between these groups are form common interests.

The result of this summary exploration of consensus theory is shown in **Box 1.**

Box 1: What is a political consensus, in theory – a synthesis

Political consensus is achieved when the majority of participants, including political parties, interest groups and other stakeholders, agree on a course of action or a set of policies, even if they do not fully share the same reasons or motivations.
In general, some *ex-ante* elements are recommended for reaching a political consensus:

- A single goal taken on politically by different political entities, not necessarily unanimously (*very close to being acceptable*), but so as to reflect the support of a large political majority in Parliament.
- Credibility of the chosen objective, which gives legitimacy to the political decision and popular support.
- Wide participation – from political parties to government and central bank, ministries, government institutions and agencies, non-governmental organisations and private sector, academia, etc.
- A willingness for dialogue, negotiation and adjustment of individual positions, allowing concessions to find an acceptable path for the majority of participants, based on mutual understanding and acceptance, rather than on temporary or coercive measures without coercive or authoritarian enforcement. It provides a stable basis for policy implementation and governance.

Simultaneously, several *ex-post* elements may make it difficult to preserve political consensus in the long term:

- Political polarization: ideological divisions or group divisions.
- Short-term interests: focus on short-term gains or electoral success.

- Diverging interests of stakeholders: the more diverse the interests and priorities of stakeholders, the more difficult it can be to reach a consensus that satisfies everyone.

Balancing ex-ante and ex-post elements becomes a difficult task to negotiate and finalises with a political agreement. This would include long-term commitments to sustainable policy-making implemented by legitimate long-term political governance structures.

Source: Burgan, 2004; Marsonet, 2015; Gamble and Lane, 2009

The first conclusion drawn from this rapid breakthrough in compromise theory shows that a broad political consensus can encompass a wide range of communities and values, for which the ”range of policy options that politicians and state officials need to consider [which are] administratively practicable, economically feasible and politically acceptable”[16] needs to be assessed, while “our expectations for the behaviour of others are realistic”[17].

In the specific case of preparing for the adoption of the single currency, a general definition of political consensus could be outlined as follows: a political agreement deliberately concluded between a wide range of political, economic, social, academic, etc. actors, intending to find policies, paths, instruments and measures to achieve *common long-term benefits* (*win-win*) for as many *communities and interest groups as possible, to serve the objective of preserving the country's stability for accession to the power structures of the Eurozone.* Former West German Chancellor Ludwig Erhard[18] found an even more stylised form of elevating compromise to the rank of art, the kind where „a cake is divided in such a way that everyone believes they have received the biggest slice” while the outcome is beneficial to all parties involved (*win-win*).

Once the definition was outlined, the analysis in this chapter needed validation. The research scope was the experiences of the nine previous Eurozone candidates: Greece (2001), Slovenia (2007), Malta and Cyprus (2008), Slovakia (2009), Estonia (2011), Latvia (2014), Lithuania (2015) and Croatia (2023). Bibliographical references examined the main national strategic documents associated with the euro preparation process to find common compromise themes that led to national political consensus. The analysis is based on two working assumptions: political consensus is necessary, but its effectiveness is limited.

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[16] Kavanagh D. (1998). “*Oxford Dictionary of Political Biography”*. Oxford University Press.

[17] Weber M. (author), Peter Lassman (editor), Ronald Speirs (translator). (1994). “|*Political Writings. Cambridge Texts in the History of Political Thought”*. Cambridge University Press, p.51.

[18] Quote attributed to Ludwig Erhard, former Chancellor of the Federal Republic of Germany and Minister of Economic Affairs in the Adenauer Government. URL: https://artsandculture.google.com/entity/ludwig-erhard/m0bj8n?hl=en

Perhaps the most illustrative example validating the need for political consensus is the Maastricht Treaty (TEU) negotiation. Because of a long series of concessions and compromises between the European leaders of the time, the signing of the TEU in 1992 was the result of an unprecedented political consensus after the Second World War, achieved in an exceptional geopolitical context (the end of the Cold War, the dissolution of the USSR and communist dictatorships). However, this consensus, though considered a great political success of the time, included several limitations. Here are three examples.

The first example of limitation comes from the very structure and functioning of the Economic and Monetary Union (EMU). The Maastricht Treaty of 1992 established an „unfinished union" (*unfinished union or lopsided union*) centred „on one pillar"[19], which confers the primacy of a monetary union over economic union. The decision to create a single European currency was taken through a political consensus that did not incorporate all the traditional features of a monetary union (financial transfers from wealthier regions to less developed areas, a framework for coordinating macroeconomic policies, a common framework for banking regulation and supervision, etc.). The TEU has legislated this political consensus for an unorthodox regime of the EMU's functioning, legally linking all national budgets of the Eurozone countries to one single monetary balance sheet, that of the ECB, and only within certain limits (specified in Articles 3, 119-144, 136, 219 and 282-284). The EMU continues to function in the same way today, with all the warning signs that have been raised in the meantime (the 2012 Van Rompuy report 'Towards a genuine Economic and Monetary Union'; the 2015 Five Presidents' Report 'Completing Europe's Economic and Monetary Union' or the 2017 'Reflection Paper on the Deepening of the Economic and Monetary Union'). It is hoped that the new EC will enhance the political ambition to progress on fiscal and other projects if member states and political parties accept new concessions and compromises in the EP and the Council, which will build a political consensus favourable to deepening EMU.

The second example of limiting political consensus relates to the persistence of the heterogeneity of the single market. For more than seven decades, the European Single Market has been a project that has not been operating at its full capacity (fully-fledged) and is continuously undergoing reforms. Although a unanimous European political consensus was achieved through the TEU (Articles 101 and 102 TEU) on the four fundamental freedoms of free movement of goods, persons, services and capital, member states nevertheless agreed to maintain restrictions and barriers protecting national interests. But it is hoped that the current geopolitical context, which has generated such a sense of urgency (*the sense of urgency*), will hasten the aware-

[19] Issing, O. (2008), "*The birth of the Euro*", Cambridge University Press.

ness of ambitious goals such as completing the Banking Union (BU), advancing the Capital Markets Union (CMU), or rethinking competition policies and expenditure allocation mechanisms to fund the growth of the EU's internal and external competitiveness.

The third example showing the limits to the effectiveness of political consensus is access to and distribution of European funds. Until the 2008 global crisis, the priority for new member states was to access cohesion and structural funds as a kind of automatic guarantee that this would achieve convergence with more prosperous member states. The principle of equal contribution was consistently invoked: all member states contribute to the long-term EU budget (Multiannual Financial Framework/MFF) (Article 312 TEU), and, as a result, all member states receive funds equally. This is true in the legal sense but not the economic one. The sovereign debt crisis in Greece and the war in Ukraine have changed this custom.

To demonstrate the necessity and effectiveness of political compromise, Chapter 2 is structured in two parts. The first part is about the past and draws on the experience of the nine countries mentioned above that joined the Eurozone in 2001-2023. Five common themes of political compromise have been extracted from five different areas: national strategy; performance of national economic policies; coordination with European policies; building a pro-euro attitude and a culture of stability and stability; and maintaining a fiscal leeway to deal with unforeseen shocks and other uncertainties. The second part is about the future and applies only to Romania. It is in the form of a *Call* for decision-makers to consider some proposals for political compromise when thinking about the country's economic policies in the long term.

Three filter criteria have been used as an analytical technique: (a) the (in)consistency of decisions and the effects generated in building a credible dialogue with the European institutions (*time consistency*); (b) the credibility of national political commitment (*political commitment*) to support the euro adoption objective; and (iii) the influence of economic policies (*shaping policy outcome*) on the implementation of the strategic euro adoption objective.

II The experience of the nine candidate countries that joined the Eurozone: compromises that facilitated national political consensus

The analysis took as its starting point documentation already existing in the public space for the nine former candidate countries in their accession to the Eurozone. The main objective of the analysis was to illustrate how the national authorities constructed a *credible* Country file. The secondary objectives combined strategic targets (how the date of joining the Eurozone and the period of preparation for adopting the euro changed) with procedural objectives (how the accession dossier was formalised as a legal obligation for the government and national parliament[20]).

The Country file contained two categories of documents in all nine cases analysed: (i) political commitments, which were undertaken and substantiated based on (ii) economic policy analyses. As such, two categories of decisions complemented each other in only one way: the political decision was shaped by the (technocratic) economic policy decision, not vice versa. In other words, economic concerns had taken precedence over political reasoning. But not always, as there were exceptions to this rule: the case of the two Baltic States, Lithuania and Latvia, which, in the negotiation process, experienced severe spill over effects from the financial crisis and the political decision to restore social peace took precedence.

In regard to the political decision, the parties divided their responsibilities into five categories of political agreements as follows: (i) the fiscal deficit responsibility (fiscal consolidation measures and disciplining public expenditure, respecting a sustainable public debt trajectory with low borrowing costs); (ii) the trade balance and current account deficit responsibility (financing and balancing internal and external sources); and, (iii) the responsibility for transposing, harmonising and fully adopting the *acquis communautaire* into primary and secondary national law; and (iv) the responsibility for implementing structural reforms (the list of reforms varied on a case-by-case basis depending on the internal and external context), (v) other specific responsibilities[21] . Each of these five political agreements included annexes with lists of concessions and compromises negotiated and agreed *ex-ante* among the political parties. A common feature was the willingness of the political class in these nine countries to maintain the country's stability and, hence, flexibility in negotiations.

For the economic policy decision, a single political agreement was required to guide economic policies while maintaining long-term coherence, regardless of the electoral cycle, to maintain the country's macroeconomic stability. In all nine cases, joining the Eurozone has become an *integrated* objective in a national trans-party programme of economic policies and not an exogenous target that must necessarily be met because it is a legal obligation in the EU Accession Treaty. But here, too, there were the same two exceptions: Lithuania and Latvia, which, caught in the middle of the negotiations, in the heat of the crisis and forced to introduce macroe-

[20] The format of presentation of the final document varied from one country to another, from a general, stand-alone document to an integral part of a Roadmap document, Euro Strategy, Euro Law, etc.

[21] Some candidate countries that have added specific objectives (e.g. Cyprus, Turkish minority issue).

conomic adjustment programmes, had to accept that to complete the accession to the Eurozone as a national strategic objective, adjustments and reforms were necessary to prove the sustainability and sustainability of the convergence indicators; without this kind of compromise, the reforms would have been much more challenging for their people to accept.

The economic policy decision was the hardest to consensus-build. The parallel examination of the nine Country dossiers revealed five compromise themes that facilitated the national political consensus:

II.1 Consensus on the strategic objective

Seemingly straightforward as a strategic objective, it has nevertheless become evident in public discourse that at least two nuances are necessary to distinguish between 'joining the Eurozone' versus 'adopting the euro'. For example, when policy was intended to prevail, the option was in favour of the phrase 'joining the Eurozone', in order to signal the candidate state's intention to increase its capacity for political and geographical integration, alignment with Eurozone policies and participation in the Eurogroup comitology. However, wherever there was a need to invoke economic reasoning, the phrase 'adoption of the euro' was used to signal the association with the technical process of preparation for the changeover to the euro.

In all nine candidate countries, these two nuances of the political-economic divide were two parts of the same whole in public. Thus, the political commitment of the candidate state to maintain, unchanged, the same strategic objective of 'joining the Eurozone' regardless of the parties in power or in opposition (*time consistency*) has complemented the technocratic commitment to implement sustainable economic policies for 'adopting the euro'.

Inconsistency problems have arisen on the implementation side, i.e., regarding the actual Eurozone accession date (in some cases, it differs from the planned date). Although all candidate countries embarked on the trek with political consensus on the timetable for implementing the waiver decision on the conditionality of the fulfilment of the legal requirements of the TEU[22] (*political commitment*), the situation changed during negotiations when the political commitment varied depending on exogenous and/or endogenous factors. For some candidate countries, new political compromises were necessary to postpone the date for adopting the single currency. Latvia is the most eloquent candidate country, having to postpone the accession tar-

[22] All nine candidate countries for accession to the euro area assumed from the outset that they were member states which, pursuant to Articles 415 and 516 of the Acts concerning the conditions of accession, from the date of accession to the EU, were subject to a derogation within the meaning of Article 139 TEU.

get three times due to the spillover effects of the global crisis of 2008, which resulted in a sustainable and unsustainable failure to meet the convergence criteria. In addition, national decision-makers failed to convince European partners that economic policies could not sustain a sustainable level of fiscal self-discipline to cope with the Eurozone's rigours; as such, there was a need for reshaping policy outcomes.

II.2 Consensus on the analysis of sustainability and sustainability of internal economic policies in support of a credible roadmap towards the Eurozone

All nine countries have produced a Roadmap strategy document[23] aimed at providing European decision-makers with their assessment of the degree to which nominal convergence criteria have been met in a systematic and sustainable manner.

Although in the long term, the national authorities kept a firm political commitment (political commitment) to fulfil all convergence criteria, nevertheless, as negotiations progressed, several inconsistencies occurred over time (*time inconsistency*).

The following are five decisions for which the political consensus was limited by external constraints (the global crisis of 2008 and sovereign debt crisis of 2014), followed by internal constraints, for which new political compromises (*reshaping policy outcome*) to accept political dominance were necessary when it came to taking measures to regulate macroeconomic imbalances which entailed painful social costs (internal devaluation through brutal adjustment of income, unemployment growth, economic recession, etc.).

The five categories of economic policy decisions that have formed the basis of long-term political consensus are as follows:

A] Decision on the economic performance analysis of the Candidate State

There were two different approaches:

The more relaxed approach, until the global crisis of 2008, when candidate countries and European partners (member states and financial institutions) reached a consensus relatively easily on a date for joining the Eurozone: 2001 – for Greece; 2007 – for Slovenia; 2008 – for Cyprus and Malta; and 2009 – for Slovakia. How was this possible?

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[23] Names/titles may differ: most commonly referred to as “Strategy for Adopting the Euro” or “Indicative roadmap for adoption of the Euro”; not to be confused with other documents drawn up during the preparation process for the adoption of the Euro, such as: “National Euro Changeover Plan”, “Master Plan For The Euro Changeover”, ‘Comprehensive Strategic Communication Plan for the adoption of the Euro”, “The Euro Adoption Act”, etc.

Firstly, the European context of the early 21st Century greatly facilitated the enlargement of the Eurozone: the EU was undergoing an incandescent political emulation caused by the enlargement of its borders, along with the gradual integration into the market economy of the former communist states and, at the same time, the optimism that the EMU and the euro were bringing. The Founding Fathers, aware of the imperfection of the new construction, accepted the compromise of bringing together economies that, although relatively close in level of development, were structurally insufficiently compatible. It was hoped that, over time, these states could form an optimal currency area [24] and that, in one way or another, the convergence process would come naturally, even without the possibility of bail-in and bail-out clauses. Although some of the candidate countries were known to be poorly prepared[25], the final decision to join the Eurozone was highly political[26].

In addition, the legal framework provided by the Maastricht Treaty also opened the way to a paradigm shift in the independence of central banks in the EU: maintaining price stability became the sole objective of national central banks while imposing strict rules banning the complete monetisation of public debt and the budget deficit and making clear the delineation of sovereign debt and fiscal deficit limits for *all* member states. Such independence for monetary policy gave rise to expectations that the newly created EMU was deemed likely to be robust enough to allow the entry of new members even if fiscal policies remained a national attribute. The deceptive thing was also that, as the Eurozone expanded, a constant economic growth of the GDP per capita was occurring in the new member states compared with the average of the Eurozone member states. This was the rationale for accepting Portugal and Spain as founding members of the Eurozone and later for the accession of Greece[27] followed by Malta, Cyprus, Slovenia, and even Estonia.

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[24] The euro area cannot fulfil the criteria of a genuine optimal monetary area, which causes major structural imbalances – for details see: Eichengreen, 1991; Krugman, 1993; Friedman, 1997; Feldstein, 1997; Issing, 1999; Alesina and Baro, 2004; Baldwin and Wyplosz, 2004; Ricci, 2008.

[25] A detailed analysis is in Royo, S. (2007). "Lessons from Spain and Portugal in the European Union after 20 years". *Pôle Sud*, 2007/26, pp. 19-45. https://shs.cairn.info/journal-pole-sud-2007-1-page-19?lang=en

[26] There is ample literature on how much the political decision in the Greek case mattered. A thorough analysis is provided by Galanos, G., Kotios A., Pavlidis G. (2011). "Greece and the Euro: The Chronicle of an Expected Collapse". *Intereeconomics,* Volume 43/2011 / Number 5, pp. 263-269, URL: https://www.intereconomics.eu/contents/year/2011/number/5/article/greece-and-the-euro-the-chronicle-of-an-expected-collapse.html

[27] Christodoulakis N. (2009). "Ten years of EMU: Convergence, divergence and new policy priorities". *The Hellenic Observatory, GreeSE Paper* No 22, 2009 and De Grauwe P. (2009). "The Euro at ten: achievements and challenges". *Empirica*, Vol. 36, 2009, pp. 5-20.

Last but not least, the requirements of the Maastricht Treaty have been applied *ad litteram* without any analysis of medium- and long-term sustainability. Three objectives were pursued in the negotiations at that time: (i) to achieve (only) the targets of the nominal convergence criteria on price developments, budget balances, exchange rate, interest rates and sovereign debt levels; (ii) to analyse the compatibility of national legislation with Articles 130 and 131 TFEU; and (iii) to fulfil the requirement for a full integration into the Eurosystem.

The more complex approach followed the 2008 global financial crisis when the preparation process for adopting the euro became complicated.

The narrative of convergence changed as the spill over effects on the economies of the Eurozone candidate states increased. Since 2011, the public discourse of the European institutions (EC, ECB, EP, etc.) has distinctly highlighted that adopting the euro does not automatically guarantee convergence with the Eurozone and warns that, in some cases, even divergent tendencies[28] may emerge. The evidence for convergence within the Eurozone was mixed. On the one hand, there have been positive examples of improving nominal convergence within the Eurozone (Slovakia, Estonia), and even outside it (Sweden, Denmark have overcome the crisis of 2008 without seeking the help of international creditors or entry into the Exchange Rate Mechanism (ERM2)). However, some negative examples also emerged, raising concerns. For instance, in terms of real convergence, Diaz del Hoyo et al. (2017) have proven that between 1999 and 2016, the GDP per capita at the EU28 level indeed converged within the Union, but this convergence was weaker within the Eurozone; convergence within the Eurozone only improved between 1999 and 2007, i.e. before the outbreak of the global crisis. After the crisis, gaps in economic performance and competitiveness, i.e. convergence, were revealed with euro-area countries converging insufficiently structurally, which fed severe macroeconomic imbalances. As such, the effects have been disruptive on real convergence, putting a complete stop to this trend in small countries that entered the crisis, such as Greece, Lithuania, Latvia or Cyprus, and only partially in large countries, such as Italy

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[28] See ECB Convergence Reports (2010). URL: https://www.ecb.europa.eu/pub/pdf/conrep/cr201005en.pdf and the EC (2010). URL: https://ec.europa.eu/economy_finance/publications/european_economy/2010/ee3_en.htm . For further information, see the Commission's Reflection Paper on 'Deepening the Economic and Monetary Union' (2017), which shows that: "Convergence trends in the first years of the adoption of the euro have proved partially illusory. (...) The crisis of the years 2007-2008 marked the end of the convergence trend and the beginning of a divergence trend, which is only slowly being corrected. (...) These developments have fuelled doubts about the design and functioning of the EU and EMU social market economy (...)" p. 12. URL: https://commission.europa.eu/ system/files/2017-06/cartea_alba_privind_viitorul_europei_ro.pdf.

(Creel, (2017); Franks and others (2018))[29]. In terms of meeting the convergence criteria, by the time of the 2008 global crisis, all Eurozone countries except France and Germany had, at one point or another, exceeded the price stability criterion, even though deviations from the long-term interest rate criterion were less frequent. In countries where corrections were needed for macroeconomic imbalances (Greece, the Baltic States, etc.), internal devaluation measures and economic austerity programmes were used. Even so, such measures could not guarantee economic recovery and did not automatically correct the banks' balance sheets, especially of the large financial and banking institutions[30], so tensions continued to build up. The focus has shifted to risk analysis and analysis of the evolution of other relevant factors targeting the sustainability and sustainability of the economic convergence process set out in Protocol 13 to the TFEU. Since 2010, the analysis of economic policy coordination capacity [31] has been added, which examines the resilience of the candidate country's economy to severe shocks, while being resilient to sustain a certain level of exchange rate at a central parity.

In such a dynamic context and under siege by extraordinary social pressures and deep political tensions, preserving the political consensus for continuing negotiations on accession to the Eurozone in the two Baltic States deeply affected by the global crisis was difficult. The absolute political priority was to restore social peace and regulate macroeconomic imbalances for macroeconomic and social stability. The change in the governments and leadership of the central banks made the political situation and exposure on the international markets even more fragile. In such a turbulent context, economic policymakers have had to accept – not easily! – new compromises. As the contagion grew, the fundamentals of the convergence criteria were affected, and the European institutions, in turn, tightened their expectations.

The ECB and EC Convergence Reports of 2010 and 2011 pointed out that, in regards to the analysis of the Roadmap convergence criteria, it is no longer only the aim (reaching, observing) of certain levels of convergence that matters but a certain degree of sustainability and sustainability of the process of nominal convergence, real convergence and structural convergence that is necessarily achieved in the medium and long term to prevent new problems. Another consensus followed on the

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[29] Creel, J. (2017). "Convergence in EMU: What and How?". *Econ Paper*, PE 614.504, April 2018, URL: https://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614504/ IPOL_IDA(2018)614504_EN.pdf

[30] An analysis of the financial sector's situation, affected by the financial crisis and the sovereign debt crisis, can be found in Dăianu, D., Kallai E., Mihailovici G. și Socol A.G. (2016). "România și aderarea la zona euro. Întrebarea este în ce condiții!". Editura Academiei Române, pp. 125-133e, pp. 125-133.

[31] European Semester (i.e. Country Specific Recommendations).

way forward: adjusting macroeconomic imbalances and returning to macroeconomic stability versus abandoning the euro project. It was agreed at the time that the only credible option for the two Baltic states, which were in the midst of negotiations for euro adoption, was to achieve a new national consensus on continuing the negotiations while ensuring that fiscal and balance of payments imbalances were addressed before entering the Eurozone. This expressly implied fiscal austerity measures implemented within the framework of a financial assistance program coordinated by international financial creditors (the so-called International Troika[32]). Given the enormous social costs of these measures, an additional national political consensus was required. This time, however, it was much more challenging to negotiate and involved significant internal political compromises, which ultimately undermined the central bank's credibility in both Baltic states. However, the ultimate goal was that, upon completing these financial assistance programs with the Troika, the two Baltic states would be able to demonstrate their ability to sustain the convergence process in a durable and sustainable manner through their own efforts.

The problem of regulating imbalances in the banking sector has not been easy either. Slovenia faced these problems in 2012, having to make adjustments within the Eurozone as a member State at costs that generated a severe financial crisis resulting in a loss of EUR 5.9 billion or 16 percent of GDP[33]. As such, the EC added, as a further condition for entering the Eurozone, the obligation to carry out an asset analysis of the national banking system and a detailed assessment of the situation of the banking system (*Assets Quality Review/AQR*) before the start of negotiations, after which the candidate State is to submit to the ECB its application for entry into the Close Cooperation Regime with the ECB and subsequently for accession to the Single Supervisory Mechanism (SSM) no later than the date of adoption of the euro. In Slovenia's case, a political consensus has been difficult to achieve, all the more so as the financial crisis was accompanied by fiscal austerity measures, which have generated a recession.

The assessment of national central banks has also evolved. Since 2009, there has been increasing advocacy for the adaptability and flexibility of monetary instruments, allowing for legally permitted and economically necessary compromises to balance the macroeconomic policy mix and ease tensions between monetary and fiscal policy – this topic is analysed in a separate section below (section 2.3.2).

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[32] Composed of the IMF, the EC, the ECB and other international creditors, depending on the external position of each member state.

[33] Močnik R., Breznik M. (2015). "Public Debt: Who Owes Whom". *The Peace Institute – Institute for Contemporary Social and Political Studies*. URL: https://www.mirovni-institut.si/en/publications/public-debt-who-owes-whom/

In conclusion, the performance analysis of the economies of Eurozone candidate states has become more complex. It continues to do so (as seen in the case of Bulgaria) due to the increasing complexity of the external environment and the growing pressures for Eurozone reform. Therefore, preparing for euro adoption is inherently associated with a certain degree of risk, with no guarantee of complete success.

B] Decision on the analysis of economic policies related to economic convergence criteria and other factors relevant to convergence

In this case, as well, there were two different approaches regarding the macroeconomic policy mix:

Until the global crisis of 2008**,** Eurozone architects were hoping that the SGP's limits on the budget deficit and sovereign debt would not be reached soon[34]. The founding, though cautious, parents proved optimistic when they hoped the fiscal rules and an independent ECB were sufficient arguments for preventing a crisis[35]. There were candidate countries that, before the crisis of 2008, put forward arguments such as membership in the Eurozone helping to finance the balance of payments, which allowed massive stocks of sovereign debt to build up (Greece, Spain). Once these states entered the Eurozone, a strong causal relationship emerged between national fiscal policies and the Eurozone's single monetary policy. National fiscal decisions regarding government expenditures, taxation, and budget deficits influenced economic performance, sustained inflationary expectations, affected monetary policy orientations and the trajectory of interest rates in the Eurozone, and, in turn, shaped investment, consumption, and saving decisions. This directly influenced borrowing costs for each member state, overall economic activity, and financial conditions within the Eurozone. Consequently, a profound interdependence developed between a unified monetary policy and nation-level fiscal policies, despite the Maastricht Treaty lacking specific provisions (such as *bail-in / bail-out* clauses) on how to address situations where a member state in a monetary union like the EMU is unable to repay its sovereign debt.

After the 2008 global crisis**,** the candidate countries were forced to resort to new concessions in order to finalise negotiations on joining the Eurozone. In the case of both Baltic States, one of the most challenging political decisions was fiscal correc-

[34] It is a fact that Portugal, Italy, Belgium had high levels of sovereign debt when they adopted the euro in 1999.

[35] The European Central Bank. (2021). "Monetary-fiscal policy interactions in the euro area". *ECB's Occasional Paper Series*, related to the ECB's Strategy review No 273 / September, p. 13 https://static1.squarespace.com/static/5e6033a4ea02d801f37e15bb/t/66398d421b95da5664abd742/1715047749966/Monetary_Fiscal_Policy_Interaction_Book.pdf

tion. Unable to resort to external devaluation measures (as they had already entered ERM II), internal devaluation was the only option for both states. Implementing drastic internal measures—such as income reductions, workforce downsizing, and production cuts—to strictly manage the budget deficit came with severe social costs. A series of new concessions and political compromises became necessary to rebalance the macroeconomic policy mix and ease tensions between monetary and fiscal policy:

- The choice between fiscal discipline and austerity versus fiscal relaxation, justified by the need to support the citizens affected by the 2008 crisis. The national authorities were divided between continuing to provide fiscal incentives to mitigate the spillover effects of the 2008 global crisis and prolonging fiscal policy easing versus returning to stringent compliance with the fiscal deficit and fiscal discipline convergence criteria. As concerns regarding the unsustainability of the price stability criterion (Latvia – details in **Box 2)** and sovereign debt (Lithuania) increased, compromise decisions with the International Troika shifted towards entering into financial assistance agreements[36]. As part of their list of conditions, political compromise was able to preserve the strategic goal of joining the Eurozone and to convince financial markets of the long-term sustainability of the economic and financial viability of the two countries. Given these constraints, the path to economic recovery and euro adoption had to be built on consensus, with policymakers acknowledging that fiscal policy was significantly more effective than monetary policy in stabilising the country. In the case of Latvia, three iterations of adjusting the euro adoption date were necessary to reach this political compromise.
- *Choosing between a more accommodative monetary policy versus easing inflationary pressures.* This type of compromise had two analytical perspectives: an external one, which required acknowledging that, since 2008, the ECB itself had been undergoing an internal process of redefinition and institutional restructuring. This involved the implementation of new unconventional measures, such as quantitative easing and liquidity provision, aimed at supporting the Eurozone economy, anchoring inflationary pressures, and managing financial stability risks. Therefore, the ECB did everything in its legal and operational power (whatever it takes) to further the European Project and support the euro. From

[36] The International Monetary Fund. (2013) IMF Country Report no.13/081. Republic Of Lithuania. Article IV Consultation. URL: https://www.imf.org/external/pubs/ft/scr/2013/cr1381.pdf and the International Monetary Fund. (2012). IMF Country Report No 13/30 2012. Republic of Latvia: Ex Post Evaluation of Exceptional Access Under the 2008 Stand-By Arrangement. Public Information Notice on the Executive Board Discussion and Statement by the Executive Director for the Republic of Latvia. https://www.imf.org/external/pubs/ft/scr/2013/cr1330.pdf

an internal perspective, the central banks of Eurozone candidate states were caught in a tight policy bind: on the one hand, they accelerated their synchronisation with the ECB and the Eurosystem; on the other hand, faced with procyclical fiscal policies and fiscal dominance, and in the absence of sustainable structural reforms and corrective fiscal measures— which were cumbersome, unpopular, and politically costly— the effectiveness of monetary policy was diminished.

- *The choice between retrospective versus anticipative perspectives.* When the focus of European institutions (ECB and EC) shifted towards evaluating additional factors relevant to convergence, candidate states were reluctant to accept incorporating a *forward-looking* perspective into the analysis. This approach required assessing the degree of integration of national financial markets and the ability to access external financing from international financial markets. This issue proved as difficult to reach a consensus on as the analysis of convergence criteria itself, as it necessitated balancing retrospective (*backward-looking*) and anticipatory (*forward-looking*) analyses through indicators related to the balance of payments and structural imbalances. An extra challenge emerged in effectively communicating this new structural approach to the public, as evidenced by the well-known failure of the EC's information campaign on structural deficits. The combination of retrospective and forward-looking analysis remains highly relevant today and is consistently reflected in all EC and ECB convergence reports, particularly in sections discussing the sustainability of economic structures and the economy's capacity to withstand strong asymmetric shocks.

C] Decision on the analysis of the legal convergence criteria

In most member states, the most challenging legal decision concerned the amendment of national central bank statutes. While EU accession required only the obligation to adapt, transpose, and implement the relevant *acquis communautaire* under the Economic and Monetary Union (EMU) negotiation chapter, Eurozone accession introduced additional explicit legal guarantees. These safeguards aimed to ensure that national central banks were fully empowered to meet all the requirements of the Eurosystem (achieving <u>full</u> legal integration <u>of the national central banks into the Eurosystem)</u>.

Due to the political commitment given by the Accession Treaty, the list of concessions and political compromises to amend national legislation was achieved in stages: it started with the transposition of the provisions of the *acquis* and, close to the conclusion of the negotiations, the central bank's national legislative package was adopted, which marked the complete fulfilment of all the criteria of legal convergence and thus of the political commitment to joining the Eurozone (*political commitment*).

D) Decision on political guarantees to maintain the country's stability

This was the most dynamic of the decisions, as in all nine cases, decision-making flexibility and a shift in the perspective of the decision-makers in negotiations with European partners was needed.

It was a set of forward-looking political commitments which provided guarantees as to the candidate country's capacity to implement these economic, monetary and financial policy measures and structural reforms, which ensured, permanently, that there was sufficient fiscal room for manoeuvre (with its sources) to finance measures to counter the effects of possible shocks (crises) that could affect the economy.

E] Decision on credible institutional governance

This decision, too, has been long disputed politically. There were member states whose national institutional capacity was well connected to European institutions, which helped in the technical process of preparing for the adoption of the euro (Greece, Spain). Similarly, there were candidate countries that kept and improved their institutional infrastructure created during the period of EU accession (Slovenia, Malta, Cyprus, Slovakia, the Baltic States). However, there were also candidate countries with limitations on institution building (Croatia, Bulgaria). For some of the candidate countries in the last two categories, the EC and the founding member states provided long-term technical assistance programmes on specific technical issues, such as the establishment of a roadmap and action plan including realisable measures, institutions and experts in charge of their implementation, as well as a timetable for work and a set of clear rules for implementing long-term economic policies.

In all nine candidate states, political concessions and compromises regarding institutional governance targeted three categories of functions: (i) the leadership of institutions responsible for drafting the negotiation dossiers (the highest hierarchical level); (ii) the appointment of technocratic negotiators with roles in the national decision-making chain, ensuring a connection with European institutions (the next hierarchical level); (iii) the appointment and retention of experts responsible for drafting negotiation documents (the third hierarchical level). In some states, the most challenging issue to reach a consensus on was the institutionalisation of hierarchical levels 1 and 2.

II.3 Consensus on consistent national institutional coordination with European policies

Implementing the '3C' principle (Coordination, Complementarity and Coherence) illustrates how political consensus can influence European policies. Legal governed by the TEU (Article 178), the ’3C’ principle operates in the form of European mechanisms and procedures that generate horizontal coherence between national policies (e.g. uniform implementation of the Common Agricultural Policy (CAP)) and vertical, European-wide coherence (penalising *all* member states that violate the SGP's rules on deficit and public debt limits).

Before the 2008 global crisis, there was a long series of political concessions and compromises tacitly accepted by member states and European institutions pertaining to the mismatch and hence the inconsistent application of the '3C' principle, particularly regarding national fiscal policies. The drawback, in this case, was not only the acceptance of breaches of the SGP rules through political concessions and compromises and without penalties (Greece is an illustrative case) but also the magnitude and duration with which these irregularities were tolerated which could jeopardise the Eurozone and the euro itself[37]. After the 2008 global crisis, the prospect of implementing the '3C' principle was changed, especially when it came to limiting the spread of contagion effects. A European political consensus was created relatively quickly to allow Eurozone candidate countries facing sovereign debt crises (Greece, Cyprus, Slovenia, the Baltic States) to access the newly established financing instruments – the European Financial Stability Facility (EFSF) (2010), replaced by the European Stability Mechanism (ESM) (2012). However, immediate, coordinated, continuous and coherent access to these financial lines was conditional on fiscal austerity measures required by the International Troika to adjust macroeconomic imbalances and return funding to the international financial markets. Therefore, the '3Cs' principle worked more effectively in times of crisis[38]. This was also confirmed during the pandemic when, again in record time, political consensus was achieved for some policy decisions that had a tremendous impact on financing recovery and resilience in *all* member states. The adoption of Next Generation EU (NGEU), with its Recovery and Resilience Facility (RRF) and later the creation of other financing instruments for the war in Ukraine[39], either from extra-budgetary sources (complementary to MFF 2021-2027) or from public-private partnerships, again validates the assumption that the EU is a political project. However, precisely because it is a po-

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[37] Heipertz, M. and Verdun A. (2010). *Ruling Europe: The Politics of the Stability and Growth Pact*. Cambridge University Press.

[38] The Maastricht Treaty are: Coordination, Complementarity and Coherence; for further information about the 3Cs principle see the Report of the Group of Heads of the EU Member States' development cooperation evaluation services and the European Commission, pp. 16-17. *Studies in European Development Co-operation Evaluation No 8/2007,* published by Aksant Academic Publishers, URL: https://cdn.sida.se/publications/files/sida61328en-evaluating-coordination-complementarity-and-coherence-in-eu-development-policy.pdf

[39] There are nuances in this case, as the consensus of some common positions has proved more cumbersome (e.g. the application of sanctions against Russia, etc.) but not impossible.

litical project, its great weakness remains tolerance for the non-compliance with rules.

An attempt was made after the 2008 global crisis to re-credit the SGP. At least two attempts are worth noting. The annual European Semester monitoring exercise launched by the EC in 2011 aimed at ensuring institutional consistency in the coordination of national fiscal policies, through the National Reform Programmes and the National Budgetary Plans so as to control the fiscal deficit and structural deficit while maintaining debt sustainability. However, after 12 years of experience, the European Semester is believed to have only partly been beneficial. Although progress has been made towards more comprehensive, coherent and integrated policy approaches in the context of the Annual Sustainable Growth Strategy, this progress is targeted and more likely to be found in frugal states that are traditionally fiscally conservative. Furthermore, the fact that the European Semester focuses on only a few areas, to the detriment of other types of economic policy, still leaves other dimensions of well-being exposed, such as the financing of the supply of European public goods, which now would have proved not only helpful but also necessary[40]. A second example of an attempt to re-build credibility around the SGP started in July 2024 with the implementation of the new European fiscal governance framework. It remains to be seen whether the recent entry of 13 member states into the Excessive Deficit Procedure (EDP) will be treated equally in light of the application of new tax procedures.

II.4 Consensus on building a pro-Euro attitude and a culture of stability

For the general public, the transition to the euro may appear as merely a currency exchange process involving primarily legal aspects of sovereignty, with few other significant challenges. However, a closer examination of the strategies and communication campaigns in the nine candidate states reveals the complexity of the issues and on-the-ground difficulties. These challenges emerged particularly in efforts to build public support, prevent panic over potential price increases and inflationary expectations, determine the duration and understanding of the exchange process, detect counterfeit coins and banknotes, etc.

Building national public support without political consensus in all nine cases was impossible. Even in the most difficult times, such as those experienced by the Baltic States, every public message required a consensus; this has consolidated, message by message, step by step, public confidence in national and European authorities.

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[40] Stegeman I., Putatti V., Godfrey A., Costongs C. (2024). "Strengthening the European Semester to Achieve Economies of Wellbeing". *International Journal of Environmental Research and Public Health* 21(5):634. https://doi.org/10.3390/ijerph21050634

Where communication campaigns and public education projects started early on, the fruits were harvested in times of crisis, when public solidarity was needed. Slovenia, Malta, Cyprus, and Estonia are examples of advertising campaigns which, although began with the aim of inducing pro-euro attitudes, subsequently, due to the economic context, adjusted their messages at regular intervals to explain the changes in economic policies. The strength of these communication campaigns lies in the credibility of the messages to the public.

Slovakia was initially affected only at the onset of the 2008 global crisis; later on, the Baltic states, where contagion effects gradually intensified, faced challenges regarding institutional credibility and, subsequently, the credibility of their public messaging. Where political actors stepped back and allowed technocrats to take the lead, the communication campaign proved successful (as in the case of Slovenia and Estonia). Conversely, when this was not the case, the consequences were reflected in improvisations and inconsistencies in communication—for instance, during the exchange rate realignment in Slovakia, or the three postponements of the Eurozone accession date in Latvia.

In Slovakia, although the changeover from the national currency to the euro coincided with the onset of the global financial crisis, the summer of 2008 was a relatively calm period at the top of the region's economic cycle. Even these conditions required the Slovak koruna (and exchange parity) to be re-assessed twice before the euro/SKK conversion rate was irrevocably fixed. This was an unprecedented measure; until then, it took both national political consensus and (above all) European political consensus (EC, ECB and the prior opinion of all Eurogroup member states) to accept this parity change. And yet, until 1 January 2009, the euro adoption date, the exchange rate proved to be overvalued[41].

In the case of Latvia, the consequences of an inconsistent communication campaign were seen in amending the date of adoption of the euro three times: 2008, 2012 and 2014. Launched in 2006, the first communication campaign focused on the benefits of euro adoption. Later, when the crisis was at its height, and when the austerity measures had a strong social impact, the messages insisted on preserving the country's economic stability. Once the target date was approaching, practical information on the transition to the euro was insisted upon. In Latvia, the only constant was the institutional behaviour and transparency of the central bank as an information and institutional trust provider.

[41] Fidrmuc J., Wörgötter A. (2013). "Slovakia: The Consequences of Joining the Euro Aea before the Crisis for a Small Catching-up Economy". *CESifo Forum, ifo Institute – Leibniz Institute for Economic Research at the University of Munich*, vol. 14(01), pp. 57-63.

Upon a parallel examination of the nine euro communication campaigns, we can talk about a few themes around which a political consensus could be achieved among national decision-makers:

- Building a *single* key public message, communicated repeatedly and centred around a *single* guiding concept (*leading concept*), as clear and easy to transmit as possible. Depending on the specific culture, but also on the historical times they have gone through, three guiding concepts have been used: (i) the benefits of adopting the euro (with three derivatives: reduced transaction costs, elimination of currency risk and it functioning as a service facilitator); (iii) managing inflationary expectations (with insistence on diminishing fears of price increases); (iii) partial ceding of national identity and sovereignty does not affect the stability of the Country (there was a need for a 'Euro Law' that clearly enacted the limits of ceding sovereignty).
- Delimitation of target audiences. Four broad segments were targeted: the general public, the business environment, financial institutions, and the media and social media; subsequently, each group built its sub-groups, depending on geography and cultural and social aspects (e.g. Estonia insisted heavily on educating the young public).
- Establishing communication channels: (i) media (TV, radio, newspapers, online platforms, etc.) and social media (interactive platforms) to address questions and shatter myths; (ii) public events (meetings, workshops, seminars and information booths) to interact directly with the public; (iii) printed material (brochures, leaflets, posters and guides) to explain the transition process; (iv) online resources (creation of a dedicated website) to provide complete information and contact details.
- Implementing, by law, educational initiatives about adopting the euro that are part of the school programmes of high schools and universities (workshops, seminars and ad hoc sessions of simultaneous education of teachers and pupils, students, master students, etc.).
- The establishment of response (*feedback)* mechanisms. Telephone lines and helpdesks have been the most effective tools for answering questions on a constant, 24/7 basis.
- Preserving institutional governance: all campaigns have been coordinated by governments in close collaboration with the central bank and other relevant authorities, as well as in partnership with business associations, consumer groups, and non-governmental organisations, to extend the coverage and credibility of the campaign. As a general remark, the institutional changes concerned the up-

per hierarchy level, each time being announced through conferences and press releases for transparency and political ownership.

Box 3 presents the dynamics of these common themes in the communication campaigns in Estonia, Slovenia and Greece.

Box 3: Three examples of consensus negotiation in a communication campaign for the adoption of the euro

Estonia had one of the longest communication campaigns for the adoption of the euro, which started immediately after the country's entry into the EU (May 2004) and ran for six years, until 1 January 2011, in two distinct phases:

a) Phase 1: 2004-2007, which explicitly sought to educate the young public while educating the business world about understanding the European Project and the benefits of EU and euro area membership.

b) Phase 2: 2007-2010, after the postponement of the first attempt to adopt the euro (1.01.2007) when the Central Bank had to confine itself to an advisory role in order to restore the image deficit due to the non-fulfilment of the inflation criterion and the postponement of the euro area accession target.

Slovenia has had one of the most successful communication campaigns for adopting the euro. As the first member state in the new wave of EU enlargement to adopt the euro, its communication campaign has become a landmark for planning, execution and a comprehensive public communication strategy. From the very beginning, it was assumed that it was to be a political project undertaken publicly by the authorities. The credibility of the communication campaign helped build public confidence in the new currency. As such, the political decision was divided into the following five categories of political concessions negotiated by politicians:

When should the preparation begin?

2. As early as possible, long in advance in order to allow enough time for planning and execution.

Who will coordinate what?

3. The government and parliament shared the responsibility of coordinating preliminary planning, immediately after EU accession, of the euro preparation process, then monitor the implementation of the timetable deadlines and follow up on the measures in the action plan with specific ministerial tasks.
4. The Bank of Slovenia not only coordinated the technical process but also the *task force* in charge of technical preparations, as well as the financial institutions and the banking community.

How will the adoption of the euro be communicated?

2. As clear as possible and by using a variety of communication channels to educate as many audiences as possible in order to build confidence from very early on, as early as possible.

What comprises a successful communication campaign?

a. Monitor progress on a regular basis, in order to know the exact status of measures implementing the requirements.

b. Adapting policies based on feedback from external partners and changing internal and external circumstances.
   Greece had one of the least inspired communication campaigns in preparation for the adoption of the euro, due to differences in vision regarding communication and transparency in relation to European institutions. Negotiations were difficult (often very difficult), which was reflected in some serious problems:
c. Misreporting of statistical indicators, in particular those related to the fulfilment of the Maastricht criteria (Fiscal Notification). As such, the magnitude of budget deficits and public debt has been underestimated.
d. The lack of transparency and inaccurate reporting of statistical data led to a distortion of Greece's macroeconomic situation, a lack of awareness of serious structural problems in the public sector and the exact extent of tax evasion.

The main lesson of the campaign for the adoption of the euro in Greece underlines the importance of reporting accurate data that faithfully illustrates the state of sustainability of meeting the criteria for the convergence of structural reforms and maintaining fiscal discipline.

Sources: websites of national banks

II.5 Consensus on the preservation of space to manoeuvre according to context and uncertainties

In all nine cases examined, the adoption of the euro was more than just an economic strategy; it was a long-term political commitment embedded in a national economic policy programme undertaken politically by the government and the parliament.

As a general observation, it is also important to note the need to avoid portraying the process of preparing for euro adoption as a purely exogenous and mandatory target, solely because it was committed to in the EU Accession Treaty. They insisted on this objective being incorporated into a national political structure, into a national programme, showing that *ownership* remains at home and that the national authorities shall maintain sufficient political bargaining space, adjustable to both the national interest and European context. This was the case for the Baltic States, faced with the spill over effects of the 2008 global crisis at the heart of the negotiations on joining the Eurozone, which had to implement unpopular macroeconomic recovery measures to ensure the sustainability and durability of the convergence indicators. The repeated renewal of political consensus was based on the parties' political will to continue finalising accession negotiations. However, this was a specific context within a particular period.

Currently, the most important guarantee that a candidate country can give to European negotiating partners is the fiscal space for manoeuvring (with explicit reference to the *output gap*) in order to deal with the succession of economic shocks over the past five years, as well as a large number of geopolitical uncertainties. Controlling the budget deficit is not only legally justifiable economically, but also a politically necessary obligation, as a guarantee to the European authorities that the accession of a candidate state with macroeconomic imbalances and problems does not destabilise or even jeopardise the Eurozone, especially after the pandemic crisis; furthermore, the main lesson of the crisis in Greece and the Baltic States is that the regulation of imbalances within the Eurozone incurs heavier social, political and economic costs than if the adjustment were to take place before entering the Eurozone.

The effect of using *room for manoeuvre* (manoeuvre*)* as a tool with which to correct macroeconomic imbalances is very limited. Slovakia's case was unique, with the authorities having had quite a balanced macroeconomic policy mix and room for manoeuvre, sufficient to reassess central parity at costs that did not destabilise the economy and did not compromise the entire accession process; indeed, the crisis did not have such strong effects on the economy either. However, the situation was the opposite in the case of Lithuania and Latvia, whose only possibility of adjusting the imbalances was internal evaluation measures. This will also be the case for other states that hope to be able to enter the Eurozone quickly and in any circumstance.

In all nine cases, the principle of 'keeping the house in order' proved effective, becoming 'a permanent rule rather than merely a desirable percept in itself'[42].

If Romania opts for the European path, there is no other option than to perpetuate this principle consistently and make it the golden rule of national economic policies.

Five possible compromise themes can help forge a consensus for setting the 'house in order' and bringing the country closer to the Eurozone:

a. Building a credible political and institutional Country Case.
b. A European NBR brings us closer to the euro; a politicised NBR increases the risk of permanent financial repression and serious damage to the country's economic and financial health and stability.
c. Bringing institutional structures closer to the Eurozone makes the coordination of national economic policies more effective.
d. Financial proximity to the Eurozone strengthens the country's economic and financial stability.
e. Romania needs to diversify its sources of financing the real economy and to access as many European public goods as possible.

The following section details these five compromise proposals.

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[42] Padoa-Schioppa T. (2005). "Interdependence and cooperation: an endangered pair?" *Dinner speech at BIS*, June 27. URL: https://www.bis.org/events/conf0506/padoa_schioppa.pdf

III Romania: Compromise proposals that would bring us closer to the Euro

III.1 Building a politically and institutionally credible country case

Historically, credibility is key to political dialogue with European institutions and member states. Romania has a credibility deficit with its European partners. Some studies validate the assumption that several specific institutional features, such as credibility and institutional balance, are positively associated with the general perception of institutional quality.[43]

The credibility of the adoption of the euro is not a given but a process involving institutions, rules, expertise and people (experts and leaders) who, together, build a *credible* path towards the Eurozone. This is the only way to prove to its negotiating partners that Romania, with institutions, policies and strong long-term political commitment, can be a *credible* political Country Case for the Eurozone and for the EU.

How can institutional credibility be built? Three negotiating options could be envisaged:

a. *Long-term political commitment to the euro*. In an ideal world, if the Romanian authorities develop, conduct and deliver, in the long term, coherence regarding the economic macro-stability of the country and sustainable economic policies for the simultaneous fulfilment of *all* conditions for joining the Eurozone, then a public perception in favour of the euro and against speculation could be built up. Reality however differs from an ideal scenario: "The idea that you can enter the Eurozone with major macroeconomic imbalances, unprepared and that participating in the Eurozone will help you is wrong. Entering the Eurozone unprepared may even exacerbate the imbalance. We have the case of Greece."[44].

b. *Promoting a credible institutional dialogue with a credible message and better synchronisation of communication between Romanian and European authorities*. These rules are part of the set defining the internal capacity of each state to build and maintain, regardless of the electoral cycle, a convergence programme towards a stability culture (Dijmarescu, 2018). Romania has a history of rec-

[43] Islam R., Montenegro (2010). "What determines the quality of institutions". *Policy, Research working paper series* no. WPS 2764 World Bank Group. URL: http://documents.worldbank.org/curated/en/416091468766754963/What-determines-the-quality-of-institutions

[44] Isarescu, M. (2014). "Romania, adoption of the euro and the Banking Union". *Dissertation held at ERMAS Annual Scientific Conference 2014*. Babeş-Bolyai University Cluj-Napoca, August 18. URL: http://www.bnro.ro/Prezentari-si-interviuri--1332.aspx

ommendations in terms of improving its administrative capacity, and international financial institutions have, over time, detected at least three structural causes that sustain this credibility deficit.

The root is the inflexibility of the administrative system, which, during the communist period, lost the democratic tradition of alternating administrative power and for 30 years now continues to preserve the same *status quo* of bureaucratic rigidity, risk aversion and without the political will to provide, competitively, quality public services and goods. The exception was the period of preparation for EU accession when the public sector in Romania, together with the other public and private authorities, managed to complete the negotiations through competitive practices of coordination of national policies in less than three years. Since joining the EU, there have been repeated attempts to reform the public sector, mainly through traditional approaches that have not yielded the expected results, reflecting inadequate design and minimal stakeholder participation, instead in the form of sectoral initiatives rather than government wide initiatives.

The second structural cause relates to what the World Bank (Roumeen and Claudio, 2024) calls a "complexity gap", that is, the gap between the problems faced by public institutions and their ability to provide quality public services and goods adapted to the dynamics of present times. Most of the recommendations for public sector reform in Romania aimed for the increasing of the flexibility of problem assessment and decision-making processes to bring public sector institutions into the 21st century. This approach involves: (i) putting the desired results first instead of the interest to control institutions and resources; (ii) promoting value-based decisions (rather than simply regulating) to enable institutions to set their own processes to help achieve common goals; and (iii) designing the interests of public services and goods around users, not interest groups.

The third, but not last cause is political. Like other member states, Romania sometimes transferred responsibility or, in some cases, avoided implementing unpopular measures, instead opting to ‘shift’ accountability and delegate the resolution of national issues to European and/or international institutions, such as the IMF.

c. *Broad political ownership and collective accountability concerning the strategic objective.* As in the case of preparation for accession to the EU, the adoption of the euro is a type of political project of a wide-ranging national character, which significantly exceeds the legal and operational scope of the NBR. As in the period of EU accession, the central bank may be an institutional pillar of stability and credibility. However, the NBR cannot do more than is permitted by the national and European legal framework, and *above all,* cannot do more with the instruments at its disposal, suitable exclusively for the elaboration and conduct of monetary, credit, exchange rate, regulatory and supervisory policy of credit institutions within its scope and partly limited to ensuring financial stability. The NBR is only part of the political consensus equation and only according to its prerogatives to 'support the general economic policy of the state, without prejudice to the fulfilment of its fundamental objective of ensuring and maintaining price stability' (Art. 2(3), Law No 312/2004 on the NBR Statute); legally and operationally, the NBR cannot surrender this consultative role.

III.2 Where the independence of the NBR may be less effective than proximity to the Eurosystem; the risk of financial repression continuing

Soon after the pandemic's outbreak, the ECB showed a professional and academic interest in exploring the nature of the policy and policy compromises needed to balance the macroeconomic mix. Especially after the pandemic, the evolution of the single monetary policy-national fiscal policies pandemic invited a reflection on how to ensure the stabilisation of the economies of the member states, the Eurozone and the Union, severely affected by the ensuing wave[45] of exogenous shocks. Institutional, horizontal and vertical coordination between the national central banks, the ECB and national tax authorities has been a simultaneous, synchronised effort, following legal prerogatives, towards the same objective: providing liquidity. The ECB was able to provide the necessary liquidity through dedicated emergency procurement programmes to support aggregate demand and maintain price stability. This type of compromise allowed tax authorities to promote expansionary fiscal policies, protecting jobs and maintaining income, but complementary to it, it also aimed at reducing the fragmentation of financial markets when they became vulnerable to destabilising price spirals and inflationary expectations[46]. A permanent expansionist fiscal policy was pursued in 13 member states, for which the EC announced in mid-July 2024 entry into the EDP due to exceeding the budget deficit limits; Romania is part of this process. The EC urged them to devise a plan of measures to correct their budget deficit and provide fiscal consolidation on a trajectory of up to seven years. As such, tensions remain between restrictive monetary policy and national fiscal policies in these 13 member states as long as no fiscal correction and adjustment

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[45] Schnabel, I (2021). "Unconventional fiscal and monetary policy at the zero lower bound". *Keynote speech at the Third Annual Conference organised by the European Fiscal Board on High Debt, Low Rates and Tail Events: Rules-Based Fiscal Frameworks under Stress*. URL: https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210226~ff6ad267d4.en.html .

[46] Schnabel, I (2022). "Managing trade policy". *Speech at a workshop organised by the European House Ambrosetti on The Agenda for Europe: Macroeconomic and Structural Policy Challenges.* URL: https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220402~9af4336c23.en.html

measures are implemented to bring the deficit and sovereign debt back into line with the SGP.

The history of the last 15 years since the global crisis shows that the persistence of a gap between strict monetary policy and large fiscal deficits is detrimental to the fiscal sustainability of euro-area countries and non-Eurozone countries such as Romania. This gap reflects the tensions between fiscal policies and monetary policy as follows: a positive gap is associated with rising sovereign debt, inflation exceeding the target, and a compression of risk premia; and vice versa. Similarly, a prolonged period of expansionary fiscal policy can fuel inflationary pressures, complicating the conduct of monetary policy.

There is a considerable degree of synchronisation between the NBR and the ECB since both are operational within the ESCB and under the auspices of the TEU, which confers identical legal prerogatives on the ECB and *all* national central banks in the 27 member states. However, an increase in the synchronisation speed and the full integration of the NBR into the Eurosystem could make a difference to the country's macroeconomic stability for several reasons.

The first reason, and most importantly, is the speed with which there would be a tense relationship between monetary policy and fiscal policy, which, at the moment, is an emergency for the ECB, just as it is for all the central banks of the Eurozone states (*unwinding support from the ECB and Eurozone central banks*). It's not just budgets that have expanded. The leverage ratio increased significantly in all member states in response to the pandemic and the ensuing wave of crises. The EC has already announced[47] that the pace of public debt accumulation is faster in the new member states than in their counterparts, as the recovery of economic structures in these countries remains slower, while high government financing needs continue to add to financial pressures. In addition, for some member states (including Romania), pressure is mounting to increase defence spending and to slow down the entry of money from the NRP due to non-fulfilment of national milestones. In this context, the EC believes that the risk is increasing that sovereign debt will not stabilise in the medium term as long as the fiscal consolidation measures foreseen in the EU's new reformed economic governance framework are not implemented, and the measures proposed by governments are not sufficiently ambitious and are not carefully calibrated to maintain the sustainability of the debt trajectory, not to harm economic growth and to persuade international markets. This is an example of a smooth unwinding of the monetary-fiscal relationship if the NBR continues to operate inde-

[47] European Commission. (2024). Spring forecast. URL: https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/spring-2024-economic-forecast-gradual-expansion-amid-high-geopolitical-risks_en

pendently, within the limits of the current legal framework and with a future insured as a Eurosystem member central bank.

The second reason is that de-escalation can also be translated into a different scenario in which the risk of fiscal dominance and the risk of financial repression[48] becoming permanent.

What can happen when fiscal-monetary tensions are high and persist for a long time? Historically, such tense circumstances have increasing repercussions on sovereign debt, inflation and the exchange rate, and increased risks for future financial crises. The IMF[49] has recently researched how fiscal and monetary tensions have evolved over the modern history of advanced economies (the last 140 years!) based on a set of macroeconomic indicators, the evolution of the IS curve and the Phillips curve and in correlation with the theory of accumulation of sovereign debt. As expected, these tensions peaked during the Second World War, falling to historic lows in the 1970s, which remained until the early 1980s (Volcker era deflation) and even until the mid-2000s. However, the fiscal-monetary gap grew after 2018, reaching the highest post-WWII levels since late 2022.

The framework for cooperation is the third reason for bringing the NBR closer to the Eurosystem. The relaxation of the monetary-fiscal relationship under the auspices of the European legal framework set up by the TEU and the Statute of the ESCB guarantees the preservation of the independence of the NBR in the same way as they do the ECB's and of other national central banks. This also applies to the way in which monetary policy compromises are accepted, and the flexibility in the design and conduct of monetary policy respects the same legal framework as elsewhere in the Eurozone. It matters greatly to Romania for this relaxation to be carried out under the auspices of rapprochement with the euro and of increasing the rate of synchronisation and total integration of the NBR into the Eurosystem, as it is a firm guarantee that the political factor is credibly dedicated to the European objective

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[48] According to the IMF, financial repression occurs when governments implement policies to channel to themselves funds that, in a deregulated market environment, could have other destinations. These policies include government-directed loans by captive domestic audiences (such as pension funds or national banks), policy measures aimed at keeping interest rates artificially low, facilitating sovereign debt financing, explicit or implicit interest rate caps, regulating cross-border movements of capital and (generally) a closer link between the government and banks, or through a strong moral persuasion (Reinhart C., Kirkegaard, J.F., Belen Brancia M. (2011) Financial Repression Reduced *IMF Finance & Development*, June, Vol. 48, No. 1. URL: https://www.imf.org/external/pubs/ft/fandd/2011/06/reinhart.htm).

[49] Bolhuis M., Koosakul J., Shenai N. (2024). "R-Star: Fiscal-Monetary Tensions and Implications for Policy". *IMF Working Papers* 24/174, 9 August. DOI: https://doi.org/10.5089/9798400282126.001

and direction of the country. The avoidance of fiscal dominance and the permanence of the risk of financial repression for an 'independent' national bank is worse than full integration into the Eurosystem. Here's why.

Currently, Romania has a serious fiscal problem. The budget deficit reached 8.65% of its GDP in 2024, the highest level in the last 3 decades. At the same time, we can expect a worsening of exposure to international markets and macroeconomic prospects, as well as of the costs of external borrowing (Romania's risk premium is already at the highest level in the region). The NBR continues to operate a restrictive monetary policy regime. Although on August 9, 2024, the NBR decided to reduce the monetary policy interest rate to 6.50% from 6.75%, for now, it a new cycle of monetary policy relaxation is not scheduled as long as fiscal policy remains expansionary[50]. The NBR is, therefore, like other member states, in a situation of persisting tensions within the policy mix. Fiscal corrections cannot be made suddenly; there is a risk that the relaxation of the policy mix will be brutal, especially as an election is coming up, and the experience of the 1990s shows that these corrections took years of austere fiscal measures and 10 international financial assistance programmes. As a result, in the case of the NBR, the amicable solution to ease the policy mix, which does not affect the stability of the country, is solving the fiscal problem and widening the fiscal space of manoeuvre in order to remove the danger of fiscal dominance over monetary policy. Otherwise, if pursued in this way, there might be a temptation for the political factor to engage in various forms of financial repression in order to pressure the NBR to abandon inflation targets and accept additional government spending; something like this would favour the sovereign debt picture and short-term political discourse, but would push the NBR away from the Eurosystem, with disastrous consequences for the central bank's independence. There were such instances in the 1990s when the legal framework (the Statute of the NBR) of 1992 and 1998 did not give full independence to the central bank and left a wide margin of manoeuvre for a policy of accommodating public expenditure (fiscal dominance), forcing credit institutions at that time to absorb even more government debt. This is a case where, ultimately, the independence of the NBR and its prolonged exclusion from the Eurosystem prove to be less valuable than its potential membership in the Eurosystem. A wide margin of caution is therefore needed with regards to the political pressures on the NBR. Before choosing to live with the persistence of mounting fiscal and monetary tensions paving the way for crisis, it would be wise for decision-makers in Romania to consider the case of the two Baltic States before the 2008 global crisis: when the relationship between restrictive monetary policy and expansionary fiscal policy was tense, fiscal policy proved to be

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[50] Isarescu, M. (2024). Presentation Inflation Report, Press Conference. August 9, URL: https://www.bnro.ro/Prezentari-si-interviuri--1332.aspx

a more effective instrument for macroeconomic stabilisation than monetary policy which, on its own, was not enough to stabilise the economy in the event of a crisis[51].

Last but not least, the fourth argument to answer the question of why the synchronisation of the NBR with the ECB matters more than the relative loss of independence of national monetary policy is about the widening of the possibilities of sharing the costs generated by sudden changes in global economic conditions, whether it is about the continuation of the war or hostilities in Ukraine or about future geopolitical shocks. The division of these costs can be reflected both at the operational level, in the balance sheet of the NBR, and at the level of the monetary policy transmission mechanism.

Box 4 — Eurosystem and monetary policy implementation instruments

Standard Tools

The Eurosystem uses *open market facilities* to control interest rates, manage the liquidity in markets and signal monetary policy stance using either supply or liquidity-absorbing operations. Four categories of instruments are available to the ECB and the Eurosystem national central banks: (a) refinancing operations (MROs), which are usually weekly repos (*weekly reverse repos*); (b) standard long-term refinancing operations (LTROs) which are offered every month with a maturity of 3 months to refinance the banking sector on the longer term; (c) *fine-tuning operations*, which can be executed on an ad hoc basis to cope with liquidity fluctuations in the market and to steer interest rates; and (d) structural operations, through *outright transactions*, reverse transactions or the issuance of ECB debt certificates, whenever the structural position of the Eurosystem needs to be adjusted vis-à-vis the financial sector. The 3-month MRO and LTROs are currently conducted as fixed rate full allocation (FRFA) tender procedures and will continue to be conducted as FRFA for as long as necessary.

Non-standard monetary policy instruments

Following the global crisis of 2008 and in the pandemic and post-pandemic period, the ECB took a number of non-standard monetary policy measures that included rounds of long-term refinancing operations with a maturity of more than three months, long-term refinancing operations (TLTROs) providing banks with long-term financing at attractive rates, conditional on meeting pre-defined lending targets, and other asset purchase programmes, with the temporary extension of the collateral framework.

Furthermore, in order to increase the effectiveness of the transmission mechanism of monetary policy in the euro area, the ECB and the Eurosystem have introduced a two-tier system for the remuneration of excess reserves, while raising forward-looking guidelines on the future path of interest rates, conditional on the prospects for price stability.

Source: ECB website

[51] Christiano, L., Eichenbaum, M., Rebelo, S. (2011). "When is the Government Spending Multiplier Large?". *Journal of Political Economy*, Vol. 119, No 1, The University of Chicago Press, pp. 78-121.

Operationally, the ECB is already making available to the NBR, through the so-called euro liquidity framework agreement, certain liquidity lines (*repo* lines) 'aimed at preventing funding tensions in international markets and undesirable effects on financial market stability' (NBR, 2024[52]). However, the proximity to the Eurosystem and the increase in synchronisation speed open the way for the NBR to access, under certain conditions and in compliance with legal provisions, a broader portfolio of instruments than this type of framework agreement – detailed in **Box 4.**

In terms of streamlining the transmission mechanism of monetary policy in times of high aggregate supply shocks and at times when inflation was well above the proposed target, as was the case for the pandemic period, central banks faced a difficult monetary policy compromise to mediate between adapting to the expected contraction in demand versus controlling inflation over the medium term. The ECB, alongside the national banks both within and outside the Eurozone (as in the case of the NBR), managed this type of compromise in a coordinated manner by calibrating the monetary policy to remain aligned with its primary objective of price stability[53].

The degree of synchronisation of business cycles between Romania and euro-area member states also matters and can be seen as an argument for bringing the NBR closer to the Eurosystem. With regards to the Eurozone, before the 2008 crisis and the pandemic, the endogenous best currency area hypothesis suggested that the synchronisation of the business cycle between participating countries could increase over time due to the deepening of financial and trade integration; member states would thus have become less exposed to asymmetric shocks, facilitating the effectiveness of the single[54] monetary policy. Currently, ECB studies measuring the correlation coefficient for the Eurozone suggest that the degree of synchronisation of the economic cycle increased sharply during the global financial crisis and peaked during the financial crisis but gradually decreased over the recovery period. Overall, until the pandemic, econometric calculations (calculated correlation index, estimated share of the variation in GDP growth explained by a common factor) indicate a relatively high level of synchronisation of the business cycle between Eurozone

[52] The ECB and the NBR renewed the framework arrangement for providing euro-denominated liquidity to the NBR through the repo line until 31 January 2025', the NBR. Press release. 9 August 2024. URL: https://www.bnro.ro/page.aspx?prid=24861

[53] Schnabel I. (2022). "Finding the right mix: monetary-fiscal interaction at times of high inflation". *Keynote speech at the Bank of England Watchers' Conference*, 24 November. URL: https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp221124~fa733bc432.en.html

[54] Frankel, J.A. and Rose, A.K. (1998). "The Endogeneity of the Optimum Currency Area Criteria". *The Economic Journal*, Vol. 108, Issue 449, pp. 1009-1025.

member states, which coincided with an overall reduction in volatility in the Eurozone[55].

III.3 Financial proximity to the Eurozone strengthens the financial and economic stability of the country

In the EU, particularly in the Eurozone, the model used by the majority for financing the economies of member states is through accumulating debt (*bank and debt-based model*). The same is true in Romania. Because the EU economy, like the Romanian economy, is so dependent on bank credit, the most important financial priorities of the new EC mandate are aimed at the financial health of credit institutions and the treatment of sovereign debt exposure.

There is currently a sense of urgency (*the sense of urgency*) between member states and European institutions in teaming up their efforts around an objective as ambitious as that of 70 years ago, when the creation of the single market was foreshadowed: financing the EU economy at top speed, with the most diversified means possible and, ideally, with sovereign debt under control. If that objective is achieved, the EU's economic model could become transformative, fostering deeper financial integration within both the Eurozone and the broader EU.

What has been done so far to improve the health of the banking system? The establishment of the BU, and the entry into force of the first two pillars (the Single Supervisory Mechanism / SSM) and the Single Resolution Mechanism / SRM) was the result of a political compromise between member states, European institutions and central banks in order to rejuvenate public confidence in the European banking sector, severely affected by the 2008 global crisis and the 2014 sovereign debt crisis. It was not just trust that helped bring about the BU project, but also a common framework of regulations, a single supervisory function for Eurozone credit institutions, and a standard set of procedures for the orderly restructuring of a bank in case of trouble, which ensures that the bankruptcy of that bank does not damage the economy and does not cause financial instability. However, the BU project is unfinished. For over ten years now, an essential pillar has been missing: the implementation of the European Deposit Guarantee Scheme (EDIS). In the absence of EDIS, the national authorities continue to use their own arrangements to accumulate, guarantee and protect liquidity deposited in their banking systems.

Negotiations are dragging on and it is hoped that a European political consensus will be achieved, even in part, at the Eurozone level, because EDIS' stake is large

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[55] Martinez-Martin J., Saiz L., Stoevsky G. (2018). "Growth synchronisation in euro area countries", *The ECB Economic Bulletin*, Issue 5/2018. URL: https://www.ecb.europa.eu/press/economic-bulletin/focus/2018/html/ecb.ebbox201805_03.en.html

and politically heavy. What is being sought is a compromise that balances the measures implementing the internal rescue mechanisms (*bail-in)* with the external *bail-out mechanisms*, and simultaneously provides for shock relief, *cross-burden sharing* and fair and cross-border risk sharing. And to complicate matters even further, what comes out of this compromise must fit into the balance of the European financial system in a sustainable way that does not affect the financial stability of the Eurozone and of the EU as a whole. It is a delicate balancing act that is difficult to reach a consensus over, primarily due to its significant implications for national budgets.

Another reason for delaying the completion of the BU is moral hazard management. This was a recognised and presumably manageable problem before the pandemic that could be addressed through decentralised arrangements and with specific national powers. With the implementation of the SSM in 2013 and the ECB taking over centralised supervisory tasks at the Eurozone level (Regulation (EU) No 1024/2013 of 15 October 2013), the national and decentralised approach to moral hazard management has moved to a supranational level. After 10 years of centralised practice, a joint study by the Bundesbank and the ECB shows that moral hazard, too, is a political[56] concept. The reasoning is as follows: the BU was a major political response to the 2008 financial crisis and the subsequent Eurozone sovereign debt crisis, whose primary cause was moral hazard[57]. Therefore, the BU can be understood as a response to moral hazard in the relationship between banks, European institutions, and member states, but also as a response to the "impossible trinity" which warns that financial stability and financial integration are not compatible with an institutional arrangement of the decentralised national[58] supervisory function. But, if institutional *design* and centralised policies in the area of banking regulation, supervision, support and resolution are not taken further with EDIS, then there is a risk that adjustments to financial imbalances will no longer be addressed in a coordinated and anti-cyclical way, which could affect the BU's credibility in managing future crises[59].

The timing is right for completing the BU project now when the level of non-performing loans is low across the EU, and there are no serious problems with sov-

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[56] Pierret, L., & Howarth, D. (2023). “Moral Hazard, central bankers, and Banking Union: professional dissensus and the politics of European financial system stability”. *Journal of European Integration,* 45(1), 15-41. URL: https://doi.org/10.1080/07036337.2022.2156501

[57] De Grauwe, P. (2011). “The Governance of a Fragile Eurozone”, Economic Policy. *CEPS Working Documents*. URL: http://www.ceps.eu/book/governancefragile-eurozone

[58] Schoenmaker D. (2011) “The financial trilemma”. *Economic Letters*, 111, pp. 57-9

[59] Véron N (2024). “Europe's banking union at ten: unfinished yet transformative”. *Bruegel*. URL: /www.bruegel.org/sites/default/files/private/2024-06/Europe's%20Banking%20union%20at%20ten_unfinished%20yet%20transformative_0.pdf

ereign debt, especially in the southern member states. There are various reasons why banks invest in sovereign government bonds, for example, to comply with liquidity requirements. However, the current regulatory treatment of sovereign exposures may not be the main reason banks invest in sovereign debt, bearing in mind that this treatment does not impose any constraint on banks to increase their sovereign exposures. The question arises: is maintaining the current *status quo justified*? If a change in the regulatory framework for exposures to sovereign debt[60] is chosen, then a succession of other issues could arise, and Romania should be an active part of this dialogue to find out how the impact of these structural changes will be assessed in the current context with so many geopolitical, economic, social, etc. uncertainties, especially in sovereign debt markets. The negotiations so far have only produced a comprehensive understanding of the specificities of sovereign debt, the risk profile and the (de)stabilising role it can play in financial markets in specific contexts (e.g. if a state has twin deficits for a long time and continues to promote an expansionary fiscal policy as is the case in Romania).

Presently, Romania has no issue fulfilling the sovereign public debt criterion. However, it has a substantial macroeconomic imbalance problem. For Romania, sovereign debt is essential for state not only funding but also for managing bank assets and liquidity, as well as a guarantee in the financial and public administration sectors. A decade after the approval of SSM Regulation (EU) No 1024/2013, negotiations in which the NBR was an active party, Romania has a window of internal and external opportunities through which it can contribute much more, respectively, as part of the solution and not as part of the problem. Internally, the timing is essential, and timing would come naturally, all the more so because, in the event of a deterioration in the macroeconomic climate, the absorption of a future asymmetric shock would somehow not turn into a magnifying factor but into a crisis, which could happen when banks continue to increase their portfolio of sovereign securities to risky levels. Externally, it also helps us to reflect on the process of enlarging the Eurozone at the EU level, as reality shows that geopolitical factors may, in a way, nudge some member states into joining the Eurozone.

Suppose Romania were to aim to synchronise national and European financial priorities as a strategic objective. In that case, the central theme of political conciliation in Romania is related to the entry into the BU. This implies political consensus for

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[60] Opinions were circulated for the possible introduction of strict limits on banks' exposure to sovereign debtors, or the addition of risk weights attached to government bonds to reduce the vicious circle between banks and sovereign debts (for details see Véron N. (2017) Southern Concentration Charges: A New Regime for Banks' Sovereign Exposures. *Economic and Monetary Affairs Committee of the European Parliament* URL: http://www.europarl.europa.eu/committees/en/ECON/home.html).

the NBR to enter into a Cooperation Agreement with the ECB and to join the SSM. "It is in Romania's interest to enter the BU primarily because three-quarters of the total banking assets in Romania are located in banks or financial entities that are predominantly euro-area based. These banks still hold two-thirds of the capital of the entire banking system. Consequently, participation in the BU is in line with Romania's national interest"[61]. Another advantage is access to a centralised financial supervision infrastructure, with safety nets shared by the category of banks and risk, which provides additional layers of protection in an uncertain world, plus rapid access to European mechanisms and instruments that can make a difference in a crisis.

However, there is a particular condition to benefiting from this window of opportunity: sustainably tackling macroeconomic imbalances and maintaining a long-term sustainable fiscal position, which entails meeting the commitments to reducing the budget deficit by increasing fiscal revenues to finance the production of basic public goods[62].

III.4 Institutional rapprochement with the Eurozone makes the coordination of national economic policies effective

A few proposals for political compromises which could speed up the institutional synchronisation between national and European authorities:

A] The reconstruction, re-delimitation and legal re-mandating of the old euro coordination infrastructure at the *national* level established in 2018 requires a renewed political consensus on:

- National strategic coordination to restore a permanent flow of real-time inter-ministerial information.
- Relevance of the information provided to European institutions on key themes of the switch to the euro in order to identify the relevant national elements that could influence the decision-making process in the EU at an early stage.

[61] Isărescu, M. (2021). Presentation release report Romania 2020: New ambitions, ambitions found. Dialogues on national interest. *Aspen Institute Romania and German Marshall Fund of the US Bucharest Office*, URL: https://www.bnro.ro/Prezentari-si-interviuri--1332-Mobile.aspx

[62] For details of this reasoning see Daianu, D. (2020) "For entry into the Banking Union, the resolution of imbalances is mandatory!" *Hotnews*, review article, October 6, URL: https://hotnews.ro/daniel-daianu-pentru-intrarea-in-uniunea-bancara-rezolvarea-dezechilibrelor-este-obligatorie-233809

- Planning coordination between Romanian authorities and European institutions to avoid institutional bottlenecks in economic policy coordination.
- Re-credibility of public discourse on the changeover.
- Coordinating communication on European issues. There are areas of particular importance for the Eurozone (such as the revisions of Article IV of the IMF Statute for the Eurozone, the international role of the euro, etc.) where coordination between member states and candidate countries is important. Experience shows that the expression of individual opinions contradicting the commonly agreed position at the Eurozone and the EU level should be avoided.

B] The construction, delimitation and legal entrustment of a coordination infrastructure between *Romania and Eurozone member states* requires political consensus on:

- Systematically coordinating with member states' embassies in Bucharest on issues of significant importance for member states but also for the EU or the Eurozone. These areas could include: (a) powers conferred onto EU institutions, in particular the single monetary and supervisory policy, reflecting the position taken by the decision-making bodies of these institutions; (b) fiscal policy issues with implications for common EU or Eurozone policies; (c) issues of financial stability and crisis resolution; (d) the role of the euro in shaping the international financial and monetary system.
- Coordination between the Romanian authorities and the European institutions regarding communication with the international financial markets, which is done in a single voice, usually in the Eurogroup format.
- The external representation of the messages on the state of play of the negotiations on accession to the Eurozone and that it is based on a single mandate agreed upon with the EU and synchronised with the progress achieved during the negotiations, especially concerning the IMF, WB, other institutions and international creditors.

III.5 The structural rapprochement with the Eurozone diversifies the sources of financing for the real economy and allows access to European public goods

The BU follows the logic of the European financing model. However, because its completion is still troublesome, decision-makers are looking for alternative solutions which could bring about a structural change in the European financial system.

For over five years, the Union and member states have been under enormous pressure to finance a long list of external emergencies (the war in Ukraine), overlapping internal priorities (increasing the Union's internal and external competitiveness, completing the green and digital transition, etc.). In addition, a new structural problem has arisen: due to the loss of the 'peace dividend'[63] in many member states, the supply of national public goods is falling (in number and quality), and citizens' demands for European public goods is increasing (the continent's need for defence and security, for centralised combating climate change, for joint research and digital development, etc.). This structural problem is of concern not only to European institutions but also to *think* tanks (Bruegel, CEPR, Eurofi, etc.). The European rationale for stimulating the production of European public goods is divided between two types of approaches. The first line of reasoning encourages a transition from the national to the European level: when the supply of national public goods cannot cope with national demand, then it can tilt towards a shift towards European public goods. Another school of thought follows the rationale of the fiscal federalism theory[64], which states that the financing of a public good should take place at the level at which it is provided.

The point of the intersection of these two approaches is in favour of the option of providing a European public good on a centralised basis (at the EU level); in this case, the assessment of each member State's participation in a common European scheme could have two benchmarks: what return to scale does it offer, and what indirect effects are generated (*spill over effects*)[65]. In the case of vital public services (health, education, etc.), the return can be judged on a value-for-money basis, and the indirect effect would be to access national public services, which, although of a lower quality, are free of charge. However, if in the long run, it becomes evident that accessing low-quality services (such as education, healthcare, etc.) has severe consequences with high political costs, this may incentivise policymakers to consider it as a politically viable compromise (win-win solution), participation in European public goods schemes that adhere to European quality standards.

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[63] Rogoff K. (2022). "Is the Peace Dividend Over?". *Project Syndicate article*. 22 March. URL: https://www.project-syndicate.org/commentary/sustainable-growth-requires-defense-energy-security-by-kenneth-rogoff-2022-03

[64] Fiscal federalism theory analyses how responsibilities, especially in terms of allocating financial resources, are shared between federal actors in a federal government or local actors with the aim of accommodating as many public policy objectives as possible and also what compromises can be made to manage spending as efficiently as possible. Source: Congressional Research Service. URL: https://crsreports.congress.gov R46382

[65] Wyplosz, C. (2024) Which European Public Goods? *Directorate-General for Internal Policies PE 755.722.* URL: www.europarl.europa.eu/RegData/etudes/IDAN/2024/755722/ IPOL_IDA(2024)755722_EN.pdf

However, like the other European priorities, implementing such reasoning is limited to money and what sources of funding may be available. As the European banking sector alone cannot cope with this considerable financing effort[66], alternative solutions are being sought. One is reviving the Capital Market Union (CMU) project as a Union of Savings and Investments. At first glance, the CMU is another bland acronym given to another complicated European project containing some fairly impenetrable ideas; in addition, it is unlikely that the CMU will rapidly offer a partial substitute for bank credit, similar to the US financial markets-based financing model (*market-based and equity financing model*). However, upon closer examination and reconsideration of the CMU project, there could be a change of play in the European financial industry. Here are a few arguments.

A] Budgetary argument to diversify sources of public funding. It is clear that, in a short time, neither the EU, nor the Eurozone can change the current financing model centred on bank credit and debt accumulation; such a goal would be utopian. However, in the medium and long term, projects such as CMU may converge with the American financing model (*market-based and equity* financing *model)*, relying on private financial resources. Public resources are not even a viable option. Why?

The overall picture of sources of funding in the Union is divided as follows: (i) public resources from the long-term EU budget (MFF 2021-2027 accompanied by *off-budget* financial sources to adapt to the current extraordinary circumstances[67]); (ii) resources combining, through partnerships between the EU and the private sector (PPP), the financing of services and goods in areas such as health[68], defence[69] and infrastructure[70]; and (iii) private retail funding resources (*private and retail money*).

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[66] "To achieve the EU's objectives (...), a minimum annual additional investment of 750 to 800 billion euro is needed, based on the latest EC estimates, which would correspond to 4.4 to 4.7% of EU GDP in 2023 (...) equivalent to about three times the investment allocated by the Marshall Plan between 1948-1951" Draghi Report. (2024). "EU competitiveness: Looking ahead". 2024a, p. 59. URL: https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en

[67] The most well-known extra-budgetary source is the NGEU Programme, with the MRR mechanism, to which amounts derived from the realisation of revenues generated by the freezing of Russian assets have been added since July 2024.

[68] During the pandemic period, the EC negotiated joint vaccine purchases for member states with Pfizer-BioNTech, Moderna, AstraZeneca and Johnson & Johnson manufacturers for free distribution to all EU citizens through the EU Joint Medical Command.

[69] The European Defence Fund finances joint European procurement of drones, cyber defence systems and combat aircraft to be delivered to Ukraine.

[70] The Trans-European Transport Network (TEN-T) is funded by the European Connecting Europe Facility (CEF) and the 5G Infrastructure Partnership (5G PPP) between the EC and

Public funding from the European budget is hard to imagine without a significant increase in the future EU Budget, which would mean a more significant fiscal effort by each member state. The diversification of financing instruments largely depends on the outcome of the negotiations that the new Commission will initiate for the next Multiannual Financial Framework (MFF) 2028–2034. It will also be influenced by the extent to which political compromise advances to enable a *fully-fledged* common fiscal capacity and the development of additional fiscal instruments similar to the Recovery and Resilience Facility (RRF), enhancing automatic stabilisation in response to severe economic shocks. This is difficult to negotiate at a time when the implementation of the new fiscal governance rules counts enormously for the EU's credibility, while Romania and 12 other member states are already in the EDP.

Complementary to budgetary sources, more money could come from off-budget sources but still under the umbrella of the long-term EU Budget. The current extra-budgetary infrastructure built by the EC to raise funds for the RRF (NGEU) reportedly works well[71], which gives hope it could be used to approve a European fund for investment in common public goods, financed like the RRF (NGEU) through the issuance of EU debts. One advantage of this financing is the opportunity to deepen the EU debt market, thus reducing financing costs. This positive effect increases with the length of time that a firm political commitment (*commitment*) is kept. However, the continuation of this beneficial effect would depend on the underlying guarantee structure for issuing EU debts. In the recent past, two forms of guarantees have been used: common national guarantees to finance the SURE programme to mitigate unemployment risks following the pandemic plus an EU budgetary guarantee (the margin between your own resource ceiling and your expenditure commitments) for the financing of the RRM (NGEU)[72]. Other proposals for extra-budgetary sources have also been put forward. For example, the European Fiscal Council (2022) considers that, under the current legislative framework, a fund linked to the EU budget could be set up, funded by national contributions, which would be an incentive for national governments because it would be possible to jointly manage the efficient spending of public money. If there is a choice to enlarge the EU's legal powers, there is also the proposal to establish a permanent central tax capacity at the EU level, which exclusively finances European public goods[73]. Additionally, if the

the private European IC&T industry is funded by the development of European telecommunications service infrastructure and free internet for European citizens.

[71] There is currently no evaluation of the efficacy of MRR.

[72] Bakker A., R. Beetsma and Buti M. (2024). "Investing in European Public Goods while Maintaining Fiscal Discipline at Home". *Intereeconomics* / Volumes / 2024 / Number 2, pp. 98-103., DOI: 10.2478/ie-2024-0021

[73] Idem Note 72

new fiscal governance framework can be credibly established in such a way that it is directly linked to access to EU financial support for transnational investment projects, this could lead to a cross-border spill over effect[74]. However, a strong political will is needed for these last two projects to become a reality.

In this context, hope is shifted to private funding resources.

B] The structural argument for broadening and deepening member states' financial markets to attract private sector capital. At first glance, for countries like Romania and less developed and less disciplined markets—such as Romania's capital market and stock exchange—the CMU project, which advocates for financing solutions based on securities, investment funds, equity markets, securitisation, etc., may seem like a fantasy. This is even more so given that the monitoring and supervisory infrastructure for the non-banking sector remains underdeveloped and often includes a significant political component in most member states.

Moreover, the current state of affairs is not helpful either: EU capital markets remain fragmented and relatively shallow, heavily reliant on major European institutions, and subject to a complex web of regulations in areas such as insolvency, taxation, anti-fraud measures, and cybersecurity. Additionally, in most member states, only banks and insurance companies provide financial services related to savings and securities investments. Furthermore, European companies are not incentivised to seek alternative financing sources beyond public budgets and bank credit without robust private equity and asset management funds with high cross-border investments in securities beyond blue chips. This, in turn, diminishes the EU's attractiveness as an investment destination, limiting expansion opportunities and prospects for stock market listings.

There is also the question of trust: the Union has credibility problems regarding the strategic development of a project of this scale. The Banking Union project itself, more than 10 years after its implementation, has been criticised for focussing much more on risk management and financial stability issues than on creating financing facilities for the banking sector to support common public policies and trans-European funding mechanisms and to mitigate differences in competitiveness, convergence and economic performance between member states[75].

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[74] Hypothesis validated by Bakker, A. and Beetsma R. (2023). "EU-wide investment conditional on adherence to fiscal-structural plans". *VoxEU.*

[75] Véron N. (2024). "Europe's banking union at ten: unfinished yet transformative" . *Bruegel.* URL: /www.bruegel.org/sites/default/files/private/2024-06/Europe's%20Banking%20union%20at%20ten_unfinished%20yet%20transformative_0.pdf

C) The argument of the 'utmost urgency' (a huge sense of urgency): the pressure exerted by the vast number of common EU objectives requiring collective financing requires the development and deepening of existing financial markets to complement the bank lending market[76].

Several emergencies are expected to be quickly resolved in the new Commission's mandate. The first step would be the urgent harmonisation of institutional procedures and legislation to enhance the passporting system, ensuring that investors perceive no differences in securities across member states. Subsequently, a smooth transition toward centralising and coordinating all financing sources would enable greater diversification in risk-sharing mechanisms. Additionally, a new legislative initiative would be beneficial, introducing a set of measures aimed at strengthening the cross-border dimension of investments by targeting two key objectives: (i) improving the passporting system for investment funds, facilitating the provision of financial services across member states and, under certain conditions, beyond the EU, and (ii) removing existing national barriers in insolvency frameworks to provide greater legal certainty for cross-border investors.

D] The argument of using the savings of European citizens. IMF calculations (Bathia et all, 2019[77]) show that in the Eurozone, only 30% of the financing of European companies is done through securities, compared to two-thirds in the US. As a result, most of the savings of European citizens are found in bank deposits, while small firms rely on bank credit financing with greater exposure to the risk of insolvency. The IMF[78] also estimated that "for every 1 percentage point drop in national GDP growth, consumption drops by 80 basis points, on average, if the country is in the EU, compared to only 18 basis points for the average US state", where the *burden sharing* is shared between investors, creditors and the government. Building on these evaluations, the Letta Report (2024[79]) proposes the creation of a European Savings Facility as a first step towards a Savings and Investment Union (part of the

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[76] Draghi M. (2024b). "Radical Change – Is What Is Needed", Speech at *the High-level Conference on the European Pillar of Social Rights,* April 16. URL: https://geopolitique.eu/en/2024/04/16/radical-change-is-what-is-needed/

[77] Bhatia A.V, Mitra S., Weber A. Aiyar S., Antoun de Almeida L., Cuervo Cristina, Oliveira Santos A., and Gudmundsson T. (2019). "A Capital Market Union for Europe". IMF Staff Discussion Note. SDN/19/07. URL: https://www.imf.org/-/media/Files/Publications/SDN/2019/SDNEA2019007.ashx

[78] Bhatia A.V, Mitra S., Weber A. (2019). "A Capital Market Union for Europe: Why It's Needed and How to Get There". IMF Blog. 10 September. URL: https://www.imf.org/en/Blogs/Articles/2019/09/10/blog-a-capital-market-union-for-europe

[79] Letta E. (2024). "Much more than a market". April 2024. European Council. URL: www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

CMU), which would finance the EU's competitive entrepreneurial sector, particularly small and medium-sized firms. At the same time, Letta also warned of the risk of negative reactions from society if the financing needs of small and medium-sized companies are not appropriately addressed.

It is possible that the CMU could progress as an individual project, with voluntary participation from member states that choose to pursue deeper financial integration at the European level[80]. If Romania opts for such an approach, then three categories of advantages should be considered.

The first category of advantages is related to the stability of the Romanian financial system, as a substantial component of the country's stability. From a financial stability policy perspective, moving away from funding that is essentially banking-centred to diversifying non-bank funding sources would be a good thing to do at the same time as the process of reviving the CMU starting in autumn/winter 2024. On its own, Romania does not have the institutional capacity to make this step of structural change. However, as part of the European effort for change, Romania would come under these auspices, which include, alongside the current macro-prudential perspective, the perspective of European coordination of consolidated supervision of the entire financial sector (banking and non-banking) in order to monitor the financial stability of the Union better.

The second category of advantages concerns the development of non-banking financial institutions in Romania. The slow pace of institutional reform in these non-banking financial institutions is often concealed by arguments citing resistance to compliance with European legislation, transparency requirements, and a certain degree of scepticism toward deeper integration into the EU. Direct involvement in CMU negotiations could serve as a crucial trust-building mechanism and a means of restoring confidence in the non-banking sector, which has been significantly affected in recent years.

The third category of advantages concerns the ability to negotiate financing schemes for European public goods, including the development of European infrastructure (energy networks, energy, and digital networks), participation in EU environmental projects focused on sustainability, climate change mitigation, and biodiversity protection, as well as mechanisms for enhancing security and defence (shared intelligence, border security, protection against cyber threats, etc.). It also includes access to EU-funded research and innovation programmes, particularly in medical research, disease prevention, cross-border healthcare, emergency health response, etc.

For now, Romania faces a long-term structural problem. This can be addressed by adjusting the fiscal deficit and structural deficit for the period 2025-2027, [which]

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[80] Proposed by France at *Eurofi High Level Seminar*. Budapest. September 11-13, 2024.

will be done on the expenditure side only"[81]. As such, the fiscal room for manoeuvre for financing public services and goods[82] provided by the public sector will be significantly narrowed. In addition, *crowding out* may also occur if increasing government spending and sovereign debt to finance government spending continues at the expense of public and private sector spending or investment. In practical terms, the prioritisation of budget revenues for servicing public debt could lead to a reduction in available resources or even the abandonment of investments and essential public goods and services. This issue is not unique to Romania. Several other EU member states—including some founding members of the Eurozone—are also facing similar risks.

In the 17 years since we have been a member state, most Romanians associate the EU with the primary provider of goods and services derived from the four freedoms of movement. In such a dynamic context of technological transformation, with global and regional challenges and geopolitical changes, rapprochement with the Eurozone can also be 'delivered' as a complementary source of access to European goods and services that better respond to growing global and regional threats (terrorism, immigration, military conflicts, cyber security, climate change, etc.). The central argument would be that until now, responsibility for the supply of public goods has largely been given to the government. However, times are changing, and new challenges call for a re-evaluation—and why not, considering the euro and the Eurozone themselves as European public goods?

After all, the euro is more than just a currency; it is a tangible link with the stability and security that only the EU can provide (Lippert, 2024[83]). Following this logic, the rapprochement with the euro is also a political issue between: 'meeting the problems with which the world will be faced… through methods of international cooperation…, or …each nation relying on its own resources and its own strength and going its own way in the world'[84].

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[81] Fiscal Council. (2024). Opinion on the State Budget Law 2024, the State Social Insurance Budget Law 2024 and the Fiscal-Budgetary Strategy 2024-2026, p. 3. URL: https://www.consiliulfiscal.ro/Opinie_CF_buget_2024_f.pdf

[82] A broad definition and analysis of public goods is set out in Chapter IV of the e-book 'Public goods and production in the public sector'. University of Bucharest. URL: https://ebooks.unibuc.ro/StiinteADM/platis/4.htm

[83] Lippert B. (2024). "EU Enlargement: Geopolitics Meets Integration Policy. The EU Is Set to Add Gradualist Elements to Its Enlargement Doctrine", *SWP Comment* /C 01, 11.01.2024. DOI:10.18449/2024C01

[84] Georgieva, K. (2024). "The 2020s: Turbulent, Tepid or Transformational? Policy Choices for a Weak Global Economy". IMF Podcast. URL: https://www.imf.org/en/News/Podcasts/All-Podcasts/2024/04/11/md-curtain-raiser-april-2024

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THE EURO AS A EUROPEAN PUBLIC GOOD? A FRAMEWORK BASED ON TRUST

Amalia Fugaru

I Introduction

Asking this question seems to be a matter arising directly from the Single Market research undertaken elsewhere by some of the authors of this volume (see Dijmărescu, coord., 2023). The single market is a success of the European economic project, and the logic suggests that the euro project should complement the single market. However, the quarter-century history of the common currency shows that this project has been associated with numerous failings in governance, which have sometimes even jeopardised the viability of the EU's political project (as in the case of the sovereign debt crisis). The slow adoption of the euro in the states that are obligated to do so dampens enthusiasm for this currency and what it represents.

The purpose of this paper is not to find an answer to the question in the title. On the contrary, the research focuses on identifying another point of view related to the possible answer to this question. The expected outcome of this exercise is a better understanding of the attitudes of those participating – closer or further away – in the Economic and Monetary Union. Since the introduction of the euro, the views on the common currency have been overshadowed by issues of economic and fiscal governance of the euro area, namely the "famous" costs and benefits of adopting the euro for those countries that have been obliged to do so since entering the EU. However, these prospects isolate the discussion about money in the economic realm, even though this subject has, in fact, political roots (because the currency is the sovereign's apparatus). Its usefulness is given, and its use is confirmed at the level of society. This means we have, if not an erroneous, at least an incomplete representation of attitudes relative to the subject of the euro. This does not mean that the following exposition seeks to answer the question in the title above within the political or social research. Instead, answers are sought for the title question in other parts of economic theory, hoping that a different perspective does not exclude the political and social factors characterising money.

In practice, the following lines formulate a series of logically generated questions, at least at the level of the author's intention, from the following sentence: 'The euro is considered to be a public good'. The chain of questions aims to help uncover as many perspectives as possible on the subject of the euro. Categorical answers, whether affirmative or negative, cannot be found in this paper, but doubts are expressed regarding each topic below.

Such an approach to the euro expresses no doubt about the common currency but merely wishes to recall that, just as there are various perspectives on the subject, so should the actors involved accept that there are different perceptions (of either each actor individually or of the same actor at other times). At least three elements underline the importance of this approach. The diversity of national economic contexts generates specific experiences and needs, directly influencing how actors (governments, political leaders, the population, European institutions, etc.) in both the euro area and the EU perceive the impact of the euro. In addition, this diversity is reflected in the variation in the degree of integration and interdependence between actors in this space, which affects the assessment of the usefulness of the common currency. Finally, these economic differences are amplified by the pluralism of political-economic traditions, which shape the perspectives on the role of the euro and economic cooperation in general.

The first part of the paper presents questions about the common currency as a public good and the possibility of applying Elinor Ostrom's *common pool resources framework* to the specific case of the euro. The following two sections test whether a particular view of the euro resulting from the first section fits with the realities of the euro area Member States and the Member States obliged to adopt the euro. The approach of the last two segments of the paper is to extract some questions related to the euro (other than those related to costs and benefits), which those interested in this topic – be they politicians, researchers or the general public – could ask themselves.

One of the significant shortcomings of this work is that it does not include aspects relating to the financial market. However, the impact of the single currency on the European economy is evident. Thus, from an integration perspective, the euro catalyses cross-border financial markets, facilitating capital flows and creating a more efficient European financial market. This increased integration reduces barriers to investment and strengthens economic cohesion at the continental level. Secondly, regarding sustainability, the interaction between the euro and financial markets plays a crucial role in maintaining the euro area's financial stability. This dynamic directly influences the effectiveness of the intervention mechanisms in the EU and the euro area, allowing the European institutions to manage systemic risks more effectively and to ensure the long-term stability of the entire European financial system. Finally, looking at the future of the European project, the relationship between the euro and financial innovation opens up new horizons for economic development. The single currency stimulates the creation of innovative financial instruments and services that have the potential to respond to emerging challenges such as digitalisation or green finance. However, one argument for excluding financial market issues is that money/currency existed even before the invention of financial markets, and the questions formulated in this paper must be valid regardless of the degree of development of the financial market.

The reading of this text should not be affected by the use of the notions of currency and money as interchangeable, although the differences are known. "*Money*" includes any object (or record) accepted as payment for goods and services and repayment of debts in a particular economy. Money refers to three functions: a means of exchange, a unit of account, and a reserve of value. Currency refers to the physical form of money used in an economy, such as banknotes and coins issued by an authority. Essentially, all currencies are money, but not all money is money.

II Can A relationship be established between the euro and public goods?

This section investigates multiple questions designed to systematically explore various perspectives on public goods and fiat currency. The analysis begins with the concept of European public goods as a foundational reference point. Subsequently, the study examines potential connections between the following key concepts: fiat money and public goods, fiat money and common goods, trust in fiat money and common goods, and the broader implications of these relationships for the euro. The investigation follows a logical sequence to ensure a comprehensive understanding of these interrelated themes.

II.1 What are European public goods?

The concept of European public goods has its intellectual roots in research into global public goods. At the turn of the millennium, World Bank economists developed the notion of global public goods, which laid the groundwork for thinking about public goods across national borders (Kaul, Grunberg Stern, 1999). These public goods, while having the basic features of any public good (non-exclusion and non-rivalry in consumption), refer to more complex goods, such as access to clean air, climate stability or scientific knowledge. On the other hand, the European Commission recommended using 'European added value' as a reference point for reforming the EU budget (Thöne, Kreuter, 2020). This recommendation shows that the EU institutions recognised the importance of demonstrating the unique benefits of EU-level actions compared to national initiatives before the current debate on European public goods developed.

The supply of European public goods is not new, as it was at the heart of European integration in the 1950s since food self-sufficiency and energy self-sufficiency were priorities at the time. Interest in this concept has been boosted since 2019 (Thöne, Kreuter, 2020), with some authors claiming that the EU should now refocus on European public goods (Fuest, Pisani-Ferry, 2019). This revival of interest is primarily driven by the EU's evolving challenges. The multiple shocks (including the refugee crisis, terrorist threats, climate change, pandemic, war in Ukraine and changing geopolitical dynamics) have highlighted the need for coordinated European responses (Fuest, Pisani-Ferry, 2019). Such challenges have highlighted the potential value of European public goods in addressing issues that go beyond national borders and require collective action at the EU level.

European public goods are defined as policies and initiatives whose value for citizens is higher when implemented at the EU level than at the national level (Fuest, Pisani-Ferry, 2019). The definition has been completed (Thöne, Kreuter, 2020, i.e. Buti, Coloccia, Messori, 2023), with the view that European public goods must meet three criteria: (i) pan-European benefits extending beyond individuals in the Member States (ii) relatively homogeneous preferences among EU citizens; (iii) cost-effectiveness of Europe-wide provision due to economies of scale.

The work on European public goods also stresses that at least one of these criteria should be met in order for a public good to be provided at the European level. Instead, existing European services, for which none of these three criteria apply, should be transferred back to the Member States (Thöne, Kreuter, 2020). In addition, some authors consider that this concept encompasses both 'pure' public goods provided directly by the EU and club[1] goods or policies with cross-border spillover effects (Fuest, Pisani-Ferry, 2019).

European public goods provide a justification for deepening European integration and cooperation in key areas. Fuest and Pisani-Ferry (2019) argue that in a context transformed by technology, global challenges and geopolitical change, the EU needs to reconsider its goal, moving beyond economic integration to address common challenges through joint actions. They identify several areas where European public goods are crucial, including climate change mitigation, digital sovereignty and de-

[1] Goods that are characterised by exclusion and rivalry in consumption, until there is a blockage in the supply of that good.

fence. Buti, Coloccia, Messori (2023) reinforce this view, suggesting that European public goods can strengthen the EU both internally and externally, making the Community bloc a significant player in a multipolar world. Thöne and Kreuter (2020) point out that the provision of European public goods can help to overcome the current stalemate in EU integration, providing a new perspective on the purpose of the Union. They argue that this approach can strengthen both the EU and its Member States through an intelligent exchange of tasks and competencies. All three sources agree that focusing on European public goods can help address the perceived EU inefficiency in addressing significant challenges.

The concept of European public goods can strengthen the legitimacy of the EU by focussing on issues where EU action provides clear added value. Fuest and Pisani-Ferry (2019) claim that by focusing on areas where the EU has a *comparative advantage over national action, such as climate change mitigation, digital sovereignty and defence, the Union can demonstrate its relevance and effectiveness to citizens.* Buti, Coloccia, Messori (2023) introduce the concept of European added value as a measure of the greater net benefit achieved at EU level compared to national supply, providing a tangible measure for assessing the legitimacy of the EU.

Documents relating to European public goods also show several obstacles to the supply of such goods. According to them, any potential increase in the supply of European public goods requires a combination of economic, political and institutional factors. Fuest and Pisani-Ferry (2019) highlight the inadequate allocation of EU resources, noting that current EU spending is overly focused on regional or local public goods, such as agricultural and cohesion policies, rather than real European public goods. They also highlight the distorted incentives in the budget process, which encourage Member States to prioritise local projects financed by the EU budget's 'common fund' over pan-European initiatives. Buti, Coloccia, Messori (2023) discuss institutional constraints, particularly how the principle of subsidiarity and unanimity requirements in certain policy areas can hinder the development of European public goods. They also address the challenge of the heterogeneity of preferences, where different national preferences complicate the agreement and implementation of European public goods in certain areas. Thöne and Kreuter (2020) focus on governance issues, noting the lack of precise mechanisms for coordinating and implementing European public goods at several levels of governance.

In conclusion, the documents quoted converge on the idea that European public goods are a way forward for European integration, which is both economically efficient and politically legitimate. In other words, the concept of European public goods is not about finding problems that correspond to a predetermined solution but about adapting the EU's role and capabilities in order to respond to the real and pressing needs of its citizens in a rapidly changing world.

II.2 Can fiat money be classified as a public good?

The classic definition of public goods (Samuelson, 1954) requires a positive response to applying the two-trait test (non-excludability and non-rivalry). Although Samuelson did not explicitly approach currency in his model, his theoretical framework provides a basis for analysing money in terms of the public goods theory.

The impossibility of exclusion, in this case, implies that once issued by a government or central authority, the fiat money becomes universally accessible for all individuals in the economy, regardless of individual characteristics or behaviours. In addition, the benefits of a stable currency—such as facilitating transactions, storing value and providing a unit of account—are available to all members of society once the currency is in circulation. This part of the test seems to be fulfilled, except in situations (partial exclusion) where banking regulations, laws on circulation and use of a particular currency or financial penalties may restrict access to the currency.

According to Samuelson's definition, public goods are non-rival in consumption, as consumption by one individual does not reduce the amount available for consumption by others. If this concept is interpreted strictly in terms of quantity, then the fiat currency does not feature the characteristic of non-rivalry in consumption. But if this feature is applied to the functions of the currency (implicitly its purchasing power), then the characteristic of non-rivalry in consumption is present.

Some theorists have argued that even in cases where non-exclusion is not fully applicable, such as in the case of partial[2] exclusion, the public provision of these goods can be justified due to the social benefits they generate (Musgrave, 1959).

Other classifications of goods have addressed situations in which non-excludability applies, while rivalry in consumption is only partial, beyond a certain threshold; however, ensuring the provision of the good becomes impossible due to congestion, as an excessive number of simultaneous users limits its availability (Buchanan, 1965). In such cases, providing the optimum quantity for that good could entail some form of limited collective action or forming a 'club'. Buchanan's concept of fiat money helps explain how the currency can usually be characterised by non-rivalry but can experience "congestion" in which non-rivalry is no longer valid, as is the case in times of high inflation or economic instability.

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[2] According to Musgrave's classification, fiat money is a mixed public good: (i) Partial exclusion – although fiat money is accessible, access may be restricted by bank regulations, laws on circulation and use of a particular currency, or financial penalties; (ii) Non-rivalry in consumption (in most circumstances) – the use of money by one person does not usually reduce its availability to others, except in extreme cases such as hyperinflation; (iii) Provision by the public and private sectors – although the government issues and regulates fiat money, private banks play a crucial role in the distribution and creation of money through fractional reserve banks.

Other authors have shown that the goods exist in a spectrum between the two limits (public and private), influenced by the institutional framework and technological progress (Cowen, 1988). Applying this theory to the fiat money means that there may be situations in which the fiat money may, at least temporarily, lose the non-rivalry trait due to the institutional framework (banking regulations, monetary policy and legal means of payment legislation) or technological progress (given that the features of money have changed over time, from commodity to fiat money and digital forms, each change being able to change their public or private good characteristics).

In addition to the classic arguments relating to the characteristics of public property, at least four other elements may be called into question in favour of treating fiduciary money as a public good or at least a quasi-public good. These elements can be more accurately described as positive externalities or societal benefits of the fiat money that contribute to the rationale for their public provision or regulation rather than directly proving their status as pure public good.

The first of these elements relates to network effects. This concept stems from Arthur (1989), demonstrating that the widespread adoption of a particular technology or system can lead to self-reinforcing benefits. In the case of fiat money, as more and more individuals and institutions accept and use a specific currency, its usefulness as a means of exchange, unit of account and reserve of value increases exponentially. This increased utility is the sum of individual benefits and creates a broader economic environment that facilitates trade, reduces transaction costs, and improves economic efficiency for all participants.

Mervyn King (2016) highlights how network effects contribute to the persistence of fiat currencies, even when they may be suboptimal from other points of view. King argues that an extensive cash changeover creates a robust, difficult-to-dismantle network, even in the face of economic inefficiencies or alternative currencies. The main argument used by King is that the difficulties and cost of coordinating the changeover to a new fiat currency system often outweigh the perceived benefits. This phenomenon became evident during the 2008 financial crisis when, contrary to expectations, global demand for U.S. dollars increased despite the crisis originating in the United States. This underscored the strength of network effects in sustaining the international role of the currency (King, 2016).

The functions of the currency contribute to the argument in favour of treating fiat money as a public[3] good. Fiat money facilitates economic transactions and provides a

[3] Removing the inefficiencies of the barter system, where the direct exchange of goods requires a double coincidence of wishes, is an example of how the fiat money acts as a universally accepted intermediary, reducing the time and effort needed to carry out transactions. This efficiency increases economic productivity and facilitates trade, bringing benefits to all of society. Moreover, as standard in value, the fiat currency provides a common measure for

value standard, functioning as a public good by improving economic[4] efficiency and stability. Keynes explains how money acts as a lubricant in the economic system, reducing transaction costs and simplifying trade (Keynes, 1936). Equally important in this regard is Menger's argument that the currency appeared spontaneously to overcome the difficulties of the barter system, serving as a universally accepted means of exchange (Menger, 1892). In addition, Friedman stressed the importance of a stable monetary framework in facilitating economic activity, thus reducing friction in economic transactions and allowing for more efficient allocation of resources (Friedman, 1960). At the same time, fiat money, providing a stable unit of account, helps to set prices of goods and services uniformly throughout the economy, which is essential for maintaining economic order and predictability (Friedman and Schwartz, 1963).

Fiat money plays an essential role in promoting macroeconomic stability, functioning as a quasi-public good by ensuring the proper functioning of the economy as a whole. This importance also derives from the ability of central banks to influence economic conditions through the management of money supply and interest rates in conditions of macroeconomic imbalances, effectively using fiat currency as a monetary[5] policy instrument. A former President of the EDF explains how monetary factors influence macroeconomic outcomes and stresses the importance of a flexible monetary system in response to economic crises (Bernanke, 2000). He points out that this flexibility allows central banks to implement counter-cyclical policies, provide liquidity to the financial system and stabilise the entire economy in times of crisis.

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comparing the value of different goods and services, with uniformity being vital for informed economic decisions.

[4] For example, the introduction of the euro has simplified cross-border trade between eurozone member countries by eliminating the need for foreign exchange and reducing the cost of transactions. This harmonisation stimulated economic activity and trade in the region, demonstrating the fiat money's 'lubricating' role in economic transactions. The euro also provides a stable unit of account in several economies, allowing businesses to plan and price their goods and services in a predictable manner. Instead, during the sovereign debt crisis, the ECB took steps to stabilise the euro and maintain its value. The ECB's interventions (e.g. quantitative easing) aimed to ensure that the euro remains a reliable exchange with a stable purchasing power.

[5] Central banks can adjust the money supply through open market operations, changing interest rates to influence borrowing, spending and investment behaviour across the economy. Central monetary institutions may also resort to unconventional monetary policies, such as quantitative easing, to provide liquidity and stimulate economic activity during severe recessions. These monetary policy actions aim at stabilising prices, moderating economic cycles and promoting global economic stability – benefits which are targeted at the whole of society, with the characteristics of public goods.

The concept of fiat money as a quasi-public good finds justification in the social contract, which underpins its acceptance and use. This perspective is based on the assumption that the trust of individuals in the issuing authority to maintain the currency's purchasing power constitutes the basis of the monetary system.

Theoretical arguments in favour of this can be found in John Locke's philosophy. Locke argued that the legitimacy of government authority derives from the consent of the governors (Locke, 1689), thus providing a conceptual framework for understanding the collective acceptance of the fiat currency. This idea was later developed in the specific context of monetary theory. In monetary history, some researchers have shown that accepting fiat money is a social phenomenon founded on collective trust (Niehans, 1978). Other studies have emphasised the state's role in establishing and maintaining this trust (Goodhart, 1998). These theoretical contributions converge to the idea that fiat money operates by virtue of an implicit collective agreement whereby the public accepts the currency issued by the competent authority based on the assumption that its purchasing power will be maintained[6].

While fiat money may have characteristics that align with the traditional definition of public goods, several arguments challenging the classification of fiat money as a public good can be listed. Considering these elements offers another insight into this subject, which can help reach a nuanced understanding of the complex nature of fiat money and its role in the economy.

Firstly, fiat currency has various forms of exclusion. The physical nature of cash can lead to its exclusion from certain economic activities, particularly in the context of illegal transactions and tax evasion, thus highlighting a form of practical currency exclusion (Rogoff, 2016). Financial exclusion due to high bank charges, minimum balance requirements and strict credit policies can effectively limit access to the monetary system for specific segments of the population (Servon, 2017). Moreover, the exclusion from the use of fiat money is manifested in banking regulations, credit restrictions and even geographical limitations on access to financial services. An illustrative example is the US "banking deserts"[7] phenomenon.

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[6] A glaring example of the importance of this social monetary contract is provided by the events that followed the financial crisis of 2008, when the large central banks had to implement unprecedented measures to maintain public confidence in the monetary system. The ability of central banks to adopt unconventional policies and prevent a systemic collapse was conditioned to a degree by the persistence of public confidence in currency and monetary authorities (Tucker, 2018), thus reflecting Locke's concept of consent-based legitimacy.

[7] A 2016 Federal Reserve Bank of New York article found that 3.74 million Americans live in areas without adequate access to bank branches or ATMs, effectively limiting their full participation in the monetary system (Morgan, Pinkovskiy, Yang, 2016).

In the case of money issuance, the exclusion manifests itself in the monopoly power granted to central banks or governments to create and control the money supply. This centralisation of monetary authority effectively excludes other potential issuers from participating in the creation of the currency. Before the confusion between currency and crypto-assets emerged, the Liberty Dollar[8] (White, 2014) the case sparked intense debate on the limits of monetary freedom and the government's right to maintain the monopoly on currency issuance, illustrating how authorities have a linked basis to actively suppress private monetary initiatives and maintain exclusive control over the monetary system.

The mismanagement of the fiat money by the central authorities is another argument against its classification as a public good by the Austrian school of economic thought representatives. Both Mises (1912) and Hayek (1976) criticise the government's monopoly on currency issuance, pointing out the economic risks it creates, such as lack of competition (i.e. the absence of other entities that would issue currency and thereby stimulate the government to maintain currency stability and innovate monetary policies), the negative influence of government policies on economic stability, and the potential to generate unsustainable economic cycles. Both economists stress that state intervention can undermine public confidence in fiat money and lead to economic instability. However, Hayek focuses more on the impact of the lack of competition and imperfect information in centralised monetary management. At the same time, Mises emphasises the subjectivity of the currency's value and the distortion of price signals, which complicates economic calculation for economic agents. This illustration can be found in the repeated currency crises in Argentina, where political instability and bad economic decisions have led to several episodes of hyperinflation and currency devaluation, causing a lack of confidence in the national currency.

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[8] The Liberty Dollar case concerns a private monetary initiative in the US. Bernard von NotHaus, founder of the National Organisation for the Repeal of the Federal Reserve and Internal Revenue Code, created and distributed a private currency called "Liberty Dollar" beginning in 1998. This currency was backed by precious metals and was promoted as an alternative to the US dollar. Liberty Dollar was issued in several forms, including metal coins (silver, gold, platinum, and copper) and paper banknotes backed by precious metals. The circulation of this alternative currency was not limited to one state. It has been distributed and used in many U.S. states, though not nationally. Its circulation was most prominent in communities and networks supporting the concept of alternative currency and in areas where NORFED actively promoted its use. In 2007, the federal government filed a lawsuit against von NotHaus and his organisation claiming that Liberty Dollar was in breach of federal currency forgery laws. In 2011, von NotHaus was convicted of making and distributing counterfeit coins.

Friedman also used the argument of imperfect information, pointing out that monetary authorities could not have enough knowledge of the exact state of the economy to make fine adjustments in monetary policy. Furthermore, Friedman pointed out that attempts to stabilise the economy through active monetary policies can lead to more instability if implemented incorrectly or at the wrong time (Friedman, 1968). Finally, Friedman pointed out the danger of unintended consequences. Friedman thus considered that EDF attempts to stimulate the economy through expansionary monetary policies led to an unexpected and persistent increase in inflation in the 1970s ("Great Inflation"). This period of high inflation has had numerous adverse effects on the economy, including distorting investment decisions and creating economic uncertainty – unintended consequences of policies aimed initially at stimulating economic growth (Friedman and Friedman, 1980).

The non-rivalry of fiat money can be challenged because bad monetary and fiscal policies can lead to inflationary pressures, effectively creating a form of rivalry in the use of money. Arguments such as intertemporal[9] budgetary constraints, the dilemma of monetary[10] policy, the "*crowding out*"[11] effect suggests that, under certain economic conditions, the use of fiat money by one actor (the government) may adversely affect the value and usefulness of money for other economic actors (Sargent and Wallace, 1981), which contradicts the existence of the characteristic of non-rivalry.

Moreover, financial crises may lead to an erosion of the value of money, affecting the characteristic of non-rivalry in consumption. Historical analysis of financial crises has shown that severe economic downturns are often accompanied by significant monetary devaluations (Reinhart and Rogoff, 2009). In these situations, the rapid loss of purchasing power creates an environment in which the use of money by some individuals (especially those who can quickly convert it into real assets) directly reduces their value for others, thus introducing an element of rivalry[12].

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[9] It refers to the fact that the government cannot endlessly sustain a budget deficit through borrowing without taking into account its future capacity to repay these debts.

[10] It is that if the monetary authority tries to keep inflation low in the presence of high fiscal deficits, it can lead to a further increase in inflation in the future.

[11] It means that large government loans are driving down private borrowing, raising interest rates and reducing private investment.

[12] A prominent example is the hyperinflation in Germany during the 1920s. The workers were demanding to be paid several times a day and their family members would collect the wages as soon as they were available and spend them. The money had to be spent as quickly as possible, before losing its purchasing power, in exchange for more stable goods of value. This behaviour, multiplied on a society-wide scale, contributed to accelerating inflation, creating a vicious circle in which future inflation expectations fuelled present inflation. Ferguson, 1975.

There is an insight into the current system of fiat money creation, both by central banks and commercial banks, which suggests that the system serves private interests alongside, or sometimes to the detriment of, public interests. The profit motive inherent in creating the fiat money, mainly through the fractional reserve banking system, calls into question its classification as a pure public good, highlighting the private benefits accrued in the money creation process.

Before the financial crisis of 2008, there was criticism of the functioning of this system, showing that the current process of creating money through bank loans generates private profits from what is apparently a public function (Huber and Robertson, 2000). Moreover, they suggested that commercial banks, by creating money through lending, effectively privatise a public prerogative, proposing instead a reform to place the power to create money in the hands of a public authority because this would align the money-making process more closely with the public interest and reduce the profit aspects of the current system (Huber and Robertson, 2000). It should be noted that the representatives of the Austrian school of economic thought criticised the fractional banking system firstly because it favours long-term economic instability and secondly because it serves the private interests of commercial banks and the financial elite in general[13].

After the financial crisis, criticism of currency creation through commercial banks was carried over into conventional economic theory. There has been a generalised view that the fractional reserve banking system is inherently unstable and crisis-

[13] Representatives of this school of economic thought argued that the fractional reserve banking system is unstable and crisis-prone, as it allows commercial banks to create money "out of nothing" through the credit process, leading to cyclical credit expansion and contraction. Rothbard (1963) and Mises (1912) pointed out that this system constituted a form of legalised fraud and induced a misallocation of economic resources. Huerta de Soto (1998) and Hayek (1966) referred to destabilising effects on economic cycles, arguing that interfering in free market mechanisms through artificial credit creation causes booms and recessions. Hazlitt (Hazlitt, 1946) adds that these practices undermine the purchasing power of the currency and confidence in the financial system, generating inflation and distorting important economic signals for investment decisions. In addition, Rothbard (1963) argued that the system allowed banks to make profits by creating "nothing" money at the expense of economic stability and the public interest. Ludwig von Mises (1912) demonstrated that the expansion of bank credit primarily benefits the original bankers and borrowers, generating economic distortions that adversely affect the rest of society. Hayek (1966) and Hazlitt (1946) argued that this system leads to a concentration of economic power in the hands of a small group of financial actors, who can influence monetary and economic policies in their favour. Finally, Huerta de Soto (1998) pointed out that fractional reserves allow banks to increase systemic risks and take advantage of cyclical expansions, while losses are often borne by taxpayers during financial crises.

prone, representing a significant source of vulnerability for the global economy (Wolf, 2014). The leading columnist for the Financial Times pointed out that commercial banks have almost unlimited ability to create credit, which can lead to bubbles and financial instability. This creates, in Wolf's view, a dangerous cycle of credit expansion and contraction, which is difficult to stop because this structure of the banking system creates perverse incentives for banks to take excessive risks, knowing that governments will probably save them in case of crisis (Wolf, 2014).

The "financial alchemy" about which the former Governor of the Bank of England wrote (King, 2016) refers to the fact that the fractional reserve banking system creates illusions of stability and safety but, in reality, generates systemic vulnerabilities and recurring crises. King points out that this illusion is (i) built on the transformation of maturity (the banks' practice of short-term borrowing and long-term borrowing), which creates a discrepancy between the liquidity of bank assets and liabilities, i.e. makes banks particularly vulnerable to liquidity crises and bank panics, as they cannot cope with a massive and simultaneous withdrawal of deposits; (ii) maintained by the role of central banks as a lender of last resort, because it encourages riskier behaviour on the part of commercial banks, knowing that they will be rescued in case of crisis (King, 2016). Each of these elements has been the case, for example, with Northern Rock's liquidity crisis 2007. This bank relied on short-term funding from the capital markets to support long-term mortgages but faced a severe liquidity crisis when the markets came to a standstill. The resulting panic among depositors led to extensive deposit withdrawals and required the bank's nationalisation to prevent a collapse.

Profit motivation in the creation of the currency may lead to results that may not be consistent with the concept of money as a public good. Motivated by the pursuit of profit, banks can engage in excessive lending during periods of economic expansion, fuelling asset bubbles and financial instability. In contrast, banks may restrict lending during economic downturns to protect their profits, exacerbating economic contractions.

Many analysts have pointed out after the financial crisis that the rapid expansion of credit (and hence the creation of money) by banks in the years preceding the crisis was primarily driven by the pursuit of profits rather than broader economic stability or public good considerations. The main elements that fostered this behaviour of commercial banks (Turner, 2015) were identified: (i) the focus on mortgage loans, considered less risky and more profitable for banks; (ii) financial innovations, which allowed banks to increase lending without seeming to take on additional risks, thereby generating higher profits; (iii) bonus schemes, which encouraged short-term risk-taking and increased credit volumes to maximise profits and bonuses; (iv) relaxation of lending standards, which led to lending to higher-risk customers;

(v) competitive pressure It was positive between banks, leading to a race for market share and profit, leading to higher risk-taking and increased credit volumes.

The existence of private alternatives to fiat money challenges its public good status, suggesting that certain monetary functions can be fulfilled through market mechanisms. This argument implies that specific roles traditionally associated with money could be provided by private entities rather than exclusively by fiat currency issued by a State authority.

These ideas circulated in economic theory, especially in the Austrian school of economic thought. As indicated above, Hayek argued that the government monopoly over coin issuance leads to abuse and subsequent economic instability. It proposed a system of competing private currencies, considering that such competition would force issuers to maintain the value of their currencies to attract users (Hayek, 1976). Hayek argues that this market-based approach would lead to more stable and efficient monetary systems than the state-controlled fiat money.

Initiatives linked to local and private currencies have multiplied in the aftermath of the financial crisis. Local currencies existed sporadically in specific communities even before the financial crisis but were aimed at limited interests (usually geographically or culturally isolated communities). In October 2008, a person/group named Satoshi Nakamoto published a nine-page document (Nakamoto, 2008) which contributed to the emergence of a new asset class – crypto-assets. Even though Bitcoin is an asset, Nakamoto's document proposed the Bitcoin solution as an "electronic money version" (Nakamoto, 2008).

The novelty of the solution proposed by Nakamoto is the technology that allows solving the problem of double expenditure without the need for a third party, who enjoys the trust of all the participants in the transactions, effectively creating a form of digital asset that could function without the existence of a central authority. The link between the financial crisis and the solution proposed by Nakamoto is reflected in the fact that the shock of the collapse of Lehman Bank has increased distrust of the financial system, with commercial banks no longer trusting their counterparts, making intervention by central banks necessary not only to save large financial institutions but, above all, to provide the liquidity required to make payments. Bitcoin was precisely the answer to the problem of a payment system based 'on cryptographic evidence to the detriment of trust, enabling any two parties to trade with each other directly without needing a third party to trust' (Nakamoto, 2008).

Since its introduction in 2009, Bitcoin has evolved from an experiment to a globally recognised digital asset with substantial market capitalisation. Its adoption by some companies for payments and its use as a valuable reserve, particularly in countries with unstable national currencies, demonstrates how private initiatives can provide some services similar to monetary ones on a large scale.

Bitcoin and other crypto-assets have aroused interest among investors, economists, and financial authorities, but their multiplication has not turned them from assets to currency. Their multiplication suggests that some functions usually associated with fiat money could be ensured through private means. This calls into question the idea that a centralised, state-issued currency is the only way to fulfil all these functions.

Regarding the contribution of private currencies, including those based on cryptographic proofs, the Bank for International Settlements (BIS) perspective is particularly relevant. The BIS has pointed out that it remains unclear what specific economic problem crypto-assets are intended to address (BIS, 2018). The institution based in Basel emphasised that crypto-assets, including Bitcoin, suffer from several deficiencies that limit their ability to fulfil the primary functions of money. These deficiencies include: (i) extreme value volatility, which undermines their ability to serve as a store of value over time and as a unit of account; (ii) scalability and energy efficiency limitations, which restrict their viability as a widely used means of payment; and (iii) vulnerabilities to fraud and manipulation (BIS, 2018). This BIS perspective provides an essential counterbalance to the enthusiasm surrounding private alternatives to fiat currency, highlighting the challenges these alternatives face in performing the traditional functions of money.

In conclusion, while it can be said that, in general, the fiat currency has the features of non-exclusion and non-rivalry, the existence of cases where either or both of these features are abolished tilts the balance towards a negative answer to the question of whether the single currency can be considered a public good.

II.3 How are common goods defined?

Common pool resources are a type of economic good characterised by two key features: non-excludability and rivalry in consumption. Unlike private goods, where ownership and access may be limited, common goods are accessible to more than one user, making them prone to collective action issues. These problems arise when individuals, acting in self-interest, can over-exploit the resource, leading to its degradation or depletion. Effective management of common goods requires cooperation strategies to prevent excessive use and ensure sustainable use. Classic examples of common goods include fishing and forests. In a fishing area, it is challenging to exclude fishermen's access to the resource (non-exclusion), and each fish caught reduces the stock available to others (rivalry). Similarly, in an open-access forest, it isn't easy to prevent individuals from harvesting timber or other forest products, and over-harvesting can deplete the resource for future use.

Elinor Ostrom developed the theory of common pool resources[14], particularly in her work "Governing the Commons" published in 1990 (Ostrom, 1990). Ostrom's research was based on the concept of "common goods", introduced by Garrett Hardin as early as 1968 (Hardin, 1968).

Hardin defined "commons" as a shared resource accessible to all members of a society. He associated this concept with problems of overpopulation and resource depletion. Hardin's main argument is that in a system where individuals have unlimited access to a finite shared resource, each person, motivated by their self-interest, will tend to over-exploit the resource (Hardin, 1968). The multiplication of this individual rationality in the entire population results in a loss for the collective, which he defines as the "tragedy of the commons" (Hardin, 1968). Hardin has applied this concept to various scenarios, including pollution, population growth and exploitation of natural resources. He argues that the freedom to use shared resources, if not controlled, inevitably leads to their destruction. This "tragedy" occurs not because individuals are inherently destructive but because the structure of common goods creates a situation in which the rational choice of each individual leads to an "irrational" collective outcome (Hardin, 1968).

Hardin disputes the idea that Adam Smith's "invisible hand" applies to common goods. He argues that individuals' interests do not always lead to the best outcome for society, especially when it comes to common goods and population growth. Hardin suggests that this belief in the invisible hand prevented humanity from taking the collective steps necessary to address these problems (Hardin, 1968). Furthermore, starting from the impossibility of simultaneously maximising multiple variables in a finite system, Hardin extends Malthus's ideas (about problems created by unequal rates of population growth and food sources) beyond food to all resources, claiming that the issue of population growth affects not only the means of subsistence but all aspects of resource consumption, including environmental degradation (Hardin, 1968).

Hardin introduces the concept of "problems without technical solutions", arguing that some problems, such as the population problem, cannot be solved by technological advances alone but require changes in human values and morality ideas. He argues that it is possible to avoid the 'tragedy' of common goods by exercising 'mutual, agreed coercion', by which he means a system in which all members of society equally accept certain restrictions on their freedoms, recognising that such limitations are necessary to prevent the over-exploitation of common goods, such limita-

[14] Elinor Ostrom was the first woman to be awarded the Nobel Prize in Economic Sciences. She received this recognition in 2009 for the development of theory in the field of common goods.

tions being democratically decided by the majority and not arbitrarily imposed, thus ensuring their legitimacy and acceptability (Hardin, 1968).

Elinor Ostrom defined common goods in terms of exclusion and rivalry in consumption. Thus, common goods are characterised by non-exclusion (it is difficult to exclude individuals from the consumption of these goods) and rivalry (the use of this good by one individual reduces the availability of that good for others). Ostrom's central thesis opposes Hardin's view that communal goods can only be managed effectively through privatisation or centralised government control. Instead, she argues that local communities can create effective self-government institutions in order to manage these resources in a sustainable way (Ostrom, 1990). She pointed out, through empirical research, that under certain conditions, institutions organised by rules on which the communities have pronounced themselves can avoid over-use and exhaustion of common goods, as she claims "the tragedy of common goods" and "the prisoner's dilemma".

In order to support his thesis, Ostrom developed a complex tool through which he could analyse the conditions under which local communities can use common goods without exhausting them and without resorting to privatisation or government control. This tool – the analysis and development framework – allows for an examination of how institutions (rules and rules that guide behaviour) affect the results of collective action in the management of common goods.

It consists of several components: (i) the arena (the social space in which individuals interact, make decisions and take action on common goods; this includes the structure of the decision-making process and the actors involved); (ii) the actors (individuals or groups participating in the action arena, each with their preferences, information and capabilities); (iii) the rules in force (the rules governing the behaviour of actors in the arena and which may be formal – laws, regulations – or informal – norms, traditions); (iv) biophysical conditions (physical and material characteristics of the common good, including size, limits and regeneration capacity); (v) the attributes of the community (c) the social and cultural context in which the common good exists, including common rules, values and community share capital; (vi) interactions and outcomes (patterns of behaviour resulting from interactions between actors in the arena and results in terms of sustainability and equity of resources); (vii) evaluation criteria (standards used to assess the performance of institutional arrangements such as efficiency, equity and sustainability) (Ostrom, 1990).

This tool developed by Ostrom shows that the successful management of common goods is not only determined by the physical attributes of the resource or the economic incentives at stake but also by the complex interaction of the rules, the characteristics of the community and the capacities of the actors involved. By systematically analysing these elements, the analysis and development framework helps identify the conditions under which communities can effectively manage their common goods without external intervention.

Ostrom also integrated into this tool the logic of collective action that Mancur Olson wrote about. Olson argued that rational individuals, when faced with the decision to contribute to a collective good, often choose not to contribute because they can still benefit from the good without bearing the costs of the contribution. This behaviour leads to a *free-rider* problem, in which the supply of public goods is insufficient or absent, as individuals rely on others to bear the burden of supply (Olson, 1965). Ostrom pointed out that overcoming *free-rider* problems is possible, and success depends on developing and implementing rules and norms of behaviour that align individuals' incentives with collective objectives.

In this regard, Ostrom has identified eight principles that can lead to the success of communities in managing common goods: (i) clearly defined boundaries (common goods and users need to be clearly defined, to manage access and use effectively); (ii) linking appropriation and making available rules to local conditions (rules for the use of common goods must correspond to local conditions and specific needs of the community); (iii) collective choice mechanisms (individuals affected by the rules for resource management must have the opportunity to participate in amending these rules); (iv) monitoring: those who are responsible to users or the community for supervising the use of the common good and ensuring compliance with them must be designated (v) graduated penalties (those who breach the rules must face penalties commensurate with the seriousness and context of the infringement); (vi) conflict resolution mechanisms (need to adopt accessible and inexpensive mechanisms to settle disputes between users); (vii) minimum recognition of the right to organise (the right of community members to design their own institutions should be recognised by external authorities); (viii) decentralisation of the management of large common goods (rather than having a single centralised authority managing a common good, management should be structured so as to involve several interconnected levels of organisation) (Ostrom, 199 0).

Although Hardin's work influenced Elinor Ostrom, her research often challenged his conclusions. Ostrom studied cases where communities successfully managed joint resources without resorting to privatisation or state control – solutions deemed necessary by Hardin. It pointed out that, under certain conditions, communities can create efficient institutions for managing shared resources. Ostrom's research highlighted the importance of communication, trust, and agreed-upon rules to successfully manage common goods, providing a more nuanced view than Hardin's solution of choosing between privatisation and government control.

II.4 Can fiat money be classified as a common good?

Analysing fiat currency from the perspective of common goods is an unconventional, yet not entirely original idea, as it has already been explored in economic literature. Several studies have argued that money exhibits certain characteristics of common goods, particularly in relation to the concepts of consumption rivalry and non-excludability.

Some authors suggest that the use of money by an individual may reduce their availability to others, reflecting the finite nature of common resources, and this is exemplified through banking systems, where individuals' cash withdrawals can drain overall liquidity (Mayumi and Giampietro, 2018). Credit creation by commercial banks can be seen as a form of exploitation of shared resources, in which excessive credit creation can exhaust the 'common good' understood as the stability of the monetary and financial system (Benson, 1994). Some experiments comparing the scenarios of public goods and common goods concluded that initial levels of cooperation were higher in common goods scenarios, although these differences often disappeared, especially in case of repeated interactions or when introducing group feedback (Sell and Son, 1997). Although their study did not refer directly to money, their findings suggest that framing financial systems as common resources rather than as public goods could initially encourage more cooperative behaviour in the management of monetary resources.

Despite the fact that money shares some characteristics with common goods, money has distinct characteristics that distinguish it from classic common goods. The example of quantitative easing policies implemented during economic crises shows that, unlike finite common goods, fiat money is a man-made commodity, which central banks and governments can generate as they see fit (Birner, 2012). Other authors express the same idea on a more brutal note, showing that within current monetary systems, money can often be created from nothing, through the credit mechanisms of the banking system, and can be removed from the system during recessions, through non-payment of loans and contracting credit, which seems to contradict the first law of thermodynamics applied to energy conservation (Mayumi and Giampietro, 2018). In other words, unlike common goods, the total amount of money in an economy can expand or contract rapidly without a corresponding transformation of physical matter or energy, which makes its evolution different from that of classic common goods. Benson (1994) identifies the historical origin of this unique attribute of money creation in the concept of the Roman law of "mutuum", which was a type of loan contract for fungible goods, which provided that an equal amount of the same category of fungible goods would be returned to the maturity of the contract. Under this type of contract, when a person lends money to another person, the money becomes the property of the borrower. This legal treatment allowed bankers to treat deposits as their property and create a new property (money) through loan agreements. This historical precedent has laid the foundations for the ability of the modern banking system to create credit, and therefore money, from contractual obligations and not from physical resources.

The authors cited above emphasised that the dual nature of the fiat money, representing the concept of private wealth for individuals but a debt at the level of the community (Birner, 2012; Mayumi and Giampietro, 2018), complicates the attempt to classify money as a common good. However, they note that, at the level of the monetary system, this characteristic of the currency creates a complex interaction between the interests of individuals and collective ones, which can be used to analyse not the fiat money itself but the monetary system as a common good.

The analysis of literature, which has approached the currency as a common good, emphasises at least two aspects that are essential for the direction to be followed. Firstly, the principles developed by Ostrom on the management of common goods could be adapted to address challenges related to the management of the financial system in keeping stability (Birner, 2012). Secondly, maintaining confidence is the core element for the sustainability of money as a common good (Mayumi and Giampietro, 2018).

There are at least three arguments in favour of the concept of fiat money as a common good. The analogy between inflation and the overexploitation of common resources is the first argument in this respect. In this perspective, money supply can be regarded as a common resource, similar to fishing or forests, where unrestricted access and use can lead to exhaustion or degradation. In this context, inflation is the "over-use" or "over-exploitation" of the monetary resource. Just as overfishing can deplete the fish population or over-exploitation of forests can degrade forests, over-creation of money can erode the currency's purchasing power. The main parallel is the incentive structure: actors (in this case, governments, central banks or commercial banks) may be incentivised in the short term to "exploit" the resource (e.g. create more money) for immediate benefits such as financing deficits or stimulating growth and lending. However, the cumulative effect of these actions, as in the traditional common resources scenarios, may lead to a collective negative outcome – in this case, inflation and the currency[15]'s value decreases. This framework highlights

[15] More or less recent economic history has recorded numerous episodes in which inflation has been the result of such developments. Thus, during a decade ended in 1994, Brazil experienced hyperinflation, as successive governments printed excessive amounts of money to finance public spending and pay debts. Excess money supply has led to a rapid erosion of purchasing power, economic instability and the loss of public confidence in the monetary system. Another example is Venezuela in the 2010s, where the government printed money on a large scale to cover budget deficits, which led to hyperinflation and economic collapse.

the tension between individual (or institutional) incentives and collective well-being, a feature of shared resource dilemmas. The Austrian School of Economic Thought insisted on the inherent inflation of the currency (see Hayek, 1976), as recalled above.

Applying the concept of the tragedy of common goods to the fiat currency can be seen as another argument in favour of the idea that fiat currency is a common good. This perspective implies that the lack of clear rules in the issuance/creation of fiat money coupled with the diverging interests of the various economic actors can lead to over-exploitation of the money supply (inflation or instability of the financial sector), which equates to the depletion of natural resources in traditional scenarios of common goods.

The theoretical support for this argument can be found in Hardin's works on the tragedy of the commons, and Ostrom's, which contain institutional solutions for managing the commons. The opposition between individual rationality and collective outcomes, which Hardin wrote about, can be seen as resembling challenges in the area of monetary policy, where short-term incentives, for example, expansionist measures, may conflict with long-term economic stability goals.

The notions introduced by Ostrom in researching the tragedy of common resources can provide at least three types of arguments regarding the similarity between the fiat currency and the common goods. Firstly, Ostrom's work shows that joint resources can be managed effectively through appropriate institutional arrangements and clear rules for collective decisions. Ostrom's principles, such as precise resource delineation and collective choice mechanisms, can also be applied in monetary policy. For example, the importance of monitoring and sanctions at Ostrom is similar to the role of central banks and international financial institutions in overseeing macroeconomic stability. Thus, the efficient management of common goods requires active monitoring to ensure compliance with the rules, similar to the constant supervision of economic indicators by central banks.

Second, the *Institutional Analysis and Development framework* developed by Ostrom (Ostrom, 2005) provides a systematic approach to studying complex interactions in institutional structures and is applicable to cash money and monetary policy analysis. A central element of this framework is the emphasis on 'practised' rules, not just formal ones, which is important in understanding the real functioning of financial[16] institutions. This framework can reveal hidden incentives, informal

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[16] The distinction between practical and formal rules is useful for understanding the real functioning of financial institutions based on the fiat money. Examples of this can be: the declared mandate of central banks (although many central banks are formally independent, their actual decision-making may be influenced by pressure from other actors, be it public

networks, power dynamics, adaptive practices and discrepancies between policy intentions and their effective implementation, thus providing a nuanced picture of institutions beyond their formal structures.

Thirdly, Ostrom's research on social-ecological systems (Ostrom, 2009) highlights the importance of a system's ability to adapt and transform in the face of disruption, a concept known as resilience. Applied to the fiat money financial system, the resilience concept is important in three directions: (i) shock absorption, indicating that a resilient monetary system must be able to withstand and recover from economic shocks, requiring diversified instruments and policies, sound regulation and adequate reserves; (ii) adaptability, implying the need for the system to evolve in line with economic and technological changes, through flexible policies and learning mechanisms from past crises; (iii) functional persistence, which means maintaining the fiat money's core functions despite disturbances.

The application of public choice theory to the analysis of monetary systems provides another argument for conceptualising fiat money as a common resource susceptible to over-exploitation due to political incentives and institutional structures. Public election theory challenges the traditional view of government as a benevolent maximiser of social welfare, claiming instead that political actors are motivated by their interests, as are private market participants (Buchanan and Tullock, 1962). It follows that policymakers, acting rationally in their own interest, can pursue suboptimal policies for society as a whole. Buchanan and Tullock (1962) develop a framework for the analysis of collective decision-making processes, emphasising the role of individual incentives and institutional structures in shaping policy outcomes. They argue that political decisions are not made by a unitary and altruistic entity but rather arise from the interactions of various actors who have their own goals and constraints.

The fiat money's vulnerability to over-exploitation, as evidenced by public choice theory, results from a complex interaction of political and institutional factors. Elected officials, driven by short-term political interest, often prioritise immediate economic gains over long-term monetary stability to boost their prospects for re-election. This short-term approach is exacerbated by fiscal dominance, whereby governments can put pressure on central banks to monetise debt or keep interest rates artificially low, fuelling inflationary trends. At the same time, the influence of powerful interest groups can shape monetary policy in favour of specific sectors, often at the expense of macroeconomic stability. Even central banks are not immune

opinion or the financial market, or even political pressure), international coordination (given that informal arrangements between central banks may influence monetary policy actions beyond formal treaties or agreements).

to these pressures, as they operate in a broader political and economic context, which can create implicit incentives to align with government objectives or prevailing economic paradigms. In addition, the inherent complexity of monetary policy creates information asymmetries that policymakers can exploit, implementing actions that bring short-term political benefits while concealing long-term economic costs. This convergence of short-term policy incentives, institutional pressures, lobby dynamics and information asymmetries creates a scenario similar to the tragedy of common goods, in which several players are incentivised to 'overfish' from the monetary fund, which may gradually erode the value of the currency over time[17].

The thesis that trust currency systems can be understood through the management of common goods is subject to a number of objections. These counterarguments are based both on the differences between the nature of money and common goods and on elements of the institutional framework governing the financial sector. The purpose of these arguments is not to disprove the view that fiat money is a common good, but rather to show what the limits of this approach are.

The argument against treating money as a common resource based on non-rivalry in consumption implies that the use of money by some individuals does not directly diminish their availability or usefulness to others. Unlike traditional common resources, such as fishing or forests, where the consumption of one person directly reduces the resource available to others, the use of money in transactions or as a reserve of value does not reduce its money supply or purchase value for other users. This non-rivalry feature of the fiat money (even more so when it relates to the electronic form of the current fiat money and the digital one in the near future) contradicts one of the key features of common resources, which are generally defined by their rival nature in consumption. However, this argument does not completely contradict the idea of fiduciary money as a common good. The lack of rivalry in the transactions of individuals does not preclude the possibility of excessive use or mismanagement at the macro level. For example, the excessive creation of money by central authorities could lead to inflation, creating a situation similar to the depletion of resources in common goods.

The argument against classifying money as a common good based on exclusion claims that access to money can be effectively regulated and restricted through various financial and legal mechanisms. Unlike common goods, where exclusion is difficult or costly, monetary systems have well-established methods for controlling

[17] Literature documents cases where political pressures have led to inflationary monetary policies. For example, the high inflation rates in the United States during the 1970s are partly attributable to political pressure from Congress on the Federal Reserve to keep interest rates down and to support growth and employment (Meltzer, 2005). This example illustrates how election cycles can influence monetary policy.

access and ownership via regulations related to both legal means of exchange and the financial sector. Thus, the ability to exclude individuals or entities from using the fiat currency calls into question a key criterion of common resources, which usually face difficulties in limiting access.

The theoretical argument of the excludability of fiat money is found in the theory of property rights (Demsetz, 1967. Demetz argues that clear property rights arise when the benefits of establishing such rights exceed the costs of defining and enforcing them. Money, especially fiat money, is one of the clearest and best-defined forms of property rights in any economic system. Demetz's work provides a theoretical framework for understanding why such strong property rights have arisen for money: the benefits of clear ownership, ease of transfer and protection against theft or unauthorised use far exceed the costs of establishing and maintaining these rights. This clarity of property rights in the fiat currency is in contrast with the ambiguous property situation in common goods[18].

Nevertheless, the similarity to common goods is not entirely negated. Thus, on a systemic level, the ability to create or influence the money supply could still be considered as a form of 'access' which could be subject to over-exploitation. Therefore, while excludability (through property rights) may be applied to a monetary unit, influencing monetary policy towards the creation of excess money (either through direct issuance by the central bank or through increased lending by commercial banks) could be viewed through the lens of common resources.

Another argument against the classification of money as a resource is that, unlike finite natural resources, money can be created ("renewed") by monetary authorities. This characteristic distinguishes fiat currency from traditional common goods such as fisheries, forests or oil reserves, which are finite and can be depleted by excessive use. In a fiat money-based monetary system, central banks have the ability to increase or reduce the money supply through various monetary policy instruments. The money supply is not fixed or naturally limited but rather a variable that central bank decisions can manipulate (see also Friedman, 1969), which distinguishes it from common goods, which are finite.

Though theoretically unlimited, the power to create money is limited by economic realities such as inflation and monetary stability. Excessive creation of money can lead to a loss of the purchase value of the fiat currency, which can create a situation similar to the depletion of resources in the case of common goods.

[18] An example of the fiat money exclusion can be illustrated by how bank accounts operate. When an individual deposits money in a bank account, he obtains certain rights to that money. Other persons are legally and practically excluded from accessing or using those funds without the permission of the account holder. This exclusivity is imposed by a combination of legal, technological (security-related, such as PINs or encryption) and institutional policies.

Monetary systems are usually managed by centralised authorities (central banks), and this characteristic distinguishes fiat money from the decentralised nature of common goods. In a fiat money-based monetary system, a single entity (or a restricted group of institutions) — the central bank — has the authority to make monetary policy decisions. The centralisation of monetary control by central banks is one of the characteristics of modern economies, allowing for coordinated policy responses to economic challenges (Goodhart, 1988). This centralised decision-making structure differs from common goods' difficulties, where several users often compete for access and use without a central authority.

However, the centralised nature of monetary control can sometimes lead to problems similar to those faced by the management of common goods, such as the potential for over-exploitation or mismanagement affecting all currency users. In addition, the influence of various stakeholders (governments, financial institutions, international bodies) on central bank decisions introduces elements of complexity and competing interests that may be similar to the problems of common goods.

Unlike many common resources, which are most often based on informal agreements, monetary systems are governed by a complex network of laws, regulatory bodies and financial institutions. This comprehensive framework explicitly defines the rules for the creation, distribution, use and management of money and, as such, differentiates fiat money from common goods.

The new institutional economy (North, 1990) claims that institutions—the "rules of the game" in a society—reduce uncertainty and provide a stable structure for human interaction, including economic transactions. North's theory, applied to the monetary system, emphasises how the complex institutional framework of the currency (including central[19] banks, commercial banks, financial regulators and legal sys-

[19] An example of a complex legal and institutional framework can be considered to be the ECB's. The institution, established by the Treaty on European Union (Maastricht Treaty) in 1992 and fully implemented in 1998, operates within a legal mandate clearly defined by the EU Treaties. It functions as the central bank for the EU Member States that have adopted the euro, working within a complex system known as the Eurosystem. The operations of the ECB are governed by the Statute of the European System of Central Banks and of the ECB, which defines its objectives, tasks and organisational structure. The ECB works in collaboration with the national central banks of the euro area countries, creating a multi-level institutional framework. This system is further supported by a set of EU laws and regulations governing monetary policy, banking supervision and financial stability in the euro area. The decision-making bodies of the ECB, including the Governing Council and the Executive Board, shall operate in accordance with strict rules and procedures. In addition, the ECB is subject to democratic accountability, reporting regularly to the European Parliament and other EU institutions. This complex and formalised structure, covering several countries and integrating various national and supranational institutions, exemplifies a level of legal and institutional complexity rarely or never encountered in the management of traditional shared resources.

tems) creates a different environment from that of common goods, which is very fluid and often informal.

The existence of the legal and institutional framework governing the fiat currency is a strong argument against classifying money as common goods. This feature, based on North's institutional economy, demonstrates that money operates in a highly structured environment with clear rules, oversight mechanisms and enforcement capabilities – features which are most often lacking in common goods. Sometimes, the complexity of these institutional arrangements can lead to challenges similar to those faced by the management of common resources, such as conflicting interests of stakeholders or difficulties in adapting to changing conditions.

Another argument against classifying fiat currency as a common good concerns the fact that the currency possesses unique properties that differentiate it from common goods. Money is divisible and scalable, which means it can be split into smaller units or added to larger amounts without losing value. This feature allows money to perfectly adapt to transactions of any size, from micropayments to large-scale financial operations. Conversely, common goods face scaling problems, and the divisibility is often limited (for example, a fishing area cannot easily be divided into small and precise units for the use of individuals, nor can it be extended beyond its physical limits to cope with increased demand).

The currency's visibility has been emphasised since the presentation of the money's functions, to which William Stanley Jevons contributed (Jevons, 1875). He argued that for a commodity to effectively serve as a currency, it must be possible to divide it into small parts without losing its value proportionately. This divisibility, as described by Jevons, allows money to facilitate exchanges of different sizes and serve as an accurate measure of value (Jevons, 1875). The scalability aspect, although not explicitly addressed by Jevons, is a natural extension of this concept in modern monetary systems, where digital transactions have enhanced the ability to increase or decrease the units of currency used as needed.

Fiat money is characterised by flexibility and adaptability, features that are not commonly associated with common goods. However, these features can create challenges in managing their value and preventing excessive or abusive use. For example, the ease of creating and manipulating money at both micro and macro levels can lead to problems such as inflation or financial instability, akin to the difficulties of overexploitation that arise with common goods.

Money's ability to retain its purchasing power over time, serving as a valuable reserve, differentiates it from classic common goods. This function allows money to maintain value and postpone consumption, differentiating it from physical resources, which usually depreciate or are consumed through use. Unlike common goods, which are often subject to exhaustion or degradation, money is designed to maintain its value, allowing economic agents to plan for the future and accumulate wealth over time.

Economists from different schools of thought have explored the function of the currency as a reserve of value, each contributing with a different perspective. However, Keynes's theory is relevant to the common goods argument. He argued that individuals hold money not only for the purpose of conducting transactions but also as a precaution and for speculative reasons (Keynes, 1936). Keynes's theory highlights how the value reserve function of money influences economic behaviour, affecting investment decisions, interest rates and general economic activity. This view emphasises the unique role of money in the economy, distinguishing it from classic common goods, which usually do not fulfil this function of wealth preservation and economic stabilisation.

The ability of money to retain value over time and serve as a tool for saving and investing casts doubt on the application of common goods issues to monetary systems. However, it should not be excluded that the very function of money as a reserve of value may lead to challenges for monetary policy in terms of inflationary pressures, which may erode the value of money over time. Such challenges are similar to the problems facing the management of common goods, particularly in balancing current use against future availability.

The function of middle-of-trade money distinguishes it from classic common goods. The role that the currency plays in facilitating transactions illustrates that this good serves as an intermediary in economic trade and is not a resource that is consumed and exhausted directly. Unlike common goods, which are usually depleted or transformed through use, money circulates in the economy, allowing countless transactions without being exhausted in the process.

However, the challenges posed by maintaining the currency's effectiveness as a means of exchange while preventing inflationary or deflationary pressures are similar to the problems posed by common goods in terms of balancing competing interests and maintaining long-term stability.

Modern monetary systems have a high degree of interconnection, which complicates the classification of fiat money as a common good. Unlike common goods, such as fishing grounds or forests that are well delineated and localised, money works within a complex and interconnected global financial system. This means that monetary policies and actions in one part of the world can have consequences worldwide. The interconnected nature of modern monetary systems requires consideration of global economic conditions, international cooperation and policy coordination among various economies, which are rare in managing common goods.

This idea is supported by the theory of optimal monetary zones (Mundell, 1961). According to this theory, the effectiveness of monetary policy depends on the degree of economic integration between regions or countries. Mundell's paper highlighted how factors such as labour mobility, price and wage flexibility, and economic diversification affect the optimal size of a currency area. This theory outlines the challenges related to the application of the principles of localised management of a resource (money) operating across national borders and subject to different economic conditions and policy objectives. Mundell's theory shows why money, as a globally interconnected resource, differs from classic common goods, which are typically managed within much narrower and much more defined geographical and jurisdictional boundaries.

The interdependence of national economies, the fluidity of international capital flows and the need for monetary policy coordination at the level of major central banks are holding back the direct application of the common goods case to monetary systems. However, the issues of harmonising various national interests, preventing systemic risks and tackling global economic imbalances show some similarities with the complexity of managing common goods.

The complex nature of monetary[20] policy and its effects on the whole economy distinguish money from classic common goods, questioning their classification in this framework. In contrast to managing natural resources, which often involves direct interventions to control use or access, monetary policy operates through complex mechanisms. Central banks use several instruments to manage the money supply and achieve economic objectives. These policy instruments have multiple effects on inflation, employment, investment and growth. The complexity of these interactions and the extent of their impact are different from the simpler challenges associated with common goods.

However, monetary policy needs transparent decision-making processes and the consideration of the interests of the various stakeholders, which calls into question the similarity between the management of fiat money and the management of common goods.

The digitalisation of fiat money complicates the representation of money as a common good. Unlike traditional common goods, digital forms of money exist in a virtual space, free from some of the constraints that commonly define common goods.

[20] The complexity of monetary policy and its effects on the economy are explored in detail, for example, in Ben Bernanke's work, especially in the research on the mechanisms of monetary policy transmission (Bernanke and Gertler, 1995). According to this study, an effective monetary policy requires a deep understanding of financial intermediation, credit availability and balance sheet effects on businesses and households (Bernanke and Gertler, 1995).

Electronic payment systems, mobile banking, and digital wallets are introducing new ways of creating, transferring, and storing value, which has changed the nature of money management. The ability to instantly transfer value across global networks, money-scheduling potential and vast data-analytics capabilities associated with digital transactions introduce a complexity not usually associated with common goods.

The central bank's analysis of the digital currency domain gained momentum after the Bahamian central bank took its first step in 2020. Studies show that such fiat money would allow central banks to improve the transmission of monetary policy (because it would have faster and more precise control over the money supply and circulation in the economy), would allow for programmable features of money, and could also change the structure of the financial system (considering possible financial disintermediation).

The introduction of such a digital form of the fiat currency allows for a precise and dynamic level of monetary management, which contrasts with the features (physical nature) of common goods. On the other hand, one of the main factors to be considered in the case of digital currency is the confidentiality of personal data. It can be considered a common good, and just as a common good such as fish can be exhausted through overuse, the privacy of the users of a digital currency issued by the central bank could be 'exhausted' through excessive data collection.

The arguments against the classification of fiat money as common good identified above are, in fact, the identification of the specific conditions under which money could present similar characteristics to common goods. These conditions arise, first of all, when money management faces challenges similar to those of traditional common goods.

For example, in hyperinflation or economic crises, the value of money can be "exhausted" by over-utilisation, which is similar to the over-exploitation of natural resources. In decentralised financial systems or in the context of global monetary policy coordination, the lack of a single supervisor can create scenarios where the decisions of several actors affect the common resource (value or stability of money), reflecting challenges related to the governance of common goods. Moreover, where monetary policy decisions have a considerable social impact, balancing the interests of the various stakeholders becomes crucial, reflecting concerns about fairness in the management of common goods. Last but not least, in the digital age, concerns about privacy and data in monetary systems present challenges similar to those faced by the management of common information resources.

These conditions suggest that while money may not correspond to the traditional definition of common good, the application of common good management principles could provide a useful perspective to address certain challenges related to the management of currency and monetary issues, especially in crisis, decentralised control or when addressing the social impact of currency decisions.

II.5 Can trust in fiat money be classified as a common good?

Trust is a central element in the study of currency because, without it, the currency cannot effectively perform its economic functions, regardless of the historical period or type of monetary standard used. In the period of bimetallism and later of the gold standard, this belief was closely linked to the intrinsic value of precious metals – gold and silver – that supported the currency. The monetary system of that period guaranteed the stability of the currency and its functions – means of exchange, unit of account and deposit of value – by trusting that these precious metals store and maintain value. As the transition to the gold standard took place, this trust focused exclusively on gold, considered a stable and safe value standard. In modern currency systems, based on fiat currency, although intrinsic material value has disappeared, confidence has remained equally important and is now anchored in the issuing authority's ability to maintain monetary stability and credibility.

The concept of credit, which underpins the currency, is closely linked to the notion of trust, both semantically and functionally, and is an essential element for understanding the functioning of the monetary systems. Etymologically, the term "credit" comes from the Latin word "*creditum*", the past participation of the verb "*confidence*", which means "to believe" or "to trust". This etymology emphasises that any form of credit implies a relationship of trust between the creditor and the debtor, where the creditor believes in the debtor's ability and intention to honour its financial obligations.

From a functional perspective, banknotes and other forms of modern currency have their origins in the concept of credit, which appeared as a promise of payment in the future. This principle is evidenced by the first documented forms of credit, such as Mesopotamian cuneiform tablets, which recorded payment obligations in cereals at a later date. These documents represented a primitive form of financial contract, in which the debt assumed was a promise to deliver a certain amount of goods in the future. Modern banknotes evolved from these early forms of credit, initially functioning as debt instruments that the holder could collect at the declared nominal value. Thus, the function of the currency as a means of exchange, unit of account and deposit of value is based on the belief that this promise of payment will be honoured. Without this confidence, the currency would lose its ability to function effectively in the modern economy.

In the context of fiduciary currencies, which have no intrinsic value, the role of trust becomes even more pronounced. Modern currencies are essentially acknowledgements of the debt and of the promise of issuing authorities to maintain economic stability and prevent excessive inflation. Thus, the functionality of the currency is directly linked to the credibility and confidence of those authorities. Without this confidence, the currency loses its usefulness, affecting its ability to function as a means of exchange, unit of account and deposit of value.

From an economic point of view, trust is not only a necessary condition but also a driving force that ensures the coherent functioning of fiat money within an economic system. The fiat money, devoid of intrinsic value, operates through a collective consensus based on the credibility of the institutions issuing it and the perceived stability of the economy in which it circulates. This confidence manifests in the acceptance of the currency as a legitimate means of exchange, reflecting the belief of economic agents that the currency will be recognised by other market players.

The stability and functionality of the fiat money thus depend on society's collective perceptions and expectations. Trust in the issuing authority is essential not only to preserve the value of the currency, but also to prevent destabilising economic phenomena such as rampant inflation or rapid devaluation. When confidence is eroded – whether because of poor management of monetary policies or economic or political instability – the currency quickly loses its ability to function effectively in the everyday economy. This can lead to a sudden decrease in purchasing power, the widespread refusal to accept currency in transactions and, in extreme cases, the collapse of the whole monetary system.

The exploration of the link between trust in fiat money and the management of common goods is based on the two features of these goods – non-exclusion and rivalry in consumption. In the case of common goods, non-exclusion refers to difficulties in restricting the access of individuals to the use of these goods, which may lead to over-exploitation. Similarly, trust in fiat currency is based on a broad consensus and general acceptance of its value by all economic participants. Non-exclusion in both contexts means that once trust is eroded or usage rules are not respected, the whole community can suffer. In both cases, unless there is an effective management or regulatory mechanism, both shared resources and trust in the fiat money can be rapidly undermined, affecting the stability and sustainability of those systems.

Consumption rivalry arises when an individual's use of the good reduces its availability to others, creating a competition that can lead to resource exhaustion. Similarly, trust in the fiat currency can be considered a limited resource, which, once undermined, affects all currency users. Suppose part of the population loses confidence in the currency's purchasing power. In that case, this can trigger negative phenomena such as inflation or rapid depreciation, which reduce the available 'value' of the currency for all others. Thus, in the case of both common goods and trust in the fiat money, mismanagement or loss of confidence can lead to adverse effects spreading throughout the community, destabilising that system.

The link between confidence in currency and shared resources, seen in the light of Elinor Ostrom's theory, can be identified by two elements. In Ostrom's theory (1990), the effective management of common goods depends on the ability of communities to self-organise and establish usage rules that all members respect. Similarly, confidence in currency depends on collective consensus and adherence to the economic and financial rules set at the societal level. The currency only works effectively when there is a general agreement on its value and usefulness, similar to how common resources are managed efficiently only when the community complies with self-imposed rules. In both cases, mutual trust and respect for the rules are essential for preventing the 'tragedy of the communes' – whether through overstretching common goods or destabilising the currency's purchasing power.

Ostrom (1990) emphasises the importance of robust and flexible institutions for the sustainable management of shared resources. In the context of the currency, confidence in its value is closely linked to the credibility of the institutions that issue and regulate it. Central banks and governments function as institutions that, through monetary and fiscal policies, ensure currency stability, similar to how Community institutions ensure the sustainable management of common goods. In both cases, institutions' efficiency and ability to adapt rules to economic or environmental changes have a crucial role in maintaining confidence and preventing abuse or systemic failure.

In conclusion, there are several arguments relating to the nature, history and functioning of the currency and the fiat currency that enables a similarity to be established between confidence in the currency and common goods. Testing this resemblance can be done by applying the principles of Ostrom.

II.6 Can confidence in the euro be classified as a common European good?

Looking at the confidence in the euro in terms of Ostrom's principles for managing common resources offers a different approach to understanding the euro area. Although these principles were initially designed to manage tangible natural resources, their adaptation to an intangible asset, such as confidence in a common currency, provides another insight into the complexity of the Community currency.

This section will examine how Ostrom's eight principles can be interpreted and applied to the collective management of trust in the euro. Confidence in the euro is a fundamental, but sometimes undervalued, resource within the euro area. This intangible asset is essential to the effectiveness and stability of the currency, supporting its acceptance, circulation and value. Unlike physical resources, trust in a common currency is built through complex interactions between political decisions, economic performance, and public perception across nations. The analysis of confidence in the euro as a common good, rather than the euro itself, can also highlight other aspects of the euro related to the reconciliation of diverging economic interests, the harmonisation of fiscal policies and the balancing of national sovereignty with collective monetary objectives. Furthermore, this approach also allows exploring the relevance and limitations of Ostrom's framework in understanding the governance challenges facing the euro area in promoting and maintaining trust between different Member States and citizens.

The governance of confidence in the euro as a common good primarily concerns the principle of clearly defined boundaries. This involves delimiting both the geographical scope of the euro area and the stakeholders involved in maintaining the stability and credibility of the currency. The Treaty of Maastricht explicitly defines these limits, identifying the Member States and their central banks, financial institutions and citizens as legitimate users and managers of the effective functioning of the euro. This clear delineation is important because it allows for the efficient management of the common resource – collective confidence in the stability of the euro. By defining the actors that can participate in and benefit from the common currency, the system aims to create a basis for sustainable management of this trust.

However, the effectiveness of these limits is questioned by the situation of EU Member States such as the Czech Republic, Hungary, Poland, Romania and Sweden. Although these countries are bound by their EU accession treaties to eventually adopt the euro, they have not done so yet. This discrepancy highlights a challenge in applying Ostrom's principle to the euro area: although legally defined, borders are not used in practice.

Interestingly, these defined limits are not unchangeable barriers, as demonstrated by the potential of these EU Member States to adopt the euro in the future. However, the existence of 'opt-out' scenarios, whether formal (such as Denmark) or de facto (countries that fulfil the Maastricht criteria are in no hurry to adopt the common currency), complicates the clear delineation that the Ostrom principle considers significant for the efficient management of common resources. This complexity raises important questions about the long-term stability and cohesion of the euro as a common good and the challenges of maintaining confidence in the currency of a diverse group of nations with different levels of commitment to the common project.

The principle of matching rules and local conditions underlines that governance rules must be adapted to the participating entities' specific socio-economic, cultural and environmental contexts. In the euro area, this principle is manifested in the need to adjust monetary policies and fiscal regulations to the diverse economic conditions of Member States. Congruence is important for maintaining the delicate balance between centralised monetary policy and the diverse fiscal realities of the euro area. It contributes to alleviating tensions that may arise from a rigid and uniform approach, thereby contributing to the long-term sustainability and legitimacy of the euro as a common good. For example, by introducing longer-term refinancing operations[21], the ECB's actions have demonstrated that the institution can respond to diverse economic realities, allowing for flexibility within a common framework.

This principle poses a challenge for countries that are required to adopt the euro. Although these countries are subject to the SGP, which pushes them towards economic alignment and coordination of economic policies, the attitude in these countries often postpones the adoption of the euro, citing the need to maintain monetary policy autonomy to address "single circumstances" (Dandashly and Verdun, 2018).

The Swedish case seems to confirm these economic concerns. Thus, voters who are financially dependent on the public sector, as well as those in export-orientated regions and regions with different employment patterns to those in the euro area, were more likely to vote against the adoption of the euro in the Swedish referendum in 2003 (Jonung and Vlachos, 2007). This could be interpreted as expressing that the key question is not whether there are asymmetries but how important they are. On the other hand, Sweden's decision to remain outside the euro area is based on the perception of the loss of an independent monetary policy, which seems to be a political and psychological barrier rather than a purely economic one, given the existing level of economic policy coordination and the fiscal rules that apply to all EU members (Jonung, 2004).

In the Economic and Monetary Union context, the principle of collective choice mechanisms refers to the importance of inclusive decision-making among interested nations.

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[21] Targeted Longer-Term Refinancing Operations (TLTROs) introduced in 2014 and modified multiple times, illustrate how policy frameworks can be designed to accommodate local conditions while maintaining overall stability and confidence in the euro. TLTROs provide banks with long-term loans at favourable rates, conditional on lending to the real economy. Typically, the terms of these operations are adjusted according to the specific economic conditions of each member state. Moreover, during the pandemic, the ECB introduced TLTRO III with even more favourable conditions for banks in countries experiencing severe economic stress. The interest rate on these operations could be up to 50 basis points lower than the average deposit facility rate, but only if banks met specific lending targets tailored to national economic conditions. This differentiated approach allowed the ECB to address the heterogeneous impact of the crisis within the euro area, providing greater support to economies that were more severely affected while preserving the overall integrity of monetary policy."

However, the governance structure of the euro poses a challenge to this ideal. The ECB, the leading monetary policy institution, functions independently to maintain price stability, free from direct political influence. This independence, however, contributes to the "democratic deficit" (the difference between decision-making at the EU level and democratic accountability to citizens). In addition, the ECB's Governing Council, in charge of setting interest rates, operates a rotation system whereby not all national central bank governors vote at every meeting. This complicates the complete representation of the interests of those who use this common good. Moreover, the Eurogroup, an informal body of eurozone finance ministers, influences economic policies that affect the euro, but there are no formal accountability mechanisms.

While designed to ensure the effectiveness and efficiency of policies, these structures raise questions about the degree of democratic oversight and collective choice in euro governance. Balancing the need for an expert-led monetary policy with democratic legitimacy remains a significant challenge.

Furthermore, these governance challenges may act as a disincentive for countries forced to adopt the euro, which could erode their confidence in the currency and complicate the future enlargement of the euro area. The perceived difficulties in adapting to a system with less direct control over monetary policy, combined with potential domestic political resilience and lessons learned about the effectiveness of interventions in previous euro area crises, further amplify concerns about joining a monetary union with such complex governance structures.

Monitoring, one of the principles used by Ostrom to define the framework to ensure the efficient management of common goods, should help maintain the integrity and stability of the monetary union.

The ECB, together with the national central banks and other European institutions, acts as the primary monitoring body and supervises monetary policy, financial stability and compliance with fiscal rules. This multi-level monitoring system aims to detect and deter *free-riding* behaviour, such as excessive deficit or excessive public debt, which could erode confidence in the euro. By ensuring transparency and accountability, the monitoring stimulates a sense of collective responsibility among euro area members. It reinforces the perception of the euro as a value buffer and a reliable means of exchange.

However, the effectiveness of this monitoring is closely linked to the credibility of the implementation mechanisms and the willingness of Member States to adhere to the agreed rules. This relationship highlights the complex interaction between institutional design and collective action in managing a common monetary resource. The success of the monitoring efforts depends on the strength of the penalties for non-compliance, the political will to implement them and the perceived legitimacy of the monitoring institutions themselves. Furthermore, the diversity of economic conditions and political priorities of euro area members can create tensions between national interests and collective objectives, questioning the effectiveness of the monitoring processes.

This dynamic highlights the need for governance structures that can adapt and balance the concerns about sovereignty with the imperative of maintaining a stable and trustworthy common currency, thereby exemplifying the complex challenges inherent in managing complex and multinational common resources.

The perceived inefficiency of monitoring mechanisms is another challenge for countries forced to adopt the euro. These states may find that preserving autonomy in monetary policy is more advantageous than joining a monetary union that seems to be applying fiscal discipline inconsistently to their current members. Paradoxically, while the monitoring of existing members is perceived as lax, the membership criteria for new members remain strict. This apparent contradiction between internal flexibility and inbound rigidity may discourage euro area enlargement by calling into question the effectiveness and fairness of the monetary governance system.

The principle of Ostrom's graduated sanctions can be exemplified, in the case of confidence in the euro, by implementing increasingly stringent measures to maintain macroeconomic stability. This approach incorporates key aspects of the Ostrom framework: (i) proportionality in addressing infringements is demonstrated by the European Commission's decision in 2016 to give Spain and Portugal additional time to correct their deficits, rather than imposing immediate fines; (ii) The clear escalation of sanctions is exemplified by Greece's experience, which progressed from initial warnings to strict austerity measures and structural reforms as conditions for accessing bailout funds; (iii) maintaining confidence in the euro as a shared resource can be exemplified by the "*whatever it takes*" moment in 2012, which has reassured the markets regarding the stability of the currency; (iv) The European Semester, introduced in 2010, is an adaptable governance structure allowing for more frequent monitoring and adjustment of fiscal policies; (v) the establishment of the European Fiscal Council in 2016 offers opportunities for learning and correction through independent assessments and the exchange of best practices.

This gradual approach allows a balance between applying the rules and maintaining cooperation between Member States, ultimately safeguarding collective trust in the euro and preserving its value as a common good.

Applying Ostrom's principle of graduated sanctions also has implications for countries that must adopt the euro. On the one hand, this system can be seen as encouraging for future eurozone members, as it demonstrates a structured and fair approach to maintaining macroeconomic discipline and stability. The gradual nature of the sanctions provides a sense of security, ensuring minor violations do not immediately lead to severe sanctions. This may make the prospect of joining the euro area less discouraging, as it allows for a learning curve and an adjustment period.

On the other hand, the system can also serve as a deterrent for some countries. The Greek debt crisis and its consequences highlighted the potential seriousness of sanctions and interventions in extreme cases. This could discourage countries worried about losing their fiscal autonomy or those with less stable economies. In addition, the complexity of adhering to tight fiscal rules and the potential for sanctions-related political tensions could put some potential members on the line. Finally, the impact of this system on a country's willingness to adopt the euro probably depends on several factors, including the economic situation, the political climate and the perception of the benefits and risks associated with joining the euro area.

The application of Ostrom's principle on conflict resolution mechanisms shows which institutions are essential for maintaining the confidence and stability of the euro. The ECB serves as the primary arbitrator of monetary policy conflicts, using its Governing Council to balance different national interests and make interest rate decisions. The Eurogroup, comprising the finance ministers of the eurozone countries, functions as a forum to address disagreements on fiscal policy and the coordination of economic strategies. For legal disputes, the European Court of Justice offers authorised interpretations of the EU treaties and settles conflicts between Member States or EU institutions. The European Stability Mechanism acts as a financial instrument for emergency cases, providing a way of resolving disputes for countries facing severe economic crises. In addition, the European Commission plays a role in enforcing tax rules and mediating disputes over budget deficits and debt levels. Together, they form a multi-layered framework for conflict resolution, enabling the euro area to address different types of disputes – from monetary and fiscal policy disagreements to legal and economic crises – thus promoting confidence in the euro.

While these institutions can help resolve conflicts between different types of euro users, their alignment with Ostrom's criteria of easy accessibility and low cost varies. While important for resolving monetary policy disputes, the ECB and the Governing Council are not directly accessible to citizens or economic actors, which may not correspond to Ostrom's ideal. As the informal body of finance ministers, the Eurogroup operates similarly at a high level, limiting the direct access of many stakeholders. The European Court of Justice offers more accessible means of redress, but the costs and complexity of international disputes may be prohibitive for some parties. Although vital to crisis resolution, the European stability mechanism is mainly used by national governments rather than individual actors. The European

Commission's role in tax surveillance and dispute mediation is more widely accessible but operates primarily at the national level. This analysis suggests that while the euro area has established comprehensive conflict resolution mechanisms, their accessibility and cost-effectiveness – highlighted by Ostrom – can be limited for many stakeholders.

Ostrom's principle of minimal recognition of organisational rights can be applied to confidence in the euro as a common good but with certain reservations. Firstly, Ostrom said that users of resources should be able to create their own rules and institutions. In the euro area, this is partly reflected in the representation of Member States in the Governing Council of the ECB, which allows a particular influence on monetary policy, albeit limited by the ECB's central authority. Secondly, Ostrom advocated limited interference by foreign authorities in managing local resources. In the case of the euro, applying this principle directly is difficult, as a central authority inherently manages the currency. However, the ECB's efforts to consider the varying economic conditions in the Member States when formulating its policies are a limited illustration of this idea. Thirdly, Ostrom stressed that authorities should recognise local agreements as legitimate. In the euro context, this is evident in the international recognition of the ECB's independence and the legitimacy of financial regulation across the euro area. Despite these parallels, the supranational nature of the euro system and the lack of a common fiscal policy point to the limits of applying the Ostrom framework, which was developed mainly for more localised resources, to a complex, multinational monetary union.

As conceptualised by Elinor Ostrom, the principle of the decentralised management of large common goods concerns the organisation of multi-layered, interconnected governance activities. Ostrom observed that this structure was often present for common goods that held out over time, allowing a balance between local knowledge and hierarchical coordination. In the context of the euro area, a decentralised structure can be identified as encompassing the ECB at the supranational level, national central banks and local financial institutions. This structure addresses confidence building through five key issues: multi-level governance, subsidiarity, interconnection, adaptability and complexity management. The multi-level approach allows policy-making at different levels, while subsidiarity ensures that implementation often takes place at the national level, closest to the populations affected. Interconnectivity facilitates coordinated action and information exchange between tiers, which is essential to maintaining constant confidence. The adaptability of the structure allows for tailored responses to the diverse economic conditions in the Member States while preserving the overall stability of the euro. Finally, this holistic approach manages the complexity of maintaining confidence in a multinational currency by segmenting responsibilities across tiers.

Although this decentralised management allows, in theory, a balance between local knowledge and hierarchical coordination, its implementation in the euro area has revealed some challenges. For example, the Greek debt crisis has highlighted how mismanagement of the national tax system could threaten the whole of the monetary union, demonstrating the limits of the principle of subsidiarity. The ECB's initially slow response to the crisis has further illustrated shortcomings in coordination between the supranational and national levels. In addition, the imposition of austerity measures by EU institutions in countries such as Greece, Ireland and Portugal has shown how hierarchical coordination can sometimes undermine local autonomy instead of strengthening it. The rise in Euroscepticism in various Member States, partly in response to the perceived loss of economic sovereignty, indicates that this approach has not always succeeded in balancing local needs with stability at the Union level. Furthermore, the persistent economic disparities between the euro area's peripheral and central countries suggest that the current structure does not adapt effectively to different economic conditions.

In conclusion, applying Ostrom's principles for the management of common goods to confidence in the euro as a shared resource provides another insight into the euro but also highlights the limitations of this framework when applied to a complex and multinational monetary union. Although some principles, such as those relating to clearly defined limits, congruence with local conditions and graduated penalties, can be adapted with some success, others, such as collective choice mechanisms and minimum recognition of organisational rights, are proving more challenging to implement in the context of the euro area. The ECB's centralised governance structure and the complexity of diverse national economies create tensions between local needs and collective objectives. These challenges are exacerbated by the situation of countries forced to adopt the euro but which are late in doing so, highlighting the difficulties in reconciling national sovereignty with the requirements of a monetary union. Ostrom's framework offers valuable insights, suggesting that the European project still has institutional steps to take in order to be able to view confidence in the euro as a common good.

II.7 Is game theory applicable to the analysis of trust in the euro?

Elinor Ostrom used the prisoner's dilemma to illustrate the inherent challenges in managing common goods. She referred to this game theory model to explain how rational individuals, acting in their interest, can exhaust common resources even when it is in their collective interest to conserve them. At the same time, Ostrom aimed to demonstrate that the simplistic and deterministic predictions of game theory are not necessarily valid in real-world scenarios related to common goods, proposing instead the solutions offered by the analysis and development framework.

The prisoner's dilemma, a type of game from game theory, was first conceptualised by Merrill Flood and Melvin Dresher and later formalised by Albert W. Tucker in the early 1950s (Poundstone, 1992). This kind of problem in game theory illustrates a scenario in which rational actors, pursuing their own self-interest, cannot achieve optimal collective results because of strategic interdependence. In game theory, a game is defined by three key components: players (decision makers), strategies (the set of possible actions available to each player), and rewards (results or benefits associated with each combination of strategies chosen by players).

In game theory, a strategy refers to a complete action plan that specifies how a player will act in every possible situation during the game (Myerson, 1991). There are several types of strategies explored in game theory: (i) the dominant strategy generates the highest gain for a player, regardless of each other's choices (Fudenberg and Tirole, 1991); (ii) the pure strategy involves the choice of a single action with certainty; (iii) the mixed strategy involves the random choice between different pure strategies, depending on specific probabilities; (iv) the Nash equilibrium strategy refers to the situation in which no player can unilaterally improve their gain by changing strategy, given the strategies of others (Nash, 1951). In the context of the prisoner's dilemma, non-cooperation is the dominant strategy, although it leads to a suboptimal collective outcome.

In its classic formulation, the prisoner's dilemma depicts two suspects facing separate interrogations, each faced with the choice of cooperating (silence) or not cooperating (betraying their accomplice). The structure of rewards creates a dilemma: mutual cooperation brings moderate benefits, mutual betrayal results in moderate punishments, while unilateral betrayal pays maximum benefit to the one who betrays, to the detriment of the one who cooperates. In this scenario, betrayal emerges as the dominant strategy, though it leads to a suboptimal collective outcome.

Understanding this type of game is complicated by the existence of single-iteration or repeat-game scenarios. In a context where the game is played once, rational agents are prone to non-cooperation because this strategy constantly generates the optimal individual win, regardless of the action chosen by the partner.

In contrast, in endlessly repeated games, the prisoner's dilemma dynamics transform, allowing cooperation to emerge as a viable and sustainable strategy. Axelrod and Hamilton (1981) demonstrated that when the prisoner's dilemma is repeated without a predictable end, players can adopt more sophisticated strategies that take into account the game's history and future implications. The tit-for-tat strategy, which starts with cooperation and then reflects the opponent's previous movement, has proved highly effective in promoting mutual cooperation. This strategy facilitates reciprocity by penalising non-cooperation and rewarding cooperation, creating a long-term incentive structure favouring mutual cooperation. In this context of repeated interactions, the possibility of future retaliation against non-cooperative behaviour may outweigh the short-term benefits of non-cooperation. Consequently, this dynamic can lead to the emergence of cooperative behaviour as a stable evolutionary strategy. Once established in a population, such a strategy resists substitution by alternative strategies (Smith and Price, 1973). Within the prisoner's iterated dilemma, cooperation becomes an evolutionarily stable strategy because, in a population in which it is widespread, individuals who use the strategy make more significant gains in the long term than those who try to exploit through non-cooperation.

The prisoner's dilemma was further expanded to encompass multi-player scenarios and continuous decision-making spaces, providing insights into issues related to public goods and resource management (Kollock, 1998). In this context, constant decision-making spaces refer to extensions of the model in which players can choose from a series of actions, not just two options (cooperation, non-cooperation), allowing more nuanced strategies and results that better reflect real-world scenarios. Its applications extend from international relations, where it shapes the dynamics of the arms race, to oligopolistic pricing strategies in the market, emphasising its importance in the analysis of strategic decision-making in conditions of interdependence and uncertainty.

Elinor Ostrom (Ostrom, 1990) used the prisoner's dilemma to illustrate the specific challenges communities face in managing common goods, such as fishing, groundwater and irrigation systems. It relied on this type of game to explain how individuals acting in their own interest can exhaust common resources even when a collective action would have better results. Ostrom applied this concept to common goods to highlight the difficulties that arise in achieving cooperation between resource users, who fear that others will overuse the resource if they do not. This fear leads individuals to maximise their interest (using the good to satisfy their needs), ultimately harming the entire group.

By examining numerous case studies from different regions and for different common goods, Ostrom has demonstrated that individuals can overcome the incentives of a non-cooperation strategy by developing efficient, self-organised institutions. For example, in its study of Nepal's irrigation systems, it found that local farmers had developed complex sets of rules and norms to allocate water correctly and efficiently, thus avoiding the over-utilisation foreseen by the prisoner's dilemma. Similarly, in the case of the Swiss Alpine grasslands, cooperative management practices allowed for sustainable grazing (Ostrom, 1990). These case studies provide empirical evidence that through repeated interactions and governance structures that adapt to new situations, local communities can create solid institutions that promote collective action and the sustainability of common goods.

In addition, Ostrom illustrates that real-world communities successfully find ways to manage common goods through collective action and mutual agreement. An essential element in overcoming the prisoner's dilemma in these contexts is the development of trust between resource users. Trust reduces the fear that others will not cooperate, favouring cooperation and collective management. Trust is built through repeated interactions, transparent communication and the establishment of common norms and aspirations. When individuals trust that others will also act in the group's interest, they are more likely to follow suit, leading to lasting and fair results (Ostrom, 1990).

The principles of the governance of Ostrom's common goods and the applications of game theory provide another insight into the diversity of elements affecting common goods such as the euro. While Ostrom's principles are a practical model for creating efficient institutional arrangements, game theory provides analytical tools to model and predict strategic interactions within these institutions. Using both instruments allows for a more detailed understanding of some decisions in the case of the euro, where individual actions by Member States have collective consequences. Game theory helps to understand why Ostrom's principles are practical by shaping how they alter the structure and balance of rewards. For example, Ostrom's emphasis on clearly defined boundaries and incremental sanctions can be understood through game theory concepts of player definition and credible threats. Similarly, its focus on collective choice agreements aligns with the analysis of gaming theory on cooperation in repeated interactions. Looking at the euro area through this twin-track perspective, a more detailed understanding can be reached both on the institutional structures governing the euro and on the strategic behaviour of the actors within this system.

Game theory, particularly repeated games, allows for analysing how cooperation within the euro area is evolving in the long term. This approach shapes the fiscal and economic decisions of the Member States as they move in a game of infinite horizon, where the benefits are related to economic stability and growth.

At the heart of this analysis is the folk theorem, according to which, in games that repeat indefinitely, players can have cooperative strategies and achieve mutually advantageous results in many different scenarios, even when they do not take into account future rewards or do not have complete information about each other, provided that these results yield greater benefits than the minimum that each player could guarantee and that players give a sufficiently high value to future rewards (Fudenberg and Maskin, 1986).

In the euro context, this theory explains how sustainable cooperation between Member States can emerge despite potential short-term incentives to deviate from agreements such as the SGP. For example, the consistent fiscal discipline of a Member State can be understood as a strategy that strengthens cooperative behaviour by encouraging similar actions from other members. The theorem emphasises how expectations of future interactions and their potential consequences influence current policy choices. Member States that value more for future benefits are more likely to retain fiscal responsibility for the long-term stability of the euro.

This temporal dimension of the strategic interaction highlights the importance of credible commitments, transparency and information flow in supporting cooperation results within the euro area.

The information available to euro area participants influences strategic decisions taken by Member States, i.e. the stability of the monetary union. Game theory distinguishes between perfect information and imperfect information scenarios, the latter reflecting more accurately the realities in the euro area.

The nature of the information available to players is important, as it directly affects their ability to formulate optimal strategies and accurately assess potential rewards (Harsanyi, 1967). In games with imperfect information, players must make decisions based on probabilistic estimates of the actions of other players and the state of the economy, which can lead to potentially suboptimal results (Myerson, 1991). In addition, information asymmetries can create opportunities for strategic behaviour, as better-informed actors can exploit the advantage of this knowledge to the detriment of less-informed parties. This can be manifested through phenomena such as moral hazard or adverse selection, which can lead to suboptimal results for the system as a whole and distort the structure of the game's winnings (Stiglitz and Weiss, 1981).

In this context, the ECB's efforts to enhance transparency, such as *forward guidance* and periodic economic projections, can be seen as attempts to mitigate such information asymmetries. These signalling mechanisms aim at guiding market expectations and reducing uncertainty. The sovereign debt crisis in the euro area, and more specifically in the case of Greece, clearly illustrates the potential consequences of information asymmetry, as incomplete disclosure of economic data has led to large-scale market reactions and unprecedented political challenges at the EU level. The European Commission has implemented enhanced surveillance procedures, demonstrating how institutional design can evolve to address information vulnerabilities.

These efforts to improve the flow of information and transparency aimed at creating a more efficient and stable economic environment within the euro area by reducing uncertainty and facilitating better-informed decision-making for all actors. However, the strategic interactions in the euro area are not governed solely by formal, quantifiable information; they are also influenced by less tangible factors, such as reputation and social norms, which interact with and sometimes compensate for imperfections in the formal information structure.

Reputational effects and social norms are also important components of the game theoretical framework in European governance. Reputational effects refer to the impact of a player's past behaviour on the expectations of others on its future actions, influencing strategic interactions over time (Kreps and Wilson, 1982). On the other hand, social norms are common expectations or behavioural rules within a group, supported by social approval or disapproval (Bicchieri, 2006). Both serve as important signalling mechanisms that complement and interact with the formal information structure (Mailath and Samuelson, 2006).

Within this framework of repeated play, a country's reputation in terms of, for example, fiscal responsibility, becomes a valuable asset, conveying information about its likely future behaviour and potentially leading to tangible benefits, such as a reduction in borrowing costs. For example, the evolution of social rules in the euro area, such as expectations of fiscal discipline, can be analysed through game theory. This branch of game theory applies biological evolution principles to study how strategies or behaviours change over time in a population of interacting agents (Smith and Price, 1973). In the euro area context, this helps to explain how certain economic behaviours or political positions become prevalent or diminish over time, depending on their relative success or failure.

For example, Ireland's growing reputation following the successful implementation of austerity measures and structural reforms following the 2008 financial crisis led to increased market confidence and lower borrowing costs. In contrast, Italy's historic difficulties with high public debt and political instability have led to continuing scepticism by other members of the euro area and financial markets, leading to higher risk premiums for sovereign bonds.

This reputation dynamic interacts with the development of social norms and the formal information structure of the euro area, creating an adaptable system that shapes the behaviour of Member States over time. For example, the Netherlands and Austria have often aligned their positions on fiscal matters, reinforcing a fiscal prudence rule among some euro area members. This interaction between formal information, reputations and social norms creates a nuanced decision-making environment crucial to understanding the polycentric governance structure of the euro area and the evolution of its economic policies.

The polycentric governance system of the euro area can be considered an application of network game theory, which captures the complex interactions between several decision-making centres. This framework shapes the euro area as a network in which each node (e.g. Member State or EU institution) makes strategic decisions affecting other nodes, which in turn is affected by decisions of different nodes in the network. The theory of network games is particularly useful in analysing coalition formation and the spread of economic shocks in the euro area (Jackson and Zenou, 2015).

For example, the formation of the coalition of the frugal countries ('*Frugal Four*', consisting of the Netherlands, Austria, Denmark and Sweden) during the 2020 negotiations for the EU Recovery Fund can be considered a strategic subnet within the more extensive euro area network. This coalition has harnessed its collective bargaining power to influence the terms of the recovery package, demonstrating how network structures can amplify the influence of more minor actors.

In addition, network game theory provides insight into the spread of systemic risks during the sovereign debt crisis. The network structure of the euro area, characterised by dense financial and economic interconnections between Member States, has played a role in the escalation of economic shocks localised in system-wide threats. This amplification has occurred through various mechanisms: Firstly, direct financial exposures between banks and sovereign states in different countries create immediate channels of shock transmission. Secondly, spreading information leads market participants to reassess risks to seemingly similar economies, leading to contagion effects. Thirdly, the complex web of trade relations means that economic recessions in one country may quickly affect the real economies of other countries. In other words, network structures with dense interconnections can transform even small shocks into systemic crises through cascading effects (Acemoglu, Ozdaglar, Tahbaz-Salehi, 2015). In the context of the euro area, this explains how the initial fiscal problems in smaller economies, such as Greece, could rapidly escalate into a crisis that threatens the stability of the entire monetary union.

This application of the theory of network games to the polycentric governance of the euro area highlights the importance of understanding both formal institutional links and informal coalitions emerging in response to specific challenges and the potential vulnerabilities created by the network interconnection. Although the theory of network games clarifies the structure of euro area interactions, addressing the challenges highlighted by this analysis often requires overcoming collective action problems.

The collective action problems in the euro area can be modelled using the framework of analysis that the prisoner's 'n' player dilemma offers. The prisoner's "n" player dilemma expands the classic two-player game, in which individual rational choices lead to suboptimal collective results, highlighting tensions between individual and collective interests (Hamburger, 1973).

Every Member State is incentivised to adopt behaviours which, while potentially beneficial in the short term, could undermine the stability of the euro if adopted by all. Establishing the European Stability Mechanism can be seen as an institutional response to this dilemma, creating financial protection to address sovereign debt problems. Similarly, the introduction of the tax pact in 2012[22] changed the reward structure of the game by introducing automatic penalties for breaching the rules, effectively shifting Nash's balance in favour of collective responsibility. Thus, the fiscal pact changed the reward structure by setting strict rules for national budgets, requiring them to be balanced or surplus, with structural deficits not exceeding 0.5percent of GDP (or 1percent for countries with a debt well below 60percent of GDP). This change directly impacts the potential strategies available to Member States in their tax decision-making process. Secondly, the document introduced a quasi-automatic penalty mechanism in case of violation, increasing the credibility of enforcement. This automation reduces the policy choice in implementing sanctions, thus altering the rewards in case of non-compliant behaviour. Thirdly, these changes effectively alter the Nash equilibrium of the tax policy game. Before the pact's conclusion, the balance often favoured countries seeking short-term fiscal expansion at the expense of collective stability, as costs were partly outsourced to other eurozone members. Instead, the new structure increases the costs of fiscal irresponsibility by providing credible penalties, making it less advantageous for countries to deviate from collective stability rules. As a result, the fiscal pact favours collective responsibility, as the optimal strategy for each country leans towards maintaining fiscal discipline. This transformation demonstrates how institutional design can harness the principles of game theory to align the individual incentives of Member States with the collective goal of euro area stability.

These institutional innovations demonstrate how Ostrom's principles for managing common resources can be applied to a monetary union, creating mechanisms that align individual incentives to collective goals. While these institutional innovations address collective issues requiring immediate action, the dynamic nature of the euro area implies an understanding of how strategies and behaviours evolve, which makes it worthwhile to consider game theory.

The evolving game theory provides a dynamic insight into the development of management practices and strategies within the euro area, shaping how different fiscal and monetary approaches compete and evolve. One helpful concept in this endeavour is that of evolutionarily stable strategies. Such a strategy, if adopted by a population, cannot be invaded by any alternative strategy (Smith and Price, 1973).

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[22] It is also known as the Fiscal Compact, it is a part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

In the euro area context, an evolutionarily stable strategy would represent a fiscal or monetary policy that, once widely adopted, offers no incentive for Member States to deviate unilaterally, even in the face of short-term pressure or other policy options. For example, commitment to price stability as the primary objective of monetary policy could be considered an evolutionarily stable strategy in the euro area, as it has persisted despite various economic challenges and has been widely accepted by Member States. The concept of an evolutionarily stable strategy helps explain why specific policies, such as joining the independence of the ECB, have become rooted in the euro area's governance.

These strategies have evolved to be 'stable' in that they have resisted change and provide a framework for Member States to operate, even when countries may be incentivised in the short term to drift. This evolutionary perspective complements static analyses based on game theory, providing insight into the long-term path of euro area governance and contributing to the design of resilient institutions.

Institutional analysis through game theory provides a framework for understanding how the rules governing the euro shape the strategic interactions between Member States and EU bodies. The treaties, regulations, and rules that form the euro area's institutional framework can be regarded as the rules of a complex game.

Mechanism design theory, a branch of game theory, focuses on designing institutions that align individual incentives with collective goals. This approach reverses the traditional game theory analysis, starting from the desired result and going backwards to create the game rules leading to that result. In the eurozone context, mechanism design theory provides a framework for developing institutional structures and policies that incentivise Member States to promote the stability and prosperity of the whole monetary union, even when their individual short-term interests might diverge.

The European Stability Mechanism can be considered an example of this. It creates a system of conditional financial assistance, which encourages fiscal responsibility (the desired collective outcome) by making access to support conditional on adherence to specific economic reforms and fiscal objectives (incentive structure).

This institutional perspective links the models in game theory to real-world policy-making, stressing the importance of taking behavioural factors into account in governance structures.

Applying behavioural economics to game theory enriches the understanding of euro governance by considering limited rationality, considerations of fairness and the role of communication in strategic interactions. Unlike traditional game theory, which requires perfect rationality, behavioural approaches recognise that euro-area policymakers operate within cognitive boundaries and are influenced by factors such as equity and reciprocity.

For example, the debate on the issuance of joint Eurobonds has highlighted how the perception of moral hazard and equity influences the positions of Member States. Countries like Finland and Estonia opposed such measures, claiming they could reduce fiscal discipline incentives and unfairly distribute the risk. This position reflects economic calculations and deep convictions about fairness and accountability, illustrating how behavioural factors can shape high-level economic policy discussions. The importance of communication in promoting cooperation, highlighted in behavioural experiments, underlines the importance of forums such as the Eurogroup in preserving the euro area's stability.

In addition, saliency in behavioural economics helps explain why specific policy issues are gaining ground. In contrast, others are overlooked in the euro area's governance discussions. In behavioural economics, the concept of saliency refers to the property of a stimulus to attract the attention of the deceased due to its prominence, contrast, or surprising nature compared to other stimuli or past experiences. This feature can distort the economic decision-making, as salient elements divert attention from other essential attributes or goals. For example, the emphasis on structural reforms of labour markets became very important in policy recommendations for southern European countries during the euro area crisis, eclipsing other critical economic considerations.

In conclusion, applying game theory to the analysis of money as a common good highlights the strategic interactions between Member States, central banks and other economic actors, revealing how individual incentives can align or move away from collective objectives.

The use of various theoretical models of games – from the prisoner's "n" player dilemma to more sophisticated approaches such as the theory of network games and the theory of evolutionary games – allows a nuanced understanding of the dynamics that underlie fiscal policies, monetary decisions and institutional concepts. These models help explain phenomena such as coalition formation, the propagation of economic shocks and the evolution of cooperation in the face of collective action problems. In addition, integrating elements of the behavioural economy highlights the limited rationality of decision-makers and the importance of the perception of fairness in shaping economic policies.

Applying game theory to the single currency as a common good underscores the fragility of the balance between the Member States' interests and the currency's collective stability. Finally, such analysis encourages questioning the choices of euro area actors, taking into account the specificities of the EU institutional framework.

III How can the assumption of confidence in the euro as a common good be applied to the Member States of the euro area?

Economic literature provides sufficient examples of the application of game theory to the analysis of the development of projects in the EU, regardless of the importance of using this theory in solving problems related to the administration of common goods, as used by Ostrom. By shaping the strategic interactions between Member States, EU institutions and other stakeholders, game theory provides another insight into the challenges and opportunities of European integration and economic governance in the common space.

The EU has created incentives for cooperation and discourages aggression through mechanisms such as economic integration, collective security commitments and conditional generosity (Schimmelfennig, 2015). This effectively changed the structure of gains to make cooperation and peace the Nash balance between EU members, representing "a better alternative" to the "*Pax Romana*" strategy of conditional aggression (Weiss and Agassi, 2021). The "*Pax Romana*" strategy of conditional aggression represents a traditional approach to peacekeeping through military power and the threat of reprisals. In terms of game theory, the principle in the Roman Empire, "*Si vis pacem, para bellum*" (if you want peace, prepare for war), aligns with the prisoner's repeated dilemma, in which the credible threat of punishment for non-cooperation maintains peace. This approach places particular emphasis on deterrence, based on demonstrating both the ability and the desire to respond aggressively to any challenge. The authors present this strategy in contrast to the EU approach, which they argue is based more on conditional generosity and positive incentives for cooperation. The Pax Romana strategy is an example of the traditional force-based approach to peace, which is less stable and riskier than the EU cooperation model (Weiss and Agassi, 2021).

There are also views that the EU's approach to integration and cooperation can be shaped as a game of 'deer hunting'[23] rather than a prisoner's dilemma (Schimmelfen-

[23] In this game, players must decide between cooperating to hunt a deer, which requires joint effort and provides a big win, or act individually to hunt a rabbit, which provides a smaller but safe win. The main differences between deer hunting and prisoner's dilemma include the reward structure, motivation and applicability. In deer hunting, there are two Nash equilibria: cooperation in deer hunting and non-cooperation in rabbit hunting. The balance of cooperation is preferable but risky, requiring mutual trust. In the prisoner's dilemma, betrayal is the dominant strategy, leading to a balance of non-cooperation, although cooperation would be more beneficial to both players. The hunt for deer accentuates the importance of co-

nig, 2015). In deer hunting, cooperation produces the best win for all players, unlike the prisoner's dilemma, where non-cooperation is always the dominant strategy (Steunenberg and Dimitrova, 2007).

Game theory has been applied to analyse various aspects of EU economic governance. These include enlargement negotiations and accession conditions (Steunenberg and Dimitrova, 2007), coordination and enforcement of fiscal policy (Schimmelfennig, 2015), banking union and financial regulation (Schimmelfennig, 2015) and Brexit negotiations (Schelkle, 2019). More recently, theoretical models of the games were used to study euro-area debt mutualisation schemes (D'Andrea and Vassalli, 2023) and internal devaluation policies during the euro-area crisis (Xifré, 2020). These applications demonstrate the versatility of gaming theory in addressing a wide range of EU economic challenges, including the 'overlapping crises' of credibility and institutional reform identified by Xifré (2020).

Game theory models suggest that the optimal share of public debt to be pooled with the EU is 50 percent (D'Andrea and Vassalli, 2023). This finding is based on an ultimatum-style game model, which considers the costs and benefits of debt-sharing for both highly indebted and low-indebted countries. The same study finds that the commitment to structural reforms of high-debt countries leads to the best balance in the debt-sharing arrangements (D'Andrea and Vassalli, 2023). In addition, Xifré (2020) argues that internal devaluation policies have served as a "means of commitment"[24] to overcome credibility problems between central and peripheral countries during the euro area crisis. This analysis aligns with Schelkle's (2019) observation that crisis management involved complex negotiation processes between Member States with diverging interests.

Game theory helps explain policy choices beyond purely economic considerations by shaping strategic interactions and signals between Member States. For instance, policies such as internal devaluation were implemented not only for their economic effects but also as costly signals of peripheral countries' reform commitment. Thus, internal devaluation measures involved political costs for governments in peripheral countries, such as electoral losses for ruling parties, and their implementation demonstrated that these governments were willing to incur high political costs to

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ordination and trust, being applicable in international relations and public policies. Instead, the prisoner's dilemma exemplifies conflicts of interest and economic competition, where mutual betrayal leads to suboptimal results. In the Romanian economic literature, both the term "deer hunting game" and the term "insurance game" are used to describe this concept.

[24] This refers to a mechanism or action that helps an actor to credibly demonstrate its intention to deliver on a promise or policy, especially when there may be incentives to deviate from that commitment in the future.

implement reforms, suggesting a genuine commitment to change (Xifré, 2020). This signalling function enabled countries in the hard core of the EU to support rescue programmes and deeper integration despite initial reluctance (Xifré, 2020). Such analysis aligns with the observation that intergovernmental negotiations in the EU often involve tough negotiations in which credible signals of commitment play a crucial role (Schimmelfennig, 2015). Even if this combination of war and negotiation between Member States seems unnecessary, strategic interactions are important for shaping the EU's responses to the crisis (Schelkle, 2019).

The ideas that emerge from applying game theory to EU economic problems broaden the understanding of complex interactions within the Union. Thus, conditionalities and incentives can effectively promote reforms and cooperation but have limits (Steunenberg and Dimitrova, 2007). For example, in the context of EU enlargement, the promise of accession can spur candidate countries to implement reforms. However, this effectiveness is diminishing as the date of accession approaches, highlighting the time limits of these incentives. On the other hand, repeated interactions and an indefinite time horizon promote cooperation (Schimmelfennig, 2015). It suggests that when EU Member States expect to engage in ongoing negotiations and collaboration without a definite end point, they are more likely to cooperate because the benefits of long-term cooperation outweigh the short-term gains from desertion. It is equally valid that changes in preferences or values, such as the attitude towards reforms, can modify the structure of the game (Weiss and Agassi, 2021). This means that changes in public opinion or political ideologies within Member States can transform the nature of interactions at the EU level, potentially changing a prisoner's dilemma into a deer-hunting scenario in which cooperation becomes more favourable.

In the EU, institutional design is important for implementing credible agreements and commitments (Schimmelfennig, 2015; D'Andrea and Vassalli, 2023). The structure of the institutions, such as the European Commission or the ECB, plays a crucial role in ensuring compliance with the Member States' commitments. For example, the structure of the European Stability Mechanism influences how effectively it can react to financial crises. Moreover, the EU approach to crisis management can be understood as a series of two-level games that balance internal and inter-state pressures (Schelkle, 2019). This means that EU leaders must simultaneously negotiate with other member states at the European level while also considering the demands and constraints of their domestic electorate, leading to complex decision-making processes.

Overall, the EU's conditional cooperation and integration approach has been more successful than the traditional power policy in promoting stable peace and economic cooperation (Weiss and Agassi, 2021). This suggests that the EU's strategy of fostering interdependence and creating mutual benefits through integration has been more effective at preserving peace and prosperity than approaches based on military deterrence or a balance of power policy.

This case study analyses the interactions between euro area actors during 2016-2019 and 2023-2024, respectively. The two-year interval 2020-2022 was excluded from the analysis to avoid the influences of the two major shocks (the pandemic and war in Ukraine) and their influences on the supply and prices of energy and food. In this case study, the theoretical framework of game theory is used, with emphasis on the prisoner's dilemma and the "tooth for tooth" ("*tit for tat"*) strategy*,* to which is added a tolerant behaviour ("*being nice"*). The application of the prisoner's dilemma is considered from the point of view of the theory of common goods, as developed by Ostrom (Ostrom, 1990). Confidence in the euro is a common good, and managing this common resource is not considered a zero-sum game. Still, it is based on the premise that, as Ostrom pointed out, a way of using this common good sustainably can be found through game theory.

The "*tit for tat*" strategy, introduced by Anatol Rapoport, is an approach in game theory, particularly characteristic in the context of the infinite repeated prisoner's dilemma (in which the game repeats itself without the players knowing when the last round will take place). This strategy works by simple rules: the player starts by cooperating and then, in subsequent rounds, applies each other's previous movements. If the opponent cooperates, the player continues to cooperate; if the opponent does not cooperate, the player responds with non-cooperation in the next round. This strategy thus allows cooperation to resume after a single round of non-cooperation and punishes the lack of immediate cooperation. In the late 1970s and early 1980s, political scientist Robert Axelrod organised a series of computer tournaments to evaluate various strategies for repeated prisoner's dilemma games (both finite and infinite). Participants presented strategies in the form of software, which were then compared to each other to determine which strategy had the highest score. The "*tit for tat*" strategy, presented by Rapoport, won the first tournament and recorded good results in the subsequent iterations. This strategy has proved robust, encouraging cooperation even under competitive conditions. Axelrod's tournaments highlighted the dynamic stability of the "all for tat" strategy, demonstrating how cooperative strategies can emerge and maintain themselves within a population.

The '*tit for tat*' strategy is effective for at least six reasons. Firstly, it promotes cooperation by starting with cooperation and continuing to respond with the opponent's previous movement, leading to higher cumulative gains for both players than continuous non-cooperation. This approach helps to avoid the mutually destructive results of continued non-cooperation. Secondly, it balances reprisals and forgiveness by immediately punishing non-cooperative behaviour while demonstrating a willingness to return to cooperation if the opponent does so, thus preventing prolonged cycles of retaliation and maintaining the potential for positive interactions. Thirdly, its clarity and predictability facilitate the understanding and adaptation of opponents, fostering confidence and encouraging cooperative behaviour by clarifying the consequences of actions. Fourthly, '*tit for tat'* demonstrates evolutionary stability, as strategies promoting cooperation tend to be more resilient over time. Those who do not cooperate cannot thrive in a population of individuals who use the "*tit for tat*" strategy because their uncooperative behaviour is constantly greeted with a negative response. Fifth, when widely used within a group, '*tit for tat*' favours a cooperative environment. It motivates individuals to cooperate and improves the overall performance and well-being of the group by establishing a culture of mutual support and collaboration. Finally, the adaptability of this strategy to different opponents, from highly cooperative to highly competitive, demonstrates its versatility and robustness to various strategic approaches, as demonstrated by its success in multiple scenarios in Axelrod's tournaments.

Robert Axelrod conducted further experiments to explore additional aspects of the tested strategies, focussing on behavioural traits. After the initial success of the "*tit for tat*" strategy, Axelrod tried to understand why it worked so well and if other strategies with similar characteristics would be effective. In the context of the iterated prisoner's dilemma, a tolerant strategy ("*being nice*") is defined as a strategy that never initiates non-cooperation, always beginning with cooperation and resorting to non-cooperation only in response to another player's non-cooperation. Axelrod identified tolerance as a basic factor in the success of the "*tit for tat*" strategy and conducted additional tournaments and simulations to test this attribute. These experiments have shown that tolerant strategies have generally produced better results than aggressive or misleading ones, creating trust and stable cooperation models. They help avoid mutual non-cooperation traps, leading to better results for both players. Tolerant strategies encourage cooperation from initially uncooperative opponents, as their predictability and fairness highlight that cooperation is rewarded, thus reducing overall conflict. Axelrod also tested the robustness of tolerant strategies in diverse contexts, such as turbulent environments and diverse populations. He introduced errors to simulate flawed communication, but the tolerant "*tit for tat*" strategy proved effective due to its permissive nature. Simulations with mixed strategy populations have shown that tolerant strategies can dominate or withstand all games and rounds. In addition, Axelrod found that tolerant strategies are stable solutions, as they bring higher average rewards to all players, leading to the widespread adoption of these strategies within the population.

The "*tit for tat*" strategy involves a response to the partners' actions by replicating their previous behaviour, thus promoting cooperation. '*being nice*' adds an element of clemency, allowing for tolerance of minor deviations in order to maintain cooperative relationships in the long term. The study attempts to ascertain whether the Member States' tax choices match the game theory predictions by measuring tax behaviour through two fundamental indicators: the budget deficit and public debt.

III.1 Case study: period 2016-2019

The choice of the 2016-2019 period for this analysis is motivated by the completion in 2016 of the crisis management and macroeconomic surveillance framework in the euro area. This framework includes several institutional reforms achieved following the financial crisis in 2008. The European Stability Mechanism was set up in 2012 with the purpose of providing financial assistance to member states experiencing financial difficulties. In 2014, the Banking Union, comprising the Single Supervisory Mechanism and the Single Resolution Mechanism, was established to ensure centralised supervision and efficient management of bank failures. In 2015, the SGP was strengthened by introducing stricter fiscal rules and more explicit sanction mechanisms for states that violate the deficit and public debt criteria. All these reforms were fully implemented in 2016, strengthening the economic governance framework of the euro area. The upper end of the range (2019) was chosen not to include the year of the pandemic in this analysis, as this shock substantially altered the macroeconomic results. The selected time frame thus provides the opportunity to assess the effectiveness of the new crisis management and surveillance mechanisms in a context of relative stability.

Focussing the analysis on the degree of compliance of budgetary plans for each Member State is justified by the fact that it allows the early identification of potential risks and imbalances, which demonstrates a medium- and long-term vision. In addition, compliance with the budgetary plans provides a more comprehensive picture of the sustainability of public finances because it is the result of a detailed analysis of the expenditure and revenue structure, the proposed structural reforms and the fiscal consolidation measures. Last but not least, conformity assessment encourages greater transparency and accountability in the national budgeting process, which should promote financial stability and confidence in the common currency and the euro area as a whole.

Compliance with the budgetary plans for euro area countries concerns the alignment of national fiscal policies with the rules and objectives set at the European level in the SGP. This process involves Member States submitting their draft national budgets to the European Commission for assessment, ensuring that they comply with the SGP criteria, such as keeping the budget deficit below 3percent of GDP and public debt below 60percent of GDP. For Member States with a government debt level exceeding 60percent of GDP, the debt reduction rule is applied, which requires that the difference between the current debt level and the 60percent threshold be reduced by an average rate of one-twentieth (1/20) per year over a three-year period. These countries have to present detailed debt reduction plans and are subject to stricter monitoring. If they fail to reduce their debt rapidly, they may be subject to the excessive deficit procedure, even if their budget deficit is below 3 percent of GDP.

The PSC operates through two main mechanisms: the preventive arm and the corrective arm. The precautionary arm aims to ensure sound fiscal policies in normal times, using instruments such as the medium-term budgetary objective (MTO) and the expenditure rule. The spending rule limits the annual growth of government expenditures to the medium-term potential growth rate of GDP. The corrective arm, the Excessive Deficit Procedure (EDP), is applied when a state breaches fiscal criteria, including those related to public debt. The EDP involves several formal steps: initially, the European Commission issues an official warning, followed by specific recommendations from the EU Council for budgetary adjustment, with clear deadlines for implementation. The Commission is closely monitoring the progress of the country concerned. If measures are not complied with and the deficit persists, financial penalties may be applied, starting with the obligation to lodge an interest-free deposit with the Commission. In extreme cases, the state can be fined up to 0.2percent of GDP. The most severe penalty involves suspending access to EU structural and investment funds until the deficit is corrected.

The concrete elements of the game in this case study are as follows, according to Table 1:

Table 1: Elements of the game

Elements of the game	Description
Players	euro area Member States, European Institutions (Commission, Council and Eurogroup)
Possible strategies	- cooperation: keeping the budget deficit and public debt within agreed limits, in line with the recommendations of the European institutions; - non-cooperation: exceeding budget deficit and public debt limits, adopting a more relaxed fiscal policy, and not respecting the recommendations of the European institutions.
Rewards of strategies	- cooperation: long-term economic stability, increased credibility on the financial markets, financial support and assistance from the European institutions; - non-cooperation: stimulates short-term economic growth, but there is a risk of increasing debt, loss of financial credibility, sanctions, or lack of financial support from European institutions.

Rules of the game	- member states make independent decisions on fiscal policy, but the regulations and recommendations of the European institutions influence these decisions. - European institutions can react to the decisions of member states by applying sanctions, offering financial support, or using other measures of influence.
Nature of the interaction	over the period under review, allowing the observation of whether states follow the "*tit for tat, being nice*" strategy.
Scenarios analysed	- comparison of Member States' tax behaviour and identification of tax cooperation or conflict models. - to assess the European institutions' responses to these behaviours and their effects on the overall economic stability of the euro area.
Implementation of the strategy	initiating cooperation: - eurozone member states initiate cooperation through tight fiscal policies in line with the European institutions' recommendations, keeping the public deficit and debt within set limits. - European institutions support these states with financial support measures and favourable monetary policies. reply to previous conduct: - cooperation: If one Member State continues to adopt strict fiscal policies, the other Member States and the European institutions will respond positively, continue to support finance, and maintain favourable conditions for economic stability. - deviation: If a Member State decides to adopt relaxed fiscal policies, exceeding the limits of budget deficit and public debt, the European institutions may apply sanctions or withdraw financial support. tolerance ('being nice'): - tolerance for minor irregularities: If a Member State exceeds limits slightly for justified reasons (e.g. unforeseen expenditure on critical investments), the European institutions may choose not to apply sanctions immediately, providing a grace period for correcting the behaviour. - Encouraging long-term cooperation: This selective tolerance promotes trust and cooperation, allowing Member States to adjust policies without immediately losing institutional support. monitoring and adjustment: - continuous monitoring: European institutions continuously monitor the member states' fiscal behaviour and economic adjustment to assess whether cooperation strategies are maintained. - proportionate response: sanctions or financial support are adjusted in proportion to the behaviour of Member States, thus encouraging compliance with established fiscal policies.

The data in Table 2 shows three changes in the evolution of fiscal discipline and stability in the euro area over the period 2016-2019, analysed in the light of the compliance of Member States' budgetary plans[25]. First, the number of Member States for which full compliance was recorded has doubled from five in 2016 to ten in 2019. Secondly, the increase in the number of fully compliant states resulted from a decrease in the number of euro area Member States with partial compliance. Finally, the number of States at risk of non-compliance remained constant at five. Importantly, in 2019, no Member State was in the EDP. It is interesting to mention the mutations between these groups, both positive (Austria and Lithuania moved into the full compliance group after being in the compliance risk group in 2016) and negative (deterioration of the situation in Estonia and Slovakia, which moved from the full compliance group to the partial compliance group, respectively Belgium, France and Slovenia, which moved from the partial compliance group to the non-compliance risk group), respectively the example of Italy which was listed in the serious risk of non-compliance category.

Table 2: The EU Commission's opinion on the compliance of the preliminary budgetary plan with the SGP

2016	2019
Full Compliance	Full Compliance
Estonia (Preventive arm)	Austria (preventive arm)
Germany (Preventive arm)	Cyprus (Preventive Arm)
Luxembourg (Preventive arm)	Finland (preventive arm)
Netherlands (preventive arm)	Germany (Preventive arm)
Slovakia (preventive arm)	Greece (Preventive Arm)

[25] Full compliance means that a Member State's budgetary plan fully complies with the criteria set out in the SGP, including limits on the budget deficit (below 3percent of GDP) and public debt (below 60percent of GDP). States that are in full compliance do not require significant adjustments in their fiscal policies to comply with the rules of the SGP and are considered to have a prudent and sustainable fiscal policy. Partial compliance indicates that a Member State's budgetary plan is partly compliant with the SGP criteria. Although the budget deficit and public debt may be within or close to the limits set, there are some aspects of the budgetary plan that require adjustments to ensure full compliance. In this case, the European Commission may recommend corrective measures to improve compliance. Non-compliance refers to a situation where a Member State's budgetary plan does not comply with the SGP criteria. This may mean that the budget deficit exceeds 3percent of GDP, or that public debt is over 60percent of GDP without a credible plan to reduce it. In case of non-compliance, the European Commission may trigger EDPs and impose progressive sanctions until the Member State adopts adequate measures to comply with the SGP rules. The analysis in this section is based on both the Commission's views and the statements of the Eurogroup on the preliminary budgetary plans of the euro area Member States.

	Ireland (Preventive Arm)
	Lithuania (Preventive arm)
	Luxembourg (Preventive arm)
	Malta (preventive arm)
	Netherlands (preventive arm)
Partial Compliance	Partial Compliance
Belgium (preventive arm)	Estonia (Preventive arm)
Finland (preventive arm)	Latvia (preventive arm)
Latvia (preventive arm)	Slovakia (preventive arm)
Malta (preventive arm)	
France (EDP, deadline 2017)	
Ireland (EDP, deadline 2015)	
Slovenia (EDP, deadline 2015)	
Risk of non-compliance	Risk of non-compliance
Austria (preventive arm)	Belgium (preventive arm)
Italy (preventive arm)	France (preventive arm)
Lithuania (Preventive arm)	Portugal (Preventive arm)
Spain (EDP, deadline 2016)	Slovenia (preventive arm)
Portugal (EDP; deadline 2015)	Spain
	Serious risk of non-compliance
	Italy

Source of information: 'Box 7 Review of draft budgetary plans' table 2016 for 2016' (ECB, 2015); Eurogroup statement (Eurogroup, 2018)

According to the game theory analysis, the euro area member states had, except Italy, a cooperation strategy. At least two arguments support this claim. Firstly, at the end of the period, all the states were on the preventive arm, with no EDP cases. This can be interpreted as having the following meaning: member states considered the payoffs for the cooperation strategy more advantageous than those for the non-cooperation strategy. In other words, the cost of EDP is greater than the benefits a non-cooperation strategy can bring (only in the short term). Secondly, the increase in the number of Member States in which full compliance has been achieved against the backdrop of the decrease in the number of States for which partial compliance has been recorded may be tantamount to the fact that the tolerant 'tit for tat' strategy followed by the European institutions has finally led the Member States to choose the cooperation strategy in the subsequent rounds.

However, this interpretation seems inconsistent with the experience of those countries for which the level of compliance of budgetary plans has worsened from full compliance to partial compliance (Estonia and Slovakia), i.e. from partial compliance to risk of non-compliance (Belgium, France and Slovenia).

The assessment of Estonia's budgetary plans deteriorated from full compliance in 2016 to partial compliance in 2017, mainly due to the increase in deviations from the medium-term objective for the structural balance and the expenditure benchmark. Although Estonia initially maintained strong fiscal discipline, minor deviations emerged, especially in structural balance and expenditure growth, which exceeded the permitted limits set by the SGP. In response, Estonia has taken several steps over the years: in 2017, the government stepped up fiscal consolidation and tighter expenditure control efforts; in 2018, it stepped up its efforts with strong measures to control expenditure growth and improve revenue collection; and in 2019, it further strengthened its medium-term budgetary framework to ensure better compliance with the SGP. In addition, over these years, the government has implemented structural reforms aimed at boosting economic productivity. The European Commission underlined the need for Estonia to implement these corrective measures and considered them partially effective as they demonstrated Estonia's commitment to address fiscal problems. However, it emphasised that further adjustments are needed to fully align with the SGP objectives and ensure long-term fiscal sustainability.

This unfolding of the game seems to suggest that the Commission's and the Eurogroup's tolerant *'tit for tat'* cooperation strategy has borne fruit. Thus, the European institutions' response after the round in which Estonia did not cooperate for the first time was to signal the risk and urge Estonia to take the necessary measures. In the following round, although the reforms adopted by Estonia did not lead to the correction required to return to full compliance, the European institutions did not consider this as an uncooperative strategy (given that Estonia had taken corrective action) and chose the tolerant response option, suggesting directions for action by Estonia. Estonia can be considered to have responded with a cooperative strategy, resorting to a series of reforms which, even if they did not deliver the expected result within the time frame under review, show a willingness to cooperate for the stability of the euro.

The European institutions considered that Slovakia's budgetary plans have moved from full compliance in 2016 to partial compliance in the coming years due to structural balance issues and the lack of more rigorous fiscal measures. In 2017, the Commission highlighted the risks related to the revenue and structural balance forecast, calling for Slovakia to continue fiscal consolidation efforts and tighten fiscal policies to address these concerns. In 2018, the European institutions acknowledged the structural balance and growth improvements. Still, they stressed the need for continued vigilance related to the potential vulnerabilities of revenue estimates and public expenditure management. Slovakia responded by further aligning its fiscal policies with its medium-term objectives and reducing the budget deficit. In 2019, the Commission underlined the importance of reducing the debt-to-GDP ratio to increase economic resilience. Slovakia projected further deficit cuts while maintaining its commitment to fiscal discipline and economic stability.

As in the case of Estonia, it can be noted that at each round of the game, Slovakia proposed and carried out several reforms. Even though this did not lead to budgetary plans falling back into full compliance, the tolerant attitude of the Commission was generated by Slovakia's cooperation strategy.

Belgium's budgetary plans in the period under review are a case where the Commission's assessment has moved from the level of partial compliance to the lower level of risk of non-compliance. Still, this deterioration has not also led to a switch to the corrective arm. The change in the framing of Belgium's budgetary plans took place in 2017. This was driven by insufficient structural fiscal adjustments and slow implementation of key reforms, particularly in pensions and healthcare, which failed to achieve the medium-term budgetary objective set by the SGP. In response, Belgium has undertaken several measures, including further fiscal consolidation efforts, improvements in public expenditure control and initiatives to increase revenue collection. The structural reforms of the pension system have been accelerated, and measures have been taken to control healthcare costs. Despite these efforts, problems remained that prevented the Commission from re-assessing the risk of non-compliance for 2019. The pace and extent of the structural adjustments were still considered inadequate, and difficulties in fully implementing the necessary reforms persisted. It is worth noting that the language used by the Commission in 2019 has shifted from a tone of concern to a tone of urgency, reflecting dissatisfaction with the pace of Belgium's fiscal adjustments. The Commission's 2019 assessment highlighted that the planned structural adjustment 'is inappropriate'. It urged Belgium to take 'corrective action', in contrast to the 2018 language, which underlined 'the need for more rigorous fiscal consolidation measures' and 'acceleration of structural reforms'.

The conduct of these successive rounds between Belgium and the European institutions may suggest at least two things: on the one hand, both sides have adopted '*tit for tat'* cooperation strategies, with the Commission maintaining a tolerant attitude, which has led to some critical reforms in Belgium, albeit not on the scale and speed sought by the European institutions; on the other hand, the change in tone of the Commission's language indicates that there is a limit to the tolerance which the players are willing to adopt in this strategy.

The example of Belgium may suggest that it is important for each state to infer what it is and what the limit of tolerance it can expect from the other players in each round.

The sequence of rounds between European institutions and France is interesting because it can reveal the relationship between players when, at a certain point, one of them adopts a strategy that closely approximates non-cooperation.

France's transition from the corrective arm to the preventive arm of the SGP, accompanied by a shift in assessment from partial compliance to risk of non-compliance, involved multiple rounds, consisting of reform recommendations from European institutions and France's responses. Since 2009, France has been under the corrective arm (SREP) because the general government deficit exceeds the 3percent GDP threshold. By 2017, France had reduced its deficit to 2.6percent of GDP, thus meeting the SGP criteria. This improvement led the Commission to recommend in May 2018 France's exit from the EDP, officially approved in June 2018, marking the end of almost a decade of strict fiscal surveillance.

In 2016, the European Commission assessed France's draft budgetary plan as fully compliant but recommended labour market reforms, reducing the tax burden on labour and rationalising public spending. In response, France implemented a law to facilitate recruitment and dismissal and introduced tax incentives to stimulate investment. The government has also worked to improve the efficiency of the public sector and reduce the budget deficit by cutting spending in areas such as health and education. The Commission also maintained full compliance with the 2017 draft budgetary plan but reiterated the need for structural reforms, including improving the business environment and the efficiency of public spending. The measures implemented by France continued by reducing corporate tax rates, increasing labour market participation and simplifying business administrative processes. In 2018, France's budget plan was assessed in the non-compliance risk group due to insufficient structural adjustments and high public debt. This led to recommendations for ambitious fiscal measures and labour market reforms. France responded with a law to increase flexibility in the labour market and to increase investment in digital and green technologies. In its opinion on the 2019 budget plan, the Commission called for more stringent fiscal consolidation measures and further structural reforms, including modifying the pension system. France, by contrast, has maintained its focus on reforms while advocating flexibility under the SGP to support investment in growth-enhancing sectors.

France's replies in the dialogue on budgetary plans in 2018 and 2019 could be seen as evidence that in these rounds, especially in 2019, France resorted to the non-cooperation strategy. Thus, while France focused on structural changes in 2018 without addressing the high public debt, in 2019, Paris explicitly called for more flexibility in the SGP.

The choice of non-cooperation strategy, particularly in the 2019 round, seems, at least prima facie, to have been a win for France. However, in 2019, French government bond yields, particularly those with a 10-year maturity, showed increased volatility, and the spread between French and German 10-year bonds increased. These are clear signs that investors have demanded higher risk premiums for holding French debt, reflecting their caution and concerns about France's fiscal situation. However, the reactions of the financial markets to France's strategy seem to suggest that the Commission's implementation of the *'tit for tat'* strategy in the next round of non-cooperation is effective.

Another interesting example of the application of the *tit for tat* strategy by the European institutions is the case in Italy. This Member State was covered by the SGP's precautionary arm between 2016 and 2019, but its budgetary plans were considered to present a risk of non-compliance (2016-2018), progressing towards a serious non-compliance (in 2019) for several reasons: (i) as regards fiscal policies, on the one hand, Italy's budgetary plans were consistently assessed as insufficient in terms of structural efforts and debt reduction, the European Commission showing that Italy's plans did not provide for adequate measures for the achievement of the MTO or sufficient debt reduction; on the other hand, each year, Italy's plans exhibited significant deviations from the fiscal adjustment paths necessary to ensure long-term sustainability and compliance with the requirements of the precautionary arm; (ii) Italy's public debt consistently exceeded 130percent of GDP, well above the 60percent threshold stipulated by the SGP, and the implementation of debt reduction measures failed; (iii) Italy's successive governments and economic policies in these years gave priority to economic growth and social spending over strict fiscal consolidation.

Due to several factors, the European Commission has changed its assessment of Italy's draft budgetary plan 2019 from 'risk of non-compliance' to 'particularly serious non-compliance'. Firstly, the 2019 budgetary plan included substantial deviations from the fiscal recommendations, mainly through increased public spending and tax cuts, undermining fiscal consolidation efforts. Secondly, Italy's high public debt, which remained at over 130percent of GDP, was not diminished by the proposed measures, which raised concerns about debt sustainability. Thirdly, the budget provided for a worsening of the structural balance, indicating a significant departure from the necessary structural improvements required by the European institutions. Fourthly, the lack of substantial structural reforms in the budget stimulating economic growth was considered a serious problem. Finally, despite continuous communications, including letters and high-level meetings, the Italian Government's fiscal policies for 2019 continued to clash with the euro area fiscal rules.

The sequence of the dialogue between Italy and the European institutions, in particular concerning the draft budget for 2019, shows how the non-cooperation strategy and the '*tit for tat*' strategy have evolved in this case. Thus, in the first two rounds, 2016 and 2017, the European institutions applied the tolerant *'tit for tat'* strategy and chose to respond with the cooperation strategy; even though Italy failed to improve its budgetary plans towards partial compliance, but managed to introduce some reforms (reduction of some budgetary expenditure and some pension reforms), even though they were too limited in relation to the handicap to recover and their implementation was inadequate. In contrast, in the round related to the 2019 budget draft, Italy can be considered to be already at the second stage of non-cooperation because in the previous year, Italy, although having the recommendation to make a structural adjustment of at least 0.3percent of GDP, chose expansionary fiscal measures (pension reform).

The response of the European institutions, applying the *'tit for tat'* strategy, represents a lack of cooperation by placing Italy's 2019 budget plans in the 'severe non-compliance' group, although this strategy was implemented gradually after having gone through several stages of attempting a dialogue with the Italian authorities. Thus, The Commission has sent several formal letters stating its concerns and asking for revisions. For example, on 23 October 2018, the Commission formally requested Italy to submit a revised draft budgetary plan due to the serious risks of non-compliance. In response, Italy submitted a revised plan on 13 November 2018. However, the Commission still found problems with this revised plan, claiming that the proposed measures were insufficient to comply with EU tax rules. Summits took place between Italian officials and the Commission to discuss possible adjustments and compromises which would align Italy's economic priorities with the EU's fiscal requirements. The Commission's public statements and press releases underlined the importance of fiscal discipline and the need for Italy to respect the SGP. This transparency aimed to keep pressure on Italy to comply. Even after submitting the revised plans, the Commission continued to monitor Italy's fiscal policies, providing further assessments and recommendations to ensure final alignment with EU standards.

The effects of the European institutions' non-cooperation strategy materialised in that the yields on Italian government bonds experienced significant volatility, reflecting investors' concerns about the country's fiscal stability. The differential between Italian and German bonds (BTPs) has increased considerably, peaking at more than 300 basis points at the end of 2018, as the conflict between Italy and the Commission/Eurogroup has intensified. Credit rating agencies responded to the fiscal uncertainty by downgrading Italy's sovereign debt or placing it under negative supervision. Moody's downgraded Italy's rating to one notch above *junk status* in October 2018. Continuing budgetary squabbling and Italy's resistance to the Commission's recommendations have led to a decline in market confidence, with the Italian stock market experiencing volatility, especially in the financial sector. Increased borrowing costs and market uncertainty had broader economic implications, such as increased debt service costs and a reduction in the budget for public investment and social expenditure.

These increased market reactions have probably pressured the Italian Government to consider more fiscally responsible policies to avoid further destabilisation. Thus, the Commission's pressures ultimately helped avoid an EDP's launch. Moreover, by the end of 2019, budget execution was more prudent, and revenue collection exceeded expectations, which contributed to improving market sentiment and reducing sovereign yields.

At least two hypotheses relating to the behaviour of Member States in relation to budgetary plans can be made, both of which are related to rewards. The first explanation would be that for member states, it is relatively easier to correct the level of budget deficit than that of public debt, except in cases where the structural deficit causes the problem. The second potential explanation lies in the more stringent threats and penalties for exceeding this indicator compared to those for surpassing the public debt indicator. This may be interpreted as European institutions exhibiting lower tolerance for deficit threshold violations relative to debt threshold breaches.

The examples of states that managed, during the analysed period, to progress from partially compliant budgetary plans to full compliance status can be cited in support of the first hypothesis. The second explanation is supported by the tolerant 'tit for tat' strategy because, on the one hand, member states are aware that non-cooperation (in terms of exceeding the budget deficit) may attract more intense sanctions or pressures in subsequent rounds from community institutions. Regarding tolerance, European institutions, such as the European Commission and the Eurogroup, have placed particular emphasis on monitoring and correcting budget deficits. These mechanisms ensure continuous surveillance and the implementation of swift corrective measures without requiring the application of sanctions. Therefore, a strong incentive exists to comply with the budget deficit criterion. On the other hand, although maintaining budget deficit control has immediate political and economic costs, these are considered relatively manageable by member state decision-makers (though reservations can be formulated on this point due to the fact that public opinion is encouraged to believe that community institutions are to blame for these budgetary adjustments, which contributes to reducing confidence in the euro project). Thus, it can be said that it is easier for euro area Member States to cooperate in maintaining the budget deficit criterion rather than the public debt criterion, thanks to strict monitoring mechanisms, pressure to comply with fiscal rules and incentives to avoid immediate sanctions.

However, the interpretation which has hitherto been given to the interactions between euro area Member States and European institutions can also be seen from the perspective which negates both the '*tit for tat'* strategy and the advantages of a tolerant and sympathetic attitude. A first argument against the effectiveness of the Commission's *tit for tat* strategy is that of limited impact. According to this explanation, changes in the attitude of states to the SGP were mainly driven by domestic economic and political factors rather than by the Commission's approach. The evidence for this argument is more difficult, but not impossible, to obtain and requires an econometric analysis comparing the relative impact of domestic economic factors (such as GDP growth and/or unemployment), policies (such as electoral cycles and government policy orientation) and the Commission's strategy on the fiscal decisions of euro area Member States in 2016-2019. Such an analysis, using a regression model and examining the annual changes in the structural budget balance as a percentage of GDP, could show whether the Commission's strategy had a statistically significant and substantial effect compared to other drivers.

To these can be added the argument of the influence of the economic cycle that the improvements observed in the attitude of Member States towards the SGP were the result of favourable economic conditions in the period 2016-2019 rather than the Commission's strategy. This would require an econometric analysis comparing the magnitude of the structural component of the deficit with indicators of the flexibility of the Commission's attitude in order to determine to what extent fiscal improvements can be attributed to the *'tit for tat'* strategy versus favourable general economic conditions in that period.

Another argument against the above conclusions could be that of the inconsistency of the application of the Commission's *'tit for tat*' strategy tolerant of each Member State, suggesting that this could undermine the effectiveness and credibility of this strategy. Evidence for this argument would be a detailed comparative analysis of country-specific recommendations and the Commission's views on EDP for Member States with similar fiscal situations. This analysis has to examine cases where countries with comparable fiscal indicators received different treatments, highlighting potential inconsistencies in the implementation of the strategy and their impact on Member States' attitudes towards the SGP in the period 2016-2019. In the case of the preliminary budgetary plans discussed above, it can only be said that the perception of favouritism in the Commission's assessments must be understood in a nuanced way. While some Member States with similar fiscal indicators received different assessments, this was often due to structural differences and specific fiscal measures proposed in the preliminary budgetary plans. For example, the various levels of compliance observed in countries with comparable debt ratios can be attributed to differences in fiscal policy measures, growth projections and compliance with previously recommended structural reforms.

Moral hazard can also be argued that the Commission's strategy encouraged Member States to expect continued flexibility, thus undermining long-term fiscal discipline. The primary evidence in favour of this criticism would be an analysis of trends in structural budget deficits and government debts of states after 2019. This analysis would highlight any systematic easing of fiscal discipline during the periods of flexibility granted, comparing fiscal behaviour before and after 2019 and between countries that have received different levels of flexibility. Unfortunately, this argument cannot be proven given that the macroeconomic framework was affected, at least in the period 2020-2023, by the series of shocks starting with the pandemic and continuing with all the problems caused by the outbreak of the war in Ukraine.

Another critique of the benefits of the 'tit for tat' strategy could be that it encouraged states to adopt temporary fiscal measures at the expense of long-term structural reforms. The primary evidence for this argument would be a comprehensive study evaluating the nature of fiscal measures adopted by member states (temporary vs. structural) following the Commission's recommendations based on the 'tit for tat' strategy. This study would analyse the proportion and impact of short-term measures compared to structural reforms, highlighting any tendency to favour quick but unsustainable adjustments to benefit from the Commission's flexibility. An indication in this regard would be if states that had reached the 'full compliance' group suddenly fell into the 'risk of non-compliance' group. Unfortunately, as was the case of the moral hazard argument, testing is difficult. However, among the states that had achieved 'full compliance' in 2019, only Finland's preliminary budget plan (drafted at the end of 2019) for 2020 was moved to the 'risk of non-compliance' group, with the Commission being concerned about the projected increase in public spending and structural budget deficit.

From this analysis and interpretation of the experience of euro area Member States, at least two lessons can be drawn for those Member States bound by the Treaty to adopt the common currency but have not yet done so. However, these two lessons are not linked to economic criteria.

Firstly, the authorities must be willing and prepared to communicate effectively and have confidence in the euro area's partners (the European institutions and the other members of the eurozone). In other words, decision-makers who look on in disbelief at European partners (either because they have different priorities or because they feel they are being treated differently) cannot participate in honest dialogue or trust the common governance framework.

Secondly, the authorities in the Member States which have to adopt the euro must be institutionally ready to deal with the rigours of the euro area's monitoring and sanctioning mechanisms (which, however, are more advantageous than the financial markets, especially in the case of structural problems). Thus, strengthening administrative and legal capacities is essential, both through the adoption of legislative reforms to align national legislation with European standards and primarily through strengthening supervisory institutions. Fiscal and budgetary management improvements are achieved by implementing sustainable fiscal policies and creating a transparent system for reporting economic and fiscal data. The ability to respond to economic and financial crises is an important pillar, requiring the development of effective mechanisms for rapid response and effective cooperation with European institutions. Civil servants' education and further training significantly contribute to ensuring that the euro area regulations and standards are correctly understood and applied. Furthermore, while some states continue to maintain faith in the potential assistance offered by monetary policy independence during necessary adjustments, this must be balanced against the critical threshold of public debt at which markets retain confidence in authorities' adjustment implementation capacity. This public debt threshold becomes progressively lower as the severity of structural problems in the economy increases.

III.2 Case study: 2023-2024 period

Further, the analysis of Eurozone member states' strategies for 2023-2024 can provide insights into cooperative behaviours or their absence from at least three perspectives. Economically, this period is crucial for post-pandemic recovery and rehabilitation following the shocks generated by the war in Ukraine, and the adopted strategies can reveal how member states perceived the contribution of implementing national recovery and resilience plans to economic stability and resilience. Institutionally, from the perspective of the European Commission and Council's response, this period provides an opportunity to observe how these institutions manage and sanction non-cooperative behaviours, thus ensuring compliance with fiscal and economic rules. Politically, the period is marked by a context dominated by the war in Ukraine and the European Parliament elections in the EU and most member states, offering the opportunity to evaluate states' commitment to Eurozone rules in an uncertain environment. Additionally, this period allows for validating the applicability of Ostrom's theory in governing common resources through the observation of norms and monitoring and sanctioning mechanisms.

As in the first part of the analysis, the focus is on the preliminary budgetary plans of each Member State. The period taken into account being shortened, the justification for the study of the Preliminary Budgetary Plans is related both to the fact that they reflect the dynamics of the relationship between the Member States and the European Institutions and to the fact that the conformity assessment encourages greater transparency and accountability in the process of drafting the national budgets, which should promote financial stability and confidence in the common currency and in the euro area as a whole.

For this period, it is significant to what extent the Commission considered that the preliminary budgetary plans of each Member State were in line with the Council recommendations. The recommendations for the 2023 and 2024 budgets reflect a change in the approach to fiscal policy. In 2023, the general derogation clause of the SGP remained in place, allowing for more flexible fiscal policies in response to the ongoing economic shocks caused by the war in Ukraine. The recommendations for 2023 were primarily qualitative, considering the uncertain economic environment. However, for 2024, it was announced that the general derogation clause would be deactivated by the end of 2023, signalling a return to stricter fiscal rules. This change is accompanied by introducing quantitative and country-specific fiscal recommendations for 2024, specifying maximum growth rates for net expenditure. Furthermore, while the 2023 recommendations allowed for the continuation of temporary and targeted energy support measures, the 2024 guidelines explicitly call for the phasing-out of these measures as soon as possible in 2023, especially in 2024.

In addition, the focus on public investment has evolved over the two-year period. The 2023 recommendations highlighted the expansion of public investment, particularly for green and digital transitions and energy security, with the mention of the REPowerEU initiative. Instead, the 2024 guidelines focus more on preserving existing national investments financed without specifying particular areas. As regards EU funds, the use of the Recovery and Resilience Facility (RRF) and other Union funds was encouraged for both fiscal years, but the 2024 recommendations put more emphasis on ensuring their effective absorption. Finally, the approach to targeting expenditure growth became more precise. While the 2023 recommendations only indicated their growth dynamic relative to potential GDP growth over the medium term, the 2024 recommendations introduced specific maximum growth rates for net expenditure, pointing to a move towards more concrete fiscal targets.

The elements of the game for this period are contained in Table 3.

Table 3: Elements of the game for 2023-2024

Elements of the game	Description
Players	euro area Member States, European Institutions (Commission, Council and Eurogroup)
Possible strategies	- cooperation: (i) Member States maintain their budget deficit below the 3percent of GDP threshold and manage their public debt to below 60percent of GDP or to show a downward trend. In 2023, the general derogation clause allowed some flexibility, but

	for 2024, strict rules are being reverted with maximum growth rates for net expenditure; (ii) Member States follow the specific recommendations made by the European Commission, including the phasing out of temporary energy support measures and the preservation of public investment, especially in critical areas such as green and digital transitions; (iii) Member States are making effective use of the Recovery and Resilience Facility (RRF) and other European funds to support economic growth and fiscal stability. - non-cooperation: (i) Member States adopt relaxed fiscal policies that result in exceeding the 3percent of GDP budget deficit threshold and/or maintain public debt at unsustainable levels (above 60percent of GDP without a clear downward trend); (ii) Member States do not follow the recommendations of the European Commission, such as not abolishing temporary energy support measures or not making recommended public investments; (iii) Member States fail to absorb European funds efficiently, leading to poor implementation of projects and loss of potential financial support.
Rewards of strategies	- cooperation: (i) access to financial support: Member States that comply with the fiscal criteria and the European recommendations benefit from easy and continuous access to QRM funds; (ii) reducing fiscal pressure: cooperating Member States will benefit from more relaxed fiscal surveillance by the European institutions, which reduces the political and economic pressure on national governments, and at the same time positive recommendations from the European institutions will help to improve the perception of the financial markets. - non-cooperation: (i) limitation of financial support: Member States not complying with fiscal criteria risk having limited or delayed access to European funds, affecting their ability to finance investment and development projects; (ii) close monitoring, warnings and sanctions: non-cooperating states will be subject to frequent and stringent fiscal surveillance by the European institutions, which will result in additional political and economic pressure on national governments, and the Commission may issue warnings and, in extreme cases, initiate excessive deficit procedures, which may include financial sanctions or other corrective measures. In addition, these countries may face higher borrowing costs on the financial markets, which may exacerbate fiscal and economic problems.
Rules of the game	- member states make independent decisions on fiscal policy, but the regulations and recommendations of the European institutions influence these decisions. - European institutions can react to the decisions of member states by applying sanctions, offering financial support, or using other measures of influence.

Nature of the interaction	over the period under review, allowing the observation of whether states follow the "*tit for tat, being nice*" strategy.
Scenarios analysed	- comparison of Member States' tax behaviour and identification of tax cooperation or conflict models. - to assess the European institutions' responses to these behaviours and their effects on the overall economic stability of the euro area.
Implementation of the strategy	initiating cooperation: - eurozone member states: in 2023, member states start cooperation by adopting strict fiscal policies, as recommended by the European institutions. For 2024, they must phase out temporary energy support measures and maintain existing national investments. - European institutions support these states with financial support measures and favourable monetary policies. In 2023, the general derogation clause of the SGP allowed for greater fiscal flexibility, but for 2024, a return to strict rules is essential. reply to previous conduct: - cooperation: if one Member State continues to adopt strict fiscal policies, the other Member States and the European institutions respond positively, supporting finance and maintaining favourable conditions for economic stability. - deviation: If a Member State decides to adopt relaxed fiscal policies, exceeding the limits of budget deficit and public debt, the European institutions may apply sanctions or withdraw financial support. tolerance ('being nice'): - tolerance for minor offences: if a Member State exceeds limits slightly for justified reasons, the European institutions may choose not to apply sanctions immediately, providing a grace period for correcting the behaviour. The 2023 recommendations allowed for the continuation of temporary energy support measures, but the 2024 guidelines call for phasing out these measures. - Encouraging long-term cooperation: This selective tolerance promotes trust and cooperation, allowing Member States to adjust policies without immediately losing institutional support. monitoring and adjustment: - continuous monitoring: European institutions continuously monitor the member states' fiscal behaviour and economic adjustment to assess whether cooperation strategies are maintained. In 2024, this process will include the evaluation of the efficient absorption of funds from the RRF. - proportionate response: sanctions or financial support are adjusted in proportion to the behaviour of Member States, thus encouraging compliance with established fiscal policies.

Table 4 shows at least three changes in budgetary discipline for euro area Member States, as analysed by the Commission in the preliminary budgetary plans for 2024 compared to the previous year. Preliminary budgetary plans in both periods were weighed against the Council and the Eurogroup's recommendations.[26].

In 2024, the number of countries fully complying with the fiscal recommendations decreased. On the positive side, Estonia, Lithuania, and Slovenia moved from partially compliant in 2023 to full compliance in 2024. In contrast, five countries underwent negative assessments: Croatia, Finland, France, Latvia and Malta. Of these, Croatia, Finland, and France fell the most dramatically in the risk category of non-compliance. Italy also downgraded from this higher category to partly respecting the recommendations. In both years, Cyprus, Greece, Spain and Ireland maintained their position of full compliance. It is not insignificant that the countries that have succeeded in following the recommendations are states that have undergone profound and costly structural reforms due to the 2008-2012 crises.

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[26] The Council Recommendations of 12 July 2022 and the Euro Group Statement of 3 October 2022 provide both a basis for construction and a judgement criterion for the budgetary projects of the euro area Member States for 2023. The Council recommendations are part of the European Semester and provide tailored guidance for each Member State to ensure financial stability, sustainable economic growth and convergence. These recommendations influence national budgetary projects, ensuring that they are aligned with common objectives and that they receive support under the SGP. The Eurogroup statement addresses the challenges of high energy prices and inflation by calling for temporary and coordinated fiscal measures to support households and companies while safeguarding long-term fiscal sustainability. It stresses the need to protect public investment and structural reforms to foster economic growth and the green and digital transition. The Council recommendations of 14 July 2023 are important for the budgetary plans of the euro area Member States in the context of the deactivation of the general escape clause at the end of 2023. These quantitative country-specific fiscal recommendations, first issued since 2019, are geared towards ensuring debt sustainability in the medium term and promoting sustainable economic growth. Member States not projected to meet the MTO in 2023 were recommended to limit the growth of nationally funded primary expenditure to a differentiated level in order to ensure prudent fiscal policy. In contrast, countries that expected to meet the MTO in 2023 were advised to maintain a solid fiscal position in 2024 without a specific quantitative limitation. All Member States were urged to reduce the energy support measures as soon as possible in 2023 and 2024 and, for those not projected to meet the MTO, to use the resulting savings to reduce the government deficit. The Council also recommended that all Member States maintain nationally funded investments and ensure effective absorption of the Recovery and Resilience Fund and other EU funds, in particular in the context of the green and digital transition and the resilience objectives. For the period after 2024, the Council suggested the continuation of a medium-term fiscal strategy of gradual and sustainable consolidation combined with investments and reforms to foster sustainable economic growth.

The number of states partially complying with the tax recommendations remained constant, but their composition changed. Portugal saw positive developments, changing from the risk of non-compliance in 2023 to the partial compliance group in 2024. Conversely, Italy had a negative development, falling from full compliance to partial compliance. Germany, Austria, Luxembourg, the Netherlands and Slovakia have remained steadily in this category, indicating stagnation in improving their fiscal situation. Latvia and Malta have dropped to this category of full compliance, which is a negative development, albeit not as severe as in the case of countries that have fallen into the category of risk of non-compliance.

The most worrying change is seen in the category of countries at risk of non-compliance. While in 2023, only Portugal was in this category, in 2024, the number increased to four countries: Belgium, Finland, France and Croatia. This increase in risk in the euro area may indicate broader economic problems or difficulties in implementing the recommended fiscal policies. In particular, the cases of France and Croatia, which moved from full compliance with the recommendations in 2023 to a risk of non-compliance in 2024, suggesting a rapid deterioration in their situation, are noteworthy.

Table 4: The EU Commission's views on the preliminary budgetary plans of the euro area Member States

2023	2024
Complies with tax recommendations	Complies with tax recommendations
Croatia	Cyprus
Cyprus	Estonia
Finland	Greece
Ireland	Spain
Latvia	Ireland
Malta	Lithuania
France	Slovenia
Greece	
Spain Italy	
Partly adheres to tax recommendations	Partly adheres to tax recommendations
Austria	Austria
Lithuania	Germany
Germany	Italy
Estonia	Luxembourg
Luxembourg	Latvia
Netherlands	Malta
Slovenia	Netherlands
Slovakia	Portugal
Belgium	Slovakia

Risk of non-compliance with fiscal recommendations	Risk of non-compliance with fiscal recommendations
Portugal	Belgium
	Finland
	France
	Croatia

The game theory applied in this case cannot reveal whether the attitude of the Member States was cooperation or non-cooperation because the game was played in only one stage (2024 versus 2023). For ease of analysis, however, it can be taken into account that in July 2024, the Council issued country-by-country recommendations and decided to open the EDP so that this half-step can also be considered to judge Member States' and European authorities' strategies.

An interesting aspect of these rounds of the game is that the European authorities intervened with the EDP for five euro area countries, even after the first year since the reintroduction of the country-specific quantitative fiscal recommendations (after 2019). This can be interpreted as a lesser tolerance of the European institutions in the '*tit for tat*' strategy.

One element that seems to support this assumption is also the fact that the transition of some countries from the group of countries complying with the tax recommendations to the group at risk of not complying with the tax recommendations occurred directly without intermediate steps, i.e. without passing through the group of countries partially complying with the recommendations, without those Member States being covered by the EDP (the cases of Croatia and Finland).

The Commission's 2023 assessment (EC, Croatia, 2023) showed that the risk of non-compliance with the fiscal recommendations for Croatia was driven by the rapid increase in public expenditure and the maintenance of emergency energy measures. In 2024, Croatia's situation has evolved with a continued high budget deficit and expansionary fiscal policy, with an increase in nationally funded spending, suggesting a continued risk of non-compliance with Council recommendations (Council, Croatia, 2024).

Thus, in 2023, the Commission considered that Croatia's budgetary plan for 2024 presented a risk of non-compliance with fiscal recommendations due to several factors, including the government deficit forecast to increase from 0.3percent of GDP in 2023 to 1.9percent in 2024. The Commission considered that this expansion was driven by increased public expenditure, including public sector wages and social benefits, measures to counter inflation and reforming the wage-setting framework. In addition, the expansionary fiscal stimulus funded by the Recovery and Resilience Facility grants, estimated at 1.6percent of GDP for 2024, contributed to an expansionary fiscal policy. The continuation of energy support measures, adopted to mitigate the impact of the increase in energy prices, continued to have a budgetary impact, as they were not withdrawn quickly enough, contrary to the Council's recommendations to use savings to reduce the government deficit. The projections also showed an increase in national expenditure financed by 10.4percent in 2024, exceeding the Council's recommendation to limit this increase to a maximum of 5.1percent (CE, Croatia, 2023). As recommended by the Council in July 2024, Croatia's fiscal and economic situation remains the result of an expansionary fiscal policy. The projected government deficit amounts to 2.6percent of GDP in 2024 due to increased spending on public wage reforms, pensions and social assistance, and nationally funded public investments, which could reach 4.5percent of GDP. While the emergency energy support measures had to be reduced, they continued to be present in the first quarters of 2024, risking not being in line with the Council's recommendations to withdraw them as soon as possible. In addition, the projections point to an increase in national expenditure financed by 14.4percent in 2024, well above the Council recommendation of 5.1percent, suggesting a continuation of the risk of non-compliance with Council recommendations (Council, Croatia, 2024).

Despite the persistence of the risk that the newest member of the eurozone will continue to fail to comply with the Council's recommendations and the risk that the budget deficit might run dangerously close to the 3percent of GDP threshold, the European authorities have not decided to take any harsher measures. This attitude could mean that Croatia's strategy was not interpreted as a non-cooperation in view of the following: (i) Croatia's projected government deficit for 2024 was 2.6percent of GDP, below the reference threshold set by the SGP; (ii) Croatia's public debt was declining, estimated to reach 59.5percent of GDP by the end of 2024, below the 60percent of GDP threshold, indicating an improvement in long-term fiscal sustainability; (iii) Croatia was considered to have demonstrated substantial commitments to implement reforms and investments, in particular by using the funds of the Recovery and Resilience Facility, geared to stimulating sustainable economic growth and reducing fiscal vulnerabilities; (iv) while Croatia's fiscal policy has not been fully aligned with the Council recommendations, there were positive elements, such as increasing nationally funded public investment and implementing green and digital transition measures, which demonstrated a shift towards aligning economic policies with long-term European objectives.

In Finland's case, it is clear that the European authorities have not identified a case of non-cooperation strategy; quite the contrary, their tolerant strategy is obvious, given that the EDP did not start in July 2024, although the budget deficit will exceed the 3percent of GDP threshold in 2024. The reasons why the Commission (EC, Finland, 2023) considered that there is a risk of non-compliance with the recommendations in 2023 – increasing the deficit and net primary expenditure and not using savings to reduce the deficit – were reflected in the Council recommendations of 2024 (Council, Finland, 2024), which highlighted the need to limit expenditure and use savings to reduce the deficit. In its opinion of 21 November 2023, the Commission highlighted the risks of Finland's non-compliance with the tax recommendations in the 2024 budget for several reasons. Finland's general government budget deficit was projected to increase to 3.2percent of GDP in 2024, above the 3percent reference threshold. The increase was attributed to lower social security contributions, higher defence, research and development, investment and interest expenses. The growth of nationally funded net primary expenditure was estimated at 4.4percent, exceeding the recommended maximum rate of 2.2percent, which indicated an unsustainable expansionary fiscal policy. In addition, the savings resulting from the abolition of energy support measures were not planned to be used to reduce the deficit, which was in breach of the Council recommendations. However, in the document of 9 July 2024, the Council acknowledged economic difficulties and reiterated the need for a prudent fiscal policy. The Council recommended that Finland limit the growth of net primary expenditure to 2.2percent and use the savings resulting from the abolition of energy support measures to reduce the government deficit. The Council also stressed the importance of maintaining nationally-funded public investment and efficient absorption of EU funds to support the green and digital transitions.

The Commission decided not to open the EDP against Finland in July 2024, even though the budget deficit is forecast to exceed the 3percent of GDP threshold at the end of 2024. Several factors influenced this decision. The difficult economic conditions and slow tax and social security revenue growth contributed to the deficit increase. Still, Finland's structural measures and reforms demonstrated a serious commitment to improving the long-term sustainability of public finances. Progress in the absorption of EU funds, including the Recovery and Resilience Facility grants, has also been a positive factor. The Commission considered it necessary to allow time for these measures to show their effects. It favourably assessed Finland's efforts to maintain public investment and implement reforms to ensure fiscal sustainability.

Another interesting aspect of these rounds of the game is the fact that the EDP was launched in July 2024 against three countries (Italy, Malta, Slovakia), which are in the group of countries for which the Commission considered that the preliminary budgetary plans for 2024 were partly in line with the fiscal recommendations. The analysis of the Council's July 2024 recommendations for these countries (Council, Italy, Malta, Slovakia, 2024) shows that the EDP was triggered against Italy, Malta and Slovakia in July 2024 due to exceeding the 3percent of GDP budget deficit threshold in a context of high government expenditure and emergency energy support measures that were not eliminated as recommended by the Council in 2023.

The EDP has been triggered against Italy because of a persistent budget deficit that has exceeded the 3percent of GDP threshold. In 2023, the budget deficit was 4.9percent of GDP, and the Commission 2024 spring forecast indicated that the deficit would only decrease to 4.3percent in 2024 and to 3.7percent in 2025, thus remaining above the permitted limit. The main problems identified (Council, Italy, 2024) include emergency energy support measures that have not been eliminated so that the savings made have not been fully used to reduce the government deficit. In addition, increases in nationally funded primary current expenditure, influenced by higher pensions and reduced labour taxes, have helped maintain a high deficit. At the same time, a high level of public debt would require prudent fiscal policy measures to ensure fiscal sustainability in the medium term.

Malta faces the EDP because the 2023 government deficit was 4.9percent of GDP, exceeding the 3percent of GDP threshold specified by the SGP. The Council's recommendations (Council, Malta, 2024) show that the growth of nationally funded primary current expenditure, particularly for emergency energy support measures, has not been reduced in line with the 2023 recommendations. For Malta, the contribution of energy support measures to the budget deficit is estimated at 2percent of GDP in 2024. Malta has also failed to comply with the recommendations to limit the growth of nationally funded primary current expenditure, which has led to maintaining a budget deficit above the permitted limit.

For Slovakia, the 2024 projected budget deficit is 5.9percent of GDP and the Commission's projections for 2025 show that the indicator will not fall below 5.4percent of GDP. Thus, Slovakia has to cope with the stringency of the EDP due to a surplus deficit generated by the increase in nationally funded primary current expenditure, particularly for emergency energy support measures, and the permanent increase in public sector wages. In addition, Slovakia has failed to reduce government spending and to comply with the recommendations to use savings from energy support measures to reduce the deficit (Council, Slovakia, 2024).

Comparing Finland's case relative to these three countries facing EDP, although all four have a budget deficit forecast to exceed the 3 percent of GDP threshold in 2024, it can be said that Finland has demonstrated a strong commitment to implementing its recovery and resilience plan, which European authorities have recognised as an essential factor in addressing long-term economic and social challenges. These reforms and investments are necessary for improving the competitiveness and long-term sustainability of the Finnish economy. In contrast, Italy, Malta, and Slovakia have not presented a credible path for reducing the deficit below the 3 percent of GDP threshold from the perspective of European institutions. Italy, for example, has not entirely eliminated emergency energy support measures, maintaining government spending at a high level. At the same time, Malta and Slovakia have experienced similar difficulties in managing expenditures and implementing Council recommendations. Thus, these countries have not demonstrated the same progress in deficit reduction and structural reform implementation, which has justified, from the European institutions' perspective, the triggering of the EDP.

The decision of the European institutions to apply *'tit for tat'* and to drop the tolerant attitude to the three countries for which the EDP has been triggered shows that the sustainability and credibility of the process of reducing the budget deficit, i.e. the continuity of structural reforms, are significant elements in the formulation of the European institutions' strategy.

At the end of 2023, the Commission decided to include the preliminary budgetary projects of Belgium and France in the category of those at risk of non-compliance with the fiscal recommendations due to persisting budget deficits and non-compliance with the measures recommended by the Council in July 2023 on limiting the growth of nationally funded net primary expenditure. In the case of Belgium, the Commission's main concerns (EC, Belgium, 2023) were related to the budget deficit and government debt projections, which remain above the Treaty reference values (3percent and 60percent of GDP, respectively). While the government deficit is projected to fall to 4.6percent of GDP in 2024, it was still too high. In addition, the increase in net primary expenditure financed at the national level was estimated to exceed the maximum recommended rate of 2percent, reaching 3.8percent, representing a risk of deviation from the Council recommendations. In France, the Commission's concerns (EC, France, 2023) were also related to the budget deficit and government debt levels, estimated to remain at 4.4percent and 109.7percent of GDP, respectively, in 2024. While the deficit was expected to shrink, it was expected to stay above the 3percent of GDP threshold. It was also estimated that net primary expenditure financed at the national level would increase by 2.8percent, exceeding the recommended maximum rate of 2.3percent. In addition, the energy support measures would not be phased out as soon as possible, contrary to the Council's recommendations for 2023. The Commission considered that these issues reflected significant risks in achieving the medium-term fiscal consolidation objectives and adherence to the established fiscal rules.

The EDP was triggered against Belgium and France in July 2024 because none of these countries demonstrated a clear and sustainable path to reducing the budget deficit. In Belgium's case, the general government deficit increased from 3.6percent of GDP in 2022 to 4.4percent in 2023 and the public debt rose from 104.3percent to 105.2percent of GDP. In the case of France, the general government deficit increased from 4.8percent of GDP in 2022 to 5.5percent in 2023, thus exceeding the 3percent of GDP threshold. In these two cases, the European authorities also considered the results of 2022. However, there were no individual deficit reduction targets in 2022 due to the temporary suspension of the SGP fiscal rules in the context of the pandemic. Nevertheless, that year's deficit and debt data were considered important because they allowed the European authorities to weigh up whether the measures taken by Member States in previous years were sufficient to bring deficits within the agreed limits and whether there was a clear and sustainable path of deficit reduction in the coming years. In the case of Belgium, the evolution of the deficit was influenced by the increase in nationally funded net primary expenditure, which exceeded the rates recommended by the Council, mainly due to permanent increases in public sector wages and automatically indexed social benefits, as well as temporary reductions in employers' social contributions and increasing demographic costs (Council, Belgium, 2024). In the case of France, the deficit was influenced by a significant drop in revenue and economic growth below expectations despite the savings generated by the withdrawal of emergency energy support measures and other budgetary adjustments. Although government debt slightly decreased from 111.9percent to 110.6percent of GDP, the Commission found that France did not comply with the Council's recommendations on limiting the growth of nationally funded primary expenditure and using savings to reduce the government deficit (Council, France, 2024).

Thus, it can be said that the EDP was triggered against Belgium and France for two main reasons: firstly, none of these countries demonstrated a clear and sustainable path of reducing their budget deficit, which resulted in the threshold of 3percent of GDP being exceeded. Secondly, Belgium and France have not implemented adequate fiscal adjustment measures to control and reduce government spending. Belgium continued to increase its nationally funded net primary expenditure, including permanent increases in public sector wages and automatically indexed social benefits, without taking effective compensatory measures. France had difficulty in limiting primary expenditure growth and using savings to reduce its government deficit, thus failing to comply with the Council's recommendations.

As in the case of the three countries analysed above, it can be said that the European institutions applied '*tit for tat*' and abandoned their benevolent attitude because taking into account 2022, these countries were already in the third round in which they had used a non-cooperation strategy. Moreover, the urgency of the punishment (EDP) seems to be because both states have significantly higher levels than the accepted threshold for public debt.

It can be argued that this stage of the game's progression suggests that European authorities have demonstrated decreased tolerance for fiscal deviations, implementing a 'tit for tat' strategy by triggering the EDP more rapidly against member states that failed to comply with Council recommendations on fiscal discipline. However, the approach was characterised by differentiated treatment based on reform commitment, exemplified by the more lenient attitude towards Finland, which demonstrated a strong commitment to implementing structural reforms and absorbing EU funds, unlike Italy, Malta, and Slovakia, which were subjected to EDP due to maintaining high budget deficit levels and non-compliance with fiscal commitments. In the cases of Belgium and France, European authorities intervened promptly and decisively by applying sanctions, triggering the EDP not only due to the persistence of budget deficits but also due to high public debt levels exceeding established limits, suggesting these states have a long-term non-cooperative strategy. Nevertheless, flexibility in assessment was evident in cases such as Croatia and Finland where, although risks of non-compliance with recommendations existed, the economic context and implemented measures were deemed sufficient to avoid immediate sanctions, thus highlighting a tolerant strategy by European authorities that emphasises long-term sustainability and commitment to reforms.

From the assessment of interactions between European authorities and Eurozone member states in this example with a limited number of rounds, it can be noted that the attitude of European authorities has shifted. Thus, European authorities appear to have lower tolerance and make swifter decisions to ensure the long-term sustainability of public finances within the Eurozone. Through the rapid application of sanctions against states that have not complied with fiscal commitments, they have sought to protect macroeconomic stability and prevent risks that could undermine confidence in the euro, thereby strengthening fiscal discipline across the entire monetary union. However, European authorities' decisions have reflected a differentiated approach based on member states' level of commitment to implementing structural reforms. In this regard, states that have demonstrated serious commitment to reforms and efficient use of EU funds have benefited from a more lenient attitude. In contrast, states that have not shown this commitment have been sanctioned more severely. This differentiation suggests that reform efforts (especially those directed towards green and digital transitions) are considered crucial for long-term recovery, even if immediate fiscal targets are not fully met.

At least two criticisms can be made of this hypothesis relating to the change in the behaviour of the European authorities. On the one hand, the application of the EDP to Italy, Malta, Slovakia, Belgium and France was the result of a "*tit for tat*" strategy rather than proactive action to ensure long-term sustainability. This means that the European authorities have decided to penalise states that have not shown credible progress in reducing their deficits rather than intervene early to correct fiscal slippages. Documenting this argument would require the existence of a history of un-sanctioned deviations, but for the previous period, the SGP's general escape clause was activated, which prevents a robust analysis. On the other hand, it can be said that the application of sanctions is inconsistent. In the case of Croatia, although the deficit forecast was below the 3percent of GDP threshold, expenditure growth and expansionary fiscal policy (without compensatory structural reform measures other than those aimed at the green and digital transitions) suggested long-term risks. However, no stringent penalties were applied, pointing to a possible inconsistency in the implementation of the EDP, which does not support the idea of swift action to ensure long-term sustainability. This analysis would entail a detailed comparison of the tax-budgetary decisions of Croatia, Italy, Malta and Slovakia, whereby it could be demonstrated that, although Croatia had less problematic tax indicators, it had more significant structural problems. Yet, it was not sanctioned by EDP, while other countries were.

The analysis and interpretation of this round of interactions between European authorities and Eurozone member states is significant as it highlights two lessons for those EU member states that must adopt the common currency but have not yet done so. These two lessons relate to how European authorities evaluate the economic decisions of each individual state. Firstly, governments must be prepared for a much faster and less tolerant reaction from European authorities when member state decisions do not comply with fiscal commitments, as the European authorities' priority is protecting macroeconomic stability. Secondly, governments must design national budgets and multiannual budgetary plans based on the principle that, in the view of European authorities, structural reform efforts (especially those directed towards green and digital transitions) are considered crucial for long-term economic stability.

IV How can the assumption of confidence in the euro as a common good be applied to those Member States obliged to adopt the euro?

Eight principles of Elinor Ostrom (1990) on "*common pool resources*" can guide communities in sustainably managing shared resources. In the context of confidence in the euro and the obligation of the Member States of the European Union to adopt the single currency, the application of these principles can provide an interesting insight into how these countries manage the transition to the euro in terms of the relevance of public projects and how they engage in these projects through their decisions. It should be noted that from the point of view of Ostrom's theory, the

Maastricht criteria are only relevant to the principle of defining borders. The Maastricht criteria assess whether an economy is stable enough to enter the euro area, clearly delineating which states are ready to adopt the single currency. However, these criteria do not provide a framework for continuous governance, which makes them irrelevant from the point of view of Ostrom's other principles, which focus on the collective and sustainable management of common goods in the long term. Principles such as monitoring compliance with rules, sanctioning their violations, and conflict resolution mechanisms are essential for maintaining fiscal discipline and preventing economic crises. These principles are implemented through the adherence of each EU member state to their commitments regarding economic and fiscal governance.

Ostrom's first principle (1990) – that of well-defined borders – refers to both the physical boundaries of the common good and the social boundaries of the user group. In the case of trust in the euro as a common good, this principle translates into the need to clearly define the criteria and conditions that the Member States of the European Union that have not yet adopted the euro must fulfil in order to become part of the euro area. The social borders of the user group refer to the delimitation of the states that have to assume their obligations towards this common good – those states that must adopt the euro and have not yet done so (Czechia, Hungary, Poland, Romania, Sweden)[27]. The physical boundaries of trust in the euro are materialised through the rules established by the convergence criteria, known as the Maastricht criteria. These criteria function as a clear demarcation of the common good—the stability and economic integrity of the eurozone—and define the group of states that can access this common good, namely those that meet these strict criteria. Without strict adherence to these boundaries, there is a risk that the premature inclusion of states that are not economically prepared could undermine the eurozone's stability, potentially leading to a decline in general confidence in the euro as a common currency. Thus, well-defined boundaries strengthen trust in the euro by ensuring that only economically well-prepared states can become part of this monetary union.

One can say that an example of the violation of this principle has resulted in the sovereign debt crisis in the euro area, which highlighted the fact that some states were admitted to the euro area without being sufficiently prepared. Although the Maastricht criteria were designed to ensure that only stable and fiscally disciplined economies could join the single currency, in practice, it has been observed that cer-

[27] Given that Bulgaria is approaching the actual changeover to the euro and Croatia has already adopted the single currency, they were excluded from this analysis, even though for the time points analysed the two states were in the early stages of the changeover process.

tain states have not fully complied with these criteria or have fulfilled them only temporarily. The lack of adequate supervision and corrective mechanisms post-accession to the economic and monetary union has allowed large deficits to build up and government debt to rise to unsustainable levels. In addition, the structural problems unresolved before accession, such as the competitiveness deficit or fiscal inefficiencies, have been amplified by the constraints imposed by membership of the euro area, where monetary policies are centralised and cannot be adjusted at the national level.

The principle of 'congruence between rules and local conditions' (Ostrom, 1990) refers to the necessity for rules governing the use and administration of common goods to be adapted to the local specificities of the communities managing them. In other words, the rules must fit and harmonise with the respective community's ecological, economic, social, and cultural context. This principle emphasises that there is no single, universally applicable solution (one size fits all type of solution) for managing common goods, and rules that function effectively in one context may not be suitable or efficient in another. Therefore, it is crucial that rules be adjusted to reflect local conditions and needs, thus ensuring sustainability and equity in the use of common goods. If these rules are incompatible with local realities, they can generate conflicts, inefficient resource utilisation, or even degradation of the resource itself. Applying this principle in the management of common goods ensures that the rules are relevant, accepted by the community, and capable of protecting and maintaining the resource long-term.

The principle, applied in the case of confidence in the euro as a common good from the perspective of the EU Member States that have not yet adopted the single currency, can be interpreted as saying that in order to build and maintain confidence in the euro as a common currency, candidate countries must be able to adapt their strategies and the necessary reforms to local conditions. It is about devising economic and fiscal policies that consider each state's domestic environment, pace of development, and ability to deal with the changes imposed by adopting the euro.

In practice, this flexibility could be used by the candidate countries to argue that further measures or time are needed to ensure a stable and sustainable transition to the euro, especially in the context of economies facing structural difficulties or a slower rate of development. Some governments could also use this principle to avoid politically unpopular or difficult measures, arguing that the necessary reforms are not yet fully compatible with local economic realities. However, flexibility in implementing reforms must be balanced with a clear and firm commitment to achieve the convergence criteria within a reasonable timeframe. Otherwise, delaying the adoption of the euro may undermine not only confidence in the single currency but also confidence in that state's commitment to the European integration process.

The principle of the active participation of those affected in decision-making has implications for the sustainable management of common goods. First, involving those directly affected in the decision-making process ensures that the rules are tailored to local needs and conditions since these community members deeply understand the resource and the context in which it is used. Secondly, active participation by those directly affected reduces the risk of conflicts and increases compliance with the rules, as they are perceived as legitimate and fair. Thirdly, this principle allows for increased flexibility, allowing the community to adjust the rules according to environmental or context changes, contributing to sustainable resource management. Lastly, involving those affected in decision-making strengthens social capital and community cohesion, which are essential for creating an environment of trust and cooperation necessary to manage common goods effectively.

Transposition of this principle to states that need to adopt the single currency means that all stakeholders in society – decision-makers, trade union employers, academia, and civil society – should be involved in the decision-making process relating to the economic and structural reforms needed to meet the Maastricht Treaty's convergence criteria. This would include debates on fiscal policies, structural reforms, economic stabilisation measures and other essential adjustments to the country's readiness to join the eurozone. With broad societal involvement in these discussions, reforms could be better tailored to local needs. They could receive broader support because compromises could be more clearly explained, increasing the probability of a successful euro adoption process.

The fact remains that scenarios are also possible on both sides of the spectrum: either decision makers move forward with the euro adoption process without consulting those directly affected, and they will assume the political costs after euro accession has been finalised (when and if it does), or politicians fail to take the necessary steps towards euro adoption or delay the process without clear communication and proper involvement of society, with the risk that people will lose confidence in them, but above all in national institutions.

When examining trust in the euro as a common good from the perspective of EU member states outside the eurozone, the transposition of the effective monitoring principle encompasses more than mere surveillance. Firstly, the monitoring aims to ensure that these countries comply with the commitments related to compliance with the fiscal governance framework. Secondly, monitoring is carried out by both the European institutions and the national authorities, ensuring the direct involvement of the candidate countries and strengthening collective responsibility concerning the commitments made. Thirdly, the transparency and accessibility of the monitored economic data are crucial to maintaining confidence in the process, allowing all parties involved to follow developments and ensure compliance. Fourthly, the monitoring system must be flexible and adaptable to changing economic conditions, allowing for adjustments needed to respond to global economic challenges. For example, in economic or financial crises, more frequent assessments or additional measures may be necessary to ensure compliance with the criteria. Flexibility in monitoring allows for appropriate responses to rapid changes in the economic environment without compromising the rigorousness and objectivity of assessing compliance with commitments already made. Fifthly, in the event of deviations from the commitments entered into, graduated sanctions, such as corrective recommendations or the imposition of specific measures, are applied in order to restore compliance and prevent risks that could undermine the stability of the common currency. Sixthly, this monitoring process is interconnected with other principles, such as the active participation of the Member States in the decision-making process, which strengthens cohesion and solidarity within the European Union, thereby ensuring confidence in the euro as a common good and in its long-term success.

Each of these components of the principle can have adverse effects on trust in the euro. For instance, regarding monitoring, the formation of perceptions concerning potential excessive surveillance merits exploration. Some states might perceive monitoring either as a form of excessive surveillance or as a lack of trust of the European institutions. This can lead to feelings of frustration or perceptions of unfairness, especially if standards are seen as being applied unequally or arbitrarily. Perceptions of 'second-class European states' and 'double standards' have become well-known. Before 2016, fiscal governance violations by certain states (especially large EU members) were readily tolerated, while economic imbalances in other states faced sanctions. Political tensions driven by these perceptions can undermine trust in the euro and fuel Euroscepticism among both the public and political leaders.

The principle of 'graduated sanctions' is important for the management of common goods and refers to how infringements of the rules must be dealt with by the members of a community that manages them. Thus, in the case of confidence in the euro, seen from the perspective of the states that have to adopt the euro, compliance with the rules and criteria established by the EU is essential to maintaining the stability and cohesion of the euro area. Member States that have not yet adopted the euro must respect the commitments to economic and fiscal governance agreed upon with the European institutions on which stability and confidence in the euro depend. Failure to do so may weaken confidence in the euro within those states and across the euro area. The escalation of sanctions reflects the importance of respecting commitments and responsible participation in the euro project. Gradual sanctions can manifest through political and economic pressure mechanisms on Member States that fail to comply with the commitments. These sanctions initially take the form of recommendations from the European institutions. The continued breach of obligations by a Member State leads to more stringent measures, such as restricting access to certain European funds or limiting its influence in policy decisions at the EU level. Failure by a Member State to comply with its commitments to economic and fiscal governance may affect the perception of its commitment to the European project. For example, suppose a Member State does so and thus postpones the adoption of the euro for domestic economic or political reasons. In that case, this can lead to a negative perception from other Member States and their citizens. In this case, the social sanctions Ostrom refers to (1990) could include political isolation or a decline in mutual trust between Member States, which can affect cooperation in other European policy areas. These sanctions encourage Member States to improve their economic performance and bring their policies in line with the standards required for adopting the single currency. For example, pressure to avoid tougher sanctions can lead a Member State to adopt the economic and fiscal reforms needed to comply with the convergence criteria, thus strengthening confidence in the euro as a common good. The effectiveness of graduated sanctions, in the context of trust in the euro, is demonstrated by their ability to allow Member States to correct their economic trajectory without bearing consequences from the very first error made. By applying progressive sanctions, the EU can guide Member States in a way that favours the adoption of the euro in conditions of stability and convergence.

The effectiveness of graduated sanctions can be weakened, for example, if a state chooses only partially to implement the reforms or delays in carrying out the necessary reforms. This situation may arise for several reasons, such as internal political pressure, resistance to change by certain interest groups or economic difficulties, making it challenging to implement the required reforms fully. If a state implements only partial reforms, it can avoid more severe sanctions in the short term. However, this does not resolve the economic or structural problems needed to meet its commitments and achieve convergence. This can lead to stagnation or even worsening economic issues in the long term, thus weakening confidence in the ability of the state to adopt the euro and contribute to the stability of the euro area. In addition, postponing the necessary reforms may lead to a continuation of the existing situation, in which a state does not meet the convergence criteria but is also not subject to severe sanctions because of the gradual approach. This strategy may allow the State to avoid short-term sanctions, but in the long term, it may create economic instability and even undermine the effectiveness of the sanction mechanism. If sanctions are perceived as too lenient or applied too slowly, there is a risk that countries might think that they can continue to avoid adopting the necessary reforms without any real consequences. This can encourage other countries to follow the same strategy, thus weakening the collective compliance mechanism with the rules that generate confidence in the euro. In order to counter these risks, graduated sanctions must be accompanied by effective monitoring and evaluation mechanisms that ensure the full implementation of reforms within a reasonable timeframe. In addition, the escalation of sanctions must be sufficiently swift and severe to discourage delays in or incomplete implementation of reforms. In this way, the effectiveness of the gradual sanctions can be maintained, ensuring progress towards euro adoption and confidence building in the single currency.

The principle of the existence of conflict resolution mechanisms reflects the need for any community managing common goods to have clear and effective mechanisms to prevent and resolve conflicts, thus contributing to the long-term stability and sustainability of the resource and the user group. Without such mechanisms, conflicts may degenerate, leading to the overexploitation of common goods or the collapse of cooperation within the community.

Transposition of the four building blocks of this principle is firstly that the accessibility of conflict resolution mechanisms to Member States which have not adopted the euro must be demonstrated by a clear and regular dialogue with the European institutions as part of the processes relating to economic and fiscal governance. Such dialogue should be sufficiently open to allow the States concerned to contribute actively to strengthening fiscal discipline. This ensures that their concerns and needs are considered to maintain economic stability and confidence in the euro. The verification of the applicability of the other components of the Ostrom principle (the low cost of these mechanisms, the efficiency and timeliness of the functioning of the conflict resolution mechanisms, and the fact that they must be perceived as impartial and fair) in this case implies at least the following: (i) the involvement of the States that have to adopt the euro in monitoring and respecting tax governance should not entail disproportionate efforts or economic sacrifices; (ii) the dialogue between these States and the European authorities on respecting tax governance must be constant to avoid escalating economic problems that could affect confidence in the euro; (iii) these States must be treated fairly in the assessment process and trust that the rules and penalties shall be applied uniformly throughout the Union.

From the point of view of transposing this principle, it can be said that a gap is opening up between the European institutions and the Member States of the euro area, on the one hand, and some states which need to adopt the common currency, on the other. Thus, the idea that the concerns and needs of the euro candidate countries are taken into account in efforts to maintain economic stability and confidence in the euro seems to be understood more and more differently by the two sides: the former believes that the states that still have the independence of monetary policy must get used to observing the rules permanently. In contrast, others think that the dialogue with European institutions is only an exercise by which attention is constantly drawn to their shortcomings, and their specific situation is not considered.

The success of the integration of non-euro states into the euro area depends on the effective interaction between national self-organisation and multi-level coordination, two other principles of Ostrom (recognition of the right to self-organisation and multi-level organisation of activities) whose observance is necessary for the effective management of common goods. The EU and the euro area must respect the autonomy of these states in formulating and implementing economic policies, recognising the characteristics of each economy. At the same time, countries must respect their commitments to economic and fiscal governance in order to contribute to the stability of the euro. This synergy is essential: if a Member State does not respect fiscal commitments, it may undermine confidence in the euro, damaging the whole system. The proper recognition and respect of the right of self-organisation can strengthen confidence, allowing States to contribute positively to the monetary and economic stability of the euro area.

Thus, in the case of countries that have not yet adopted the euro, the European institutions recognise the right of these countries to choose their economic and fiscal policies in a way that respects both the national context and the European commitments. Although there is a common framework governing fiscal policies, each state has the autonomy to implement its economic policies as long as they are in line with the common objectives of the Union and the Euro area. This recognition is essential to ensure Member States can adapt their tax strategies to local needs while respecting commitments. Economic and fiscal governance in the EU is a clear example of a multi-level organisation. Fiscal policies are monitored at both national and European levels. Member States which have not yet adopted the euro must coordinate their national policies with the objectives and regulations set at the Union level. This multi-level organisation allows for a fair distribution of responsibilities and an adaptation to changing economic circumstances. For example, a Member State can implement fiscal adjustment policies that better respond to domestic economic conditions and, at the same time, contribute to the overall stability of the euro by respecting fiscal commitments.

However, for states which have to adopt the euro, it is sometimes easy to attach importance only to the principle of the right to self-organisation, ignoring the fact that it is intended to enable the effective management of the common resource. In other words, it seems that sometimes some states which have to adopt the euro would like to have access to the common resource (confidence in the euro) without, however, complying with the rules of the community but fully respecting their right to self-organisation.

Applying Ostrom's principles to the case of states that have to adopt the common currency has a weakness: it assumes that there is a uniform understanding between all states that trust in the euro is a common good, that is, a resource whose usefulness for all those involved cannot be contested. However, the economic literature relating to the adoption of the euro in the countries subject to this obligation and analysed in this section (Czechia, Hungary, Poland, Romania, Sweden) does not allow an unequivocal answer to be given to the question of the economic usefulness of the euro and the confidence it provides.

As regards the case of Sweden, several studies have concluded that Sweden would not benefit from joining the euro because it is the economy that has the least to gain from EU membership (Campos, Coricelli, Moretti, 2016) or because the introduction of the euro would lead to a decrease in economic activity (productivity, exports, investment and consumption) and an increase in government spending (Gyoerk, 2017). At the same time, studies are underlining the advantages that joining the single currency would bring to Sweden due to the strong historical links between the euro and the Swedish krona (Stoupos, Kiohos, 2017) or because Sweden would have relatively little to lose at least in terms of monetary policy independence (Reade, Volz, 2009).

For the other countries included in this analysis, studies after 2016 focus on researching exchange rate dynamics and central bank decisions and less on convergence aspects. Opinions that emphasise that several factors influence these states' decision to adopt the single currency can be identified. They are not correlated either with the level of development, the duration of EU membership, or with other rational factors (Arató, Koller, Pelle, 2021), and integration into the euro area requires that candidate countries be able to demonstrate at least two factors (Palánkai, 2015): maturity (meeting the Maastricht criteria) and acceptance (which implies both willingness and preparation for this step). Research on the independence of monetary policy in these states shows that the Czech Republic and Poland may be able to maintain their monetary independence when the ECB tightens monetary policy. At the same time, Hungary and Romania may fail to do so (Dąbrowski, Papież, Śmiech, 2019). Other studies show that exchange rate volatility reduces the risk of recession in the Czech Republic, increases the risk in Hungary and Romania, and has a neutral effect in Poland (Shevchuk, Kopych, 2021). Some researchers suggest that the Czech Republic and Hungary are not prepared to adopt the euro because the long-term impact of the single currency on their economies would be negative, and these currencies are vulnerable to adverse financial shocks. In contrast, Poland and Romania are considered ready to adopt the euro, as their currencies show a positive and stable long-term alignment with the euro, being more resistant to economic shocks (Stoupos, Kiohos, 2017). Another study, however, shows that the adoption of the euro is more advantageous for countries whose national monetary policy is already limited or ineffective for the following reasons: (i) have a close link to Euribor (if interest rates in a country are already closely linked to Euribor, that country's central bank may have a limited influence on the local money market); (ii) difficulties in stabilising their money markets (if the local money market does not return rapidly to regular aftershocks, indicating persistent instability, the central bank may have difficulties in efficiently managing the market). Thus, adopting the euro would be more appropriate for Hungary and Sweden. At the same time, Romania, Poland and the Czech Republic may prefer to maintain national currencies, given the influence of central banks on local markets (Gabrisch, Buscher, 2014). The replication of the study for 2020-2024 shows that adopting the euro would be more appropriate for all of these countries except Hungary.

The review of these works is neither exhaustive nor prescriptive. It is just an attempt to point out that (i) there is no consensus on the relevant factors to assess whether and/or when a country is ready to adopt the euro, and (ii) it is even less likely that there will be a unanimous understanding of the famous benefits and costs of adopting the single currency.

The analysis presented below, concerning the rounds between players involved in managing the common good called trust in the euro, does not aim to be either an adequate method for evaluating the euro adoption issue in these five countries (Czech Republic, Hungary, Poland, Romania, Sweden), or to identify the reasons explaining these states' behaviour regarding the euro. This section's sole 'ambition' is to offer an alternative perspective on how interaction occurs between certain actors involved in discussions about euro adoption in these countries and within European institutions.

The period analysed in this section refers to three distinct moments in time: the years 2016, 2019 and 2024. An analysis over the whole period 2016-2024 could provide a detailed view of long-term trends, allowing for the observation of annual fluctuations and the identification of lasting changes in macroeconomic indicators and public opinion towards euro adoption. This approach would be more helpful in understanding the impact of economic policies and the dynamics of public opinion in the context of the different economic developments in the Member States that need to adopt the euro. However, the advantage of such an analysis is undermined by external shocks, such as the pandemic and the war in Ukraine, which have introduced discontinuities in economic trends. These events have caused economic shocks and volatility, complicating the interpretation of long-term developments. For this reason, the analysis focused on these moments over time – the years 2016, 2019 and 2024 – can clarify some key aspects of these states' evolution. Thus, as mentioned in the previous section, 2016 is a reference point for completing the economic surveillance framework in the EU and the euro area. 2019 marks the period immediately before the pandemic, giving a picture of economies in a relatively stable context ahead of significant shocks. The year 2024 is crucial because it reflects the state of economies and public opinion after the crisis and in the context of recent influences of the war in Ukraine, thus providing insight into the future direction of economic policies and euro adoption.

The analysis focuses on the budget deficit and public debt, as these two indicators are important for understanding how confidence in the euro, seen as a common good, is influenced by the fiscal policies of the Member States. In the context of Ostrom's common property and game theory, these indicators are critical because they reflect fiscal discipline and economic sustainability, which are important for maintaining stability and confidence in the euro. The budget deficit reflects the extent to which a state manages revenues and expenditures stemming from public policy priorities. In contrast, public debt shows the state's capacity to honour its financial obligations. Poor management of these issues could undermine the confidence of the public and of the financial markets in a state's ability to contribute positively to the stability of the euro area. Although the Maastricht criteria include other elements, such as price stability, long-term interest rates, and exchange rate stability, the budget deficit and public debt are necessary for assessing a country's fiscal risk and financial health. The choice of these indicators to the detriment of other instruments under the European Semester, such as the macroeconomic imbalance analysis, the social scoreboard or country-specific recommendations, is justified by the fact that these instruments, while helpful in understanding the broader economic and social context, do not directly measure fiscal behaviour in terms of deficit and debt (macroeconomic imbalance analysis), do not directly capture elements affecting confidence in the euro as a currency (social scoreboard), do not provide an assessment of fiscal risks or the ability to sustain confidence in the euro (country-specific recommendations). Thus, the budget deficit and public debt can be considered the relevant indicators, as they allow a clear assessment of the impact of fiscal policies on confidence in the euro, a central aspect of gaming theory applied in this context.

Concrete elements of the game in this case study are as follows, according to Table 5:

Table 5: Elements of the game

Elements of the game	Description
Players	the European institutions (Commission, Council, ECB), the countries' governments that need to adopt the euro, the public of these countries, and the political leaders of these countries.
Possible strategies	- cooperation: (i) European institutions offer support, guidance and flexibility in judging the fulfilment of commitments made in the SGP; (ii) state governments adopt prudent fiscal and monetary policies; (iii) public voices support for euro adoption,

	as reflected in positive surveys; (iv) political leaders promote euro adoption through public statements. - non-cooperation: (i) European institutions impose strict sanctions or restrictions for failing to meet commitments made in the SGP; (ii) state governments delay or avoid implementing the necessary policies; (iii) the public expresses scepticism about or opposition to euro adoption, as reflected in polls by declining support for the common currency; (iv) political leaders adopt eurosceptic or nationalistic rhetoric, exploiting public fears, to gain political capital.
Rewards of strategies	- cooperation: long-term economic stability at both macroeconomic and individual levels, smooth transition towards euro adoption, popularity for political leaders and increased confidence in the European project; - non-cooperation: sanctions or restrictions on the Member State; loss of confidence in the dialogue with the European institutions; protection of national interests in the short and medium term at the risk of political isolation within the EU; loss of confidence in the European project.
Rules of the game	- the game is infinite: no euro adoption deadline allows players to adjust their strategies as interactions evolve. - feedback and adaptation: the strategies can be continually adjusted based on the evolution of public opinion (measured by the Eurobarometer) and the reactions of political leaders. European institutions and governments are adapting their strategies to these dynamics. - impact of public statements: statements by political leaders are seen as strategic actions that can directly alter the game's dynamics, influencing the behaviour of other players and changing the public's perception.
Nature of the interaction	- continuous interaction, meaning that each actor can change its strategy depending on the actions and reactions of others. The '*tit for tat, being nice*' strategy shows that European institutions and national governments are adjusting their approaches according to the level of cooperation of the other actors.
Scenarios analysed	- cooperative scenario: Governments adopt rigorous fiscal policies, keeping the budget deficit below 3percent of GDP and committing to maintaining or gradually reducing public debt, in line with the commitments made in the SGP. These measures are supported by political leaders, who, through public declarations, highlight the long-term benefits of euro adoption and the importance of compliance with European rules. The European institutions recognise and support these efforts by assisting and validating the progress and strengthening cooperation. The public, positively influenced by the messages of the political leaders and the support of the European institutions, is becoming

	supportive of adopting the euro and supporting the government policies necessary to achieve this objective. - non-cooperation scenario: political leaders adopt nationalistic and populist rhetoric, exploiting austerity fears and highlighting the risks of tight fiscal policies. This type of speech makes the public eurosceptic, opposing measures to reduce the deficit and public debt. Responding to domestic pressures and desiring to maintain electoral support, governments are prioritising domestic public spending and increasing public debt, thus exceeding the deficit limits imposed by the commitments in the SGP. The European institutions, faced with this uncooperative behaviour, react with warnings, sanctions or restrictions on financial support, which undermines confidence in the ability of states to join the euro area.
Implementation of the strategy	- the European institutions could initially cooperate, but if a national government or political leaders adopt uncooperative rhetoric or fail to meet the convergence criteria, the European institutions could respond with sanctions. - for their part, governments and political leaders could return to cooperation if the public expresses support for the euro or if the European institutions offer additional support.

In the case of this game, the Member States of the euro area have been ignored, as they are already operating under a consolidated set of rules, differentiating them from the states that have to adopt the single currency. Their inclusion would introduce variables and objectives irrelevant to the purpose of the analysis. In contrast, politicians in the candidate countries were included among the participating actors because their statements and actions can shape public perceptions and expectations, thus directly influencing the direction of the government's fiscal and economic policies. In addition, politicians may take positions different from those of governments, representing partisan or ideological interests that can sustain or undermine government efforts in the euro adoption process. The public in the countries that need to adopt the euro is included in the game because its opinion plays a role in adopting the single currency. Public support or opposition to the euro can influence policy decisions, and its perceptions and fears, often shaped by politicians and the economic situation, can affect the euro adoption process (e.g. its inception or duration). The public's views are taken into account based on the Eurobarometer published by the Commission (European Commission, 2016, 2019, 2024) on the question, 'Are you personally more in favour or against the idea of introducing the euro in our country?', from which the weight of the answer 'rather in favour of introduction' was selected. The other possible answers were considered less important for this analysis, as they refer to those whose opinion is relatively fixed in terms of their weight in the total answers at that particular moment in time (either "very much in favour", "very much against" the introduction of the euro, or "I don't know").

Table 6 shows several changes for Member States that need to adopt the euro. Firstly, a deterioration of the fiscal balance is observed in most of these countries between 2016 and 2023. The Czech Republic, Hungary, Poland and Romania moved from relatively controlled deficits to significantly higher ones in 2023, well above the 3percent GDP threshold. In particular, Hungary and Romania recorded the highest deficits in 2023, with figures of -6.7percent and -6.6percent of GDP respectively. Sweden is the only country with a low budget deficit, remaining below the 1percent GDP threshold in 2023. This development indicates a significant challenge for Eastern European states in maintaining fiscal discipline. Romania is noticed by exceeding the threshold for fiscal deficit even before the shocks of the period 2020-2023, which indicates the existence of structural problems.

Second, comparing the 2016 data with the 2023 data, it is noted that Czechia and Romania recorded substantial increases in public debt, indicating a deterioration in fiscal sustainability. Hungary had a high level of debt but with a slight reduction, suggesting relative, albeit vulnerable, stability. On the other hand, Poland reduced debt, reflecting an improvement in public finance management. Sweden stands out by reducing public debt, pointing to sound fiscal management and better preparation for euro adoption. Sweden's performance is all the more important because it achieved this progress despite the shocks suffered in 2020-2023. The introduction of the EDP in 2024 for Hungary, Poland and Romania highlights the European institutions' concerns about these governments' ability to keep deficits below the 3percent GDP threshold. It highlights the risks associated with an unsustainable fiscal policy. In contrast, Czechia and Sweden are not subject to the EDP, which suggests that there is compliance with the commitments in the SGP, even if, in the Czech case, the 2023 deficit exceeded the set threshold[28].

Public opinions in favour of adopting the euro do not seem to have changed much in Poland between the times analysed here. In contrast, public support for adopting the common currency increased significantly in Sweden and, to a lesser extent, Romania and the Czech Republic. The difference between these three states is that the initial level of support is much higher in Romania compared to the Czech Republic. Hungary's case is interesting, as public support for euro adoption increased by 2019, exceeding 50percent, but decreased in 2020-2024. This dynamic differs from that in

[28] The EDP information for individual countries comes from the European Commission: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure/excessive-deficit-procedures-overview_en

other countries, where shocks in 2020-2023 seem to have contributed to increased public support for adopting the euro.

Table 6: information about countries included in the game

	Czech Republic	Hungary	Poland	Romania	Sweden
Budget deficit/surplus (percentage of GDP)					
2016	0.7	-1.8	-2.4	-2.5	1.0
2019	0.3	-2.0	-0.7	-4.3	0.5
2023	-3.7	-6.7	-5.1	-6.6	-0.6
Government debt (percentage of GDP)					
2016	36.6	74.9	54.5	37.8	42.2
2019	30.0	65.3	45.7	35.1	36.5
2023	44.0	73.5	49.6	48.8	31.2
PDE					
2016	No	No	No	No	No
2019	No	No	No	No	No
2024	No	Yes	Yes	Yes	No
Share of population responses "rather in favour of euro adoption" (percentage)					
2016	22	49	31	42	26
2019	26	52	29	42	29
2024	26	45	30	49	38

Data source: for deficit/surplus and government debt data Eurostat, table: Government deficit/surplus, debt and associated data, DOI:10.2908/gov_10dd_edpt1

Considering these data from the perspective of strategies, the surveyed states can be classified into three distinct categories. Sweden is showing constant cooperative behaviour, managing to keep both deficit and debt within the SGP and, above all, to reduce the public debt-to-GDP ratio in recent years, demonstrating prudent fiscal management and preparedness to adopt the euro. Another group seems to include Poland and the Czech Republic, which initially showed cooperative behaviour. Poland reduced its public debt from 54.5percent in 2016 to 45.7percent in 2019, and the Czech Republic had a budget surplus of 0.7percent of GDP in 2016. However, after the multiple shocks in 2020-2023, these countries deviated from their SGP commitments, with increasing deficits of -5.1percent of GDP in Poland and -3.7percent in the Czech Republic in 2023. Even though Poland has been classified as a non-cooperative country (hence the EDP), its imbalance can be corrected. In contrast, Hungary and Romania displayed predominantly uncooperative behaviour over the period, with increasing deficits and public debt. These developments undermine confidence in their ability to integrate into the euro area in the near future, raising serious questions about their commitment to the fiscal stability necessary for adopting the euro.

One interesting case remains Poland, given its policy of going "alongside the euro". There is a view that Poland is also maintaining this path because it has given it a certain isolation from the effects of external shocks such as the financial crisis and the sovereign debt crisis. This success of Poland seems to be based on five elements: a large internal market, low dependence on exports of the economy, a well-capitalised and profitable banking system, low macroeconomic imbalances and a flexible exchange rate policy (IMF, 2010).

The mere identification of those elements does not indicate the order of their importance or the thresholds from which they are no longer significant. If macroeconomic imbalances make things easier to assess, it is relatively difficult to justify what a sizeable internal market or low export dependency of the economy means. Perhaps some of these elements depend on a case-by-case basis on the nature and extent of the shock to which the economy is subjected.

In 2024, it is difficult to say whether Poland still retains the cumulative advantage of these factors, especially in the context of the EDP triggering, or whether such an advantage can be obtained by any of the countries east of the continent. Furthermore, if Poland's experience could be used to draw any lessons for the other states which have to adopt the single currency, it could be said that the greater the macroeconomic imbalances, the more difficult it becomes to use fiscal and exchange rate policies to absorb shocks. In other words, from a certain level of macroeconomic imbalances, monetary independence is no longer an advantage, and entry into the euro area is becoming an increasingly demanding target to achieve.

The European institutions have applied the tolerant *"tit for tat"* strategy in their interaction with all the countries under review, initially offering them opportunities for cooperation and support. However, the activation of the EDP for Hungary, Poland and Romania in 2024 reflects a necessary response to non-cooperation strategies on tax behaviour. Although Czechia has chosen a rather non-cooperation strategy, European institutions have decided to continue applying a tolerant approach in the hope of a return to fiscal discipline. Due to its consistently cooperative fiscal behaviour, Sweden has received the support of the European institutions, demonstrating that the cooperation strategy is rewarded.

The analysis of the development of public support for adopting the euro does not seem to correlate with the attitude of either governments or European institutions. In Hungary, the public no longer seems to support a cooperative strategy, given the decreasing share of those favouring adopting the euro. However, Hungary and Romania have the highest share of those supporting the changeover to the euro. In contrast, the share of those who support the common currency has increased in Romania. Poland and the Czech Republic are somewhere in the middle, with relatively smaller shares of those with a cooperative attitude, stagnation in the case of Poland and growth in the case of the Czech Republic. Sweden seems to be at the opposite end of the dynamics about Hungary, although the share of those who want to switch to the euro in Sweden in 2024 is lower than that in Hungary.

A possible explanation for some of these public strategies can be found in the attitude of the leaders, although it is unclear which side influences the other. Thus, in the case of Sweden, a 2023 study (Bergqvist, 2023) showed that, although political discussions about the decrease in purchasing power of the national currency have led to increased support for the changeover to the euro, the author does not consider a weak currency to be a weighty argument for the changeover. Another example is the Czech Republic where, in the New Year's declaration 2024, the President of the country called for concrete measures to adopt the euro (Anghel, 2024). Instead, Governor Matolcsy stated in 2023 that Hungary should not consider adopting the euro before 2030, as joining the euro area before the economy is adequately prepared could have negative consequences (Than, 2023). Political tensions between the Hungarian Government and the European institutions, related to respect for the rule of law and culminating in the blocking of access to some funds in 2023, have been accompanied by anti-European rhetoric, which may have contributed to the declining interest in adopting the single currency. On the one hand, it could be considered that the unblocking of access to funds for Hungary, following negotiations with the Commission in 2024, reinforced the anti-European sentiment in the country. On the other hand, it could be said that the same event contributed to maintaining a greater interest in the changeover to the euro than in other countries except Romania.

By analysing these player strategies, at least three hypotheses can be formulated. Firstly, in the case of the Czech Republic, Poland and Sweden, it can be said that there is no strong and immediate interest in adopting the euro, and specific circumstances condition public and political support. Thus, public support for euro adoption remained relatively stable and low in the Czech Republic and Poland, suggesting a lack of enthusiasm or strong political impulses for euro adoption. In both countries, the public has remained somewhat sceptical, probably reflecting the perception that the benefits of euro adoption are not convincing enough in the current context. Moreover, the behaviour of governments and political leaders signals a prioritisation of domestic economic stability and national policies, suggesting that interest in adopting the euro could arise only if certain conditions are met. By contrast, although public support increased between 2019 and 2024 in Sweden, it remains moderate, indicating an increase in public appetite for the single currency, given the current economic conditions of the national currency, but not necessarily a strong impetus for euro adoption. The Swedish government and political leaders appear to be taking a cautious stance, which may indicate that the interest in adopting the euro is rather conditional, depending on the economic circumstances and perceived risks.

In order for that hypothesis to be contradicted, it would be necessary to make some changes without necessarily concomitant changes. There should be an increase in public support for euro adoption, reflected in a notable rise in the percentage of those supporting monetary integration in surveys. This would indicate a change in the perception among the population, which would see the euro as a real and stable economic advantage. Governments and political leaders should make a strong and clear public commitment to euro adoption, including clear timelines and concrete measures to achieve this goal. Political declarations should reflect an unequivocal political will, independent of external conditions or future economic developments. It would also require a rapid and sustainable improvement in the economic situation, reducing the budget deficit and public debt to levels in line with the Maastricht criteria, thereby demonstrating that economic stability is achieved and sustainable. Moreover, intensified external pressures from the European Union, such as stronger demands or specific economic incentives for adopting the euro, could prompt these states to speed up the monetary integration, indicating that interest in the euro is more substantial than is currently perceived.

Another hypothesis is that, in the case of other states, there is tension between the government's ability to quickly correct macroeconomic imbalances, eurosceptic or even anti-European rhetoric of political leaders, on the one hand, and the public's desire to find stability through adopting the euro, on the other. For example, the Hungarian government failed to implement effective measures to correct economic imbalances. This is reflected in the budget deficit increase from -1.8percent of GDP in 2016 to -6.7percent in 2023 and in maintaining a high public debt to 73.5percent of GDP in 2023. Moreover, the Eurosceptic and sometimes anti-European attitude of political leaders in Hungary, which is well known in the European political context, indicates a lack of desire to comply with European rules and values, undermining confidence in the European project. By contrast, while public support for euro adoption fell from 52percent in 2019 to 45percent in 2024, the level remains relatively high, suggesting that a large part of the public sees the euro as an opportunity to distance itself from perceived ineffective or destabilising domestic policies, perceiving the European currency as an anchor of stability.

Even if the rhetoric and attitude of political leaders would change, not only in Hungary, the correction of macroeconomic imbalances remains a long-term process with uncertain effects on public perception, both towards the European project and the adoption of the euro. In these circumstances, to contradict the above hypothesis, an increase in tolerance on the part of the European institutions towards the efforts of the Eastern European countries may be necessary. Such flexibility could facilitate the economic adjustment process and positively influence public perception, increasing the chances of these political and economic changes having a real and lasting impact. In other words, in addition to economic restructuring, the "political" capacity of Member States to move forward with the integration process will be needed" (Daianu, 2024).

The third hypothesis refers to a situation different from the previous one, where political leaders maintain pro-European rhetoric despite issues regarding the government's capacity to correct macroeconomic imbalances, with public desire persisting to find stability through euro adoption. Romania is an example in kind. The figures demonstrate that decision-makers in Romania failed to correct economic imbalances, as evidenced by the increase in the budget deficit from -2.5percent of GDP in 2016 to -6.6percent in 2023 and the increase in the public debt from 37.8percent to 48.8percent of GDP in the same period. These data point to a deterioration in fiscal stability, highlighting the government's difficulty in efficiently managing the structural problems of the economy. Despite these difficulties, political leaders in Romania continued to promote a pro-European discourse, supporting European integration and highlighting the benefits of the European project. This pro-European rhetoric can be interpreted as an attempt to maintain public support for the government and to compensate for the lack of progress in domestic economic reforms. Public support for euro adoption increased from 42percent in 2016 and 2019 to 49percent in 2024, suggesting that despite domestic economic challenges, the public sees euro adoption as a way to ensure economic stability and distance itself from government policies perceived as inefficient.

Such an attitude of the actors in Romania and other states that have not yet adopted the single currency may indicate that the European project is perceived in terms of the free movement of goods, services, jobs and capital rather than as a political construction of which the single currency is part (Dijmărescu, 2023).

At least three changes would be needed to refute such an assumption. Decision-makers should, therefore, demonstrate the ability to implement effective policies leading to reducing the budget deficit and stabilising or reducing public debt. These actions would suggest that the government can correct economic imbalances sustainably. Secondly, political leaders should adjust their discourse, focusing on domestic economic challenges and recognising the need to strengthen the national economy through sound domestic reforms. Finally, a significant improvement in public perception of government efforts would be needed. If the public starts to see these efforts as effective and credible, they could increase confidence in the government's ability to manage the economy, thus easing pressure for adopting the euro as an economic stabilisation solution.

In the absence of such changes, the alternative would be a long-term plan to correct macroeconomic imbalances, which could cast doubt on the European institutions' intentions to adopt the euro, at least in this decade (Isarescu, 2024).

Returning to the interpretation of these rounds of interactions from the perspective of Ostrom's theory on the administration of the common good of trust in the euro, some conclusions can be drawn. The data analysed suggest a lack of correlation between conventional economic indicators and the confidence level in the euro. This decoupling indicates that confidence in the euro as a common good is complex and is influenced by many factors beyond the purely economic sphere. This means that the management of the euro journey (irrespective of the target date) has to consider not only economic aspects but also socio-cultural, political and psychological elements shaping public perception of the single currency. This is nothing new, but what is significant is that the 'famous' cost-benefit approach to euro adoption must include more elements outside the economic and political spheres.

Confidence in the euro is likely to remain/increase despite the overall deterioration of economic indicators. This persistence of confidence in the euro suggests the existence of a social and economic capital 'pool' associated with the single currency, which goes beyond short-term economic fluctuations. This also points to a stabilising role in the euro adoption perspective, which can anchor confidence even during economic turbulence. For policymakers, this conclusion underlines the importance of maintaining a long-term vision and a consistent commitment to the euro adoption process, even when facing temporary economic challenges.

Although the timeframe analysed is short, the data indicate a particular polarisation between countries with high and low confidence levels in the euro. This situation may become more acute in the future. This divergence is illustrated by the increasing gap between the countries with the highest and lowest confidence in the euro, as well as by the persistence of distinct national trends, such as the consistently low level of confidence in the Czech Republic and Poland, in contrast to the higher levels in Romania and Hungary. This suggests that specific national factors – be they cultural, political or historical – play a more significant role in shaping confidence in the euro beyond the common economic criteria established by the EU. That could mean that the confidence 'buffer' in the euro could be eroded before some states start the euro area accession process.

In conclusion, for the countries that need to adopt the euro, it is essential to realise that they can maintain a strategic wait-and-see position on joining the euro area only as long as they maintain macroeconomic balances within acceptable parameters and maintain an adequate level of public confidence in the common currency project, optimising the timing of monetary integration according to specific national political interests.

The importance of managing confidence in the euro as a process that goes beyond the purely economic sphere is not based solely on applying Ostrom's principles. In fact, trust in the euro has, besides the economic component necessary for its operation, a social component, which is characteristic of any fiat money since it incorporates the collective memory of economic transactions (Kocherlakota, 1996)[29], plus the specific euro component of the political project as part of the construction of the wider European project.

V Conclusions

The approach of this work, of asking as many questions as possible about the assertion that the euro could be considered a public good, has revealed at least two interesting things and five aspects that should perhaps be included in the considerations of analysts and decision-makers in the countries which are obliged to adopt the single currency.

Applying Ostrom's principles for managing common goods to confidence in the euro has some limitations because the monetary union is a complex multinational project. While some principles, such as those relating to clearly defined limits, congruence with local conditions and graduated penalties, can be adapted with some success, others, such as collective choice mechanisms and minimum recognition of organisational rights, are proving more challenging to implement in the context of the euro area. The ECB's centralised governance structure and the complexity of national economies create tensions between local needs and collective objectives. These challenges are exacerbated by the situation of countries obliged by the Treaty to adopt the euro but which are late in doing so, highlighting the difficulties in reconciling national sovereignty with the requirements of a monetary union.

The game theory applied in this case allows for a nuanced understanding of the dynamics underlying the interactions between the actors in this complex game within the EU and the eurozone. Not only does this analysis allow the choices of euro

[29] The currency can be regarded as a social project. Operating as a distributed trust system, it enables cooperation between individuals without a direct history of interactions. Its value derives from the collective agreement, which is an economic 'social contract'. The currency serves as an abstract record of social obligations and contributions, facilitating complex large-scale exchanges (Kocherlakota, 1996).

area actors to be questioned, taking into account the characteristics of the EU institutional framework, but it also highlights the fragility of the balance between the individual interests of the Member States and the collective stability of the currency.

The issues that should be of interest to decision-makers and analysts in countries obliged to adopt the common currency relate to factors that are not strictly economic and institutional matters. Thus, these countries must first be willing and prepared to communicate effectively and have confidence in the euro area partners (the European institutions and the other eurozone members). In other words, those who look on in disbelief at European partners (either because they have different priorities or the perception that they are being treated differently) cannot participate in honest dialogue or trust the common governance framework.

Secondly, governments in the countries that have to adopt the euro must be institutionally prepared to deal with the rigours of the euro area's monitoring and sanctioning mechanisms, which are often more advantageous than the financial markets, especially in the context of structural problems. Strengthening administrative and legal capacity is essential, not only by adopting legislative reforms to bring national legislation in line with European standards but in particular by enhancing the supervisory institutions. Fiscal and budgetary management improvements are achieved by implementing sustainable fiscal policies and creating a transparent system for reporting economic and fiscal data. The ability to respond to economic and financial crises is an important pillar, requiring the development of effective mechanisms for rapid reaction and cooperation with European institutions. Civil servants' continuous education and training contribute significantly to correctly understanding and applying euro area regulations and standards. Moreover, even if some countries still consider the independence of monetary policy essential for the necessary adjustments, this has to be balanced with the critical level of public debt until the financial markets remain confident in the authorities' ability to implement these adjustments. The critical level of public debt diminishes as the structural problems of the economy intensify.

Thirdly, in the new economic and fiscal governance framework, the countries adopting the common currency must be prepared for a quicker and less tolerant reaction by the European authorities in the event of non-compliance with their tax commitments. This is because the priority of the European authorities is to safeguard macroeconomic stability. Fourthly, the economic policymakers in these countries must construct the budgets and the multiannual budgetary plans, bearing in mind that, in the eyes of the European authorities, structural reform efforts, particularly those relating to the green and digital transitions, are essential for long-term economic stability.

Finally, for the countries that need to adopt the euro, it is essential to understand that they can maintain a strategic wait-and-see position on joining the euro area only as long as they keep their macroeconomic balances within acceptable limits and maintain an adequate level of public confidence in the common currency project. The timing of monetary integration can thus be optimised in the light of specific national political interests.

Whether considered a common good or not, confidence in the euro is essential for actors who want to continue the political project of European construction. Trust is a mutual process to which everyone who wants to participate must contribute. The exclusive pursuit of national interest cannot support a common construction project; it can only be a contractual exchange relationship.

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EURO ADOPTION: OPPORTUNITY AND CHALLENGE FOR ROMANIA

Silviu Cerna

I Introduction

Like the other Central and Eastern European countries, Romania has committed itself to adopting the single European currency – the euro – when it fulfils the conditions laid down in the European treaties: the Treaty on European Union, the Treaty on the Functioning of the European Union (Maastricht Treaty), the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (European Fiscal Compact) and the Statute of the European Central Bank and the European System of Central Banks.[1] However the candidate countries have considerable freedom in deciding when to adopt the euro. On the other hand, the euro area institutions also have an important role to play in the euro adoption process.

Some former communist countries (Slovenia, Slovakia, the Baltic States, and Croatia) have already adopted the single European currency. Bulgaria missed the date initially set for the introduction of the euro (1 January 2024); the date subsequently set by this country for the euro adoption is 1 January 2026. Other countries (Czech Republic, Poland, Hungary, Romania, and Poland) are delaying the resolution of this important issue and some of them (Hungary, Poland, and Romania) have recently been reluctant to set a precise date for the adoption of the euro.

In Romania's case, the introduction of the euro would be an important step in the country's return to Western civilization, from which it was kept isolated by the communist regime for half a century. At the time of Romania's entry into the EU (2007), the authorities announced in the Convergence Program that the date of Romania's entry into the Economic and Monetary Union (EMU) would be 2011. Sub-

[1] Șandru D.M. (2019, 16 aprilie). Cadrul juridic și instituțional al aderării la moneda euro. Starea de drept și de fapt în România, https://www.juridice.ro/636241/cadrul-juridic-si-institutional-al-aderarii-la-moneda-euro-starea-de-drept-si-de-fapt-in-romania.html.

sequently, however, they have repeatedly postponed this date: 2014, 2015, 2019, 2024-26, and now, it seems, *sine die*. This permanent hesitation shows that the adoption of the euro was never taken seriously by the Romanian authorities.

However, in December 2018, the government published a national plan for the adoption of the euro.[2] In its turn, the government commission set up for this purpose has drafted a report on the rationale of the national plan for the adoption of the euro, outlining various aspects of the process.[3] However, these official documents do not foresee the economic policy measures to be taken to this end, with precise tasks and deadlines, nor do they set a specific date for the adoption of the euro, but rather contain general analyses of the Romanian economy and possible scenarios for its future development in the European context.

The adoption of the euro is an important investment in sustainable economic growth, as it can serve as an "anchor" for the continuation of the necessary reforms to complete the transition from a centrally planned to a market economy[4] and to implement an economic policy that can correct the imbalances in the Romanian economy. Entry into the euro area requires achieving real and nominal convergence of the Romanian economy with the economies of developed European countries. This process of catching up implies a series of domestic economic adjustments, likely to stimulate investment and foreign trade, increase the employment rate, and accelerate the efficiency of capital utilization. Achieving economic convergence – real and nominal – does, however, come at a cost.

The balance between the benefits and costs of EMU participation and the timing of euro adoption depends to a large extent on the economic policy pursued by the Romanian authorities to achieve this objective. This policy should aim to fulfil the Maastricht Treaty criteria and reduce the risks generated, in particular, by the nominal convergence process.

II Conditions for joining the euro area

A candidate country adopts the euro through a procedure – legal and economic – which is laid down in the European treaties. Essentially, this procedure consists of

[2] Guvernul României (2018). Planul național de adoptare a monedei euro, București, Decembrie.

[3] Guvernul României (2018). Raportul de fundamentare a Planului național de adoptare a monedei euro, București, Decembrie, https://media.hotnews.ro/media_server1/document-2019-02-1-22948555-0-raportul-fundamentare-planului-national-adoptare-monedei-euro.pdf.

[4] In Romania, there are still 1,400 public enterprises. (https://static.anaf.ro/static/10/Anaf/Declaratii_R/S1001/Lista_finala_a_IP_16.10.2023.pdf).

verifying that certain macroeconomic criteria are met and that the rules on central bank status are harmonized.

Thus, accession to the euro area is conditional on the fulfilment of so-called "convergence criteria", expressed by macroeconomic indicators. The treaty that laid the legal foundations for the creation of EMU (the Maastricht Treaty) lists five such criteria, two of which relate to fiscal policy (fiscal criteria) and the other three to monetary policy (monetary criteria).

The fiscal criteria are the size of the budget deficit and public debt. Thus, a candidate country must demonstrate that the ratio of government deficit to GDP – planned and actual – does not exceed 3% and the ratio of government debt to GDP does not exceed 60%.

The monetary criteria are price stability, long-term interest rates, and exchange rate stability. Under the first criterion, the inflation rate in the candidate country may not exceed by more than 1.5 pp the average inflation rate in the three best-performing EMU countries in terms of price stability.[5] According to the second criterion, nominal long-term interest rates cannot exceed by more than 2 pp the average of nominal long-term interest rates in the three best-performing countries in terms of price stability.

The third "nominal" convergence criterion concerns the exchange rate. Thus, a candidate country must first participate in the European Exchange Rate Mechanism (ERM II) for at least two years. During this period, the exchange rate of the respective national currency against the euro must be maintained within a fluctuation band of +/-15% of the central rate agreed between the European Central Bank (ECB) and the respective national central bank, or possibly within a narrower band, as agreed in the accession negotiations. In the meantime, there should be no severe tensions in the foreign exchange market and, in particular, no depreciation of the national currency against the central rate set on the date of entry into ERM II.

The Maastricht convergence criteria reflect the features of a healthy economy with low inflation, balanced public finances, and a stable exchange rate. If these criteria are met, the country can be said to be in a position to adopt the euro, as its economy will remain competitive after this event and will, therefore, not be a burden on other Member States.

Romania's decision to adopt the euro and the timetable proposed by the authorities to this end – if and when it will be worked out – will indicate, among other things, when negotiations will start on the detailed terms of participation in ERM II. This

[5] Currently, these countries are: Ireland (1.0%), Italy (1.4%), and Luxembourg (1.6%).

concerns first of all the determination of the central rate of the leu/euro, i.e. the range within which the market rate may fluctuate around this "central" rate.[6]

The European body responsible for adopting the formal decision on a country's accession to the euro area is the Economic and Financial Affairs Council (ECOFIN), which is based on the conclusions of the convergence reports drawn up every two years by the European Commission and the ECB, or at the express request of the candidate country, as the case may be. It follows that, after the successful completion of the preliminary stage of participation in the ERM II, Romania will be able to request such a "report...", assessing its readiness for the next stage, i.e. EMU.

III Positive effects of euro adoption

The adoption of the euro has indisputable benefits for the Romanian economy and society. The positive effects are both direct (immediate) and indirect (long-term).

III.1 Direct (immediate) effects

The direct effects stem from the irreversible and historically unprecedented change in the monetary conditions of economic activity in Romania and are immediately apparent after the adoption of the euro.

III.1.1. Elimination of transaction costs

The most obvious and quickest effect of the adoption of the single currency is the elimination of transaction costs incurred by businesses and the general public when exchanging leu into euro – and vice versa. These costs can be grouped into two categories. The first comprises financial costs, such as, for example, the bid-ask spread, fees charged by banks and bureaux de change for these operations, and insurance premiums against currency risk. The second category includes the administrative costs (internal costs) incurred by enterprises as a result of using financial and human resources in the foreign exchange activity instead of the core activity. More specifically, these are the costs generated by currency risk management, expenses incurred for financial reporting, opportunity costs involved in managing cash and cash on account in lei or foreign currency, expenses caused by the inherently longer

[6] According to the Resolution of the European Council of June 16, 1997, on the establishment of ERM II, the decisions regarding the central rate and the fluctuation range are adopted by mutual agreement by the finance ministers of the euro area member states, the ECB, the finance ministers and the governors of the national central banks of the EU member states that wish to participate in ERM II, through a procedure in which the European Commission also participates, after consultations with the Economic and Financial Committee (EFC).

duration of payments in euro, etc. Internal costs are a significant financial burden, especially for small and medium-sized enterprises, which have to allocate a relatively large share of their resources to foreign exchange operations instead of using them for core business.

An important factor influencing the size of transaction costs is the openness of the economy. The more open an economy is, the greater the positive effects of eliminating transaction costs. The Romanian economy currently has a high degree of openness (92%), which magnifies the positive effect of eliminating transaction costs.

In principle, the size of the financial costs can be calculated based on the income obtained by banks and other financial intermediaries from foreign exchange operations provided to customers. These revenues reflect the consumption of resources incurred by the latter in carrying out these foreign exchange operations. After the adoption of the euro, the financial and human resources freed up in this way will be used for other types of financial or economic activities. As a result, the value of these freed resources is a good estimate of the GDP growth likely to be realized by eliminating financial costs.[7] In the case of Romania, the information on the volume of revenues obtained by banks and foreign exchange bureaux from customer-order operations, which can be used as a proxy for financial transaction costs, cannot be obtained from documents published by the authorities, as the data contained in these reports are highly aggregated.

One method of estimating costs of this type is the processing of publicly available information on the number, size, and costs of different types of foreign exchange transactions. In Romania, however, no statistical data are published on the volume and costs of foreign exchange operations carried out by financial and non-financial institutions, grouped by specific instruments, maturities, and counterparties.

Other methods of estimating financial transaction costs are balance of payments data, expert estimates, and information from foreign exchange bureaux.

It follows that empirical research is needed to estimate the share of financial transaction costs in GDP, which is currently lacking, but even so, these costs are not negligible.

The (internal) administrative transaction costs incurred by firms in Romania are even harder to quantify. Businesses in Romania carry out various types of economic activities, ranging from agriculture and industry to trade and tourism, and the assessment

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[7] It should be noted that, following the accession to the eurozone, only the transaction costs related to leu/euro exchange operations will be eliminated, while the costs underlying transactions involving other currencies, primarily transactions in US dollars, will remain.

of these costs would require a detailed analysis of a representative group of non-bank economic agents, which carry out transactions with payment in foreign currency.

It should be emphasized that the impact of eliminating transaction costs on GDP will depend on the **Romanian economy's ability** to optimally reallocate the capital and labour freed by the disappearance of foreign exchange transactions.

III.1.2. Elimination of currency risk and lower interest rates

Entry into EMU eliminates the exchange rate risk, i.e. the probability of losses as a result of changes in the leu/euro exchange rate between the beginning and the end of an economic relationship or international trade contract. This is the second unprecedented and irreversible economic change brought about by Romania's entry into the euro area.[8]

Foreign exchange risk arises from unpredictable changes in the leu/euro exchange rate, which cause a decrease in the euro value of assets denominated in lei and an increase in the euro value of liabilities denominated in lei. As a result of these fluctuations, companies may incur significant losses in the period between the occurrence of a foreign receivable or liability and the settlement of the respective transaction (transaction risk), respectively because of exchange rate changes between the occurrence of a foreign receivable or liability and the balance sheet data (translation risk). Regardless of how it arises, currency risk hampers economic growth because it increases the cost of capital needed to finance business, makes investment planning more difficult, and ultimately leads to sub-optimal use of production factors.

The elimination of currency risk improves the general conditions for economic activity and, at the same time, triggers a series of adjustment processes in foreign trade and foreign and domestic investment. First of all, the elimination of currency risk reduces the uncertainty inevitably faced by exporters and importers, who have to estimate, creatively and hypothetically, the future level of their costs, revenues, and profits. Reduced uncertainty, in turn, stimulates growth in foreign trade, as the calculations and decisions needed to conduct efficient economic activity become easier and more precise. Second, the disappearance of currency risk reduces the overall investment risk of the country concerned (improves the country's credit rating), thereby encouraging inflows of foreign direct investment. Third, the elimination of currency risk contributes to lower domestic interest rates, as it renders unnecessary the currency risk premium, which is always more or less explicitly included in interest rates. In this way, the cost of capital is reduced, which stimulates growth in domestic investment. Moreover, the elimination of currency risk plays an important

[8] Romania's accession to the eurozone only eliminates the currency risk related to the leu/euro exchange rate; the risk of exchanging other currencies will still exist.

role in stabilizing the general price level, as investment decisions become more accurate and capital allocation more efficient. The latter argument is particularly relevant for small and medium-sized open economies, such as Romania.

Under these circumstances, an important positive effect of the introduction of the euro in Romania will undoubtedly be the decrease in domestic interest rates. Indeed, the main factors that determine the interest rate differential in Romania compared to interest rates in other countries are exchange rate risk, insolvency risk, liquidity risk, and the predictable or unpredictable changes in the exchange rate of the leu. Because of currency risk, the return on assets denominated in lei is volatile. As a result, a relatively high rate of return is necessary for risk-averse foreign investors (risk averters) to be willing to place their capital in Romania and, therefore, it is unlikely that interest rates in Romania would be higher than in the euro area.

The foreign exchange risk premium is of particular importance in countries with relatively low economic credibility, as the size of this element depends on the degree of investor confidence. As is known, the international rating agencies (Standard & Poor's, Moody's, Fitch) place Romania in the last recommended investment grade, and the main factors that can lead to an improvement in the country's rating are those that contribute to the fulfilment of the convergence criteria for entry into the euro area: reduction of the budget deficit, stabilization of the share of public debt in GDP, reduction of the risks related to external financing by improving the position and structure of the current account deficit, reduction of external debt, and increase in international reserves.

III.2 Indirect (long-term) effects

The entry into the euro area and the radical and irreversible improvement in the general conditions of economic activity are likely to trigger numerous adjustment processes in the economy in the long run. Thus, lower transaction costs, the elimination of currency risk, and lower interest rates are leading to increased foreign trade and investment, greater macroeconomic stability, financial market development, and increased competition in the goods and services markets. And all these processes contribute to accelerating long-term economic growth.

III.2.1 Impact of euro adoption on investment

An important positive effect of the adoption of the euro is to stimulate investment growth, which is a key factor for economic development. The elimination of exchange rate uncertainty and of the exchange rate risk premium lowers domestic interest rates. As a result, the cost of capital falls, stimulating an increase in the volume of domestic investment.[9] The elimination of transaction costs also works in the same direction.

The increase in factor productivity associated with these processes leads to an increase in GDP, including the part of GDP that can be invested. However, since the elimination of transaction costs has only a marginal effect on economic activity, the main factor likely to stimulate domestic investment will probably be the aforementioned decline in interest rates brought about by Romania's accession to EMU.

The adoption of the euro will also influence foreign direct investment, which **is a key growth factor** for an emerging market economy such as Romania. Moreover, FDI stimulates the inflow of new technologies and opens new markets for goods produced in Romania. The macroeconomic stability and the increased confidence of foreign investors in the Romanian economy following the entry into the euro area are expected to favour an increased inflow of foreign capital invested in the long term.

Another factor contributing to the increase in foreign direct investment is the elimination of currency risk. Exchange rate movements influence foreign direct investment in various ways. The direction and magnitude of these actions depend, among other things, on the size of the exchange rate risk existing before the adoption of the euro, the risk aversion of foreign investors, the size of *sunk costs*,[10] the type of investment, the intensity of competition, etc.

In general, large fluctuations in the exchange rate of the host country's currency increase uncertainty about the potential costs, revenues, and profits of companies investing in that country. Because of risk aversion, an investor may prefer a lower return with low risk rather than trying to achieve a higher return with high risk. Exchange rate movements therefore increase investment risk and decrease the likely return on foreign investment. Consequently, the risk premium and minimum rate of return demanded by foreign investors are higher. Thus, large fluctuations in the exchange rate of the host country's currency may lead to a decrease in the volume of foreign direct investment in that country. This is true even for risk-neutral investors, i.e. especially if the investment expenditure contains irreversible elements (*sunk costs*).

In the literature, however, there is also the view that there is a positive relationship between exchange rate volatility and the size of foreign direct investment. One explanation is that larger exchange rate fluctuations increase the expected profits of

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[9] The decrease in the cost of capital is also related to the fact that, through the adoption of the euro, the creditworthiness of the majority of enterprises in Romania improves.

[10] Sunk costs are the expenses incurred definitively; they are neither refundable nor otherwise recoverable.

the investor. This is because decisions on the volume of output also depend on the exchange rate. As a result, in the event of favourable exchange rate movements, an enterprise's additional foreign exchange profits may exceed the potential loss from the fall in output. It should be emphasized, however, that because of the inherent rigidity of the production process and the existence of various administrative barriers and fixed costs, adjustments in the volume of output, and hence in the amount of profit from exchange rate movements, are limited.

Another argument in support of the idea that exchange rate fluctuations stimulate FDI inflows is that a multinational company has great flexibility in its choice of production location. Depending on the movements in the exchange rates of various currencies, it can locate production appropriately in different countries to maximize profits. This possibility exists despite the sunk costs incurred by a multinational company setting up a production facility abroad. The lower these sunk costs, the greater the incentive to locate production capacity abroad, even if the exchange rate of the country's currency fluctuates more.

The effect of currency risk on the size of foreign direct investment also depends on the type of foreign direct investment. For example, currency risk stimulates the growth of horizontal investment (similar production carried out in different countries) but dampens vertical investment (different stages of the production process carried out in several countries). Less developed countries, such as Romania, are especially attractive for vertical foreign investments, which makes the currency risk a strong negative influence on the long-term foreign investments likely to be attracted by them. Moreover, exchange rate volatility negatively affects the flow of export-oriented foreign direct investment typical of these countries.

III.2.2 Increased external trade

The adoption of the euro and the elimination of exchange-rate risk greatly change the business conditions for economic agents who trade with EMU countries. Eliminating exchange rate fluctuations reduces uncertainty about the future profits of exporters and importers, leading to an increase in foreign trade with euro area countries.

The increase in the volume of foreign trade in turn affects the economy as a whole in several ways. First, it allows for greater specialization of production and hence an increase in its volume. Second, increased foreign trade stimulates domestic investment, as it requires an additional increase in the capital of exporting firms. Third, increased foreign trade increases the diffusion of technology and scientific and professional knowledge, which, particularly in less developed countries, contributes to higher productivity growth and hence to faster economic development.

Traditionally, the effects of monetary union on the volume of foreign trade of the participating countries are assessed by analysing the relationship between currency risk on the one hand and the size of intra-EU imports and exports on the other. However, empirical research on this relationship does not lead to very clear conclusions. This is because the techniques used in these studies to measure currency risk do not fully reflect the uncertainty inherent in economic activity in general. Quantifications based on historical data are also not fully satisfactory, as exchange rate volatility can change unexpectedly. Moreover, due to the different means of hedging against exchange rate risk and the different duration of foreign trade contracts, investors' perception of exchange rate risk differs from one investor to another, which means that there is no single measure of this type of risk.

Almost 75% of Romania's foreign trade is conducted with EU member countries. The assessment of the benefits arising from an increase in the volume of trade with these countries is based on the premise that these economic relations have an important positive influence on the economic development of the partners. The question arises, however, whether the increase in Romania's trade with euro area countries (development of foreign trade) will lead to a decrease in trade with countries outside the euro area (diversion of foreign trade). Joining a monetary union does indeed remove an important trade barrier between the participating countries: the existence of several currencies that have to be frequently exchanged for each other, with the costs and risks inherent in such operations. As a result, a country's trade with other member countries may replace its trade with third countries, and the country's total external trade volume may remain in principle unchanged.

A further problem in estimating the impact of monetary union on external trade is the difficulty in knowing the time needed for the trade effects of monetary union to manifest themselves. The models used in the literature do not provide a clear answer to the question of how long it takes for the assumed trade and economic growth to take place, which complicates the estimation of the long-term effects of euro adoption.

Although the assessments of the growth in foreign trade as a result of monetary union are quite different from one author to another, the empirical analysis generally leads to the conclusion that this growth rate is a positive and statistically significant magnitude. The results obtained so far show that the trade effect and the related growth effect are notable, although they cannot be estimated a priori with precision.

III.2.3 Decreasing country risk

In general, rapid economic growth requires high investment. Increased investment is particularly necessary in a country like Romania, which needs to catch up significantly with developed economies. Membership of the monetary union stimulates investment growth, among other things because it reduces country risk. Thus, Romania's entry into the euro area permanently eliminates the risk of a currency crisis. The corollary is an increase in the credibility of the domestic authorities' economic policy and a reduction in the risk of sudden capital outflows, which generally have a destabilizing impact on the economy.

Romania's economy is characterized by a relatively low capital-to-labour ratio, and insufficient domestic saving is a serious brake on economic growth. The gap between domestic capital accumulation, on the one hand, and the investment needed for economic development, on the other hand, can be bridged by foreign capital inflows. However, a higher inflow of foreign capital is associated with a deterioration in the current account deficit, which creates the risk of a currency crisis.[11]

Excessive widening of the current account deficit can lead to a sudden halt in foreign capital inflows or sudden outflows of foreign and domestic capital, as investors fear that sooner or later there will be a substantial depreciation of the domestic currency. The adoption of the euro eliminates the risk of such a crisis and thus increases the sustainable level of the current account deficit: although the deficit is possibly higher, foreign investors no longer consider this to be a danger to Romania's macroeconomic stability. On the other hand, the rapid growth in total investment is freed from the constraint of low domestic capital accumulation. As a consequence, economic growth, previously held back by insufficient capital formation through domestic saving, becomes economic growth based on increased investment – foreign and domestic.

The adoption of the euro also has a positive influence on the stability of the Romanian economy, as it reduces uncertainty about the authorities' economic policy stance. Although the National Bank of Romania (NBR) has gained remarkable credibility in recent years thanks to a consistent monetary policy, the transfer of monetary policy to the ECB is expected to reinforce this positive perception. The Law on the organization and functioning of the NBR (Law No 312/2004), which states that the fundamental objective of the NBR is to ensure and maintain price stability, provides a solid basis for the credibility of monetary policy. However, as the NBR's "autonomous" monetary policy has failed to eliminate inflation, financial markets continue to perceive Romania as a country relatively exposed to inflation risk.

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[11] The term "currency crisis" usually refers to a sudden and significant depreciation of the national currency as a result of a decline in investor confidence. It should be emphasized, however, that a currency crisis does not necessarily imply the depreciation of the national currency. The latter phenomenon occurs in particular when massive capital outflows are accompanied by a significant increase in interest rates or a strong intervention by the central bank in the foreign exchange market, leading to a rapid depletion of reserves of international means of payment.

Remaining outside the monetary union, Romania thus faces the risk of unpredictable capital outflows, caused by factors other than the deterioration of economic fundamentals. Monetary history is full of examples of this kind, showing that currency speculation and loss of confidence of foreign investors, even when the latter's lack of trust is not justified by the economic performance of the country concerned, have often led to rapid capital outflows, which have seriously affected macroeconomic stability. While membership in the Euro-Atlantic structures has undoubtedly increased Romania's credibility, this alone has not eliminated the risk of exchange rate fluctuations caused by the "contagion effect". However, this risk will be removed by the adoption of the euro.

The positive influence of the common currency on the credibility of a candidate country is reflected in the rating agencies' assessments of that economy both before and after the euro adoption. In the eyes of these prestigious institutions, the benefits of participating in a monetary union far outweigh the costs of abandoning an autonomous monetary policy. Experience in other countries shows that euro adoption raises government debt ratings on average two to three notches higher than before. Empirical research also confirms that raising a country's credit rating by just one notch significantly reduces the cost of attracting foreign capital and visibly increases foreign investors' confidence in the economy. As a consequence, euro area membership is expected to favour the growth of foreign direct investment in Romania and thus strengthen the fundamentals of Romania's sustainable economic growth. Although the positive effects of the strengthening of macroeconomic stability are difficult to measure, their impact on Romania's long-term economic growth is undoubtedly considerable.

III.2.4 Integration of financial markets

The literature shows that the main driving forces behind financial integration[12] within EMU have been the elimination of exchange rate fluctuations and the implementation of a single monetary policy at the euro area level. It is to be expected, therefore, that Romania's entry into the monetary union will enable the country to amplify and multiply the benefits of participating in the European financial market. The adoption of the euro will make it easier for domestic companies to access foreign financial markets on better terms. The more liquid and deeper financial markets in the euro area will help to reduce the cost of capital and make it easier to obtain financial information that will enable Romanian companies to better plan their business.

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[12] The term "financial integration" here denotes the access of economic agents to the financial markets of a given region.

The euro area financial market facilitates the access of domestic economic agents to financial services that are not available on the domestic market in Romania and allows them to work with the most competitive international financial intermediaries. Thus, joining the euro area offers Romanian companies the opportunity to participate in the European (euro)bond market. As a result, Romanian economic agents with a relatively low credit rating (bankability) and companies in sectors absent from the financial markets will find it easier to obtain the capital available internationally. In addition, it is easier to place large nominal bond issues on the market in the euro area than in Romania. This is also true for the equity market, although the latter is less harmonized at the European level.[13]

Financial integration also contributes to better capital allocation, which in turn allows for greater risk diversification. Finally, a larger and deeper financial market offers economies of scale to large participants. In addition, the reduction in macroeconomic risk, the elimination of leu exchange rate fluctuations, the reduction in transaction costs, and the trend towards their alignment with the European level create a closer link between Romanian companies' share prices and Romania's economic performance and lead to a better allocation of capital within Romania.

Access of domestic companies to foreign capital is limited by the rating of the country in which they are located (e.g. BBB- for Romania in Fitch's rating; Baa3 in Moody's rating). After entry into the monetary union, the rating of the euro area will be more important than the rating of the country in which the issuer of the securities resides. As the euro area rating is rated at the highest possible level (AAA), this will not be a constraint on the availability of capital for companies in the euro area. As a consequence, the factors that will determine the yield of financial securities placed on the European market by Romanian issuers will be sector risk and individual creditworthiness rather than their location in Romania.

Increased competition in the domestic financial market leads to increased efficiency of domestic financial intermediaries (banks, non-bank financial institutions, insurance companies, mutual or cooperative credit organizations, etc.) and lower prices and tariffs for the services they provide. Strong competition also stimulates financial innovation and a wider range of financial products on the market. All these factors increase the demand for capital and quality financial services, which in turn drives the development of the domestic financial market.

Financial market development will also be supported by the inevitable improvement in domestic regulation. More effective financial supervision, accompanied by a

[13] The unification of the capital markets is the main element of the European Competitiveness Deal, adopted at the extraordinary meeting of the European Council on April 17-18, 2024.

greater diversification of risks and sources of capital, contributes to financial stability both in Romania and the euro area as a whole.

The literature shows that financial market development has a considerable influence on economic development. A developed financial market stimulates economic growth and macroeconomic stability primarily at the national level.[14] Empirical studies confirm that there is a strong correlation between the degree of financial market development on the one hand and the pace of economic growth on the other. Although financial sector development is largely driven by economic growth, there is empirical evidence of reverse causality (feedback) between these two processes. In addition to stimulating economic growth, financial market development reduces fluctuations in output and employment.

The integration of financial markets is a powerful impetus for their development. Empirical research shows that countries with relatively less developed financial markets benefit most from international financial integration. From this point of view, the benefits of financial integration are expected to be substantial for Romania, although it is extremely difficult to measure them accurately and a priori.

In this context, it should be noted that the extraordinary meeting of the European Council of April 17-18, 2024 outlined a reform aimed at increasing the competitiveness of the European economy. This draft (European Competitiveness Deal) contains several important measures to deepen the integration of the single market, in particular capital markets, and to simplify administrative procedures and regulations. The 27 agreed to prioritize the unification of capital markets, which has been under discussion for over a decade. According to the ECB, the integration of capital markets will allow European businesses to raise an extra €470bn a year in financing. This is at a time when much of the capital is leaving the EU and going to the US, where it is placed in investment funds, which then buy up European start-ups.

EU leaders have finally agreed to look into centralized supervision of systemically important financial operators. Even this decision is an important step forward, as several countries initially rejected the idea of centralized financial market supervision, while others (Luxembourg, Ireland) were concerned that it would encourage financial intermediaries to migrate to Paris, the home of the expanded European Securities and Markets Authority (ESMA).

[14] The development of the financial market is usually measured by the following indicators: the ratio between the volume of credit granted to domestic entities and GDP; the total capitalization of the stock and bond markets as a share of GDP; the volume of transactions carried out on the securities market in relation to the capitalization of this market; the size of the spreads obtained by financial intermediaries; and so on.

Another issue discussed at the meeting was the refinement of the financial technique called "securitization" (the transformation of illiquid assets into readily tradable securities such as bonds).

So after a decade of debate, the EU is visibly looking for a new way forward.[15] If it fails, it will probably have to move forward with only a few member countries. Will Romania be among them or not? – that is the question.

III.2.5 Strengthening competition

The introduction of the single currency and thus the elimination of transaction costs and currency risk will lead to greater price transparency and increased competition in the internal market for goods and services.[16] The costs involved in operations to exchange the leu for the euro – and vice versa – and the exchange rate fluctuations applied in these transactions are major causes of the price differences currently observed between Romania and euro area countries. These differences cannot be completely eliminated by the international flow of goods and services, as they stem from the difficulty of comparing prices in the context of currency exchange, transaction costs, and exchange rate fluctuations. All these factors make risk-averse foreign investors (risk averters) cautious in their decisions to enter a new market. As a result, only less efficient companies remain in the domestic market and the allocation of factors of production is suboptimal. Increased competition following monetary union will therefore improve the allocation of capital and labour and increase the pressure for efficient use of factors of production, thereby stimulating growth.

The first effect (inter-sectoral reallocation of resources) stems from the fact that increased competition changes the relative prices of factors of production. These readjustments in relative prices in turn change the comparative advantage ratios of different sectors and branches of the economy. The adoption of the euro exerts this regulatory effect both directly and indirectly. The direct effect stems from the increased transparency of domestic and international prices and costs, which makes it possible to highlight the real profitability of domestic producers. The indirect effect consists primarily in the reduction of currency risk and, consequently, lower interest

[15] This path is indicated by the competitiveness compass (A Competitiveness Compass), presented by the European Commission on January 29, 2025. According to this document, the Commission will take measures to develop the EU financial market, the creation of additional financing capacities at the level of banks (which should benefit in particular lending to enterprises and SMEs), and measures for unified supervision; will reform and harmonize insolvency regulations at EU level, currently still very fragmented, including classification of claims and insolvency procedures or rules on financial guarantees and settlement; it will also remove tax barriers to cross-border investment.

[16] Dijmărescu E. (coord.) (2023). Piața unică la 30 ani, Institutul Național de Cercetări Economice „Costin C. Kirițescu", București, pp. 118-119.

rates and an increase in the volume of investment. The second indirect effect is the additional inflow of foreign direct investment as a result of reduced country risk. In both cases, the increase in the supply of capital changes the relative prices of factors of production and leads to a reallocation of resources across industries. The effects of this type are described by classical foreign trade theory and we do not dwell on them.

The second effect – increased pressure for more efficient use of factors of production – also occurs in an economy with monopolies or oligopolies (imperfect competition). Under conditions of imperfect competition, firms may have an incentive to keep output below the level that could be achieved in a perfectly competitive economy because they gain extra profit from the scarcity of a particular good. The external competitive pressure that arises from external trade liberalization, financial integration, and monetary unification causes the economy to readjust and provides an additional stimulus to growth. These readjustments are mainly realized within individual branches of the economy (intra-sectoral reallocation of resources).

Assuming that in some economic sectors there is monopolistic competition and opportunities for as yet untapped economies of scale, but market entry and exit conditions are liberalized as a result of euro area entry, the increase in competitive pressure leads to the following intra-sectoral adjustments:

(a) decrease or elimination of windfall profits (monopoly rents), leading to lower prices;

(b) the elimination of inefficient producers from the market;

(c) increased production by the remaining firms in the market, using efficient technologies, which contribute to lower costs and lower prices.

The theoretical basis for the analysis of the influence of foreign trade liberalization on the adjustment of the economy under conditions of imperfect competition is the so-called "new trade theory".[17] Empirical research based on this theory has largely focused on the case of developing countries, where the distortion of perfect competition is often very strong. Recently, however, several studies inspired by this theory have been carried out also on the case of EMU candidate countries. The latter research shows that the effects of the elimination of monopolies (imperfect competition) on the benefits and costs of joining the monetary union are relatively small, but in the medium term, economic growth is accelerated, with all that this entails.

An important consequence of increased competition following the adoption of the euro is the growth effect of innovation (creative destruction – Schumpeter) and the

[17] Helpman E., Krugman P. (1989). Trade Policy and Market Structure, Cambridge Mass, MIT.

diffusion of new technologies. Faced with greater competitive pressure, firms that want to stay alive will introduce innovative products and new technologies to increase their productivity.

Empirical research confirms that there is a certain link between competitive pressure in product and service markets on the one hand and the level of labour and capital productivity on the other. The results of these studies also show that the strengthening of competition as a result of the creation of the single European market has contributed to improved productivity and faster economic growth in this part of the world.[18] But, as with the positive effects of financial market integration, it is not possible to quantify precisely the benefits of increased competitive pressure in the internal market for goods and services in a priori terms.

IV Costs and risks of euro adoption

There are costs associated with abandoning the national currency. These stem first and foremost from the loss of monetary policy autonomy, which allows the relatively efficient use of interest rates and exchange rates as instruments of national economic policy. As economic cycles in EMU member countries are not fully synchronized, interest rates set by the ECB at the euro area level may be inappropriate in light of economic conditions in one country or another. Moreover, euro area membership implies the loss of the stabilizing function of the relatively flexible exchange rate.

IV.1 Loss of monetary policy autonomy

Romania's adoption of the euro practically means replacing the leu with the euro. On a deeper level, this is tantamount to giving up the use of interest rates as a tool for achieving economic policy objectives (price level, GDP size, employment rate, etc.), as well as the disappearance of the stabilizing function of the flexible exchange rate.

However, in an open economy, even before the adoption of the euro, the central bank faced the problem of the "triangle of incompatibilities": fixed exchange rates, free movement of capital and autonomous monetary policy cannot exist side by side. In a fixed exchange rate regime, interest rates have to be adjusted according to the interest rate set by the central bank of the country whose currency is used as an anchor for the domestic currency (allowing for a certain risk premium, which takes into account the relative liquidity of assets denominated in domestic currency, the

[18] Dijmărescu E. (coord.), op. cit., p. 117 and the following ones.

risk of default on foreign borrowing and the risk of depreciation of the domestic currency).[19]

The exchange rate regime currently in place in Romania (managed floating) gives the central bank considerable freedom in setting interest rates. This allows it to take domestic economic conditions into account to some extent in the design and implementation of monetary policy. Under the assumption that there are no major threats to price stability – the primary objective of monetary policy – the central bank can also be concerned with smoothing business cycle fluctuations (the size of GDP and employment). In addition, a managed floating exchange rate regime facilitates the smoothing of fluctuations in output and employment caused by external demand shocks and/or exchange rate shocks.

Joining the euro area raises the question of the appropriateness of the ECB's monetary policy to Romania's specific economic situation. The economic conditions that need to be met for a country to irrevocably fix its exchange rate, join a monetary union, and give up an independent monetary policy are frequently discussed in the literature on the optimal currency area theory. First put forward by the Canadian economist Robert Mundell[20], this theory shows that a group of countries constitutes an optimal currency area if the introduction of a single currency does not reduce welfare in those countries. This requirement is satisfied if several conditions are met. First, the markets for goods and services in the countries concerned must be integrated. Secondly, there must be free movement of the factors of production: capital and labour (labour mobility is very important). Thirdly, and especially in the case of insufficient labour mobility, an important condition for an optimal currency area is price and wage flexibility, which allows for the neutralization of possible economic shocks. In addition, it is desirable that shocks are symmetric (affect dif-

[19] In a fixed exchange rate regime, if the central bank maintains lower interest rates than abroad, that country faces capital outflows and downward pressure on the national currency. To prevent this depreciation, the central bank is forced to intervene in the market by using foreign exchange reserves, and after they are exhausted, it must let the national currency depreciate. If the central bank keeps interest rates higher than foreign rates, it causes a massive capital inflow, which pushes the domestic currency to appreciate and curbs exports. In order to keep the exchange rate fixed and thus limit inflationary pressure, the central bank is forced to absorb additional liquidity from the money market (created by interventions on the foreign exchange market) through open market operations ("sterilization" operations). The cost of such interventions has a negative impact on the profit of the central bank, and as a result, does not allow the continuation of these sterilization operations for a longer period.

[20] Mundell R.A., A Theory of Optimum Currency Areas, American Economic Review, reprod. in: Blejer M.T., …, (eds.), Optimum Currency Areas. New Analytical and Policy Developments, IMF, 1997, pp. 17-27.

ferent economic regions equally) so that their neutralization can be achieved through the single monetary policy.

The cost of abandoning autonomous monetary policy depends on the degree to which these conditions are met, which, if they are low, can amplify fluctuations in output and employment. Increased volatility in domestic output can in turn lead to large fluctuations in private consumption, which is perceived by the population as a steady decline in welfare. Moreover, large economic fluctuations can lead to an inefficient allocation of resources, with a negative impact on economic growth.

As empirical research shows, the cost of economic fluctuations is an unobservable variable that is extremely difficult to quantify. However, it can be argued, based on the analysis carried out for other countries, that the possible cost of increased economic fluctuations after Romania's accession to the euro area will be relatively low.

IV.1.1. Exchange rate adjustment

The analysis of the monetary policy transmission mechanism in Romania confirms that autonomous monetary policy can be used, to some extent, to stabilize output and employment. Empirical results show that the real economy generally reacts, albeit with some lag, to changes in the policy interest rate.[21] Therefore, the renunciation of an autonomous monetary policy implies the disappearance of an important means of smoothing business cycle fluctuations.

The problem is that adopting the euro also means giving up another monetary policy instrument: the exchange rate. The consequences depend on the extent to which, in open, small and medium-sized economies, the exchange rate is a shock absorber (it reflects economic fundamentals) or is itself a shock generator (it does not reflect fundamentals but distorts them). In other words, the question is whether the cessa-

[21] It is worth noting that, although in the short run monetary policy influences the real sector of the economy, in the longer run this action is relatively weak. Empirical studies devoted to this issue usually refer to the so-called "neutrality" and "supra-neutrality" of the currency. Currency neutrality means that a singular change in the money supply does not influence real economic variables (GDP, unemployment rate). This phenomenon is usually confirmed in the long term by empirical studies. (Antohi D., Udrea I., Braun H., Monetary policy transmission mechanism in Romania, BNR Study Book, 13, 2003; Radu R., Interest rate transmission mechanism, BNR Study Book, 28, 2010; IMF Country Report, Romania: Selected Issues Paper, 12/291, October 2012). Supra-neutrality (dynamic neutrality) means that changing the growth rate of the money supply does not influence real variables. The supra-neutrality hypothesis is usually rejected based on monetary theory and empirical results, even in the long run. The negative influence of high inflation (and high dynamics of the money supply during the inflationary phenomenon) on economic growth and real money demand illustrates that supra-neutrality does not exist.

tion of the exchange rate's regulatory function will hinder the normal functioning of the Romanian economy or, on the contrary, will help it.

The foreign exchange markets are characterized by an accentuated globalization and, therefore, by the amplification of international capital flows. Under these conditions, the share of capital flows in the balance of payments of most countries in the world is relatively high. Consequently, the influence of international financial flows on exchange rates is strong. Exchange rates therefore react relatively less to real shocks and more to developments in financial markets.

In the case of Romania, the share of financial flows in GDP is illustrated by the balance of payments. This document, compiled and published by the NBR, reflects both current account flows, determined primarily by trade in goods and services, and financial flows. In 2023, for example, the financial account recorded net inflows of €11,943 million, mainly as a result of the amplification of portfolio investment inflows mainly due to the increase in the volume of government securities issuance.[22] These developments led both to an increase in the size of international reserves and to a stable leu/euro exchange rate.

In these circumstances, it can be said that the effectiveness of the exchange rate's regulatory role depends on the factors that cause exchange rate movements. Thus, market expectations regarding the long-term real exchange rate level depend on the perception of economic agents regarding the current equilibrium level of the "real" exchange rate (nominal exchange rate adjusted for inflation), i.e. how they represent the exchange rate level as justified by economic "fundamentals". A relatively floating exchange rate has the advantage that it adapts to fundamental changes in the economy and therefore absorbs real shocks. For example, negative information about the size of the current account deficit feeds into investors' pessimistic expectations about the future equilibrium level of the exchange rate, leading to a depreciation of the national currency in the present. In the case of Romania, such a situation existed, for example, in the decade 2005-2015, when the leu depreciated against the euro by 22%, from 3.6 lei/euro to 4.4 lei/euro, and then never returned below the 4 lei/euro threshold. In the same period, the leu depreciated against the US dollar by 56%: from 2.5 lei/dollar in 2006 to 3.7 lei/dollar in 2014, and in 2015 the national currency crossed 4 lei/dollar.

At present, all forecasts point to a probable depreciation of the leu, i.e. an increase in its nominal exchange rate to above 5 lei/euro, although the leu has appreciated at times in recent times. The factors behind this surprising development are portfolio investments made by foreign investors through the purchase of government securi-

[22] BNR, Raport Anual 2023, p. 205.

ties denominated in lei, which have a much higher expected yield than government securities denominated in euro or dollars, inflows of foreign exchange by Romanian citizens working abroad and agricultural exporters, and sales of foreign exchange by the Ministry of Finance, stemming from government bonds denominated in euro or from funds from the PNRR.

The stabilizing function of the exchange rate is exercised through the mechanism of adjusting the equilibrium level of the exchange rate to changes in economic fundamentals. However, the exchange rate is also influenced by factors outside the real sector of the economy. For example, the exchange rate in the current period reacts to anticipated changes in the future stance of monetary policy. Thus, assuming an unexpected increase in interest rates, this surprise triggers a chain reaction by investors. First, expectations about interest rate increases become pessimistic. As a result, arbitrage between the current interest rate and the expected rate for various maturities arises. As a result, the demand for domestic financial assets increases, which is reflected in an immediate appreciation of the real exchange rate up to the level at which the expected depreciation becomes equal to the expected interest rate differential adjusted by the risk premium. Thereafter, the currency depreciates, in line with the difference between the interest rates of the various maturities, until it reaches the long-term equilibrium exchange rate. It follows that a restrictive monetary policy creates the risk of temporary overvaluation of the national currency.

In the case of a floating exchange rate, the volatility of the spot exchange rate is largely explained by changes in the expected risk premium. This parameter depends mainly on the following factors: country credit rating, currency risk, uncertainty in financial markets, and investors' risk aversion. As a result, some significant changes in the exchange rate level may be caused by financial shocks rather than shocks in the real economy. Consequently, the spot exchange rate may deviate significantly from the long-run equilibrium exchange rate. Such a situation may arise, inter alia, because of the "spill-over effect", which may also be reflected in the exchange rate of the leu, despite its recent stability.[23]

[23] The term "contagion effect" refers to the situation where a shock in one country is transmitted, to a greater extent than the economic "fundamentals" would suggest, to other countries. The causes of the contagion effect are, among others: the integration of capital markets, the investment strategies of financial institutions, or the tendency of investment behaviour to imitate the decisions of other investors in making their own investment decisions (herd behaviour on the capital market). Consequently, a crisis in one country often causes investors to withdraw their funds from other countries not initially affected by the crisis. This phenomenon, in turn, can lead to a significant increase in macroeconomic instability in all respective countries.

The causes of the exchange rate deviating from equilibrium depend on the nature of today's financial markets. Empirical research shows that short-term changes in exchange rates are often random. This feature, together with uncertainty about the nature of the relationship between the real economy and the exchange rate, means that speculation in the foreign exchange market is essentially short-term speculation, which relies on the continuation of the current market trend. This creates conditions for persistent deviations of the exchange rate from its long-term equilibrium level.

The inertia of the foreign exchange market is explained by the fact that speculating against its trend is usually costly and risky. It is costly because it entails the risk of incurring losses (e.g. from buying a depreciating currency), which requires a relatively higher capital coverage. Speculating against the currency market trend is risky because the timing of a reversal is unpredictable. For both reasons, speculation against the trend in the foreign exchange market is actually a rare phenomenon.[24]

Since foreign exchange market participants cannot be sure of the relationship between the real sector and the exchange rate level, they try to guess the future course of the exchange rate simply by observing the behaviour of other market participants. Consequently, traders tend to react to changes in the foreign exchange market rather than to information about the real sector of the economy. This is not to say that short-term speculation is the only determinant of exchange rate movements. However, they reinforce market trends by amplifying deviations from the equilibrium rate.

Another factor influencing the size of the deviation of the exchange rate from the long-term equilibrium level is the depth of the financial market (the ability of the market to sustain relatively large orders without affecting the price of financial assets). In the case of Romania, the financial market is underdeveloped and as a result, the deviations of the exchange rate of the leu from the level corresponding to the "fundamentals" may increase, even if the volume of transactions on the foreign exchange market decreases. Such a situation may arise, for example, if the difference between the domestic and foreign interest rate (the interest rate spread) narrows, which leads to a decrease in the volume of speculative capital inflows generated by the interest rate spread. An underdeveloped domestic financial market may therefore contribute to amplifying the impact of capital flows on the exchange rate.

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[24] The reluctance of investors to speculate against the market trend is also determined by the fact that in the foreign exchange market, there is no referential element, that is, a certain level to which the exchange rate must return. Forward rates do not reflect market expectations regarding the level of the spot rate. In the absence of a referential element, making a stabilizing speculation is far too risky. As a result, investors do not normally speculate on the return of the exchange rate to the level considered to be the equilibrium level.

The Romanian financial market has recently witnessed some developments that increase the likelihood of the above-mentioned phenomena. Indeed, there has been an increase in the volume of portfolio investments in government securities denominated in lei. This type of capital inflows favours forward foreign exchange transactions, which are more speculative than spot transactions.

Empirical research shows that, in general, the role of determinants of the level and development of exchange rates that are not linked to the real sector of the economy is significant. These studies also show that financial shocks caused by financial contagion and increased country risk have a substantial impact on the exchange rate volatility of Central and Eastern European currencies.

In conclusion, changes in the evolution of the expected interest rate, the risk premium, and the behaviour of financial markets may cause the current exchange rate to deviate from its equilibrium level. In terms of their impact on economic activity, the costs of this deviation are significant. On the one hand, an overvaluation of the national currency means that companies that would be operating at full capacity at a "normal" exchange rate have to limit or even cease production altogether. At the same time, undervaluing the exchange rate allows firms that under "normal" conditions are uncompetitive to survive and even grow, which means that factors of production (capital and labour) are not used efficiently.

It follows from the above analysis that giving up the national currency by joining EMU entails a lower cost than that predicted by the traditional theory of the stabilizing function of the exchange rate. This conclusion, confirmed by recent empirical research, is explained by the fact that a floating exchange rate can generate shocks to the real sector of the economy. Moreover, even in some papers devoted to the development of the theory of optimal currency areas, it is argued that the exchange rate adjustment mechanism does not play the role attributed to it in neutralizing asymmetric shocks. This conclusion does not change the fact, however, that the entry of a country into a monetary union, and hence the complete renunciation of the exchange rate adjustment mechanism, creates the need for other adjustment mechanisms. These alternative adjustment processes offset the negative effects of asymmetric shocks, and their presence or absence affects the overall benefit-cost ratio of monetary integration.

IV.1.2. Adjustment through the labour market

The entry into a monetary union, and hence the abandonment of autonomous monetary policy, reveals another feature of an optimal currency area, namely labour market flexibility.[25] Indeed, after joining the euro area, real wage adjustment and the

[25] The flexibility of the labour market is manifested by the effective reallocation of the workforce and the adjustment of wages following the change in economic conditions – internal and external (changes in demand, technological changes, etc.). Includes: labour mobility (between

free movement of labour are, apart from fiscal policy, the only remaining economic mechanisms to mitigate the negative effects of asymmetric shocks.

If an asymmetric demand shock occurs in a monetary union, the region in which the fall in demand occurs may experience a reduction in output and employment. If the factors of production (capital and labour) are sufficiently mobile, shifting them from a country affected by a negative aggregate demand shock to a country where there is no such shock makes it possible to restore macroeconomic equilibrium and halt the rise in unemployment in both countries.

However, the practical effectiveness of this mechanism is limited. By its nature, the cross-border mobility of productive capital is low and the free movement of labour is hampered by language and cultural barriers, mismatch of human skills demanded and offered in different national labour markets, and other such factors. In Romania, an additional cause limiting external migration is institutional barriers, which restrict access to labour markets in some EU countries and, until recently, to the Schengen area.

With limited labour mobility, the only way to mitigate the negative effects of asymmetric shocks is to adjust real wages. Thus, a fall in aggregate demand in a given country inevitably leads to a fall in the marginal productivity of labour in that country.[26] A new equilibrium can only be achieved by lower real wages. The size of this regulatory effect depends, among other things, on the extent to which trade unions are willing to restrain their demands for real wage increases by opting to maintain more but lower-paid jobs. In the extreme case of fully rigid wages, the adjustment of the economy to falling labour demand is achieved entirely by reducing employment (increasing the unemployment rate). In contrast, flexible wages can mitigate the increase in unemployment caused by the occurrence of an asymmetric aggregate demand shock.

In Romania, the effectiveness of the wage adjustment mechanism is favoured by the relatively higher productivity growth in sectors exposed to foreign competition (tradable goods sectors). Indeed, in the case of demand shocks, real wage growth in these sectors can be absorbed by slowing nominal wage growth, not necessarily by

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regions, jobs, and firms), how wages are set, freedom of choice between different forms of employment, hiring and firing procedures, working time regulations, trade unions, the social security system, and labour market policies. (OECD Employment Outlook, 2023, https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2023_08785bba-en).

[26] In the case of a decrease in demand for the goods produced by a certain enterprise, its production is reduced. Assuming that the amount of factors of production remains temporarily the same, reducing output equates to a flatter production function and thus a lower marginal product of labour.

lowering it. However, wage flexibility in Romania is generally low, mainly due to the wage bargaining system and minimum wage regulations. As a consequence, Romania is likely to face some negative effects from the renunciation of monetary policy autonomy after euro area accession.

An important factor determining the effectiveness of labour market adjustment is its legislative framework. In Romania, this framework is relatively broad and complex, but it should be emphasized that this is also the case in other EMU countries. On the other hand, the quality of human capital in Romania is poorer than in most euro area countries. Consequently, like most European countries, Romania needs relatively rapid economic growth in order to keep the unemployment rate at an acceptable level. It should also be added that assessing the benefits and costs of monetary integration requires measuring in absolute, not relative terms, the efficiency of the regulatory function of the labour market in terms of mitigating asymmetric shocks. In other words, comparing the flexibility of the Romanian labour market with markets in other countries is not sufficient to assess the cost of abandoning autonomous monetary policy.

Therefore, the Romanian labour market is not a feasible alternative mechanism to mitigate the negative effects of asymmetric shocks. The main problem is the relatively high real wage rigidity. As a consequence, abandoning the autonomous monetary policy creates the risk that asymmetric shocks will amplify employment and income fluctuations after euro area accession. In order to mitigate this risk, a comprehensive labour market reform is needed to make the wage formation process more flexible and to improve other features of the labour market.

IV.1.3. Fiscal adjustment

One means likely to be used to smooth output and employment fluctuations caused by asymmetric shocks is fiscal policy. By abandoning autonomous monetary policy, fiscal policy becomes the main instrument for stabilizing the economy.

Fiscal policy influences the economy in two ways. First, it acts through automatic fiscal stabilizers. If the volume of output falls, government tax revenues inevitably fall, and some categories of public expenditure rise, for example, unemployment-related expenditure. As a result, the budget deficit widens, which feeds aggregate demand, counteracting to some extent the reduction in economic activity. In other words, automatic stabilizers trigger a regulatory response of fiscal policy. In the economic recovery phase, the budget deficit shrinks just as rapidly, as a result of increased tax revenues and reduced social assistance spending.

Second, fiscal policy influences the economy through discretionary measures taken by the authorities in response to economic shocks. This intervention is, in fact, the main solution recommended by traditional Keynesian theory. However, in recent years, economic theory and empirical research have provided numerous arguments that discretionary fiscal policy is less effective in stabilizing cyclical fluctuations. Thus, the impact of an expansionary fiscal policy on aggregate demand growth turns out to be considerably weaker than previously thought and sometimes even negative. Moreover, the actual effect of such a policy manifests itself with a considerable lag, as the authorities first need to identify the economic shock, and only then can they initiate the appropriate legislative process, which often takes a long time itself. Moreover, in contrast to automatic stabilizers, the effect of discretionary fiscal policy is usually asymmetric: for political reasons, a lax fiscal policy during a recession is difficult to reverse in the upswing phase of the business cycle for political reasons. This asymmetry leads to a steady increase in public debt, as the case of Romania clearly illustrates.

These facts, in addition to the provisions of the Treaty on the Functioning of the European Union (TFEU) and the Stability and Growth Pact (SGP), clearly show the optimal form of fiscal policy for euro area member countries. These countries should aim to achieve a structural budget deficit that is small enough to allow the automatic stabilizers to operate normally and not allow the deficit to rise above the 3% of GDP reference level.[27] In turn, discretionary fiscal measures should be limited to supporting those structural changes that are necessary for the economy[28] and countering very strong asymmetric shocks.

The functioning of automatic stabilizers depends on the type of shock in the economy. In the case of demand-side shocks, stabilizers react relatively strongly and favourably in the direction of economic stabilization, while in the case of supply-side shocks, their impact is weaker and may even slow down the adjustment processes of the economy. However, in the case of demand-side shocks, the strength of the stabilizing effect depends very much on the macroeconomic variable affected. Thus, the

[27] The size of the automatic stabilizers that act on the economy at a given moment depends on the size of the deviation of production from the long-term potential (output gap), as well as on the sensitivity of public finances to this deviation. In the case of a negative output gap, i.e. of a production below potential, the automatic stabilizers cause the general public deficit to increase. The additional deficit, resulting from the operation of the automatic stabilizers, is called the "cyclical deficit". The fraction of the deficit dependent on discretionary fiscal policy is called the "structural deficit." After the deviation of output from potential becomes positive, a "cyclical surplus" occurs, and the general public deficit becomes smaller than the structural deficit.

[28] The main actions of this kind are changes in the tax system to stimulate employment, social assistance measures, changes in the structure of public expenditures, increasing the volume of investments in infrastructure projects, human capital, scientific research, and development of new technologies.

stabilizing effect is stronger in the case of a fall in consumption and considerably weaker in the case of a reduction in domestic investment or a fall in external demand. In the case of supply shocks, the stabilizing effect depends on the persistence of the disturbances. If the shocks are short-term, automatic stabilizers have some stabilizing impact on output, but only at the cost of feeding inflation. On the other hand, if changes in supply determinants are chronic, stabilizers may slow the adjustment of the economy towards the "new" level of potential output.

The responsiveness of the budget deficit to cyclical fluctuations depends on the elasticity of this parameter to changes in the volume of output. Empirical studies show that the impact of automatic fiscal stabilizers is influenced by the following factors: the size of the public sector, the progressivity of the tax system, the number and size of taxable items that are sensitive to the business cycle, the unemployment insurance system, the sensitivity of unemployment to cyclical fluctuations, etc.

These analyses suggest that, after euro area accession, the excessive structural deficit will be a major obstacle to Romania's effective use of automatic stabilizers. Even if the deficit will be reduced to the 3% of GDP reference value, which seems unlikely, the automatic stabilizers will not function normally. As a result, fiscal policy will not be able to stabilize cyclical fluctuations. A comprehensive reform of public finances is therefore needed beforehand to restore the stabilizing function of fiscal policy and thus reduce the cost of euro area membership. There are three major reasons why such a reform should focus on the expenditure side of the state budget.

First, experience shows that an expenditure-reducing public finance reform is more consistent and sustainable in reducing the deficit than one that focuses on increasing the tax burden.

Second, there are numerous examples of fiscal consolidation programs based on expenditure restraint that did not have negative effects on aggregate demand but contributed to economic growth. These effects are referred to in the literature as "non-Keynesian effects", in the sense that they operate contrary to the traditional view that, in the short run, tightening fiscal policy hurts the economy. The non-Keynesian effects are associated inter alia with the role of expectations in the transmission of economic policy: if financial markets and, more generally, private agents believe in the success of a program to consolidate public finances and reduce the budget deficit sustainably, private demand can fill the gap caused by the contraction in public sector demand.

There are other channels through which curbing public spending improves the competitiveness of the economy and increases output and employment. The first operates in the case of reduced public sector wage expenditure, which reduces wage pressures also in the private sector. The second channel is the exchange rate: fiscal consolidation leads to a depreciation of the currency, thus boosting the external competitiveness of the economy. Thirdly, given the current structure of the public finance sector in Romania, a policy of restraining public spending is more appropriate than one oriented towards increasing tax revenues. The public sector in Romania constitutes a huge fiscal burden for the economy and the population, and there is a large amount of populist social spending, which is often bypassed by the reforms envisaged by the authorities. Taxation on earned income is high and social security contributions are significant, which constitute serious obstacles to hiring new workers.

IV.1.4. Synchronization of business cycles

The cost of abandoning autonomous monetary policy depends extremely on the country's vulnerability to asymmetric shocks. Measuring this vulnerability is usually based on quantifying the degree of synchronization of the country's business cycle with the cycle of the other countries in the monetary union. If these national business cycles are synchronous, asymmetric shocks are less frequent. As a result, there is less need for a floating exchange rate to smooth asymmetric external demand shocks. In addition, there is also no need for a stand-alone monetary policy, as consumption and investment fluctuations follow similar patterns in all countries of the monetary union, which makes the monetary policy of the ECB, for example, sufficient to stabilize economic fluctuations in the euro area as a whole.

Empirical research confirms a certain relationship between the synchronization of business cycles on the one hand and vulnerability to asymmetric shocks on the other. In other words, a higher synchronization of countries' business cycles implies a lower risk of asymmetric shocks, leading to lower costs of exiting the respective national currencies.

The synchronization of euro-area and third-country business cycles is the subject of much empirical research. Two analytical approaches can be distinguished. Under the first approach, the synchronization of business cycles is assessed based on correlations between the main macroeconomic variables of the countries under consideration. However, these indicators are not sufficiently relevant for assessing the vulnerability of a given country to asymmetric shocks, as they reflect the combined effect of both the coincidence of shocks and the correlation of adjustment processes.

A more sophisticated approach involves decomposing economic fluctuations into demand shocks and supply shocks. This method allows separate analysis of the timing of the two categories of shocks, which provides a more complete view of the convergence of business cycle fluctuations. Through this prism, the cost of monetary integration appears to depend mainly on the synchronization of demand shocks, as these types of shocks can be mitigated by monetary policy. It must be said, however, that the correlation parameters of demand-side shocks may overestimate the cost of monetary integration. These coefficients depend to some extent on the shocks caused by the different stances of economic policy in different countries, a phenomenon that is likely to be eliminated by entry into the monetary union.

The synchronization of supply shocks is less important when discussing the cost of abandoning autonomous monetary policy since the possibility of neutralizing the effects of supply shocks through monetary policy instruments is limited. The non-synchronization of supply-side shocks mainly reflects structural differences between the economies under consideration, which will not be removed by the simple entry of the candidate country into the euro area. However, in principle, the convergence of such shocks should also be taken into account when assessing the similarity of the cyclical patterns of the various countries.

In light of the above, it is very difficult to assess unambiguously the cyclical convergence of the Romanian economy with the euro area economy. The Convergence Reports and Country Reports regularly prepared by the European Commission show that the Romanian economy is relatively well integrated into the euro area both through foreign trade – including participation in global supply chains – and through foreign investment.[29] However, these documents confirm the existence of important macroeconomic imbalances in Romania which are not found in other euro area countries. These are the large fiscal deficit, the external account deficit, and the competitiveness and potential growth problems that have resurfaced recently.

Also, the analysis carried out in the aforementioned report based on the national plan for the adoption of the euro[30] indicates a relatively high degree of asymmetry between the shocks in Romania and the euro area, mainly because the degree of correlation between supply shocks is relatively low and there is no evident upward trend in this parameter. This shows that there are still important structural differences between the Romanian and euro area economies.

As a result, the adoption of the euro makes it necessary to solve the problem of the convergence of Romania's business cycle with that of the other EMU member countries. It is also important to know to what extent the degree of cyclical synchronization between the Romanian and euro area economies is sustainable in the long run.

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[29] European Commission, Convergence Report 2022; Comisia Europeană, Raportul de țară din 2023 privind România, Bruxelles, 24.5.2023.

[30] Raportul de fundamentare a Planului național de adoptare a monedei euro, ed. cit., p. 147.

IV.1.5. Endogenization of optimal currency area criteria

The conditions formulated by the optimal currency area theory do not all have to be met before a country enters a monetary union. Therefore, the analysis of the positive effects and costs of participation in a monetary union must take into account not only the situation prior to the introduction of the single currency, but also the conditions assumed to prevail after the economic results of membership in the single currency area have materialized. The literature shows that monetary unification contributes to the development of economic linkages between the countries concerned, which leads to greater synchronization of their business cycles, increases the efficiency of the adjustment mechanism through labour markets, and reduces the cost of abandoning autonomous monetary policies.[31] This phenomenon is referred to in the literature as the "endogenization of optimal currency area criteria".[32]

The main factor reducing the vulnerability of the Romanian economy to asymmetric shocks is the increased trade integration of Romania into the euro area in the run-up to and following the adoption of the euro. According to the results of empirical research, monetary unification stimulates trade between member countries. Also, the increase in intra-EU trade volume leads in turn to an increase in the degree of synchronization of business cycles[33]. In addition, entry into monetary union stimulates investment and in particular, the inflow of foreign direct investment, which is usually associated with the transfer of modern technology and know-how. The latter process will certainly lead to an increase in the share of higher value-added goods in Romania's foreign trade structure and to the expansion of intra-sector trade. As a result, it can be said that the adoption of the euro will reduce the risk of asymmetric shocks in the Romanian economy.

[31] The processes that accentuated the cyclical synchronization of Romania's economy with the economy of the eurozone were triggered since the beginning of the EU accession negotiations. For example, the prospect of EU membership limited the possibility of the Romanian government pursuing a discretionary fiscal policy, and then Romania was subject to the provisions of the Stability and Growth Pact, which also prevented the populist fiscal policy expected by some Romanian politicians.

[32] Frankel J.A., Rose A.K., The Endogeneity of the Optimum Currency Area Criteria, NBER Working Paper, No. 5700/1996.

[33] Economic theory does not provide a clear answer to the question of whether increased foreign trade between EMU member countries increases the cyclical synchronization of the respective economies. The problem can only be solved empirically. Some analyses show, however, that increased foreign trade leads to increased production specialization, thus increasing the risk of asymmetric shocks. Other studies, however, provide empirical evidence that increased economic integration and increased bilateral trade are accompanied by increased synchronization of business cycles.

The adoption of the euro also increases the degree of synchronization of the economic cycles of Romania and the euro area. Romania's entry into the euro area implies the elimination of a potential source of asymmetric shocks, namely the discrepancies between the monetary policy of the NBR and the ECB. Under an autonomous monetary policy, it is possible, even when there is perfect cyclical synchronization between Romania and the euro area, that the monetary policies of the two central banks – NBR and ECB – may not be fully consistent in terms of the size and timing of interest rate changes. Romania's entry into the euro area implies the acceptance of a single monetary policy at the euro area level, which is likely to favour the synchronization of economic cycles.

Romania's accession to the euro area will also increase real wage flexibility and thus increase the effectiveness of the absorption of asymmetric shocks through labour market mechanisms. The degree of wage flexibility is affected by many factors, including the exchange rate regime. Under a floating exchange rate domestic currency, falling external demand creates expectations that the currency will depreciate, which increases the competitiveness of domestic firms. However this process reduces the effectiveness of the wage adjustment mechanism. In contrast, membership in the monetary union eliminates the exchange rate adjustment mechanism and contributes to increased wage discipline at the firm level, as well as to a stronger link between wages and labour productivity.

In conclusion, accession to the monetary union is expected to lead to a greater synchronization of the business cycle of Romania and the euro area countries, as well as to an increase in the effectiveness of the alternative adjustment mechanisms to the exchange rate mechanism, which will disappear. Consequently, the cost of abandoning the national currency will be further reduced.

IV.2 The short-term cost of meeting the inflation criterion

Joining the euro area requires fulfilling the price stability criterion of the Maastricht Treaty, which requires an inflation rate of no more than ±1.5 pp above the average of the three best-performing member countries in terms of price stability. In Romania, the annual inflation rate in 2024 was 5.1% – the highest in the EU. It is therefore necessary to bring inflation up to a level in line with the convergence criterion. The process of reducing inflation may, however, generate some costs in the form of a temporary slowdown in economic growth. As the transmission mechanism of monetary policy effects has several lags, inflation-reducing measures need to be taken well in advance of euro adoption.

According to the mentioned price stability criterion, the average annual growth rate of the harmonized index of consumer prices (HICP) in Romania must not exceed the reference value.[34] The decision as to when this criterion will be checked is, however, at the candidate country's discretion. However, in practice, this moment is expected to be somewhere towards the end of the period of compulsory participation in ERM II, as the experience of countries that are already members of EMU shows.

The assumption underlying the NBR's monetary policy is that keeping inflation around the current target (2.5% ±1 p.p.) does not cause the volume of output to deviate from its potential level (output gap). As a consequence, reducing inflation below this target to the reference value of ±1.5 pp. relative to the average of the three best-performing Member States in terms of price stability is likely to lead to some deviation of GDP from its potential level. Estimating the size of this temporary output gap can be done using various growth forecasting models or the Phillips curve.

Irrespective of the results of these forecasts, it can be assumed that any slowdown in economic growth as a result of a reduction in the inflation rate towards the level required by the related convergence criterion will be short-term. Moreover, it should be borne in mind that the results of simulations such as those mentioned depend very much on the size of the reduction in inflation that the authorities are aiming for. The reference value for the Maastricht Treaty inflation rate is very low and, as a result, achieving it will be difficult. Observational data and simulation results therefore suggest a pessimistic scenario in this respect. However, if the inflation reference value were eventually to be revised, this condition would no longer be so constraining and the short-term cost of fulfilling the price stability criterion would be lower.

V Optimal economic policy on the road to the euro

The analysis of the positive effects, costs, and risks of euro adoption does not exhaust the discussion of Romania's accession to EMU. An equally important issue is the definition of the economic policy needed to prepare for euro area entry. This policy must fulfil a twofold requirement: on the one hand, to ensure the fulfilment of the convergence criteria and, on the other hand, to cope with the challenges created by participation in ERM II. ERM II membership implies giving up the adjustable nominal exchange rate (managed floating) and implicitly limiting monetary policy autonomy. In this way, the proper coordination of monetary and fiscal policy and the strengthening of the latter become essential conditions for ensuring economic stability and euro area entry.

An essential element of the economic policy that can be pursued in the run-up to monetary union is also the setting of the central rate at a level appropriate for long-

[34] In 2024, this rate was 5.8%.

term equilibrium. Finally, the experience of other countries shows that the effectiveness of economic policy geared towards the goal of EMU entry depends on the credibility of this policy, i.e. the firm commitment of the fiscal and monetary authorities to achieve this goal.[35]

The analysis of the fulfilment of the convergence criteria shows that Romania does not meet any of them so far. Moreover, the only two criteria met at one point in time – the budget deficit and public debt – have ceased to be so due to the populist fiscal policy pursued lately by all Romanian governments that have succeeded each other in power after 2018. Nor does the current government seem able to make the political compromises needed to put public finances on a sound footing, delaying difficult but necessary decisions.

In this context, the question arises of the right mix of monetary and fiscal policies to reduce inflation and the budget deficit and halt the growth of public debt. The design and implementation of such a policy mix must be realized even before Romania participates in ERM II, as autonomous monetary policy will inevitably be constrained thereafter.

Arguably, any attempt to meet the inflation criterion through an inappropriate policy mix (i.e. a restrictive monetary policy and a lax fiscal policy) risks leading to a real appreciation of the leu, as the large volume of public borrowing needed to finance this scheme will inevitably lead to higher domestic interest rates and thus to massive inflows of foreign capital. Moreover, the attempt to bring, and then maintain, the inflation rate close to the euro area level will lead to a nominal appreciation of the leu through the phenomenon known as the Balassa-Samuelson effect.[36]

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[35] A successful example in this sense is that of Greece, which managed to increase the credibility of its macroeconomic policy in the period before joining the eurozone. Added credibility was achieved by the adoption in 1994 of a convergence program designed to prepare the economy for participation in monetary union. The coordinated action of the fiscal and monetary authorities contributed to strengthening the confidence of the financial markets in the Greek economy. On the other hand, the Greek government's intention to participate in the eurozone has triggered wide-ranging changes throughout the economy. Macroeconomic policy was no longer limited to reducing the budget deficit, and inflation, but included far-reaching measures in the field of structural reforms. All these factors increased the credibility of the economic policy carried out by the Greek authorities and helped to convince the international financial markets that the nominal convergence process of this country is sustainable.

[36] The Balassa-Samuelson effect consists in the fact that, under fixed exchange rates, the inflation rate in a given country is determined by the inflation rate in the country whose currency is used as an anchor and by the differences between productivity developments in the two countries. Estimating the Balassa-Samuelson effect is difficult even post factum, due to the problems raised by the identification of the sectors that produce tradable and non-tradable

Finally, the expectation that the central bank will defend the national currency against any significant depreciation against the central rate creates a moral hazard, which fuels speculation that the leu will appreciate.

All these processes may lead to an overvaluation of the leu, which is likely to deteriorate the current account position. The longer the process of excessive appreciation of the leu, the more abrupt and rapid the subsequent depreciation will be.

As a result, the tensions likely to emerge in the foreign exchange market are likely to prevent the fulfilment of the convergence criteria on inflation and exchange rate. As a consequence, Romania will have to bear the cost of achieving nominal convergence for a relatively long period. This disadvantage can be avoided by designing and implementing from the outset an appropriate economic policy mix, which would alleviate the pressure towards appreciation of the leu – a trend inherent to the prospect of euro adoption – and enhance the credibility of the policies envisaged for this end.[37]

The need to reduce inflation significantly will probably result in a temporary slowdown in economic growth (deflation). Estimating the size of this temporary reduction in the growth rate can be done using various types of forecasting models. However, this phenomenon is expected to worsen the position of the consolidated government budget and thus prevent the fulfilment of the fiscal convergence criterion. In other words, if compliance with the fiscal criterion is pursued with only a small safety margin, there is a danger of breaching the 3% of GDP deficit limit and completely blocking the EMU accession process. However, the restrictive fiscal policy in the run-up to euro adoption eliminates this risk.

The absence of a rigorous fiscal policy requires the application of a restrictive monetary policy, necessary to meet the criterion of price stability. However, the restrictive monetary policy leads to a brake on private investment. In contrast, cutting government spending allows inflation to fall without a significant tightening of

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goods, as well as the choice of the appropriate measure of productivity in the two sectors and the price indices of the two categories of goods.

[37] The process of appreciation of the leu within ERM II involves the risk of a likely repeated return of the market exchange rate to the central rate. If this setback is sudden, it can lead to an untimely rise in inflation. This increase in inflation would probably not prevent the fulfilment of the price stability criterion in the reference period (the assessment is based on the moving average of a 12-month period), and the depreciation of the leu could take place in the period after the examination of the fulfilment of the convergence criteria. However, the sustainability of meeting the convergence criteria will be questioned. This problem can be solved by a revision of the central rate either during participation in ERM II, as Greece did, or after the reference period has passed, as in the case of Ireland (European Commission, Convergence Report 2000).

monetary policy, which mitigates the drag on private investment. Such a combination of economic policies is therefore advantageous from the perspective of long-term economic growth.

Another challenge related to Romania's participation in ERM II comes from the fact that meeting the exchange rate criterion provided for by this arrangement (+/-15%) requires an economic policy that supports the stability of the exchange rate and does not generate tensions on the foreign exchange market. This policy should aim in particular to eliminate the factors likely to lead to the depreciation of the leu.

Fulfilment of the exchange rate criterion is highly dependent on the operation of setting the central rate at a level that financial markets consider stable. From an economic point of view, this means choosing a central exchange rate compatible with the long-run equilibrium rate. The undervaluation of the leu determines the intensification of inflationary pressure, which undermines the credibility of the entire process of monetary integration. The overvaluation of the leu diminishes external competitiveness and excessively increases the current account deficit, which can trigger speculative attacks. Setting the final leu/euro conversion rate at an overvalued level would also cause an adjustment of the real exchange rate through a relative decrease in wages and prices. As a result, economic activity will slow, unemployment will rise, and corporate profits will fall. If the exchange rate were greatly overvalued, it could take more than a decade to rebalance – as happened in the former East Germany.

Among the risk factors related to participation in ERM II are some traditional ones, or characteristics of the exchange rate regime called managed floating. The currency crises that have hit the economies of many developing countries in recent years show that maintaining a quasi-fixed exchange rate under conditions of free movement of capital can lead to speculative attacks, which almost always result in a significant depreciation of the target country's currency. As mentioned earlier, an expansionary fiscal policy and a restrictive monetary policy create favourable conditions for speculation in the foreign exchange market. This statement is vividly illustrated by the speculative attacks observed in the Hungarian foreign exchange market in 2003 and 2008, for example.

It should be noted that currency market pressure can also occur in the case of a relatively adequate economic policy mix. One cause may be the testing by market participants of the central bank's ability to mitigate negative deviations from the central rate. In order to reduce the tensions in the foreign exchange market, it is therefore necessary to gain the confidence of the financial markets in the economic policy of the authorities. Thus, one of the important conditions for the credibility of the exchange rate policy is a sound fiscal policy. If the financial markets consider that the currency policy carried out by the authorities is not likely to ensure compliance with the fiscal criterion, confidence that Romania will be able to join the eurozone will weaken, risk premiums will increase, and some portfolio investments will be liquidated.38 Loss of market confidence would put pressure on the leu, which could eventually force the central bank to devalue the national currency. Reduced credibility of fiscal policy can thus contribute to failure to meet the exchange rate stability criterion and to postponing eurozone accession for many years, as regaining market confidence is usually a very long process.

The above-mentioned considerations lead to the following conclusions regarding the optimal economic policy on the road to the euro:

1) In the period before the adoption of the euro, a significant and sustainable strengthening of fiscal policy is necessary. A relatively light or inconsistent tightening, aiming to meet that criterion with a small margin of safety, accompanied by the tightening of monetary policy and the resulting slowdown in economic growth, is likely to lead to exceeding the reference value of 3% of GDP for the budget deficit. Furthermore, the combination of loose fiscal policy and tight monetary policy is inappropriate for long-term economic growth. The insufficient strengthening of the fiscal policy may also give rise to tensions on the foreign exchange market, although the mix of economic policies necessary during the participation in the ERM II would require ensuring the stability of the exchange rate and thus preparing to meet an important criterion for entering the eurozone. It follows that the optimal mix of economic policies required for EMU entry is a disciplined fiscal policy combined with a moderately restrictive monetary policy.
2) Safe passage of the ERM II phase is possible, provided that the terms of participation in this interim arrangement are adequately defined. This operation primarily involves establishing a central exchange rate close to the long-term equilibrium exchange rate and a relatively wider fluctuation band than the current one.
3) Considering the traditional risks associated with quasi-fixed exchange rate regimes (controlled floating), the period of Romania's participation in ERM II should be as short as possible. The analysis of the issue of meeting the exchange rate criterion foresees the need to accept a greater tolerance for the appreciation of the leu in relation to the central rate than for its deprecia-

[38] Uncertainty about Greece's meeting the inflation criterion and, consequently, about its membership in the eurozone led to a massive outflow of capital in the first half of 2000. This phenomenon forced the Bank of Greece to intervene heavily in the foreign exchange market to defend the drachma (Bank of Greece, Annual Report 2000, Athens, 2001).

tion. This presupposes that, in the event of postponing eurozone membership, the current monetary policy (inflation targeting) and the adjustable nominal exchange rate regime (controlled float) are to be continued.

VI Conclusions

The adoption of the euro is a chance and a challenge for Romania, as it equates to the definitive return of this country to Western civilization, which is the civilization of the world at the beginning of the third millennium and from which it was isolated by the communist regime for almost half a century. The official decision to replace the national currency – the leu – with the single European currency has already been taken through the EU accession treaty, but Romania can collaborate with the European institutions to establish a suitable date for entering the EMU. The latter decision depends on achieving a balance between the positive effects – short and long-term – and the costs involved in adopting the euro.

Romania's entry into the eurozone is conditioned by the fulfilment of the monetary and fiscal convergence criteria provided by the Maastricht Treaty. That is why, in addition to evaluating the advantages, costs, and risks of adopting the euro, it is necessary to design and apply an optimal economic policy along Romania's long and hesitant road to EMU. This policy must enable both compliance with convergence criteria and minimization of inherent costs and risks.

The immediate effects of adopting the euro are the elimination of currency risk and the reduction of transaction costs borne by businesses and the population due to variations in the leu/euro exchange rate. The disappearance of the currency risk causes, in turn, the reduction of interest rates and, therefore, the decrease of the cost of capital. Also, the elimination of this risk stimulates the growth of Romania's trade with the countries of the eurozone and a greater inflow of foreign direct investments. This last process is accompanied by the strengthening of competition and the integration of the financial market in Romania with the financial market of the eurozone. The combined effect of all these factors is increased investment, improved labour productivity, and faster economic growth in Romania.

Romania's accession to the eurozone also implies the definitive elimination of the risk of currency crises. Combined with the greater credibility of the economic policy, the disappearance of this threat contributes to the substantial reduction of Romania's country risk. The macroeconomic stability achieved in this way will encourage capital inflows and the modernization of Romania's economy. Also, as a result of the adoption of the euro, internal saving, currently limited, will no longer constitute an obstacle to sustainable economic growth, and investments will increase, without giving rise to the risk of the collapse of the national currency, in the event of a sudden change in the direction of international capital flows in which Romania is surrounded.

In addition to these direct economic effects, there are indirect effects, exerted by the increase in foreign trade, the intensification of competition, and the integration of financial markets. Although these indirect effects cannot be accurately assessed ex-ante, it can be assumed that they will also contribute to supporting economic growth.

In general, it can be stated that the potential increase in GDP, which will undoubtedly take place following the adoption of the euro, will be greater than the simple positive impact of monetary integration, which constitutes a minimal level.

The positive economic effects – direct (immediate) and indirect (long-term) – will be all the greater the sooner Romania adopts the euro. The stronger economic growth stimulated by this fact will be accompanied by a significant increase in the incomes of the population, ultimately allowing the sustainable growth of consumption and, therefore, prosperity.

The main predictable cost of adopting the euro in Romania is the loss of monetary policy autonomy. After entering the eurozone, the NBR will no longer be able to autonomously set interest rates. Joining the EMU also means giving up the stabilizing function of the adjustable exchange rate (managed floating). Consequently, the independent interest rate policy and the relatively flexible exchange rate will no longer constitute means of mitigating fluctuations in the volume of production caused by asymmetric shocks, likely to affect Romania's economy. The impossibility of applying an anti-cyclical monetary policy creates the risk of amplifying fluctuations in production, employment, and income of the population and, therefore, the risk of reducing the standard of living. As a result, a lucid and responsible assessment of the extent to which the ECB's single monetary policy can be designed, taking into account the specific conditions of Romania's economy, is necessary.

In addition to the fact that the abandonment of autonomous interest rate policy implies the disappearance of a relatively effective tool for mitigating fluctuations in the volume of output, it also leads to the elimination of the stabilizing mechanism of the floating exchange rate. However, both economic theory and empirical studies show that under the conditions of free movement of capital, the regulatory function of the exchange rate is limited. Under a floating exchange rate regime, this variable is not necessarily consistent with economic "fundamentals", which reflect the current and future performance of the economy. These deviations can be significant and long-lasting, and the exchange rate itself can be the cause of asymmetric shocks. In other words, the cost of abandoning the exchange rate mechanism is overestimated in the theory and practice of monetary integration. Therefore, it can be stated that giving up the autonomous monetary policy will have a lower cost than that assumed by Romania fulfilling the traditional criteria of the optimal monetary area.

The size of the costs generated by abandoning the autonomous monetary policy depends inter alia on the existence of alternative mechanisms for regulating the economy, which can neutralize the effects of potential shocks even in the absence of an autonomous monetary policy. However, the reduced flexibility of the labour market in Romania does not allow relatively effective neutralization of the negative effects of possible asymmetric shocks through wage adjustments and/or labour mobility. However, it is expected that the process of integration into the economic structures of the EU, accompanied by the elimination of barriers to the free movement of labour through the full entry of Romania into the Schengen area and the elimination of the need for realignments of the exchange rate, will stimulate the increase in the flexibility of the labour market.

The effectiveness of fiscal policy as a tool to mitigate fluctuations in production and employment – the only one left available after the adoption of the euro – will depend on reducing the budget deficit, which is currently excessive and continuously growing. In order to achieve this objective, there is an urgent need for an extensive reform of public finances, which focuses on the reduction of budget expenditures. The fact that Romania is in the excessive deficit procedure provided for by the stability and growth pact should make the government responsible and lead it to adopt measures that lead to the reduction of structural fiscal imbalances and, therefore, to the creation of better conditions for the operation of automatic fiscal stabilizers. Ultimately, it is expected that the effectiveness of alternative mechanisms for regulating the economy will increase as Romania's economic integration in the eurozone progresses. This process will further reduce the cost of losing monetary policy autonomy.

The cost of abandoning the autonomous monetary policy is also lessened by the existence of strong economic ties between Romania and the eurozone countries. Since the beginning of the 90s, the share of foreign trade in GDP has increased systematically, and the eurozone is Romania's main trading partner. Also, the improvement of the structure of Romania's trade with the respective countries is noted. Both processes are factors for synchronizing economic cycles in Romania and in the countries of the eurozone. That trend must be strengthened in the near future, which will stimulate foreign direct investment inflows and reduce the technological gap between Romania and developed countries. All these developments, combined with the predictable increase in trade between Romania and the eurozone countries following the adoption of the single European currency, will lead to the gradual accentuation of the cyclical convergence of the two spaces. This phenomenon supports the idea that, after the adoption of the euro by Romania, the risk of significant shocks, which would affect the economy of this country asymmetrically in relation to the euro area, will be reduced. Therefore, it is expected that the cyclical fluctuations of production and employment in Romania will be relatively closely correlated with those in the euro area, and the single monetary policy of the ECB will become an effective tool for mitigating these fluctuations including in this country.

There is, indeed, a short-term cost of meeting the Maastricht Treaty inflation benchmark. This cost comes from the need to reduce the inflation rate well below the current NBR target. Such a reduction is necessary – although not necessarily – to meet the convergence criterion regarding price stability, but may result in a temporary slowdown in economic growth (stagflation). Both statements are based on the conservative assumption that the inflation benchmark for EMU accession will be maintained at the current level provided for in the Maastricht Treaty. However, it is not excluded that the respective reference value will be increased and, therefore, that the fulfilment of the inflation criterion will cause a relatively smaller slowdown in economic growth.

The analysis also presents the main elements of the optimal economic policy in the remaining period until the adoption of the euro. The objective of this policy must be to meet all nominal convergence criteria, given the limited autonomy of exchange rate policy implied by prior participation in ERM II. First of all, it is necessary to design and implement an economic policy that leads to a decrease in the inflation rate while maintaining the stability of the exchange rate of the leu and respecting the criterion of fiscal convergence. Maintaining a stable exchange rate may be particularly difficult due to the need to minimize the depreciation of the leu relative to the central rate, established upon entry into ERM II. Our analysis shows that the optimal mix of economic policies, which allows the simultaneous achievement of the above-mentioned contradictory objectives, is a smart combination of a rigorous fiscal policy and a moderately restrictive monetary policy. Furthermore, this policy mix is more conducive to long-term economic growth than the reverse mix.

The balance sheet of the positive economic effects and the costs involved in the adoption of the euro by Romania is positive. The degree of the economic integration of Romania in the eurozone is already high, and the effectiveness of the exchange rate adjustment mechanism is limited anyway. Moreover, it is possible that, after Romania's accession to EMU, the efficiency of alternative adjustment mechanisms specific to the labour market and fiscal policy will increase. Therefore, the cost involved in the eventual amplification of economic fluctuations following the introduction of the euro will be relatively small, and it is unlikely that the ECB's policy will prove inadequate for Romania's economy. On the other hand, the cost represented by the temporary slowdown of economic growth following the measures aimed at meeting the inflation criterion will be compensated by the favourable effects exerted by the adoption of the euro on economic growth in the long term. Thus, the introduction of the euro will allow Romania to achieve a sustainable and significantly higher GDP and consumption, and this only with a slight amplification of the fluctuations of these two variables. Consequently, Romania's membership in the monetary union will be reflected in increased well-being, which is the major argument for the adoption of the euro.

The predominantly positive effects of Romania's entry into the EMU suggest that postponing the decision to adopt the European currency is, in fact, equivalent to giving up the possibility of accelerating economic growth through convergence towards the developed economies of Western Europe. The adoption of the euro as quickly as possible and, therefore, the fulfilment of the convergence criteria as quickly as possible also require the urgent application of an economic policy likely to lead to long-term economic growth. Moreover, delaying adoption is not just a matter of placing in a nebulous future the moment when the opportunities for economic growth will finally become capitalized, as there is a risk that the unjustified delay will affect Romania's competitiveness in terms of attracting foreign capital in the long term. Therefore, entering the EMU as soon as possible is in Romania's first interest, and the economic policy must be oriented towards creating the conditions to achieve this objective.

During the period of participation in the ERM II, it is necessary to significantly strengthen the fiscal policy, simultaneously with the application of a moderately restrictive monetary policy. Such a balance of economic policies is the only means of meeting all the convergence criteria and reducing the risk of severe tensions in the foreign exchange market. In order to increase the credibility of such an economic policy and thus ensure the sustainable fulfilment of the convergence criteria, it is necessary to strengthen the fiscal policy even before entering ERM II. This approach requires a deep reform of public finances.

The period of participation in ERM II must be as short as possible and not exceed by much the two years provided for in the treaty. The application of an exchange rate policy in accordance with the traditional interpretation of that criterion can trigger serious tensions in the foreign exchange market, which can significantly delay the process of nominal convergence and, therefore, Romania's accession to the eurozone. However, this risk can be reduced by maintaining the regime of controlled floating of the exchange rate until the moment of accession to the ERM II, participating in that arrangement for as short a period as possible, and applying, in the manner described in detail in this work, an economic policy likely to lead to the stability of this rate.

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HUNGARY AND THE EURO[1]

Adam Kerényi[2, 3]

I Introduction

Hungary became EU member in May 2004. As part of the "acquis communautaire", participation in the new version of the exchange rate mechanism (ERM II), and subsequently in the European Monetary Union (EMU) is obligatory for all new EU members (no opt-out clause is available). Therefore, the question since then for Hungary and other new member countries has been no longer whether or not to enter the eurozone but rather the time horizon when Hungary's entry should happen. More specifically, as a condition for EMU membership, a country must be prepared to adopt the euro as the single currency and be able to meet the obligations arising from the Stability and Growth Pact. The formal condition for a country's preparedness to adopt the single currency is the fulfilment of a set of nominal convergence criteria, the so-called Maastricht criteria.

A single currency offers many advantages: it makes it easier for companies to conduct cross-border trade, the economy becomes more stable, and consumers have more choice and opportunities. However, a variety of political and economic obstacles barred the way: weak political commitment, divisions over economic priorities, and turbulence in international markets. These all played their role in frustrating progress towards the Economic and Monetary Union. All EU member states are in principle obliged to introduce the euro once they fulfil the convergence criteria. The EU countries that have not negotiated a currency opt-out are Poland, the Czech Republic, Hungary, Romania and Sweden (Hampl, 2023). The only exception is Denmark, which has an 'opt-out clause' in the EU treaties, exempting the country from

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the obligation to adopt the euro. Denmark may nevertheless apply for membership of the euro area if it so decides.

There are not many polls that measure the levels of support of adopting the euro among Hungarians. But a Eurobarometer study puts the percentage of Hungarians who would like to replace the forint with the euro at 72% in 2023, in contrast to 56% in 2003 (Eurobarometer, 2023).

II Hungary and the Euro – a literature review

The Hungarian political economy is conventionally approached in reference to (one of) several typologies seeking to capture the broader, systemic variations of capitalism that emerged in Central and Eastern Europe (CEE) (Sebők-Simmons, 2022). Most often grouped together with its Visegrád peers, Hungary's post-transitional mode of capitalism and its institutional arrangements are seen as having equilibrated onto a specific capitalist type variously described as 'embedded neoliberalism' (Bohle-Greskovits, 2012), 'dependent market economy' (Nölke-Vliegenthart, 2009) or an 'foreign direct investment (FDI)-based (second-rank) market economy' (Myant-Drahokoupil, 2010). Hungary was thought to become a part and parcel member of the European Union and then that of the Economic and Monetary Union by building on the grounding conditions established along the years after the regime change. As is often the case, expectations and reality did not converge satisfactorily to each other since the country is now featured with eurolessness (Kovács, 2020). According to Bod et al (2020) in the Hungarian academic and analytical community, the first wave of discussions on this topic dates back to 1999. At that time, several research institutes prepared analyses on EU membership and subsequently on professional preparations for future eurozone entry, commissioned by the Ministry of Finance to support governmental positioning. Over time, the stance of the Hungarian National Bank (MNB) also emerged (Csajbók–Csermely, 2002). Due to various changes in the Hungarian government's intentions, the topic temporarily fell off the agenda, resurfacing only occasionally (Darvas–Szapáry, 2008). The 2008 financial crisis and the political shift in 2010 created a new situation. The realities and the disturbances within the eurozone at that time were considered by those who participated in the debate initiated in *Közgazdasági Szemle* on rethinking the euro introduction (see the discussion starter by Neményi–Oblath, 2012), which was responded to by numerous experts in the same journal). After several justified years of absence (as there was no governmental intention for entry and the new order of the eurozone was still taking shape), in 2017, Portfolio.hu opened a debate on the timeliness of the Maastricht criteria and what should be done in the preparation process if political will emerged (see the discussion starters by Madár [2017a], [2017b]). In light of recent developments, the topic resurfaced in the November 2019 issue of *Ellensúly* (Dobozi (2019), Bod (2019). The staff and leadership of the Hungarian National Bank also took a stance on the issue of transitioning to the euro in several professional publications and commentaries (see Virág ed. (2020).

Accession to the Economic and Monetary Union is one of the most important steps in Hungary's European integration, which will entail abandoning the national currency and adopting the euro as domestic legal tender. For Hungary as a new member state in the EU, introduction of the euro will not be an option but an obligation. Nevertheless, new EU members will have some leeway to set the date of adopting the euro. Therefore, it is useful to analyze the likely costs and benefits of joining the euro area for Hungary and to define the choice of medium-term economic policy strategy in the light of the results of this analysis. This analysis is confined strictly to the economic benefits and costs of introducing the euro and is not intended to examine its other possible impacts, including, for example, the implications for politics and national security. Adopting the euro will likely have a permanent impact on Hungarian economic growth. This impact will become evident through numerous channels. Bank staff have attempted to quantify and sum up the extent of this impact transmitted through the various channels. The findings of this analysis suggest that the introduction of the euro will bring about significant net gains in growth. However, welfare is influenced not only by the level and rate of GDP growth, but their stability as well. A widely fluctuating national income will produce lower welfare than a more stable one, even if on average the two income levels are identical. For this reason, it is important to examine whether joining the euro area will increase or mitigate the volatility of business cycles. In other words, the key question is whether Hungary and the euro area form an optimum currency area that is whether the monetary policy of the euro area is capable of adequately substituting independent Hungarian monetary policy in smoothing out cyclical fluctuations. In the findings of this analysis, the euro area seems to be in most respects at least as optimal a currency area for Hungary as for less developed euro area member countries (Csajbók and Csermely, 2002).

III Adopting the euro – economic history before and after the Orbán-era

While the Hungarian government has been planning since 2003 to replace the Hungarian forint with the euro, as of 2024, there is no target date and the forint is not part of the European Exchange Rate Mechanism (ERM II).

Hungary originally planned to adopt the euro as its official currency in 2007 or 2008. Later 2010 became the target date, but that date was abandoned because of an excessively high budget deficit, inflation, and public debt. For years, Hungary could not meet any of the Maastricht criteria. After the 2006 election, Prime Minister Ferenc Gyurcsány introduced austerity measures, causing protests in late 2006 and an economic slowdown in 2007 and 2008. However, in 2007, the deficit had been reduced to less than 5% (from 9.2%) and approached the 3% threshold in 2008. In 2008 analysts claimed that Hungary could join ERM II in 2010 or 2011 and so might adopt the euro in 2013. After the 2008 global financial crisis, the likelihood of a fast adoption seemed greater. In October 2008 the head of Hungary's largest bank called for a special application to join the eurozone. Ferenc Gyurcsány ran out of political capital in March 2009 to accept necessary measures. The Bajnai government could not lead Hungary into the ERM II.

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The soft Eurosceptic Fidesz won enough seats in the 2010 Hungarian parliamentary election to form a government on its own. In 2010, Finance Minister György Matolcsy said they would discuss euro adoption in 2012. However, in February 2011, Prime Minister Viktor Orbán made clear that he does not expect the euro to be adopted in Hungary before 2020. Later, Matolcsy also confirmed this statement. Orbán said the country was not yet ready to adopt the currency and they would not discuss the possibility until the public debt reached a 50% threshold. The public debt-to-GDP ratio was 81.0% when Orbán's 50% target was set in 2011. In April 2013, Viktor Orbán proclaimed euro adoption would not happen until the Hungarian purchasing power parity weighted GDP per capita had reached 90% of the eurozone average. According to Eurostat, this relative percentage rose from 57.0% in 2004 to 67% in 2024.

In 2013, Orbán appointed György Matolcsy, his right-hand man on all economic matters, as the governor of the Hungarian central bank (Matolcsy-headed Hungarian National Bank, MNB). Together with their international enablers (Johnson-Barnes, 2015), political entrepreneurs such as Matolcsy jointly laid the ground for a massive shift towards financial nationalism. Theirs was, however, an idiosyncratic brand of financial nationalism and their strategy was aimed at a sweeping transformation of domestic finance, making use of tactics which are normally not associated with 'traditional' financial protectionism (Sebők-Simmons, 2022).

In 2015, Orbán declared that his government would no longer entertain the idea of replacing the forint with the euro in 2020, as was previously suggested, and instead expected the forint to remain "stable and strong for the next several decades", although, in 2016 Minister Mihály Varga suggested that country could adopt the euro by the "end of the decade", but only if economic trends continue to improve and the common currency becomes more stable.

Under Prime Minister Viktor Orban, Hungary amended its constitution[4], which now says that the forint is the country's currency. The fundamental law must be amended again if the euro is to be adopted. Hungary's government is currently "fighting for sovereignty by unorthodox policies" and is having conflicts with the European Commission in a couple of areas. In the domain of finance, Hungary's deviation in this period from the orthodox-neoliberal convention is best characterized by a form of financial nationalism (Sebők-Simmons, 2022).

In addition, with respect to the Hungarian commitment to Eurozone entrance, it seemed that the country was approaching Maastricht criteria in an acceptable way, and yet, not only its political commitment was lacking (i.e. not stepping into the ERMII) but the European Commission itself revealed some important backlogs in terms of legal compatibility. Furthermore, exchange rate stability was not among the priorities of the government as the rate followed a rather volatile path by implying growing uncertainty. Apart from this development, since the ruling government recreated the constitution in 2012 by literally stipulating that Hungary's official currency is the Hungarian Forint (i.e. it is not possible to make a referendum about the introduction of the Euro), Eurozone accession requires a constitutional amendment a two-thirds majority vote. With the benefit of hindsight, the Hungarian economic governance was no longer just neutral to the issue of Eurozone entrance but it made a runaway even further. Partly because of the blurred picture of the ongoing modernization of the institutional architecture of the Eurozone, which, of course, represented and still represents a factor of uncertainty. All things considered, the impression that not entering the Eurozone in case of Hungary is more like a political choice rather than an economic determinism (Kovács, 2020: pp. 6).

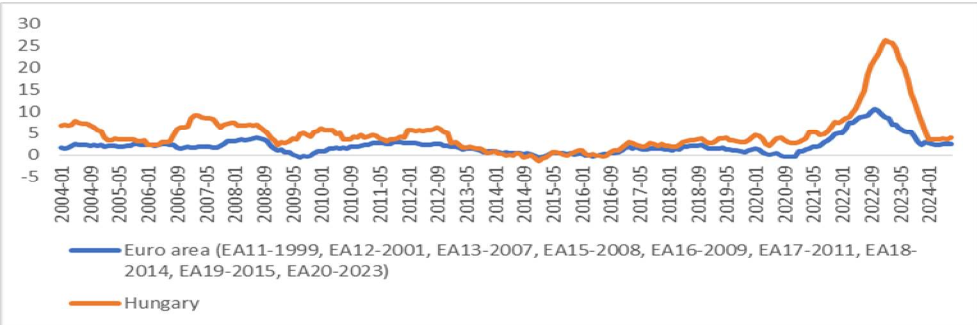
IV Convergence process in numbers with respect to the reference value

Hungary does not fulfil the criterion on price stability. In May 2024, the reference value was 4.1%, calculated as the average of the 12-month average inflation rates in the Netherlands, Italy and Latvia, plus 1.5 percentage points. The corre-

[4] The Hungarian constitution states that "the official currency of Hungary shall be the forint" (Fundamental Law, 2011).

sponding inflation rate in Hungary was 8.4%, 4.3 percentage points above the reference value. Over the last two years, HICP inflation first increased substantially peaking at 26.2% in January 2023 before easing steadily to 3.9% in May 2024. Average annual HICP inflation rose to 15.3% in 2022 and 17.0% in 2023, and was significantly above that of the euro area in both years. This inflation differential was due to the higher HICP weight of energy and food in Hungary, a more positive output gap in Hungary in 2022 driven by expansionary policies, and significant currency depreciation in 2022. The inflation differential vis-à-vis the euro area narrowed until early 2022, then widened substantially until early 2023, and has narrowed again since then, mainly driven by energy price inflation that was influenced by measures aimed at reducing the effect of the inflation shock on households purchasing power (Figure 1) (EC, 2024: pp: 86-87).

Figure 1: HICP monthly data in the euro area and Hungary (2004-2024)

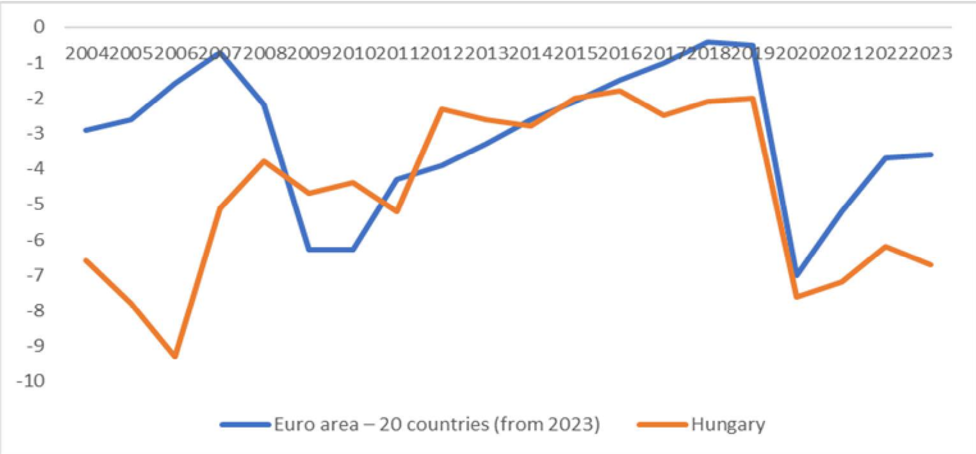


Source: Eurostat https://doi.org/10.2908/PRC_HICP_MANR

Public finances

The general government deficit remained high over the 2022-2023 period, increasing from 6.2% in 2022 to 6.7% in 2023. Revenues as a share of GDP were below the pre-pandemic levels at 42.7% in 2022 and 42.4% in 2023. While personal income tax revenue grew robustly on the back of rapidly growing nominal wages, the growth in social security contributions was hampered by the tax cuts implemented in 2022. The VAT revenue and excise duties fell as a share of GDP in 2023, in the context of weak consumption. The introduction of windfall profit and sectoral taxes over 2022-2024, levied on companies in the energy, financial and retail sectors, has temporarily mitigated a steeper decline in the tax-to-GDP ratio. The expenditure-to-GDP ratio remained significantly above the pre-pandemic levels at 48.9% in 2022 and 49.1% in 2023, due to elevated discretionary spending, and the impact of high inflation and high energy prices. The elevated expenditure levels in 2022 and 2023 were driven in particular by a significant increase in interest burden in the context of high inflation and high nominal interest rates (from 2.8% of GDP in 2022 to 4.7% in 2023), and the introduction of measures adopted to mitigate the economic and social impact of the increase in energy prices, in particular the subsidies to utility companies for the losses incurred due to caps on residential energy prices and support schemes for energy-intensive companies. The fiscal impact of measures adopted to mitigate the economic and social impact of the increase in energy prices, net of the revenue from taxes on windfall profits of energy suppliers, was estimated at 1.0% of GDP in 2022 and 1.6% in 2023 (Figure 2) (EC, 2024: pp: 91).

Figure 2: Government deficit/surplus in the euro area and Hungary (2004-2024)

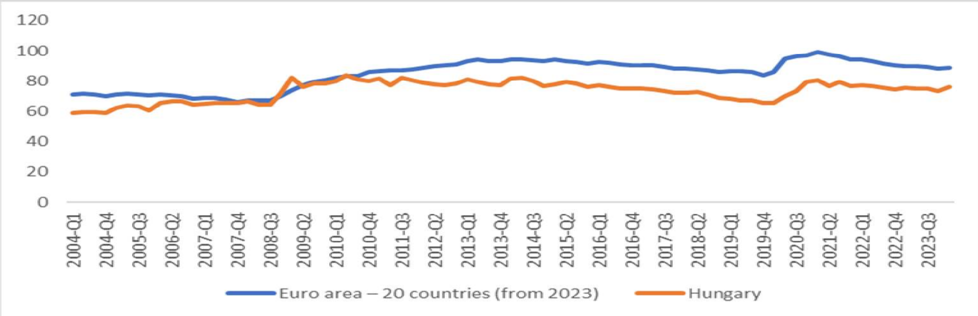


Source: Eurostat https://doi.org/10.2908/GOV_10DD_EDPT1

Debt sustainability risks appear medium over the medium run. Government debt is projected to slightly increase from around 74% in 2024 to around 78% of GDP in 2034. This projection assumes that the structural primary balance improves from a deficit of 1.3% of GDP in 2023 to a neutral position in 2024 and remains at that level (excluding changes in the cost of ageing) over the projection period (Figure 3) (EC, 2024: pp. 94).

The Commission report under Article 126(3) concluded that, after considering the opinion of the Economic and Financial Committee, the Commission intends to propose to open an excessive deficit procedure for Hungary, by proposing to the Council to adopt a Decision under Article 126(6) establishing the existence of an excessive deficit. On 19 June 2024, the Commission adopted a report under Article 126(3) of the TFEU. The report assessed the budgetary situation of Hungary, as its government deficit in 2023 exceeded the Treaty reference value of 3% of GDP. The report concluded that the general government deficit in 2023 exceeded and was not close to the Treaty reference value of 3% of GDP. The excess over the Treaty reference value was not considered to be exceptional and was not expected to be temporary. The general government deficit was 6.2% of GDP in 2022 and 6.7% of GDP in 2023, above the Treaty reference value of 3% of GDP (EC, 2024: pp. 14).

Figure 3: Quarterly government debt in the euro area and Hungary (2004-2024)



Source: Eurostat https://doi.org/10.2908/GOV_10Q_GGDEBT

Hungary does not fulfil the exchange rate criterion. Inflation targeting regime with the inflation target set at 3 percent with a tolerance band of +/-1 percentage point. Since 26 February 2008, the exchange rate band was abolished and a floating exchange rate regime was adopted that, however, allows foreign exchange interventions by the MNB. In 2022, the HUF/EUR exchange rate was on a steep depreciation path that started at the end of February following Russia's full-scale invasion of Ukraine. Starting from a level of around 355, the forint fell to a low of 430 HUF/EUR in October 2022. The depreciation of the forint reflected general uncertainty related to the war, a deteriorating current account balance due to high energy prices, inflation rising much faster in Hungary than in the euro area and concerns about the future EU fund receipts for Hungary. Following the monetary policy measures of October 2022, the forint started appreciating, a reversal which was later supported further by favourable developments regarding Hungary's receipt of EU funds. Inflation also started falling rapidly further contributing to the improvement of the risk assessment of the HUF/EUR exchange rate. The HUF/EUR appreciated to around 370 by May 2023. Since mid-2023 the forint was on depreciating path again while the central bank continued its monetary policy easing. In May, it traded against the euro on average at about 387 HUF/EUR. International reserves of the central bank that had already reached EUR 38.4 billion end-2021 rose to 38.7 billion by the end of 2022. Reserves increased more sharply in 2023 and reached EUR 41.4 billion by end 2023, which was around 21% of GDP. Reserves were increased by the issuance of foreign currency denominated government bonds and by inflows of

EU funds, while debt servicing, foreign exchange expenditures of the Treasury, the change in the central bank's forint liquidity providing FX swap holdings, and valuation effects of central bank assets mitigated the increase. International reserves increased to EUR 47.7 billion in May 2024. Short-term interest rate differentials measured by the 3-month interbank interest rate spread visà-vis the euro area increased sharply and peaked at 1400 basis points at the end of 2022. The increase reflected monetary tightening in view of rapidly rising inflation. Throughout 2023, the interest rate differential fell substantially reaching a level of around 570 basis points by end 2023, as inflation fell and monetary easing started in Hungary while the ECB was tightening its monetary policy. The spread stood at around 343 basis points in May 2024 (Figure 4) (EC, 2024: pp. 94-95).

Figure 4: Hungarian forint (HUF) versus the euro (2004-2024)

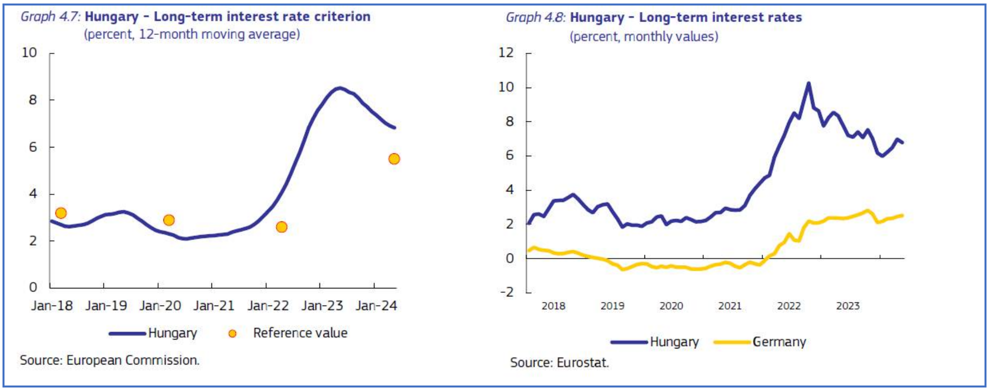
Source: European Central Bank[5]

Hungary does not fulfil the criterion on the convergence of long-term interest rates. The long-term interest rate in Hungary used for the convergence assessment reflects the secondary market yields on a single benchmark bond with a residual maturity of about 10 years. The Hungarian 12-month moving average long-term interest rate relevant for the assessment of the Treaty criterion was above the reference value at the time of the 2022 convergence assessment of Hungary. It increased from the 4.4% of May 2022 to reach 8.5% in June 2023 and then started to decrease. In May 2024, the latest month for which data are available, the reference value, given by the average of long-term interest rates in the Netherlands, Italy, and Latvia, plus 2 percentage points, stood at 5.5%. In that month, the 12-month moving average of the yield on the Hungarian benchmark bond stood at 6.8%, i.e. 1.3 percentage points above the reference value. The long-term interest in Hungary rose steeply in

5 https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-huf.en.html

2022 reflecting rapidly rising inflation, monetary policy tightening and heightened risk aversion due to Russia's full-scale invasion of Ukraine. It peaked at 10.2% in October 2022 but then started declining on the back of falling inflation and monetary easing. In May 2024, the long-term interest rate of Hungary was 6.8%. The long-term interest rate spread vis-à-vis the German benchmark bond widened substantially in 2022 and peaked at around 800 basis points in October, reflecting markedly higher inflation and central bank policy rates in Hungary as well as higher sovereign risk in a context of emerging macroeconomic imbalances, as evidenced by a widening of credit default swaps spreads. As inflation started falling steeply, the Hungarian central bank started easing at the end of 2022, while German short-term rates edged upwards and then declined in 2023. The long-term interest rate spread narrowed to around 427 basis point by May 2024 (Figure 5) (EC, 2024: pp. 95-96).

Figure 5: Hungary long term interest rate (2018-2024)



Source: European Commission, 2024

V Conclusion

All things considered, the impression that not entering the Eurozone in case of Hungary is more like a political choice rather than an economic determinism (Kovács, 2020: pp. 6). In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Hungary does not fulfil the conditions for the adoption of the euro. Legislation in Hungary – in particular the Law on the Magyar Nemzeti Bank (the MNB Law) – is not fully compatible with the requirements of Article 131 TFEU. Incompatibilities notably concern the independence of the MNB, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption with regard to the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute. In addition, the MNB Law also contains further imperfections relating to central bank independence and the MNB's integration into the ESCB. Hungary does not fulfil the criterion on price stability. The average inflation rate in Hungary during the 12 months to May 2024 was 8.4%, well above the reference value of 4.1%. It is projected to remain above the reference value in the coming months. Hungary does not fulfil the exchange rate criterion. The Hungarian forint does not participate in ERM II. The forint started depreciating again in the second half of 2023. In May 2024, the forint was about 0.7% weaker against the euro than 2 years earlier. Short-term interest rate differentials vis-à-vis the euro area increased substantially throughout 2022 reaching 1400 basis points as monetary policy reacted to surging inflation levels and currency depreciation much more strongly than in the euro area. The short-term spread fell considerably in 2023 and early 2024 but remained large at 343 basis points in May 2024. Hungary does not fulfil the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12 months to May 2024 was 6.8%, above the reference value of 5.5%.

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DILEMAS AND CHALLENGES OF POLAND'S ACCESSION TO THE EUROZONE

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Discussions in Poland on the possibility of our country joining the euro area have recently intensified. This has been caused primarily by the dynamically changing geopolitical situation in Europe, especially in the European Union (the effects of the protracted war in Ukraine, crisis or inflation tendencies in EU countries, problems related to EU migration and environmental policy (the concept of the European Green Deal), and finally political issues related to the elections to the European Parliament). Therefore, this paper focuses on presenting the views of academics, authority and business representatives on issues related to the viability of Poland's adoption of the single currency. These issues are presented mainly in terms of the expected potential benefits and costs of adopting the common currency, as well as the degree of Poland's preparedness for the introduction of the euro, primarily by meeting the nominal (resulting from the Stability and Growth Pact) and real convergence criteria (flowing from the assumptions of the so-called Optimal Monetary Area Theory). An important part of the carried out considerations is based to a large extent on the experiences of the other 'new' EU countries related to the implementation of the euro, as well as on the results of public opinion polls on this issue.

I Arguments for the renewed substantive discussion on Poland's accession to the euro area

In the Polish discourse on the situation in the euro area, still too little attention is paid to the significant transformation that has taken place within the euro area since

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2010. Instead, arguments referring to the situation of individual countries dominate: the Greek debt crisis or Italy's economic problems. Meanwhile, following the expansion of the ECB's actual role in stabilising the euro area, including in the face of new challenges (pandemic, climate change; Smoleńska, Tokarski, 2022), the emergence of new solidarity mechanisms (European Stability Mechanism) or countercyclical tools to manage capital flows within the euro area (macro-prudential policy), the EMU is now much better prepared to deal with external shocks.

Moreover, EMU is still evolving. Discussions are under way on strengthening risk-sharing mechanisms, which remain fragmented (e.g. deposit guarantees in the banking union, capital markets), and on spending rules. The place of the euro area in the global monetary system is also being transformed. The unprecedented issuance of EU debt in euros in the context of the NextGenerationEU facility and the increasing use of the single currency as part of the trend towards sustainable finance brings the prospect of creating a eurozone 'safe asset' and strengthening its international role closer (ECB, 2023; Smoleńska, 2023; Lupin, Machura-Urbaniak, 2023).

While it is certainly too early to talk about the end of the dollar's dominance in the international monetary system, the trend towards economic multipolarity, fragmentation and the increased role of global e-commerce platforms may have a destabilising effect on economies using currencies that are 'lower' in the global hierarchy, as in the case of the zloty. It is also worth noting the increasing role central banks play in a world of 'militarisation of interdependence' (Farell, Newman, 2019; Lagarde, 2023), e.g. through their ability to freeze other central banks' reserves in a given currency (as in the case of Russia's central bank reserves, see: Quaglia, Verdun, 2023).

Being part of a larger monetary system means being able to influence the use of an additional tool of economic pressure on states challenging the global order. In addition to Russian aggression, the drive towards multipolarity is evident in the economic confrontation between the US and China (www.piie.com/ microsites/rebuilding-global-economy), the shrinking number of democracies in the world or the growing competition for production technologies (e.g. semiconductors) and resources (raw materials, including rare earth metals). These trends argue in favour of accelerating the process of Poland's integration into Eurozone structures as an additional guarantee of stability and agility.

From the point of view of assessing the relationship between EMU and Poland, the dynamics of the separation of the euro area from the EU-wide structures is crucial. Formally, this trend has been halted in recent years. So far, neither a separate euro area fund has been created, nor has a special committee of the European Parliament. Instead, one can observe examples of 'creeping' differentiation emerging at the level of policy implementation.

For example, the reconstruction fund established in response to the pandemic is of particular relevance for the euro area. The procedures for coordination and peer review of the National Recovery Plans (NRPs), even if conducted in an EU-wide forum, significantly deepen the already existing economic policy coordination in the euro area. This effect is reinforced by the fact that Poland – as one of the largest beneficiaries of the programme – de facto remains on the margins of this process due to problems with the rule of law. In addition, the 'maturing' of the single currency, the shifting centre of gravity more towards eurozone countries in the Union after Brexit and Croatia's adoption of the euro in 2023, means that even where internal market regulation issues are decided among the EU27, the eurozone institutions (i.e. the ECB) play a key role in their implementation. These trends may increase the risk of marginalisation more than the formal differentiated integration in which, so far, safeguards for non-eurozone countries have usually been built in (e.g. participation in eurozone summits as foreseen in the 2012 Fiscal Compact, special voting procedures in the decision-making bodies of the European Banking Authority).

The change in dynamics between eurozone countries and those outside the eurozone is of particular importance in the context of the transformation of the economy towards sustainability. The 2019 European Green Deal and the 2021 climate law are leading to a 'greening' of various branches of EU economic regulation, such as the EU budget, fiscal rules, public procurement law and state aid (Ananicz, Buras, Smoleńska, 2021). Particularly affected by this trend are EU financial market regulations4. EU regulation mobi¬lizes the structural position of finance for the transition towards sustainability, including through incentives designed for instruments such as green bonds or loans. This trend requires appropriate coordination between economic, financial and monetary policies at national and EU level, which so far is proving to be incomparably more efficient in the euro area, e.g. with regard to the integration of sustainability into monetary policy making (Smoleńska, Weber, Opoka, 2023).

II Institutional determinants of Poland's accession to the euro area

II.1 General institutional frameworks and rationale for Poland's entry into the euro area

Firstly, the framework for the discussion of euro adoption in Poland was rooted in the EMU before the reforms implemented after the debt crisis (Sutkowski, 2023). Insufficient consideration was given to:

- new developments in economic thought, e.g. with regard to the ability to shape monetary policy independently in the context of integrated financial markets, i.e. so-called monetary sovereignty (Rey, 2015; Murrau, van 't Klooster, 2022) or the relationship between corporate governance and inflation (Weber, 2023),
- the implications of the institutional transformation of the euro area (Ananicz, Buras, Smoleńska, 2023),
- the technological transformation shaping the space for central bank action, e.g. in relation to digital currencies (European Commission, 2022),
- the new tasks that monetary policy plays in the face of global challenges (e.g. transformation towards sustainability (Smoleńska, 2023)).

Secondly, although the Polish discussion interweaves arguments related to economic issues (e.g. implications for economic growth) and political issues (e.g. issues of security guarantees, influence within the EU structures), they are treated too disconnectedly, without a deeper reflection on the feedbacks between them. As a result, the potential and subjectivity of Poland as a full member of EMU2, the efficiency of national public institutions in implementing policies related to the adoption of the common currency and the influence of the country on the shape of economic integration are rarely considered.

II.2 Importance of the Polish economic policy

Over the last decade or even more, we have seen rapid development of the Polish economy. In terms of the wealth of its citizens, Poland is much closer to the European average, despite accumulating problems resulting, inter alia, from the high level of inflation, persisting in the post-pandemic period. In this context, integration with the euro area, provided that an appropriate programme and strategy are prepared, may be a driving force for development, especially in the context of a broader transformation of the economy towards sustainability (e.g. by deepening access to capital or reducing financing costs). Analyses of the costs and benefits of Poland's integration with the euro area consistently highlight the need for appropriate macroprudential policies and those that support the competitiveness and innovativeness of enterprises (NBP, 2014; Czerniak, Smoleńska, 2019).

The competitiveness of the Polish economy, which is still based on low wages, with low spending on research and development, in the context of the energy transition and the war in Ukraine, means that imports of technology, including military technology, will remain high for the foreseeable future. In this context, monetary stability would be desirable. At the same time, the Polish economy is slowly exhausting the growth phase based on cheap and skilled labour. The discussion on maintaining the potential of the Polish economy should therefore also take into account how currency integration may become an additional factor supporting the ‘maturing’ of the Polish model of capitalism.

The ideologisation of the discussion on Poland's integration into the euro area has led to a reduction in the debate within public institutions, shallowing the level of analysis . The erosion of civil service functions and analytical facilities is reflected in the low level of public debate and low awareness of the Eurozone among Poles (Eurobarometer, 2022; Kurs na euro, 2023), even though the popularity of the common currency has increased, especially among pre-entrepreneurs, as a result of the war in Ukraine and rising inflation. The retreat from the rule of law, including the decline in the quality of lawmaking and the weakening of state institutions (including the parliament), raises the question of how these institutions can be rebuilt in the future. For it is not only the rule of law that is at stake, but also the agility of institutions to implement necessary reforms in the economic and financial area (e.g. with regard to financial supervision, reforms of economic indicators). This discussion cannot be conducted in isolation from a deepening of cooperation within the European Union (a kind of return to European values), including through a clear political signal in favour of deeper integration into the euro area and a constructive co-determination thereof.

II.3 The degree of Poland's fulfilment of the nominal convergence criteria

II.3.1 Outline of Poland's general economic and legal convergence situation

Economic and legal convergence criteria are a sine qua non for entry into the euro area. It is assumed that their fulfilment indicates macroeconomic and fiscal stability, which predestines a country to adopt the single currency. There are five criteria: price stability, long-term sustainability of public finances, exchange rate stability, stability of long-term interest rates and the legal criterion (Chrostowski, 2023).

Poland fulfils only the criterion of sustainability of public finances, and only partially (the analysis of Poland's fulfilment of the convergence criteria is based on data covering the period to the end of February 2023). While Poland's public debt in relation to gross domestic product (GDP) is 50.3% and below the reference value (60% of GDP), which speaks of stability in this respect, the general government deficit is -4.4% in relation to GDP, thus above the reference value (-3% of GDP; data on public finances refer to the third quarter of 2022). The criteria for price stability and long-term interest rates are not met. Poland's average annual HICP inflation is 8.8 percentage points higher than the reference value, while the average annual level of long-term interest rates is 2.1 percentage points higher. The zloty did not participate in ERM II and hence cannot be subject to a convergence assessment, but was subject to a floating exchange rate (Chrostowski, 2023).

It is therefore possible to analyse the evolution of the euro/PLN exchange rate in the period from January 2021 to January 2023 and, based on this, determine whether Poland would meet the exchange rate stability criterion if it participated in the two-year ERM II mechanism. During the reference period, the euro/PLN exchange rate was characterised by large fluctuations against the January 2021 benchmark exchange rate of PLN 4.52. The maximum upward deviation was 10.6%, while the downward deviation was 1.3%. The standard fluctuation band in the ERM II system is at +/-15%, hence – assuming no change in the fluctuation band – Poland would meet the currency stability criterion, despite the high volatility of the zloty (Chrostowski, 2023).

Given that we do not meet most of the economic convergence criteria, we do not participate in the ERM II mechanism, and the European Commission and the European Central Bank in their latest Convergence Reports of 2020 and 2022 pointed to the incompatibility of the existing national legislation, it can be assumed that Poland will not enter the euro area in the coming years. The process of gradual monetary integration will only be possible when the macroeconomic situation returns to equilibrium with low inflation and low budget deficit and the risk of external shocks is low. Current macroeconomic projections suggest that such a state of macroeconomic equilibrium will be reached in 2025-2026 (NBP, 2023). However, we are living in times of Great Volatility, so such predictions should be treated with some caution (Chrostowski, 2023).

II.3.2 Detailed characteristics of Poland's fulfilment of the specific nominal convergence criteria

II.3.2.1 Price stability criterion

According to the Polish Ministry of Finance (MF) estimates, from the end of 2019, the level of Poland's Harmonised Index of Consumer Prices (HICP) is above the reference value. In October 2023, the average 12-month growth rate of the HICP index in Poland amounted to 12.4% and was 5.1 percentage points higher than the reference value. Poland is one of the 13 EU countries that do not currently meet the price stability criterion. The reference value was calculated on the basis of data from the 3 EU countries with the most stable prices, including Finland, Netherlands and Malta. For the calculation of the reference value, countries considered as outliers, with inflation levels significantly below the EU average (the so-called wide margin), i.e. Belgium, Cyprus, Denmark, Greece, Spain and Luxembourg.

According to the EC's latest forecast, inflation in the EU is expected to decline further in 2024 and 2025, in the last quarter of which it is expected to reach level slightly above 2%. Also inflation dynamics in Poland, according to the EC forecast, is expected to decrease in 2024 and 2025, in which is expected to reach a value still above the inflation target, and its decline is expected to be gradually, which should be influenced by easing of monetary policy (MF, 2023).

In May 2024 the 12-month average rate of HICP inflation in Poland was 6.1%, i.e. well above the reference value of 3.3% for the criterion on price stability. This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks. At the same time, the tight labour market will continue to exert upward pressure on inflation. Unit labour costs grew by 22.0% over the period from 2020 to 2023, which is well above the euro area rate of 9.5%. There are concerns about the sustainability of inflation convergence in Poland over the longer term. Unless counteracted by an appreciation of the nominal exchange rate, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still lower in Poland than in the euro area (EC, 2024).

II.3.2.2 Interest rate criterion

The interest rate criterion states that over a period of one year prior to the examination, the average nominal long-term interest rate shall not exceed by more than 2 percentage points above the average over the same period of interest rates in at most three of the Member States with the best price stability.

Interest rates are calculated on the basis of yields on long-term government bonds or comparable securities of approximately ten-year maturity, for which the market is sufficiently liquid. While the price stability criterion is designed to assess inflation in a given country in the short term, the interest rate criterion provides the basis for assessing the medium- and long-term macroeconomic stability of a country (included in the pricing of government bonds carried out by financial market participants).

The long-term interest rate in Poland in the 2023 until July remained in a downward trend, and for the next three months it increased slightly. According to the estimates of the MF in October 2023, the average long-term interest rate for Poland for the last 12 months amounted to 6.1%, thus was 1.0 percentage point above the criterion reference value of 6.1%. The average of the 12 months of the long-term interest rate interest rate for Poland has been declining since May 2023. For about last 10 years, the value of this statistic has remained most of the time below the reference value. However, since February 2022, it has been at a level above this value.

In 2022, in EU countries could see a a significant increase in long-term interest rates, taking place in line with rising inflation and the tightening of monetary policy. In 2023, an increase in the level of long-term interest rates slowed down. In most EU countries, their value increased further, but to a lesser extent, and in some it even even declined somewhat, as in Poland or in Hungary, where central banks have already started to loosen monetary policy due to the strong decline in inflation dynamics (MF, 2023).

Over the reference period from June 2023 to May 2024, long-term interest rates in Poland stood at 5.6% on average and were thus above the reference value of 4.8% for the interest rate convergence criterion. The differential between long-term interest rates in Poland and the euro area (GDP-weighted) interest rate declined slightly, standing at 2.6 percentage points at the end of the reference period. Capital markets in Poland are smaller and much less developed than those in the euro area (EC, 2024).

II.3.2.3 Fiscal criterion

The fiscal convergence criterion provides that a Member State, at the time of the assessment may not be the subject of an Ecofin Council Decision that an excessive deficit exists within the meaning of Article 126 of the Treaty on the Functioning of the European Union (TFEU) . The excessive deficit procedurę shall be applied when the general government deficit of a Member State government deficyt as a share of GDP exceeds 3%, or its debt sector exceeds 60% of GDP. The exceptions are when the debt-to-GDP ratio is declining and approaching the reference value in a satisfactory rate.

Due to the continuing 2022 economic recovery, Poland's debt as a % of GDP fell by 4.3 percentage points and stood at 49.3% of GDP, moving away from the reference value. This was not a high level of debt compared to EU countries. However, the deficit of the general government sector in Poland deteriorated and amounted to 3,7% GDP (1.9 percentage points higher than in 2021).

The outbreak of war in Ukraine has significantly hampered the recovery from the Covid-19 pandemic, creating new challenges for the economy. The energy crisis, rising inflation and tightening of monetary policy, contributed to a slowdown in economic growth in 2023, which was forecast by the EC to be only 0.4 per cent. At the same time, public spending was increasing significantly, particularly – in the case of Poland – military expenditure.

Therefore, according to the EC's autumn 2023 forecast, Poland's public debt was expected to rise to 50.9% of GDP in 2023, with a further increase projected for 2024 and 2025, which, although approaching 60% of GDP, will remain below this level over the forecast horizon value. On the other hand, according to EC and MF forecasts, the deficit level will again exceed the reference value in the current and next year.

From 2024, the General Escape Clause (GEC) , which was introduced in 2020, due to the severe economic downturn caused by the pandemic and extended until the end of 2023 due to the uncertainty caused by the war in Ukraine. The general exit clause allows EU Member States to support their economies in response to current challenges, provided they do not jeopardise the sustainability of public finances in the medium term (MF, 2023).

The European Commission found, in June 2024, that Poland did not fulfil the deficit criterion of the Stability and Growth Pact. Poland’s general government budget deficit was 5.1% of GDP in 2023, i.e. well above the 3% reference value, while its debt-to-GDP ratio was 49.6%, i.e. below the 60% reference value. In June 2024, the Commission found that Poland did not fulfil the deficit criterion of the Stability and Growth Pact and announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Poland (EC, 2024).

II.3.2.4 Exchange rate stability criterion

The exchange rate criterion requires the participation of a country's currency in the European Exchange Rate Mechanism (ERM II) for at least two years. As the zloty is not participating in ERM II, Poland does not fulfil the exchange rate criterion (MF, 2023).

In the two-year reference period from 20 June 2022 to 19 June 2024, the Polish zloty did not participate in ERM II, but traded under a flexible exchange rate regime. The exchange rate of the Polish zloty against the euro exhibited, on average, a relatively high degree of volatility over the reference period. On 19 June 2024 the exchange rate stood at 4.3300 zlotys per euro, i.e. the zloty was 6.8% stronger than its average level in June 2022. Between March 2022 and mid-January 2024 Narodowy Bank Polski had a swap line arrangement with the ECB, under which it could borrow up to €10 billion against zlotys in order to address potential euro liquidity needs in the Polish financial system (EC, 2024).

II.3.2.5 Legal criteria

Moreover, EC stated that Polish law does not comply with all the requirements for central bank independence, confidentiality, the monetary financing prohibition and legal integration into the Eurosystem. Poland is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty (EC, 2024).

II.4 Euroland, criteria of the optimal currency area (OCA) and the necessity of their fulfilment by Poland

The creation of the eurozone has come to embody the theory of optimal currency areas (OCA), pioneered by Canadian economist Robert Mundell. The OCA is a set of criteria that must be met for a currency area to operate efficiently for the benefit of each member state. In the 1960s, economists focused primarily on endogenous requirements: labour mobility, price and wage flexibility (Mundell, 1961), openness of the economy (McKinnon, 1963) and diversification of production (Kennen, 1969). The aforementioned economists pointed out that economies belonging to a currency area must be characterised by convergence of business cycles, fiscal integration and similarity of inflation rates.

Over the years, the OCA has evolved. Economists have devoted their research to analysing the benefits and risks of exchange rate rigidity and participation in a common currency area. Based on their research, Mongelli, Frankel or Rose argue that currency integration leads to a revival of trade and a convergence of business cycles. For example, Rose estimated that after the introduction of a common currency, the volume of trade between members of a currency union increases by about 2-3 times. Still other studies indicate that the volume increases by 50 per cent. Accordingly, the new theory of optimal currency areas assumes that a country can meet the OCA criteria after adopting a common currency, when convergence becomes more achievable (Chrostowski, 2022).

For a currency area to operate efficiently and optimally, at least three basic factors need to be in place: the convergence of business cycles (GDP growth, unemployment levels), a similar response to external supply and demand shocks as measured, inter alia, by the behaviour of inflation levels, and the existence of almost full price and wage flexibility throughout the EMU area and the occurrence of market mechanisms leading to an optimal allocation of production factors (Chrostowski, 2022).

Convergence of business cycles should be understood as a high degree of synchronisation between the economies belonging to a given monetary union – in this case the euro area. In other words, member countries should be in a strong recession or recovery at the same time. A natural indicator to examine the convergence of business cycles over the lifetime of the euro area is the GDP growth rate. Empirical evidence shows that the euro area no longer fulfils the first of the fundamental factors for the effective functioning of a currency area (Chrostowski, 2022).

Poland's fulfilment of the real convergence criteria with the euro area is one of the key conditions for our country to benefit from the introduction of the euro. In particular, it is a matter of achieving a satisfactory degree of convergence of business cycles, above all in terms of: production, employment, unemployment, wages, unit labour costs and foreign trade turnover. However, it should be emphasised that the euro area itself shows significant inconsistencies in this respect, which further complicates the situation.

III Prospects for adoption of euro by Poland

III.1. The importance of macroeconomic stability for increasing the degree of convergence of the Polish economy with the euro area

‘The safe adoption of the single European currency requires the achievement of an appropriate level of nominal and real convergence and a satisfactory level of preparation of the economy for the constraints of the introduction of the euro in economic policy, in particular monetary policy. Current estimates of nominal convergence indicate that the following criteria remain unfulfilled: price stability, interest rates and exchange rate stability (due to the fact that the zloty has not been included in the ERM II mechanism)’ – states the MF (MF, 2024).

‘The differences observed so far in the structure of economies and, to a lesser extent, in the course of business cycles between developed countries and Poland are significant but characteristic of the catching-up process. However, the economy's recovery from the difficult period we have experienced in recent years will be characterised by an improvement in macroeconomic stability and, consequently, will bring closer the prospect of meeting the nominal convergence criteria and increasing the degree of Poland's real convergence with the euro area’ – it added (MF, 2024).

‘This is due, inter alia, to the fact that part of the convergence criteria is conditional on the situation in other EU countries and market conditions. In addition, each country must also fulfil the legal criterion, i.e. fully adapt its laws to the requirements of participation in the euro area. In the case of Poland, this requires, inter alia, an amendment to the Constitution and the amendment of a number of specific provisions’ – it added (MF, 2024).

‘Thanks to the progressing economic convergence processes, the balance of opportunities and threats will improve. As Poland's economic integration with the European Union continues and the level of synchronisation of business cycles increases, the risk of a significant difference in optimal interest rate levels between Poland and the euro area will decrease. At the same time, the scale of costs is reduced by the progressing globalisation processes, which reduce the effectiveness of monetary and exchange rate policies as a tool for stabilising economies, as a result of the growing influence of international factors on domestic inflation’ – they wrote.

‘In addition, the costs flowing from this decision depend on other factors, e.g. product and labour market flexibility, which remain under the control of a member state's economic policy after euro adoption. It is therefore crucial that a country is properly prepared institutionally and economically before deciding to join the euro area,’ – the MF points out.

The MF points out that the costs of abandoning the exchange rate channel as a mechanism to absorb macroeconomic shocks, which could possibly negatively affect more vulnerable sectors of the economy, depend on the effectiveness of stabilisation instruments other than monetary and exchange rate policy (MF, 2024).

The magnitude of these costs according to the MF depends on the flexibility of the economy, including the product and wage market (the competitiveness channel), as well as fiscal policy, which can absorb asymmetric shocks through the actions of automatic economic stabilisers (MF, 2024).

'From this point of view, it is important to carry out the necessary reforms to ensure the smooth functioning of the market for goods and services before joining the monetary union, in order to prepare the economy properly on the one hand and minimise costs on the other. For export-oriented sectors, it is important to bear in mind the positive effects associated with the common currency, i.e. the elimination of transaction costs associated with currency exchange and exchange rate risks, which will contribute to a perceptible increase in foreign trade in the long term' – it added (MF, 2024).

III.2 The role of adjustment processes in the economy in the process of increasing convergence of the polish economy with the Euro area

Formulating a multi-year reform plan in response to the question: 'how to join and be a member of the euro area?' requires a distinction between (Smoleńska, Tokarski, 2023):

- the levels of action (national, EU, citizen/community),
- the time horizon (short and medium term),
- scale of ambition (formal criteria, necessary actions and strengthening of Poland as a full member of the European Monetary Union – EMU).

The process of joining the third phase of EMU requires the fulfilment of formal criteria both at national and EU level. On the other hand, due to politic constraints, in the short term (up to three years) we are also identifying space for action by civil society, universities and research centres, as well as businesses. A strategic approach to the (multi-annual) process of adopting a common currency therefore requires a distinction to be made between short- and medium-term milestones, as well as the scale of the ambition of the measures to be taken. In addition to meeting the formal criteria, it is necessary introduction of appropriate national policies to strengthen the resilience of the economy and society in the face of change. As the experience of other countries shows, the key to full subjectivity of a euro area member in the processes of co-shaping EMU is not only economic power but also diplomatic not only economic power, but also diplomatic, human resources or oriented oriented co-shaping of EMU research.

At the national level, for proper preparation of content and coordination of activities, the function of the Eurozone Plenipotentiary in the government should be restored and a corresponding unit within the NBP.

The key, from the point of view of taking advantage of the development opportunity that eurozone membership may offer, is to go beyond the (obviously relevant) discussion on the fulfilment of formal conditions. Legal issues (such as the need to amend the constitution or restore of the constitution or restoring the credibility and de facto independence of the central bank) and adequate supervision of fiscal policy (e.g. by the European Commission) are crucial.

They have been addressed in successive convergence reports of the European Commission or a rich literature of Polish experts (Smoleńska, Tokarski, 2023).

Many authors have also pointed out that the scenario of Poland's development and rapid modernisation upon entering the euro accession to the euro is contingent on effective policies, efficient institutions, and the condition and adaptability of enterprises and adaptive capacities of enterprises (Orłowski, 2019). In today's context four more areas of reform should be added to this list (Smoleńska, Tokarski, 2023):

Firstly, the restoration of rule of law, also understood as a system of control mechanisms and standards of creation and enforcement of the law.

Second, anchoring the discussion on a new economic model and Poland's potential as a full economic model and Poland's potential as a full member of the EMU in the discussion on the transformation in an environmentally and socially sustainable direction.

Thirdly, strengthening market institutions through housing and labour market reforms, among others, to ensure that the monetary transition is fair.

Fourth, deepening the Polish financial market and strengthening its supervision, while maintaining high standards of corporate governance, investor protection and taking advantage of the opportunity for ‘jump-development provided by the sustainable finance trend . Early accession to the banking union may prove helpful in this context (Smoleńska, Tokarski, 2023).

At EU and eurozone level, action in three areas is key. First, the diplomatic initiative. According to Article 140 TFEU, the enlargement of EMU requires an appropriate proposal from the European Commission, consultation of the European Parliament, the consent of a majority of the Member States and a positive recommendation of a majority of the euro area members (Eurogroup). The exchange rate is fixed on a proposal from the European Commission, after consultation with the ECB, unanimously by the euro area countries and the new member of the third stage of EMU. This complex procedure means that securing a favourable exchange rate, as well as other conditions, will require years of work both in Brussels and in Frankfurt and the individual capitals. Secondly, it is necessary to support, prepare and promote our own cadres capable of taking up key positions in the euro area institutions. In this context, the potential of many Poles already working at the European Central Bank should be utilised. Since monetary institutions often operate transnationally, especially in the area of research, which sets new policy directions, research exchanges of Poles in this area should be supported, as well as regional cooperation (Smoleńska, Tokarski, 2023).

Thirdly, it is necessary to promote, in a substantive and multi-level manner, such a direction of euro area reforms that is consistent with the direction of development of the Polish economy in the context of European integration. Thus, this includes the challenge of a transformation towards sustainability, which requires huge financial outlays with simultaneous relative (financial) stability. The fact that the European Central Bank (to which the European Parliament contributes in no small measure), is increasingly taking into account the impact of environmental and climate change issues, as well as social inequalities, on financial stability provides a great opportunity in this context. Poland, with its post-transformation tradition of responsible fiscal policy, has an opportunity to be a credible and constructive partner in the discussion on the evolving structures of the euro area (Smoleńska, Tokarski, 2023).

The analysis carried out in the report Euro od/nowa: scenarios for Poland (Smoleńska, Tokarski, 2023) leads to the following conclusions regarding the process of Poland's accession to the euro area and its efficient/effective shaping:

(1) In the current dynamically shaping geopolitical context, embarking on a multi-year and multi-stage process of integration into the euro area would be beneficial for Poland politically, economically, in terms of security, as well as in terms of transformation towards sustainability. It would significantly enhance Poland's political standing in the EU at a time when issues of importance to our country, such as institutional reforms or Ukraine's membership prospects, are on its agenda.

(2) Poland should learn from the experience of other economies in shaping the optimal path towards membership, as well as in creating an effective institutional framework of economic policy necessary for functioning in the single currency area. The greatest benefits from adopting the single currency accrue to countries that have strong and independent market and political institutions (independent media, high level of rule of law).

(3) Integration into the euro area could be an important element in the process of restoring the rule of law, strengthening the institutions of the state, and creating mechanisms and institutions that would hinder the partisanship of fiscal policy, such as the Fiscal Stability Board.

(4) Integration into the euro area would also lead to the decoupling of monetary policy from party influence, move away from banking nationalism and strengthen the stability of the Polish banking sector through entry into the banking union.

(5) Integration with the euro area would revive the debate on the structural weaknesses and growth drivers of the Polish economy in the next decades. Since 2015, economic policy discussion has mainly focused on redistributive aspects.

(6) Adopting the euro would prevent the worst-case scenario for Poland: a post-Brexit that could be a side-effect of political infighting, a self-perpetuating process that could potentially spiral out of political control. Such a scenario cannot be completely ruled out in Poland.

In the period 2021-2023, EU funds financed a number of projects related to increasing the capacity of the Polish financial system with regard to the trend towards sustainable finance (EC, 2023).

III.3 The Poles' attitudes towards the adoption of the euro. Results of opinion polls. Views of political parties, politicians and economic experts

SW Research, commissioned by the Foundation for Economic Freedom (FWG), conducted a CAWI poll on a representative sample of adult Polish residents. The survey was conceptualised by dr Robert Sobiech (Collegium Civitas) and prof. Marek Góra (Warsaw School of Economics), and its aim – as we read – was to find out social attitudes towards the introduction of the euro in Poland.

The Foundation has been running a Course for the euro campaign, but for the time being it is difficult to speak of unequivocal support for the currency changeover among Poles. There are 34.9 per cent in favour of such a move in the next few years and 50.8 against (Pora na wprowadzenie euro?…, 2023).

However, the authors of the report underline that Poles are afraid of sudden changes. Marek Tatała, CEO of the Economic Freedom Foundation, draws attention to the lack of knowledge of citizens about the euro and, in his opinion, too little involvement of public institutions whose duty it is to inform about the euro. He recalls that Poland had already committed to adopt the euro 20 years ago, when it signed the Treaty of Accession to the European Union. – There is a lack of education and information activities of the government and the central bank on the euro, and additionally some public institutions are currently engaged in demonising the euro and propaganda against the EU currency," the economist comments. – Therefore, as a non-governmental organisation, we are helping the government in this by running the KursNaEuro.pl campaign, he adds (Pora na wprowadzenie euro?…, 2023).

Graph 1. The Poles' attitude to the idea of entering to the European Monetary Union (EMU).

Source: Polacy o wspólnej walucie euro / Poles about the euro single currency, CAWI survey, representative sample of adult Polish residents (N=1020). Contractor: SW Research. Implementation, May 2023, Foundation for Economic Freedom.

Previous campaign surveys have shown that the introduction of the euro is largely perceived in terms of a rapid change, bringing many risks both to everyday life and to the functioning of state institutions unprepared for such a change.

The few existing surveys carried out by Polish centres generally examine opinions on the subject as if it were a question of introducing the euro in Poland virtually immediately. No wonder that in the conditions of high inflation, war behind the eastern border and anti-EU propaganda, fears prevail and more than half of the respondents declare that they are against the euro," point out the authors of the concept of the survey, dr Robert Sobiech and prof. Marek Góra.

Voters of different parties have different opinions

The analysis shows that the majority of voters of the Civic Coalition (KO) (67.9 per cent), the Left (62.1 per cent) and to a slightly lesser extent the Third Way (44.9 per cent) are in favour of adopting the euro in the coming years.

There is strong opposition among voters of the United Right. The adoption of the euro in the future is rejected by 76.4 per cent of this party's voters. Only 16.3 per cent are in favour.

More than half (55.9%) of Confederation voters oppose the euro, but one in three Confederation voters support its introduction in the long term. The situation is similar among voters undecided about voting for either party. 49.3 per cent of respondents in this group are against, 29.6 per cent are in favour (Pora na wprowadzenie euro?…, 2023).

Should Poland get ready for the euro?

The adoption of the common euro currency is preceded by a long period of preparation, consisting in fulfilling the conditions for entering the euro area. Its adoption requires, among other things, a lower inflation rate, lower interest rates and a stable exchange rate of the zloty against the euro.

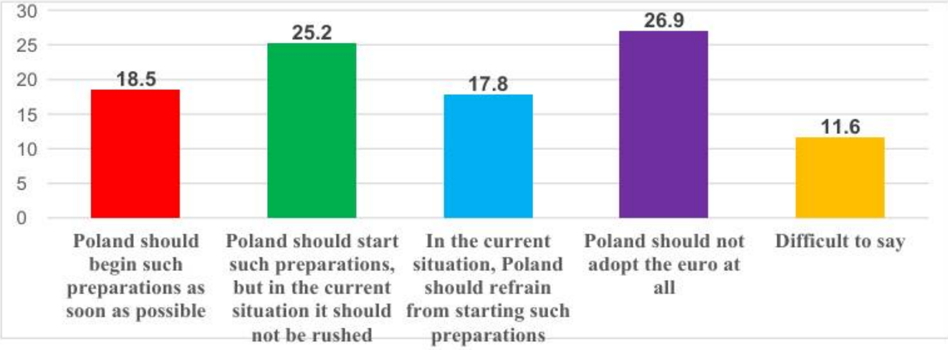
According to prof. Artur Nowak-Far, euro programme advisor at the Foundation for Economic Freedom, the current government is trying to impose a narrative that not adopting the euro is its choice – The government is simply unable to meet most of the required accession criteria and wants to 'sell' this inability to ensure a good, disciplined economic policy as a deliberate action against euro adoption, the expert comments.

However, nearly half of the respondents (43.7%) are in favour of starting preparations for Poland's entry into the eurozone. Among them, 18.5% of respondents are in favour of starting this process as soon as possible. The option that Poland should start such preparations, but in the current situation we should not rush, is chosen by 25.2% of respondents. Only 26.9% of respondents believe that Poland should not adopt the euro at all (Pora na wprowadzenie euro?…, 2023).

The adoption of the euro single currency is preceded by a long period of preparation, consisting of fulfilling the conditions for entry into the euro area. In order to adopt the euro, it is necessary to meet the so-called nominal and real convergence criteria in the form of a specific level of inflation rate, interest rates, public debt and budget deficit, as well as a stable PLN/EUR exchange rate. In this connection, respondents expressed the following opinions – see graph 2.

These attitudes were also tested against political preferences. 70 per cent of KO and Left voters believe that Poland should start preparations to adopt the euro, including 40 per cent who think they should start as soon as possible. 55 per cent of Third Way voters are in favour of starting preparations. A similar view is held by 45 per cent of Confederation voters. Only Law and Justice voters are opposed. Against this background, the significant isolation of United Right voters is apparent. Only one in five voters supports the start of preparations, and nearly half strongly rule out Poland's adoption of the euro (Pora na wprowadzenie euro?…, 2023).

Graph 2. The Poles' opinion on necessity of preperation for Poland's adoption of the common european currency (euro).



Source: Source: Polacy o wspólnej walucie euro / Poles about the euro single currency, CAWI survey, representative sample of adult Polish residents (N=1020). Contractor: SW Research. Implementation, May 2023, Foundation for Economic Freedom.

Centre for Public Opinion Research (CBOS), commissioned by the Polish Press Agency, conducted another survey on The introduction of the euro in Poland . Respondents were reminded that when joining the EU 20 years ago, Poland committed itself to adopt the euro and were asked when Poland should adopt the euro (https://www.money.pl/gospodarka/euro-w-polsce-sondaz-cbos-49-proc-polakow-mowi-stanowcze-nie-7031960301279936a.html).

13 per cent of respondents answered that within the next 3 years, 22 per cent that within the next 10 years; 10 per cent. – 10 percent still later. In the opinion of 49%, we should not adopt the euro at all. The answer "difficult to say" was given by 6% of respondents.

CBOS also checked how voters of individual political parties feel about adopting the euro (https://www.money.pl/gospodarka/euro-w-polsce-sondaz-cbos-49-proc-polakow-mowi-stanowcze-nie-7031960301279936a.html).

Only 1% of PiS voters are of the opinion that we should adopt the euro within the next three years. Such an opinion was expressed by 28 per cent of Civic Coalition voters, 7 per cent of Third Way voters, 25 per cent of Left Party voters and zero per cent of Confederation WiN voters, 6 per cent of undecided voters and 14 per cent of respondents not intending to vote.

The idea of adopting the euro in the next 10 years is supported by 10 per cent of PiS voters, 42 per cent of those declaring support for KO, 37 per cent of supporters of the Third Way, 31 per cent of those declaring support for the Left. – Left; 6 per cent of Confederation of WiN voters, 19 per cent of undecided voters and 9 per cent of respondents not intending to vote.

Even later, Poland should adopt the euro according to: 12 per cent of PiS voters, 9 per cent of KO voters, 18 per cent of Third Way voters, 5 per cent of Left, 18 per cent of WiN Confederation voters, 11 per cent of undecided voters and 4 per cent of respondents not intending to vote.

Poland should not adopt the euro at all according to: 75 per cent of Law and Justice (PiS) voters, 13 per cent of Civic Coalition (KO) voters, 37 per cent of Third Way, 34 per cent of Left, 75 per cent of WiN Confederation, 59 per cent of undecided voters and 62 per cent of respondents not intending to vote.

The most frequent answers that we should not adopt the euro at all were given by respondents aged 55-64 (54%), residents of cities with up to 20,000 inhabitants (61%), people with primary education (68%), farmers (81%) and those with a monthly net income of up to PLN 1999 (62%) (https://www.money.pl/gospodarka/euro-w-polsce-sondaz-cbos-49-proc-polakow-mowi-stanowcze-nie-7031960301279936a.html).

IV Expected benefits and costs of the introduction of euro by Poland

IV.1 Benefits and opportunities

There is no doubt that with joining the euro area, a Member State gains many opportunities and benefits. Reduced exchange rate risks and transaction costs, lower interest rates and cheaper credit, increased credibility for foreign investors, easier capital flows, resulting in a revival of trade and enhanced financial market integration. For consumers, prices become more transparent, while for producers (importers) foreign supplies become cheaper. McKinsey estimated that the introduction of the common currency results in a fall in prices for producers of 2-3 per cent and an increase in profit of 15-50 per cent (Chrostowski, 2022).

According to M. Polubiatko (2024), the advantages of being part of the euro area include:

- lower costs associated with exchange rate risk and lack of currency conversion – promotes business stability and has a positive impact on foreign trade,
- ease of comparing prices in different countries of the Eurozone – promotes competition between companies,
- price stability,

- easier to sell outside the European Union,
- more efficient financial markets,
- greater influence on the global economy,
- much lower inflation in a crisis,
- lower interest rates on credit – this is a pro-growth factor, but only with financial discipline, which Polish politicians seem incapable of maintaining,
- easier planning and management of financial flows – due to the absence of currency fluctuations,
- positive impact on operational security,
- a tangible symbol of European identity – important economic argument put forward by the European Union itself.

IV.2 Costs, risks and threats

On the other hand, the adoption of a single currency entails the incurred costs of adapting the euro to IT systems and cash-handling devices. The single currency also means incurring costs for staff training and losing some of the banks' income from forex transactions. Finally, joining Euroland means depriving oneself of monetary sovereignty, as a result of which there is no possibility of raising or lowering interest rates in the case of inflation outside the inflation target – in the case of the NBP, 2.5 per cent with a deviation range of +/- 1 percentage point. The lack of independence of the central bank also means no possibility of currency interference in the case of too strong an appreciation or depreciation of the national currency (Chrostowski, 2022).

In addition, the exchange rate is an automatic stabiliser of the economy, as ING economist Piotr Poplawski points out. The exchange rate acts as an automatic stabiliser in the economy. In periods of weaker economic conditions, the weakening of the PLN supports net exports and, as a result, GDP growth. This was particularly evident during the pandemic period. Adoption of the common currency means that during a slowdown, there will be no other tools to stimulate growth than fiscal instruments, assesses ING expert Piotr Popławski in a commentary given to the portal Obserwator Gospodraczy (Chrostowski, 2022).

According to M. Polubiatko (2024), the main disadvantages of the euro area entry zone can be considered to be:

- loss of the possibility to adjust the exchange rate in relation to the situation on the internal market,
- loss of possibility to control the profitability of exports,

- lack of influence on the value of one's own currency,
- slower reaction of the central bank to emerging economic problems – the National Bank of Poland reacts faster than the European Central Bank,
- no analysis of the situation of a specific country (e.g. Poland) – the European Central Bank analyses the entire euro area,
- no fear of economic bankruptcy – this favours indebtedness (cheap credit, low rates, greater credibility, large currency volume, price stability – example of Greece).

The introduction of the euro can be dangerous from an economic and political points of view. The Polish economy is still immature, technological differences, the development of the financial system, the level of competitiveness require accelerated modernisation. Our economy is only emerging from dependent development, time is needed.

The main conclusion can be made as follows – Poland should not join the euro area due to the risks posed by the current mechanisms and governance system in EMU. The adoption of the euro can be considered after a thorough reform of the Eurosystem. The two most important reasons that justify such a conclusion are (Bilski, 2024):

(1) The Eurosystem authorities have created a debt trap mechanism for deficit countries. This leads to uncontrollable debt and loss of financial sovereignty. Debt becomes unsustainable. The lack of manageability at the level of states triggers processes that favour the creation of quasi-federations.

(2) There are phenomena in the monetary union that petrify the division between centre and periphery countries; this exacerbates development disparities between EMU members. Moreover, peripheral countries are being pushed onto a path of dependent development. An explanation for these processes is the deforming effect of an overvalued real exchange rate.

There are concerns that joining the eurozone now could hinder the country's economic and social development. The reasons are mainly: (1) the high public debt in the euro area countries and the mechanism for its transfer to the euro area accession countries and (2) the development disparities between EU countries (Bilski, 2024).

IV.2.1 The EU as a 'community of debt'

The situation of public finances in most countries in the southern flank of the euro area is dramatically bad. Today, some countries in the monetary union are more indebted than during the worst years of the Second World War. At the time of the global financial crisis, Greece was considered bankrupt with a public debt of 126 per cent of GDP (2009). In Q3 2022, after the implementation of draconian recovery programmes, Greece is already indebted at 178 per cent of GDP, Italy at 147 per cent, Portugal at 120 per cent, Spain at 115 per cent, France at 113 per cent. In comparison, Poland at 50.3 per cent of GDP (Bilski, 2024).

In 2022, six countries (Germany, Italy, France, Belgium, Spain, Austria) have annual debt servicing costs exceeding 16 per cent of GDP. This threshold is regarded as a critical point by the European Commission. This means that the EU's largest economies could be facing a liquidity crisis. And this is not the opinion of economists hostile to monetary integration – it is the Commission's forecast in the (EC, 2023).

How could such a dangerous increase in public debt have occurred? In view of J. Bilski, it is a combination of three following sets of causes that triggered the debt trap (Bilski, 2024):

(1) The first is due to the fact that the euro area does not have countervailing mechanisms in place to force countries to achieve external balances. The only potential method of balancing the current account at the level of governments is the so-called internal devaluation. This means cutting spending, reducing investment, cutting wages, employment and more. The aim is to improve the external competitiveness of economies. For many governments, consciously driving the economy into recession is the wrong thing to do, both economically and socially. In this situation, countries are left with the tried and tested methods of achieving balance, i.e. borrowing and importing capital. No mechanisms or rules of conduct have been created at the Eurosystem level to substitute for compensatory processes. There have been proposals in euro area reform projects to use risk sharing to cushion the negative consequences of asymmetric shocks. As research shows, the effects of these measures are very modest (ECB, Annual report, 2021).

(2) The second set of reasons for the build-up of debt were the unusually favourable market conditions for external financing of domestic imbalances in the last 10-12 years (up to 2021/2022). According to the BIS, interest rates were the lowest since the 14th century (BIS report 2021), ranging from 0.0 per cent to 1.5 per cent. Interest rates were negative over long periods. Inflation at the time fluctuated between 0 and 2 per cent in most euro area countries. The European Central Bank has pursued a policy of quantitative easing since the Global Financial Crisis. Bond-buying programmes have been an important mechanism in this process. The effect has been to increase market liquidity, create steady demand for treasury securities and consequently keep bond yields low. The situation presented has created an unlimited temptation to permanently indebt countries.

(3) The only constraint, rather theoretical, was the rules of the Stability and Growth Pact (suspended from 2020 to 2022 and suspended again in 2023). And this is where science came to the rescue. This is the third group of causes of the debt trap. At the turn of the second decade of the 21st century, the view became widespread that debt accumulation in a low-cost financing environment could be beneficial for economic growth and at the same time neutral for the country's fiscal stability.

The views presented were propagated by the highly opinionated 2019 paper by Olivier J. Blanchard: 'Public Debt and Low Interest Rates'. This was an argument, for many economists and politicians, for maintaining the current method of financing deficits. The author believed that low interest rates and the ease with which debt can be rolled over means that increasing public debt does not create fiscal costs. Financing debt does not require raising taxes. As a consequence, fiscal rules, as the German economist Daniel Gros wrote, have now become just an academic problem. It must be said at this point that the fairly widespread acceptance of Blanchard's conclusions was, however, met with criticism. The work of this and others (Gros and others, 2021) is a case in point.

It is also worth noting the dynamics of rising public finance deficits in recent years. In six countries, debt has increased by around 10 p.p.. The record-holder is Spain with around 20 p.p.. In Poland and eight other countries, debt-to-GDP levels have fallen. These figures show that the build-up of deficits is not a consequence of asymmetric shocks or cyclical fluctuations. The phenomenon is systemic and its origins lie in the poorly functioning mechanisms of monetary union (Bilski, 2024).

IV.2.2. Problems related to the high costs of servicing public debt

The European Commission has been examining the debt sustainability of EU countries for several years. The result of this work is annual reports. It is interesting to note that these studies change their name and partly their methodology every year. Two recent reports are used in this article: (1) the Fiscal Sustainability Report 2021 (published in 2022) and (2) the Debt Sustainability Monitor 2022 (published in 2023).

In the most indebted EU countries (France, Italy, Spain, Greece), the annual GFN will be more than 20% of GDP. In 5 countries, debt servicing costs are estimated at around 5 per cent of GDP. In Poland, the cost of debt financing, according to the cited report, will be around 6 percent of GDP annually (Bilski, 2024).

The main negative consequence of the ECB's intervention is that it blocks the operation (via the interest rate) of the mechanisms for achieving an equilibrium between the demand for capital (the price of loan capital) and the supply of funds (savings). This is the effect of the underpricing of debt in some Eurosystem countries. The lack of a link between the risk premium and the volume of debt has eliminated the market-based constraint on the build-up of liabilities.

The allocation mechanisms and functions of the euro area financial markets have been deformed. It is true that asset-buying programmes were also in operation in other countries (US, UK), but never for so long and on such a scale. For example, in 2021, ECB programmes covered a significant proportion of countries' GFNs: Portugal – 74 per cent, Slovakia – 72 per cent, Greece – 47 per cent, Germany – 40 per cent. This created a sub-market for government debt where central banks are the only investors (Bilski, 2024).

Could the situation presented above for the countries in the southern flank of the eurozone happen to Poland? Could our economy fall into a debt trap? I am afraid so. Poland's international competitiveness and external balance are very fragile. The position of exports is based on price competition, not technological competition. Flexible, independent monetary and exchange rate policies are a sine qua non for controlling deficits. Tough market conditions inhibit the temptation to live beyond one's means (Bilski, 2024).

The purpose of forming integration groupings is to equalise the level of development of the member countries. Economic and social convergence is enshrined in the European treaties. The lack of progress in this regard implies the dysfunctional nature of integration mechanisms. In 2022, J. Bilski conducted research on the differences in the level of development of different groups of EU countries.

J. Bilski (2024) divided the countries of the Community into three groups (full classification of countries in the article in the Financial Observer): The centre is made up of countries with the highest level of development. The semi-periphery consists of countries mainly in the southern flank of the euro area and Central and Eastern and Southern Europe, the least developed EU countries are the periphery.

This study differs in taxonomy from most of the work I am familiar with. It is perhaps the first time that countries are covered by an identical survey methodology to the other EU economies. I used two groups of indicators in the analysis. The first are indices indicating the economic sophistication of countries. These include, for example, GDP per capita, labour productivity indices, value added of exports and others. The second group consists of measures comparing the level of convergence in two areas – the synchronisation of business cycle phases and the similarity of the sectoral structure of the economy. The study covers the last 20 years.

In general, the conclusions of the analyses can be presented as follows (Bilski, 2024):

(1) The development gap between the centre countries and the semi-periphery is widening; this implies a progressive polarisation of the euro area economies;

(2) The peripheral countries (mostly outside the EMU) have reached a level close to the semiperiphery countries in many indicators.

The paper by C. Gräbner and J. Hafele (2020) discusses the body of global literature on centre-periphery relations in the EU. Their research confirms the division into two groups of countries with different levels of technological sophistication of their economies. In addition, a large body of work points to a widening disparity in the euro area. Different authors point to different reasons for the polarisation processes. These include:

- uneven distribution of technological potential,
- different structure of GDP formation,
- non-equivalent trade, understood more broadly as technological exchange,
- neoliberal models of international exchange,
- different models of economic growth,
- financialisation of economies with particular reference to the Global Financial Crisis,
- social and institutional causes.

The reasons mentioned are therefore, in my opinion, not decisive. The main reason for the polarisation of economies in the EU is the malfunctioning of the eurozone. The long-term deviation of the real exchange rate from the nominal exchange rate in parts of the eurozone countries petrifies the traditional sectoral structure of GDP formation, which hampers labour productivity growth and reduces the external competitiveness of the economies (Bilski, 2024).

IV.2.4 Issues related to the flawed architecture of the euro area and its adverse impact on the economy of the EU countries

Adoption of the euro versus economic growth

Replacing the national currency with the euro does not at all guarantee a faster 'catch-up' with the highly developed countries. Poland functioning with its own currency is growing faster than, for example, Slovakia and Slovenia, which adopted the euro relatively early after joining the EU. Moreover, Poland is also strongly improving its position vis-à-vis the weaker countries of the original euro area (these are the so-called PIGS: Portugal, Italy, Greece and Spain, which are systematically 'losing' compared to, for example, Germany). This is illustrated in the chart. Note the radical 'slide' of Spain against Germany, as well as the irregularity and low rate of progress (relative to Germany) in both Slovakia and Slovenia. Note that, according to Eurostat, Poland, starting from a low position relative to Slovakia, has already overtaken it (Podkaminer, 2022).

Eurozone versus discipline fiscal policy

Contrary to widespread complaints about fiscal policy in Poland (and hopes that it will be 'disciplined' after the adoption of the euro), public debt in Poland remains in check – and this despite the policy of 'handouts'. Meanwhile, despite various formal restrictions, this debt is experiencing a veritable explosion in the euro area. This also applies to countries that 'joined the euro' without having a public debt problem. The debt has appeared over time – precisely ‘in this union’ (Podkaminer, 2022).

The flawed structure of the eurozone: one size doesn't fit all

Why do the eurozone countries have such an extraordinary tendency to accumulate public debts – and this despite all those Treaties and Pacts supposed to 'discipline' their national finances, after all. And why is their economic growth anaemic and erratic? This also applies to Germany, which is growing faster than the PIGS – but still quite slowly, much slower than, for example, the USA.

Longer answers to these questions can be found in the literature available (though rather poorly known) in the country. The short answer: the common monetary policy and the common currency are to blame. "The 'fathers' of the single currency recklessly believed in the doctrine of one size fits all. But one and the same monetary policy, one and the same ECB interest rate, applied to a vast area made up of countries with very different macroeconomic and structural characteristics cannot be effective. It leads to destabilising and costly imbalances in individual member countries, which consequently spill over into the euro area as a whole.

The result is not only anaemic and unstable economic growth, but also enforced public finance deficits. The fact that, in the long term, the euro area has turned out to be a zone of secular economic stagnation, in addition to being shaken by periodic crises and recessions, is therefore no coincidence. By remaining outside the Eurozone, Poland is growing economically much faster and much 'healthier' than countries that have long since abandoned their own currencies. Its own 'sovereign' currency is proving to be an important factor for growth and stability – even if its exchange rate against the euro seems to "go crazy" from time to time (Podkaminer, 2022).

Euro and common monetary policy versus low inflation

Can the current high inflation in Poland (HICP 11.4 per cent in April) support the thesis that it would be lower 'within' the euro? The fact that the average inflation rate for the euro area was 7.4 per cent in April tells us little about inflation in individual euroland countries. And inflation during this period was really high in Estonia (19.1 per cent), Lithuania (16.6 per cent), Latvia (13.1 per cent) and Slovakia (10.9 per cent) and very high in some of the 'old' EU countries: Belgium and the Netherlands (9.3 and 11.2 per cent respectively). Where is the certainty that under the euro regime, inflation in Poland would not be even higher than it is now? Advocates of joining the eurozone as soon as possible are also among the strong critics of the overly lenient (in their view) NBP policy. They are racing to demand a further, rapid and radical increase in interest rates. However, if Poland were to adopt the euro, they would have to come to terms with zero (or even nominally negative) official interest rates dictated by the European Central Bank (ECB) (Podkaminer, 2022).

Geopolitical benefits

The (short-lived) panic in the currency market following the Russian invasion of Ukraine has evidently also infected many economic commentators, journalists and politicians. They are calling for some kind of extra-ordinary effort to replace the zloty with a common European currency immediately. They seem to think that a Poland with its own currency will be more vulnerable to Russian aggression than a Poland without its own currency. This is a rather naïve belief. Are the Baltic countries – by virtue of having the euro – less vulnerable than Poland? (Podkaminer, 2022).

IV.3 The experience of the other CEE countries with the process of joining the euro area

One of the greatest achievements of the euro is the significant increase in trade between countries in the euro area. The simplification of the transaction process and the elimination of exchange rate risk has made intra-EU trade easier and less costly. The introduction of the euro has also increased Europe's attractiveness as an investment destination. The single currency has facilitated the movement of capital between member countries, which has contributed to an increase in investment. The single monetary policy also had an impact on macroeconomic stability in the region through greater control over inflation and interest rates across the euro area (Euro – 25 lat wspólnej waluty, 2024).

However, the single currency has also faced challenges, particularly in the context of public debt management. The debt crisis in some euro area countries revealed weaknesses in the EU economic structure, which led to the need for reforms and rescue measures. Following the introduction of the euro, some countries experienced significant economic difficulties due to a combination of internal and external factors, and the introduction of the single currency further exposed existing structural and economic problems. Such problems were faced by Greece, Portugal, Ireland, Spain or Italy, among others (Euro – 25 lat wspólnej waluty, 2024).

The euro, while central to European integration and economic development, has not escaped challenges along the way. One of the biggest was the debt crisis that began in 2009. Countries such as Greece, Ireland, Portugal, Spain and Cyprus were struggling financially, requiring intervention and financial assistance from other EU countries and the International Monetary Fund. The crisis sparked a debate on financial solidarity in the Union and how to manage common fiscal and monetary policies. The introduction of the euro exposed differences in the economies of the member states. While some countries experienced rapid growth and stability, others struggled with high unemployment and public debt. These disparities led to tensions within the euro area and discussions on structural reforms. The euro faces many challenges. One key trend that could affect the future of the euro is the increasing digitalisation of finance. The development of blockchain technology and cryptocurrencies is creating new opportunities, but also challenges for traditional currencies. The European Central Bank (ECB) is exploring the possibility of a digital euro, which could affect the way the currency is used in everyday transactions (Euro – 25 lat wspólnej waluty, 2024).

The euro will continue to face economic challenges such as public debt, economic imbalances between member states and political tensions within the EU. Managing these challenges effectively will be key to maintaining the stability and strength of the single currency (Euro – 25 lat wspólnej waluty, 2024).

There are currently 19 European Union (EU) countries in the euro area, with seven of them having joined the into the euro area between 2007 and 2015. In this report, we focus on the experience of 4 Central and Eastern European (CEE) countries that have introduced the euro, with a similar level of development and history of economic transformation to Poland. These are: Slovakia, Estonia, Latvia and Lithuania. Slovakia introduced the euro in 2009, Estonia in 2011, Latvia in 2014 and Lithuania in 2015. The countries studied have adopted a different path to stabilise the currency exchange rate, as required by the Maastricht Treaty. Slovakia followed a floating exchange rate policy, and in late 2005 incorporated its currency into the European exchange rate stabilisation system against the euro (ERM2 mechanism), in which it remained for a period of more than 2 years. The Baltic countries, on the other hand, had for years applied a fixed exchange rate policy against the euro, which the EU institutions considered an acceptable way of fulfilling the criterion (Orłowski and others, 2018).

Preparing for the adoption of the euro was relatively low-cost in Slovakia, which took advantage of the period of prosperity. In the case of the Baltic countries, however, it required a consistent, decisive policy leading to this goal despite the economic problems caused by the global crisis. Overall, it can be said that the introduction of the euro has made a moderately positive contribution to the improvement in the economic performance of Slovakia, Latvia and Lithuania, and in a strongly positive way to the improvement of the economic growth performance in Estonia. The adoption of the euro was not associated in the 4 countries surveyed with a worsening of the current account deficit of the balance of payments current account deficit and an increase in foreign debt. This means that these countries did not repeat the mistakes made after the introduction of the single currency by the southern EU countries. Thanks to the good preparation of the 4 countries surveyed for the changeover, the introduction of the euro did not involve there was no significant price increase. However, the spectacular increase in the price of certain goods caused the perceived inflation was significantly higher than real inflation. It can, however, be said without any doubt that, contrary to what is sometimes claimed, the introduction of the euro itself does not trigger a process of of convergence in price levels towards those observed in the richer western European countries. The introduction of the euro was associated with major political benefits for the countries surveyed, both direct and indirect. These countries increased their influence on the direction of changes in the Union's reforms, their ability to building coalitions and pushing their interests in the Union, they also increased their sense of security through participation in the 'hard core' of integration processes (Orłowski and others, 2018).

The 'new' countries surveyed adopted a different path to stabilise their currency exchange rate, as required by the Maastricht Treaty (Orłowski and others, 2018):

- Slovakia followed a floating exchange rate policy until 2005. In November 2005, the Slovak
- koruna was incorporated into the European exchange rate stabilisation system against the euro
- (ERM2 mechanism), in which it remained for more than 2 years. During this period, the only problem was the market pressure to strengthen the Slovak currency.
- For years, the Baltic States had applied a fixed exchange rate policy against the euro, which the EU institutions considered an acceptable way of fulfilling the criterion. These countries had made great efforts to maintain exchange rate stability even in the violent crisis of 2008-2009.
- The examined CEE countries prepared for the adoption of the euro under very different economic conditions (Orłowski and others, 2018):
- Slovakia's preparations took place in good economic conditions before mid-2008. This allowed the this to simultaneously meet the convergence criteria

and a marked fall in unemployment. Unemployment However, unemployment temporarily increased after the introduction of the euro, following the outbreak of the global financial crisis in autumn 2008.

- Estonia carried out its programme for the fulfilment of the convergence criteria at a time when the global financial crisis erupted and the economy fell into a severe recession. This meant a particularly difficult conditions for keeping the budget deficit under control, with a strong increase in unemployment.
- Latvia and Lithuania fulfilled the convergence criteria at a time when the main wave of the global financial crisis had passed, the economies of both countries had returned to growth after a sharp recession and their public finances had managed to stabilise. As a result of this, the adjustment took place with very high but slowly falling unemployment.

In the long term, all the countries studied have seen a significant decline in the unemployment rate.

The biggest problem for western European countries preparing for membership of the eurozone was to reduce the scale of budget deficits and public debt. Also for the surveyed CEE countries, the adjustment of fiscal policy required determination and consistency (Orłowski and others, 2018):

- In Slovakia, the adjustment implied the need to reduce the scale of the public sector deficit from an excessive 3.6 per cent of GDP in 2006 to 1.9 per cent of GDP in 2007 (this year's figures were taken into account in the assessment of Slovakia's fulfilment of the Maastricht criteria).
- In Estonia, the adjustment was achieved by a further reduction in the government deficit level
- from 2.7 % of GDP in 2008 to 2.2 % of GDP in 2009 (this year's data was taken into account in the assessment of Slovakia's fulfilment of the Maastricht criteria) and this despite the severe recession that hit the economy.
- In Latvia, the adjustment meant that the public sector deficit had to be reduced from an excessive 3.2 per cent of GDP in 2011 and to achieve a surplus of 0.2 per cent of GDP in 2012 (this year's data were taken into account in the assessment of the fulfilment of the Maastricht criteria), despite the still difficult economic situation.
- In Lithuania, the adjustment meant that the public sector deficit had to be reduced from an excessive 3.1 per cent of GDP in 2012 to 2.6 per cent of GDP in 2013 (this year's data was taken into account for the assessment of

the fulfilment of the Maastricht criteria), despite the still difficult economic situation.

It should be noted that, for all these countries, the level of public debt was well below the permitted by the Maastricht Treaty, and therefore there was no need to take any additional measures to reduce the level of this debt. Meeting the criterion of sufficiently low inflation often proved even more difficult (Orłowski and others, 2018):

- In Slovakia, the scale of inflation had to be reduced from 4.3% in 2006 to 1.7% when the fulfilment of the Maastricht criteria (spring 2008). The average inflation rate in the three EU countries with the lowest inflation was 2.5% at that point.
- In Estonia, the scale of inflation had to be reduced from a high of 10.6% in 2008 to deflation (a fall in prices of of prices by 0.7%) at the time of the Maastricht criteria assessment (spring 2010). The average inflation rate in the three EU countries with the lowest inflation at that point was 1.0%.
- In Latvia, the scale of inflation had to be reduced from 4.2% in 2011 to 1.3% at the time of assessing the fulfilment of the Maastricht criteria (spring 2013). The average inflation rate in the three EU countries with the lowest inflation was 2.7% at that point.
- Lithuania has twice tried to bring inflation down to the level required by the Maastricht Treaty.

The first attempt, made in 2004-2006, failed due to a slight exceeding the inflation criterion. In the second attempt, Lithuania managed to reduce the scale of inflation from 3.2 per cent in 2012 to 0.6 per cent when the fulfilment of the Maastricht criteria was assessed (spring 2014). The average inflation rate in the three EU countries with the lowest inflation was 1.7% at that point.

Meeting the inflation criterion was the result of a consistent programme of adjustment measures taken in the area of monetary and fiscal policy in all four countries. It has also led to a decline interest rates to the desired level.

Preparing for the adoption of the euro was relatively low-cost in Slovakia, which took advantage of the period of prosperity. In the case of the Baltic countries, however, it required a consistent, determined policy leading to this goal despite the economic problems caused by the global crisis (Orłowski and others, 2018).

V Summary/Conclusions

The chapter presents numerous dilemmas and challenges related to Poland's potential accession to the euro area. Attention was drawn first of all to the risks associated with this, primarily in the form of losing important tools for influencing the economic situation and international economic competitiveness, both the autonomous monetary policy and the exchange rate. In addition, an insufficient level of socio-economic development was highlighted, expressed primarily in Poland's failure to meet most of the nominal and real economic convergence criteria. However, on the other hand, the benefits possible for the Polish economy as a result of the implementation of the euro have been pointed out, mainly such as: elimination of transaction costs and exchange rate risk, increased economic and financial credibility of the national economy, integration and increased efficiency in the functioning of financial markets, stimulation of international trade, possibility of cheaper credit, wider opportunities for foreign direct investment (FDI) inflows, greater macroeconomic stability, possibility of receiving financial support from the ECB .

However, it should be emphasized that the achievement of above-mentioned benefits is crucially dependent on the Polish economy achieving a sufficiently high degree of convergence (nominal and real) with the highly developed countries of the euro area in particular.

It is noteworthy that there are significant discrepancies among specialists with regard to the expected benefits of the disadvantages of Poland's possible accession to the European Union. However, it should be noted that successive opinion poll results indicate growing support among Poles for the introduction of the euro. Political factors largely related to the results of the June European Parliament elections also play an important role in shaping the situation related to accession.

Attention should also be paid to other important factors, which are the declining reputation of the EU and its problems with functioning as a fully integrated grouping. In the author's opinion, the experience of other so-called 'new' EU countries, which have joined the euro area relatively recently, should provide a basis for objective opinions on the viability of Poland's adoption of the euro.

If Poland decide to join the euro area, it would be crucial to define the entry scenarios and the optimal exchange rate level at which the conversion of the zloty into the euro would take place.

In conclusion, Poland's adoption of the euro in the coming years seems very unlikely, primarily due to:

- lack of political consensus in Poland on the adoption of the euro, without which it is impossible to change the Constitution, which is key to replacing the zloty with the single currency,
- Poland's failure to meet the economic criteria for entry into the euro area and the low probability of their cumulative fulfilment in the next few years,
- the fact that the National Bank of Poland (NBP) will be headed for the next six years by a staunch opponent of the euro – prof. Adam Glapiński.

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CZECH REPUBLIC AND EURO

Vilém Semerák[1]

A brief look at the map of Europe or a slightly more complicated analysis of economic flows between the Czech economy, the EMU, or the rest of the world immediately suggests that Czechia should be among the hottest candidates for a fast introduction of the common currency. Like other accession countries from the 2004+ enlargements, Czechia is bound to adopt the euro. The country was even very close to meeting the official accession criteria in the past, and its government adopted a scenario for euro adoption many years ago (2006). Its companies and the public seem to like using the euro in their private transactions. Still, negative opinions of the public on the euro strongly contribute to the fact that the date of future euro adoption is not known at present. This text reviews the status quo of Czech attitudes to euro adoption and briefly analyses the likely causes and implications of the current situation. Finally, it argues that even though the positive benefits of euro adoption outweigh possible risks, a mix of both domestic and international factors makes fast adoption of the euro by Czechia less likely than the country's macroeconomic position suggests.

I Brief historical overview

It is interesting that the emergence of the Czechoslovak/Czech crown, the currency the existence of which will end at the moment of adoption of the euro by the Czech Republic, is linked to perceived or expected troubles with monetary blocs, i.e. monetary "unions" which included regions with divergent policies or economic development. In 1919, the monetary separation from the currency of the former Austrian-Hungarian Empire was carried out successfully (Šůla 2017). The successful implementation of a monetary divorce was then repeated in 1993 (Vencovský 1993), when the shortly existing monetary union connecting the newly separated Czech and Slovak Republics was terminated because of worries about the future stability

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of such a monetary union. Both events were successful and trouble-free, which is perhaps the reason why they do not seem to have left a significant mark on the collective historical memory of the Czech population; interestingly enough, they are not mentioned as possible factors in surveys which attempt to analyze the attitudes of Czech voters and experts towards euro.

The path towards future euro adoption started for Czechoslovakia/Czechia in 1989, when the desire and need to "return back to Europe" appeared as a popular slogan outlining the direction for economic and political reforms. Like other countries of the region, the country benefitted from the support provided by EC countries and started to negotiate an association agreement with the bloc (1990-1991).

The break-up of Czechoslovakia in 1993 temporarily halted the process of ratification of the association agreement with the EC (negotiated in 1990-91), although actual economic relations already profited from the "Interim agreement". A newly negotiated and updated Europe Agreement was ratified in 1995. In 1996, the application for full EU membership was submitted, and since 1997, the process of negotiations and regular evaluation of the candidate country was launched. Finally, the process was successfully completed in 2002 in Copenhagen, and after a successful referendum (2003), Czechia became a new member of the EU during the 2004 "Eastern Enlargement", the first enlargement after the launch of the euro. Unlike countries which were members of the EU prior to the euro creation (UK, Denmark), Czechia had no opt-out clause from the third stage of the EMU, i.e. the Czech Republic was bound to adopt the euro when it prepared to do so. This fact was no secret (to either policy-makers or the public), and early surveys of public opinion suggested that the majority of the population was in favour of euro adoption (see Figure 4).

The Czech government started preparing for official euro adoption actively relatively shortly after the EU accession: in 2005, a "National Coordination Group" was created, and a material describing the institutional arrangements for the preparatory phase was adopted. The Ministry of Finance became responsible for the whole process, and the central bank (Czech National Bank) became the main strategic partner. In 2006, the government also decided on the scenario which outlined the main features of the future introduction of the euro. Informally, the timing of possible euro adoption was described as 2009-2010. In 2007, a National Coordinator for Euro Adoption was appointed (prof. Oldřich Dědek), and an Updated Euro Area Accession Strategy was adopted, which explicitly abandoned the unofficial tentative date for the adoption. This position (i.e. preference for not revealing a tentative date for euro adoption) was reconfirmed by the government in 2010. No official date has been announced since, too.

During the process of economic transition (i.e. since 1991), the joint effect of mutual liberalization of trade relations and of the proximity of the Czech economy to the core of the Eurozone (esp. Germany), Czechia became deeply interconnected with the EU and global value chains related to the EU. This process continued after 2002 when Czechia was experiencing an unprecedented spell of growth, accelerated convergence and deepening integration into the European economy . Euro adoption seemed to be a logical extension of the process.

The Global Financial Crisis and its aftermath (Greek crisis, weakness of the EU/EMU), together with the subsequent rise in global economic and geopolitical uncertainty, interrupted the process abruptly. The preferences of the public changed dramatically; since 2008, a strong majority has been consistently against euro adoption (or at least against fast adoption of the common currency). At the same time, however, the informal use of the euro in the Czech economy has increased gradually, and Czech citizens and companies definitely do not shun using the euro in their own activities.

The combined effect of the preferences of the public, the rise of economic nationalism and instability made the euro a politically sensitive topic, a symbol of preferences for deeper European integration. In spite of occasional attempts to restart the debate (e.g. by President Petr Pavel in April 2024) and in spite of the fact that Czechia is closer to meeting the formal criteria than other countries, the whole process of euro adoption can be described as being on the back burner. Consequently, the Czech Republic is inching towards greater use of the euro in its economy, but the final decision on formal adoption is being avoided. It is symptomatic that the position of the National Coordinator for Euro adoption has not been backfilled since 2017 – and nobody seems to be particularly concerned about it.

The text continues as follows: section two outlines data illustrating the depth of the relationship between Czechia and Eurozone countries, and section three summarizes Czech readiness for euro adoption (the country's ability to meet both official and less formal requirements relevant for monetary integration). Section 4 focuses on the issue of voters' and politicians' opinions on the possible effects of Euro adoption, while section 5 attempts to summarize the findings and outline scenarios for future development. Section 6 concludes.

II The importance of eurozone and euro for Czechia

Notwithstanding the interruption of the natural evolution of economic ties during 1948-1989, the geographical and cultural proximity always generated deep and strong economic relations connecting Czechia with current EMU countries (of course, especially Germany and Austria).

The observed development is fully in line with the logic of gravity models (for trade and investment) and with the regionalization patterns included in the logic of the evolution of global value chains. This implies that the linkages described in the following two subsections are likely to be natural and stable and that the apparent rise of the role of the EU countries in foreign trade activities of Central and Eastern European countries (CEE) after 1989 should rather be seen as a return to normal (Gros and Gonciarz 1996). Whether policymakers like it or not, CEE countries (including Czechia) will have strong trade and investment ties with EMU countries, and they will be provided with opportunities for integration in global value chains which are either headquartered in the EMU (and use CEE countries as manufacturing floor) or for which the EMU countries constitute dominant final demand.

II.1 Trade relations and investment flows

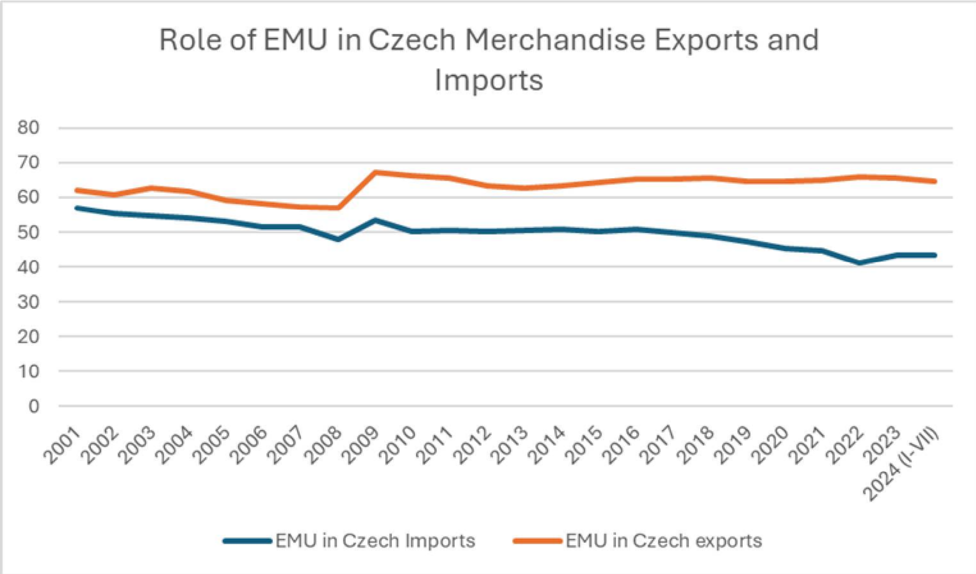
As most of the trade reorientation of the CEE countries occurred in the 1990s, the share of EMU markets in direct merchandise exports from Czechia has been relatively stable between 2001 and 2024. In 2023, the share amounted to 65%. The import dependence of Czech was lower, and it was declining during the same time period – partially due to the rise of China in global merchandise trade, which accelerated after the 2001 admission of China into the WTO, partially due to the positioning of the EMU countries in global economic relations (focus on services, offshoring of physical manufacturing to other locations – including the CEE countries). The EMU thus accounted for approximately 43 % of Czech merchandise imports in 2023. The development of direct export and import dependence is depicted in Figure 1.

Similar results are apparent from a broader and more elaborate view provided by statistics based on trade in value added (TiVA). As Figure 2 demonstrates that out of the overall value added generated by the Czech Republic in 2020, almost 19 % was consumed by final demand residing in Eurozone countries. If we consider only the value-added used by final demand abroad, the relative share of the EMU increases to almost 46 %.

The TiVA perspective also allows us to evaluate the role of the foreign value added imported from Eurozone countries that is embodied in exports of Czechia (FVA). Building again on the OECD ICIO data for 2020, we find out that overall gross exports of the Czech Republic included a substantial share (38 %) of foreign value added, out of which 15.9 percentage points (about 41.5 % of the overall FVA used in Czech exports in relative terms) originated in Eurozone countries.

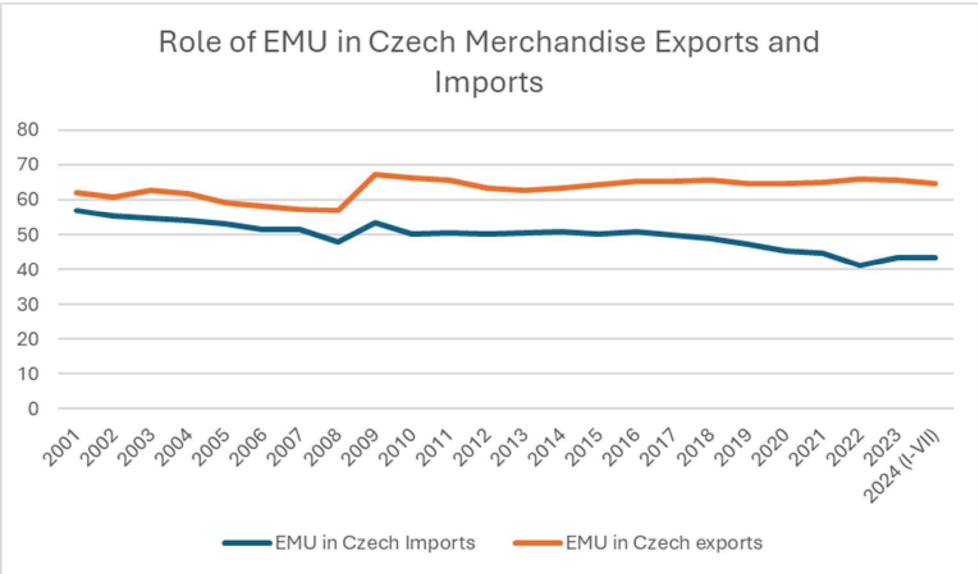
As in the case of the role played by the Eurozone in Czech external trade and compatible with the findings on the TiVA trade, the Eurozone also plays a dominant role in Czech foreign direct investment. The share of FDI stocks originating in the Euro area in inward FDI stocks in Czechia amounted to 78.5 % in 2022. The share of Czech outward FDI stocks, which ended in the Euro area, was lower, but it still amounted to almost 67% in 2022.

Figure 1 Role of EMU in Czech Merchandise Exports and Imports (%)



Source of data: Czech Stat. Office

Figure 2 – Results based on OECD ICIO input-output data for 2020 calculated with the use of STATA ICIO module



The implications of similar decompositions are clear: Czechia is critically dependent on trade relations which either target final demand in the EMU or are based on intermediate inputs produced with a substantial use of EMU value added. Much of the actual related activity located on the Czech territory takes place in units controlled by entities from the EMU.

It is unlikely that this type of collaboration and symbiosis could be harmed by the adoption of the euro. Quite to the contrary, naturally occurring adaptation of companies (see the next subsection for details) suggests that their involvement in international value chains motivates companies to pursue informal euroization and that companies are pushed towards the use of the euro. It, therefore, seems likely that the adoption of the euro would help preserve or perhaps increase the relative competitiveness of the Czech economy and its attractiveness to foreign investors.

II.2 Use of Euro by resident companies and households

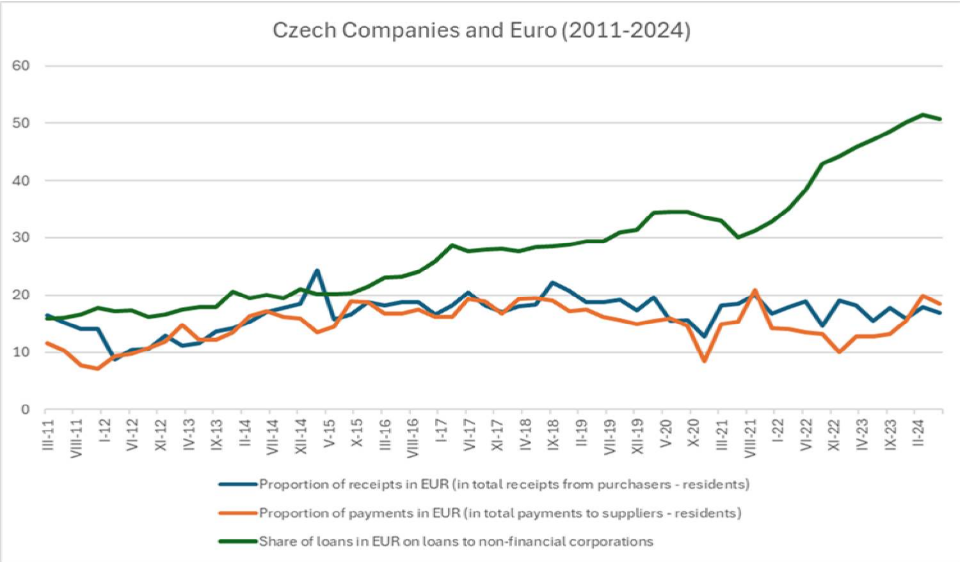
The proximity of Eurozone markets, the necessity to collaborate with companies from Eurozone, but also its importance as a source region, as well as transit/final destination for tourism services provided or consumed by Czech residents, all motivate both companies and individuals to gradually increase the use of euro in their transactions and of euro-denominated assets in their wealth. Differences in interest rates also motivated companies to explore the opportunities for financing in euros.

Figure 3 describes changes in the use of the euro by resident ("Czech") companies during 2011-2024. As apparent from the data, the companies are using euro also in domestic transactions, i.e. when selling to resident purchasers or when buying from resident buyers. The share of such receipts fluctuated mostly between 15 and 20 % during the analyzed period.

Unlike in the case of the proportion of euro in payments, there was a strong upward trend in the share of euro in total loans obtained by non-financial corporations in Czechia. This trend was clearly linked to a significant interest rate differential between loans in Czech crowns and the euro, and as such, it can be temporary. Still, the overall share of such loans, which exceeded 50 % during the first quarters of 2024, shows resident businesses are likely to be much less afraid of borrowing/investing in foreign-currency-denominated assets.

Analogical tendencies can be observed in data on the behaviour of Czech households. While the role of borrowing in foreign currencies (including euro) remains very low, there has been a significant increase in the use of foreign-currency-denominated accounts. The volume of the deposits in euros increased to approximately 9 % of total deposits in early 2024. The motivation behind the trend is clear – frequent travels to or via the Eurozone, online transactions and transfers in euros, or attempts to save receipts in euros and use them in future without any conversion. The trend was supported by the effects of competition, which led to decreasing costs and increasing the usefulness of such accounts (zero fees, positive interest rates, provision of debit cards for direct payments in euros).

Figure 3 – Resident companies and the use of euro



Source of data: CNB, system ARAD

The tendencies described in Figure 3 are likely to intensify in the near future: since 2024, Czech businesses can run their accounting and pay taxes in euros (and US dollars or British pounds). Companies are also allowed to pay wages and salaries in foreign currencies. We can, therefore, expect further progress in the informal euroization of the Czech economy.

Seen from the perspective of the relative costs and benefits of the adoption of the common currency, the effects of this form of euroization are ambiguous. The increased easiness of using the euro (and reduced costs of transfers) reduce the traditional benefits of full integration into the monetary union. The degree of interconnectedness with the Eurozone is not likely to become much higher (if we abstract from the accounting effect of the accession of new members), which also reduces the space for additional benefits of the common currency. The same conclusion is supported by the revisionist literature on the size of the Rose effect, which unlike the original contributions (Rose, Lockwood, and Quah 2000), suggests that the effect of a common currency on mutual trade can be relatively small (and possibly insignificant) – as summarize e.g. in a metanalysis in (Havránek 2010). On the other hand, trends towards euroization also restrict the actual control of the central bank over monetary policy as well as the space for the incidence of some asymmetric shocks, and therefore, they reduce the costs of monetary integration, too. The most likely implications are, therefore, in the form of an increased probability that any future introduction of common currency can be implemented more smoothly and without any substantial surprises.

III Readiness for euro adoption

The postponement of euro adoption in Czechia was not caused by the inability to meet to official (Maastricht) convergence criteria. Although the criteria were technically not met (at the very least the ERMII-participation criterion), the doors towards meeting them were kept open, and the country would almost always be able to meet all of the criteria with relatively little additional effort. The reason is simple: the country has maintained a relatively conservative and sound macroeconomic framework, including one of the lowest public debt-to-GDP ratios in the EU (significantly lower than most Eurozone countries).

III.1 Official convergence criteria

The Czech National Bank and the Czech Ministry of Finance have been publishing regular assessment reports every year since 2004. The latest evaluation of the readiness for euro adoption (and of the country's ability to meet both the official criteria and possible additional requirements was carried out by the Czech National Bank at the end of 2023. The following Table (Table 1) provides an excerpt from the reports published in 2008, 2010, 2014, 2016 and 2023 respectively. As apparent from the Table, there were periods during which the Czech Republic might have been capable of meeting the official criteria relatively easily – for example, between 2013 and 2018, the only unfulfilled criterium was the exchange rate related one. However, even this is not quite true because, as a side effect of the special intervention regime applied by the central bank during 2013-2017, the volatility of the CZK exchange rate to the Euro remained much lower than the fluctuation band used in the ERMII. Meeting all the criteria also formally would have been indeed easy.

Had Czechia tried to meet all the criteria, the probability of success was quite high. It is also quite likely that the Council of the EU would give its consent to Czech accession to the euro area relatively easily – the addition of another country deeply connected with the core of the euro area and with relatively good macroeconomic indicators would be seen as desirable.

Table 1 – Fulfilment of Maastricht Convergence Criteria

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023*	2024*
Consumer prices (%)	1.6	2.1	3.0	6.3	0.6	1.2	2.1	3.5	1.4	0.4	0.3	0.6	2.4	2.0	2.6	3.3	3.3	14.8	12.1	3.5
Government balance (%)	-3.6	-2.7	-0.7	-2.7	-5.8	-4.8	-2.9	4.0	-1.2	-1.9	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.1	-3.2	-3.6	-2.2
General government debt (%)	29.8	29.6	29.0	30.0	34.2	37.8	41.0	45.5	44.9	44.2	39.7	36.6	34.2	32.1	30.0	37.7	42.0	44.2	44.7	45.9
Long-term interest rate on government bonds (%)	3.5	3.7	4.3	4.6	4.8	4.2	3.7	2.8	2.1	1.6	0.6	0.4	1.0	2.0	1.5	1.1	1.9	4.3	4.4	3.6
ERM II participation	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No

Source: CNB & MFCR (2008, 2010, 2014, 2016, 2023)

III.2 Additional considerations

The assessment reports also show that economic activity in the Czech Republic is usually highly correlated with economic activity in the eurozone – e.g. (MFČR, ČNB 2023). It is true that the reports emphasize the structural dissimilarity and suggest that the substantially higher share of industry in the Czech GDP might lead to an increased risk of asymmetric shocks, but this argument is formulated rather superficially and does not evaluate the dissimilarity with the use of criteria/methods that would take the functioning of global value chains into account.

Two additional arguments appeared in some presentations of members of the CNB board and partially also in the assessment reports.

The first argument (which also appears in the assessment reports) is the claim that the Czech economy might need to grow and become richer before adopting the euro because the subsequent convergence might be slower or inflation higher. The argument seems to be based on a simplified interpretation of the Balassa-Samuelson (Balassa 1964; Samuelson 1964) model and the form of its presentation ignores the empirical evidence that the inflation differentials of CEE countries vis-à-vis euro were only partially caused by this effect – (Mihaljek and Klau 2008), (Égert et al. 2003). Even more importantly, Czechia has been one of the two richest CEE countries in the EU (depending on year and measure, the two richest countries are Slovenia and Czechia), and if we consider the GDP per capita in 2023, it was already richer than seven eurozone members.

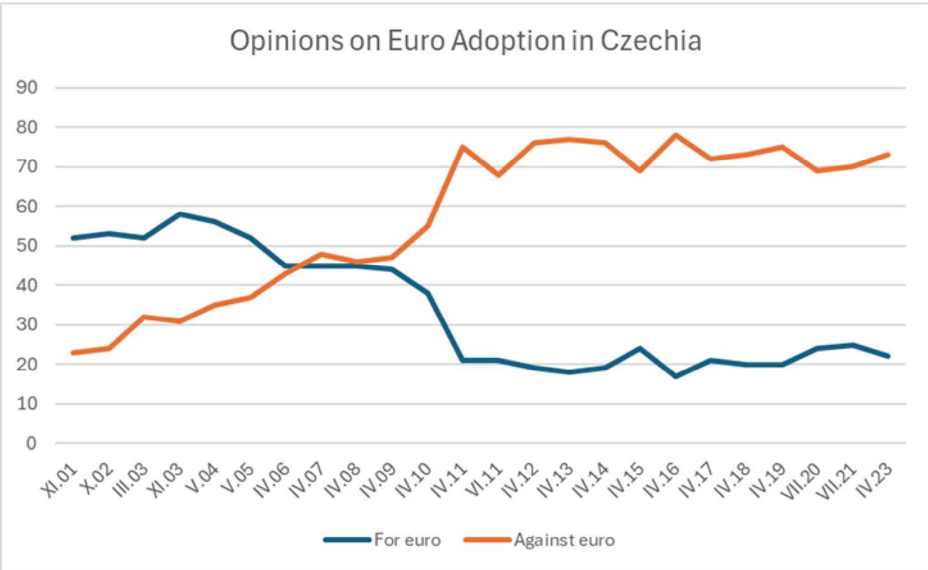
The second argument appeared, e.g. in the interviews and presentations by Prof. Jan Frait (current vice-governor of the CNB) , and it is based on the relationship between the adoption of the euro and the obligation to join the banking union. The gist of the argument is the assumption that the procedural rules for the accession of new members changed in 2020 and that Bulgaria and Croatia were asked to join the Banking union when entering the ERMII. Even though this requirement does not seem to be supported by EU legislation, some voices in the CNB worry that the cases of Bulgaria and Croatia can be used as precedents and that the CNB would lose many of its powers even before officially fully adopting the euro. However, this argument is newer (it does not explain the decision not to adopt the euro before the requirement appeared) and its relevance can be conditional upon the ability to modify some of the conditions by negotiations and upon the future ability of the CNB to perform its supervisory functions adequately (and better than the ECB within the institutional framework of the Banking Union).

IV Roots of scepticism on euro adoption: historical experience, uncertainty or disinformation?

As visible from the data presented in the previous section, the prospects of the country meeting the Maastricht convergence criteria have been relatively good; it was the absence of the political will to initiate the process that caused Czechia to still not use the euro. But how can we explain this lack of political will?

Figure 4 provides a partial answer. The initial position attitudes to the euro changed between 2007 and 2009 when the majority of survey respondents switched to the side which expressed negative opinions on euro adoption. The gap further widened in 2010 and 2011, and it has become very wide ever since: about 70-75 % of survey participants are against the euro, and some 20-25 participants are for the euro (the rest “did not know”).

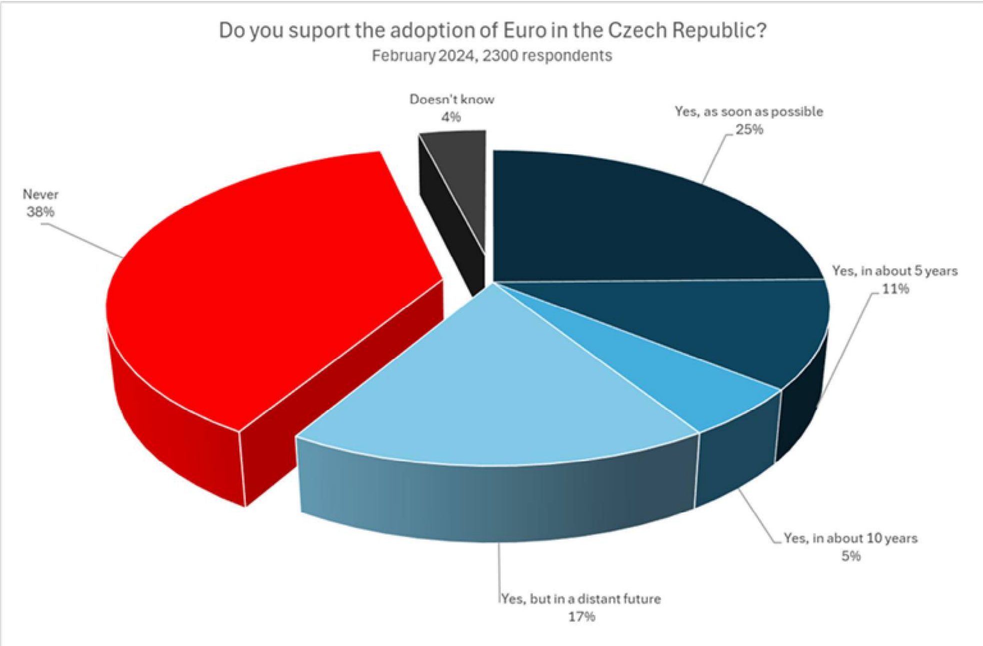
Figure 4 – Opinions on Euro Adoption, based on CVVM surveys. "For euro" sums categories "definitely agree" and "rather agree" with euro adoption, while "Against euro" sums categories "definitely agree" and "rather agree" with euro adoption



The situation is quite curious – as apparent from previously presented data, Czech citizens and firms increasingly use the euro in their transactions voluntarily. So why the clear disagreement with euro adoption?

Other (ad hoc) surveys lack continuity but provide additional details. A survey carried out in February 2024 and presented in Figure 5 suggests that the two attitudes are not necessarily contradictory. It seems that "only" about 40 % of the surveyed were strictly against the euro; the rest were open to the idea but preferred to postpone the adoption (about 27 % preferred postponement by 10 years and more).

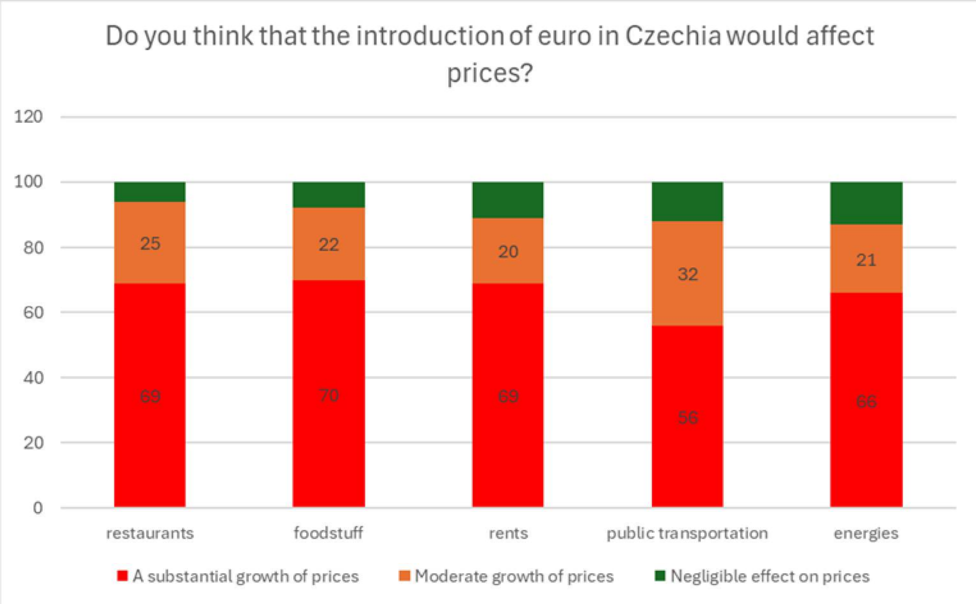
Figure 5 – Answers to the question "Do you support the adoption of euro in the Czech Republic



Source of data: Výzkumník seznam

The same survey also attempted to explore the reasons behind the participants' opinions on euro. When the respondents who opposed euro adoption were asked about the expected effects of euro introduction, they revealed their expectations of a rather substantial inflationary shock caused by monetary integration – Figure 6. In addition to this, 43 % of respondents from the same group ("against the euro") expected further negative effects in the form of increased unemployment.

Figure 6 – Opinions on prices amongst the respondents who oppose the euro



Source of data: Výzkumník seznam

A second type of explanation appeared in, e.g. a similar survey amongst exporters in 2021. While exporters appeared to be logically more supportive of the euro adoption (29 % even supported as fast adoption as possible; the support increased to 57 % if longer time horizons were considered), there was also a non-negligible share of exporters who rejected the euro (25 %). The exporters who opposed the adoption of the euro expressed their concern about the effects and costs of possible future crises and the break-up of the eurozone.

A modified version of a similar argument often appeared in public discussions during the time of the Greek debt crisis – the concern that after entering the euro area, the Czech taxpayers would have to finance the rescue plans designed to help weaker EMU members, i.e. that euro adoption increases the risk of direct fiscal costs for the Czech Republic.

IV.1 Role of distorted historical experience and experience of other countries

Figure 6 illustrates a well-known feature of the discussions between the proponents and opponents of euro adoption; such discussions usually sooner or later turn towards the possible effect of euro adoption on prices. Although such an effect is unlikely and empirical evidence from other countries does not support it, there are several factors that can help explain and understand the emergence and persistence of similar beliefs.

Firstly, especially older generations still remember rather extreme differences in price levels between the Czech market and, e.g. Germany or Austria in the early 1990s. These differences in comparative price levels were caused by the deep initial devaluation of the Czechoslovak currency implemented in 1990. The presence of steep inflation differentials (in combination with the pegged exchange rate) reduced the differences gradually, but the shared belief that prices abroad are higher prevailed for many years and persists even today, when cost-conscious shoppers often travel to neighbouring countries (including Eurozone countries such as Germany) to make use of lower prices of selected products.

Secondly, geographical proximity and numerous direct contacts mean that many Czech citizens were directly exposed to German citizens' dissatisfaction with the alleged effects of euro adoption on German price levels, i.e. the famous claim "euro = teuro". Although the empirical evidence shows otherwise and although most of the alleged effect was due to the difference between perceived and actual inflation (Brachinger 2006), the belief that something like that must have happened still seems to prevail.

Thirdly, Czech media reported intensively about the economic development of Slovakia (and the Euro area) after the euro was introduced in the country. Slovakia adopted the euro formally on January 1st, 2009. The timing unfortunately coincided with the effects of Global Financial Crisis (it influenced CEE countries with a delay relative to Western Europe and the USA). While Czech (and Polish currency) were floating and their significant depreciation softened the blow caused by the sudden drop in demand for the countries' exports, Slovak currency was irrevocably linked to the euro – and the depreciation of other currencies in the region implied an abrupt and steep real and nominal appreciation of the new Slovak currency (newly adopted euro). And even worse – before the negative initial shock linked jointly to the Global Financial Crisis and the relative appreciation fully subsided, politically sensitive debates on the participation of Slovakia in the assistance to Greece (a country with higher incomes and pensions than Slovakia) appeared.

Last but not least, the arguments experienced a rejuvenation in 2023 when Croatia's adoption of the euro (a typical holiday destination for many Czechs) coincided with increased inflation. While the actual price dynamics experienced by Croatia can be credibly explained by other factors (Falagiarda et al. 2023), the simplified reports linking inflation and euro adoption seem to have confirmed and reinforced some of the existing beliefs about the pro-inflationary effect of euro adoption.

Similar to many other countries, Czechia did not avoid the unfortunate trend towards the popularity of "alternative truths" and distrust of experts and official media. This creates a very suitable environment for the persistence of unfounded beliefs about the adverse effects of euro adoption.

IV.2 deeper reasons behind the negative preferences

The survey organized by Výzkumník seznam in February 2024 also revealed that those who tend to oppose the adoption of the euro are usually less informed about the euro, older respondents and voters who support populistic (ANO) or fringe/extremist parties (SPD, Trikolóra, Stačilo). Indeed, Euroscepticism and the rejection of deeper integration have become typical for the programs and slogans of the populist and anti-system parties (Císař and Štětka 2016).

Euro adoption has become a symbol of deeper integration and trust in traditional Western democratic values. Voters with pro-Western orientation seem to be in favour of the euro not just because they are typically more educated and mobile (and they have therefore a higher probability to profit from its adoption) and not because they would necessarily believe that monetary integration will have significant direct positive effects for Czech economy, but rather because it coincides with their worldview and political preferences – many of them want euro as a symbol of pro-Western and democratic orientation. Similarly, those critical of euro adoption reject the euro not (only) because of their beliefs in possible risks but because they fear that euro adoption would imply even deeper integration and further transfer of power to Brussels.

This symbolic role of the euro and the existence of deep distrust and division in society makes rational discussion on euro adoption difficult; voters do not necessarily care about economic predictions or attempts to prove that the euro does not have to have pro-inflationary effects. This unfortunate trend seems to be further exacerbated by disinformation campaigns by means of which external actors attempt to weaken European unity in dealing with international crises. Euro is not necessarily the main target of such attempts (Syrovátka and Štěpánek, n.d.), but it is, at the very least, hit by negative side effects of such campaigns.

The aforementioned factors cause building a stronger consensus and support base for euro adoption to be complicated and politically costly. Indeed, the reduction of international tensions and weakening of the external actors’ motivation can become crucial factors that would speed up the adoption of the euro.

V Scenarios for future development

Before we attempt to outline scenarios of possible future attitudes to euro adoption, it is important to realize that the aforementioned tendencies such as the rise of the importance of anti-systemic and populistic parties and the related increased risk of weakening of democratic institutions (democratic backsliding) have also implications for the costs and benefits of monetary integration.

Traditional economic analysis of costs and benefits attaches rather high importance to the loss of automatic adaption mechanisms (flexible exchange rates) or active monetary policy measures and the resulting dangers of having to live with suboptimal ("one size fits all") monetary policy. Can the danger of democratic backsliding modify this logic? There is some evidence suggesting that it is not necessary (for example, the relative independence of the Russian central bank, which was allowed to attempt to maintain a solid macroeconomic framework even during Putin's kleptocratic and corrupt regime). But there is also conflicting evidence that suggests that the quality of economic policies may be endangered, too. Clientelism and corruption might lead to appointments based on key positions which are not based on expertise; the new decision-makers can adopt decisions motivated by private gains rather than national welfare.

While not an imminent risk at present, it is important to realize that in the Czech Republic, decisions on appointments to the top positions in the central bank (members of the Board, governor) are fully in the hands of the President. The preferences and individual qualities of the elected President can thus have a very important effect on the quality of monetary policy. Some partial precedents exist: The Eurosceptic leaning of former president Klaus (in office from 2003 to 2013) influenced some of the appointments and made the CNB more Eurosceptic too (Verdun and Dandashly 2015). Similarly, some decisions made, for example, by President Zeman (2013-2023), did not seem to be motivated by (only) the expertise of the appointed. It is quite easy to imagine that a further rise in populism might lead to future election results and subsequent appointments/clientelism that will lead to rather detrimental effects on the quality of monetary policy decisions. This would have interesting implications for the costs and benefits of monetary policy: the common monetary policy originating in the ECB would not be necessarily worse than the biased policy possibly generated by domestic decision-making bodies.

Let us now proceed to the attempt to summarize the assumed implications of factors discussed on previous pages into three simplified scenarios that outline the possible timing of the transition to a common currency (and of the development of costs/benefits of such a change).

- Positive scenario. This scenario assumes successful resistance to populism and disinformation and reversal of the tendencies to slide towards oligarchization or illiberal democracy (similar to Hungary or Slovakia), both in Czechia and in key actors abroad. This scenario leads to a higher probability of gradual adjustment of the public's opinion on euro adoption, as well as political elites' willingness to support monetary integration. Interestingly, the costs of non-participation in the Eurozone might be lower because of the lower likelihood of clientelism in decision-making on monetary policy.

- Negative scenario. The scenario assumes further weakening of public institutions and further rise of populistic tendencies. In this case, faster adoption of the euro is unlikely, though the unofficial euroization will not only continue but can even accelerate due to the higher possibility of economic instability and lack of trust in public institutions. Future adoption would be getting more complicated because of the fiscal positions of possible future populistic governments (and most probably lower economic growth). The costs of non-adoption are likely to be higher: mainly due to the increased risk of inadequate monetary policy, the quality of which would be negatively influenced by implications of clientelism.
- Continuation of status quo and muddling through. A realistic middle scenario based on the assumptions that there will be neither successful political stabilization (not just in Czechia, but in the EU and USA) nor a full-scale transition to a non-liberal regime. The current lack of willingness to support the euro by most political elites is likely to continue, just like the fears of the general population. Czechia would thus continue on its path to the adoption of the Euro in a more distant future (postponements would continue), with informal adoption of the Euro by companies and households increasing gradually.

VI Conclusion

The coexistence with the EMU and the increasing informal adoption of the euro in the Czech economy implies that the definition and logic of traditional costs and benefits of Euro adoption have evolved since the 1990s and early 2000s. Still, the geographic position of the Czech Republic, the similarity of consumers' behavioural patterns with the core of the EMU (Germany), the already achieved deep integration in international EU- and EMU-centered supply chains as well as the doubts about the ability to fully effectively utilize the available space for independent monetary policy (esp. in the scenarios with increased risks of clientelism) imply that the expected benefits of Euro adoption exceed the costs.

The real barriers to euro adoption, as well as the obstacles related to the official Maastricht convergence criteria, are low and manageable: Czechia would be capable of meeting the criteria without significant macroeconomic troubles. The former National Coordinator, Prof. Dědek, summarized this for the media in a rather straightforward manner, e.g. in January 2024: “If we want, we will pay with euro in two, three years”.

However, in spite of the renewal of the debates about euro adoption in early 2024 and the fact that some high-ranking politicians (President Pavel) openly supported the adoption in media, significant political barriers to faster adoption persist. The main obstacles consist of the rise of populistic tendencies in (not only) Czech society but also the less than convincing ability of the EU/EMU to demonstrate its cohesion, stability, and decisiveness.

Given the plethora of existing risks and divisive factors that will threaten the stability and internal cohesion of both Czechia and the EU (destabilizing disinformation campaign, Russian aggression, the rise of China as a possible challenge to the status quo in the Pacific region), a sudden and substantial acceleration of the process is unlikely. Czech firms will increasingly rely on transactions and financing in Euros, and Czech households will increasingly collect salaries in Euros and leave a higher proportion of their wealth in Euro-denominated assets, but their risk-aversion and related status-quo bias will imply that a rise of a strong political entity that would have both the will and strong enough support to push for a fast adoption of the euro remains unlikely.

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ECONOMIC AND FINANCIAL INTEGRATION OF BULGARIA ON THE ROAD TO THE EMU: MAIN TRENDS AND PROSPECTS

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Abstract

The paper discusses the adjustment of the Bulgarian economy to the integration process in the EU and the European Monetary Union as regards the prospects to join the EMU. The economic and financial integration of Bulgaria since the start of its official membership in 2007 coincided with the Global financial and economic crisis and with the European sovereign crisis in the European Moneraty Union (EMU) as the "core' of the EU integration. The last decade the integration process has been challenged by the deep institutional reforms as crucial for deepening and enlarging the EMU. The macroeconomic performance of Bulgaria is revealed with regard to the compliance with the macroeconomic nominal convergence criteria for the EMU. The real convergence is discussed to outline the ongoing reforms to speed up economic growth and competitiveness in compliance with the EU regulations. Conclusions and future prospects are summarized for the Bulgaria's EMU entry as a challenge and opportunity for further integration of Bulgaria the EU.

Key-words: European integration, EMU, Maastricht criteria, financial stability, EU reforms in the financial sector, financial integration.

JEL: G12,G28,G32,F36,F450.

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I Introduction

The adoption of the Euro in Bulgaria has been a priority since the country signed the EU Accession Treaty on April 25, 2005. However, Bulgaria's path toward economic and monetary integration with the European Monetary Union (EMU) began much earlier—during its EU pre-accession period in the mid-1990s, particularly with the introduction of the Currency Board regime in 1997.

By pegging its currency to the German mark, Bulgaria laid the groundwork for a seamless transition to the Euro once it was introduced in 1999 during the third stage of the EMU. The Euro, serving as an anchor within Bulgaria's Currency Board, has played a crucial role in the country's financialization and transition from a centrally planned to a market economy, aligning with the Copenhagen criteria.

According to the 2005 Strategy of the Bulgarian National Bank, Bulgaria's preparedness for joining the Economic and Monetary Union (EMU) could have been achieved within a foreseeable medium-term period, supported by favorable economic growth trends and the country's fiscal and monetary stability at the time. Furthermore, when Bulgaria officially became an EU member on January 1, 2007, policymakers were optimistic that compliance with the Maastricht criteria would be ensured through the well-functioning Currency Board.

Bulgaria's experience on the path to EMU membership highlights the complexity of meeting the required criteria, as well as the significant role of political factors in the process. The country's progress has depended not only on structural adjustments to align with the EU Single Market but also on strengthening institutional capacity and economic governance to meet the Union's convergence criteria.

The ongoing expansion and deepening of the EMU have led to significant advancements in its institutional framework and regulatory capacity. In response to the Global Financial Crisis and the European Sovereign Debt Crisis, the EMU has reinforced its governance, particularly in macroprudential policy, banking risk management, and financial supervision. Bulgaria has been actively involved in this process, working toward greater compliance with EU financial regulations, including banking sector consolidation and risk management. However, the delay in Bulgaria's EMU accession has become part of a broader challenge of differentiated integration, as meeting the evolving institutional and regulatory requirements of the EMU has increased compliance costs.

Since 2014, Bulgaria's banking system and financial intermediation have been key areas of focus in its efforts to meet EMU requirements. On July 10, 2020, Bulgaria was accepted into the Exchange Rate Mechanism II (ERM II) and the Banking Union—the so-called "euro area waiting room"—following its formal commitment in June 2018 to enter into a "close cooperation" agreement with the European Banking

Union. Over the past four years, Bulgaria has taken steps to introduce the Euro, recognizing the necessity of full compliance with EMU criteria. However, ongoing political instability over the last three years, marked by frequent government changes, has hindered progress, delaying the adoption of essential legislation and preventing Bulgaria from meeting the initial accession timeline.

To address these setbacks, an updated National Plan for the Introduction of the Euro in the Republic of Bulgaria was adopted by Decision No. 797 of the Council of Ministers on November 13, 2023, setting a new target date of January 1, 2025 for euro adoption.

EU membership has brought both opportunities and challenges, requiring Bulgaria to adapt to the single market's principles of free movement of goods, services, capital, and labor, in accordance with EU law (acquis communautaire).

Since Bulgaria joined the ERM II of the EMU in 2020 much more comprehensive approach has been applied that relies on the political will and commitment to prepare for the Euro by mobilising efforts to raise public confidence and information in all sectors, public institutions and the private sector for preparation to join the euro area.

Since 2021 the political turmoil in Bulgaria has been prolonged for nealy 3 years and the unfavourable economic performance due to the external and domestic factors of the energy crisis and the war in Ukraine have caused slowdown of growth in 2023 to 1.8 percent driven by a decline in private investment due to uncertainty and by the unwinding of the inventory buildup of 2021–2022. In spite of the fact that headline inflation decelerated to 3.1 percent in March 2024 as a result of the lower energy and food prices, core inflation remains stickier (3.9 percent), with services prices still growing by 5 percent. The inflation has remained higher than the price criterion for the EMU. Despite sustained wage and pension growth and inflationary pressures of 2024 budget, inflation is projected to continue declinining, but it has remained higher than required by the criterion of price stability.

The European Commission, in a Convergence Report dated 10/06/2024, announced that the Republic of Bulgaria is not yet fully ready to join the Eurozone on the 1st of January 2025 due to the non-fulfilment of one of the accession criteria – price stability. Therefore, the new target date for the introduction of the euro remains open for the time being and is subject to a decision of the Government of the Republic of Bulgaria following a favourable convergence report of the European Commission and a Decision of the Council of the European Union on the adoption of the euro by the Republic of Bulgaria adopted in accordance with Article 140(2) of the Treaty on the Functioning of the European Union.

The analysis comprises three main parts of discussion of the present issues of Bulgaria's EU economic and financial integration. The first part presents the outstanding characteristics of the main stages of the preparation of Bulgaria to the EMU.

The second part discusses the macroeconomic performance of Bulgaria with focus on the public finances's compliance with the Maastricht criteria as required by the framework for EU convergence. The third part presents the real convergence of Bulgaria as an ongoing further adjustment to the requirements for the EMU entry. Conclusions are drawn with regard to medium term official forecasts for the economic development and the achievement of further progress to join the EMU.

II Main stages of economic and monetary integration of Bulgaria to the EU and the preparation to join the EMU

Since the beginning of its transition from a centrally planned to a market economy in 1990, Bulgaria has pursued the strategic goal of deepening its integration into the European economy. The country's EU accession efforts have enjoyed broad public support and consistent political consensus, with successive Bulgarian governments committed to completing the necessary preparations for membership.

In February 1995, Bulgaria signed an Association Agreement with the EU, establishing a free trade zone for industrial goods, set to be fully implemented within a decade. In December of the same year, Bulgaria formally submitted its application for EU membership. After concluding accession negotiations in 2004, Bulgaria became a full EU member in January 2007. As a Member State with a derogation, Bulgaria is required to meet all adaptation requirements outlined in Article 109 of the Treaty.

Bulgaria's progress in preparing for Economic and Monetary Union (EMU) must be viewed within the broader context of European integration, where macroeconomic convergence is increasingly influenced by the interdependencies of the EU27 and the deepening of the EMU. The Bulgarian experience underscores the critical role of national policy choices in aligning with EMU compliance criteria, particularly as evolving EMU governance has heightened the need for improved economic management at the European level.

Thus, Bulgaria serves as an example of how the EU, as both an economic and normative power, drives the Europeanization process in new Member States, shaping their economic policies and institutional frameworks. The concept of the Europeanisation has been applied by analogy with the EU-ization – a term introduced by Helen Wallace, a British professor of European studies at the start of the pre-accession stage (Wallace, 2001). The "EU-ization," as defined by the *acquis communautaire*, has become the chosen instrument for hastening the process of transformation from centrally planned to market economy.[3] Due to the fact that the EU itself has been undergoing deep changes of its regulative power during the last three decades the impact of the EU-ization has brought challenges to policy making that lie ahead before the integration process of deepening and widening of the EU (Wallace, 2020).

Bulgaria's experience deserves to be discussed also as a case of Euro-ization perceived as monetary integration based on the Euro as single currency and following compliance with convergence requirements of the EMU. Since the preaccession period up to 2007 the Euro has played the role of an "anchor" of the transformation process to open market economy and also has been a driving force of economic restructuring in search of convergence with the EU.

The process of preparation for the adoption of the euro has taken place at an uneven pace since 2007and there have been not only economic but also political controversies concerning the adoption to the Euro. The adjustment process of compliance with Maastricht criteria has had ups and downs and still the prospects of EMU are dependent on the compliance with rules of entry.

In the pre-accession period until 2007 the common view has prevailed among scholars and politicians in Bulgaria that the time of the adoption of the euro should be as soon as possible after the date of the country's accession to the European Union, namely in the second half of 2009 or on 1 January 2010 at the latest. The Euro has been chosen as the anchor of the Currency Board and its adoption was regarded as instrumental to speed up convergence,

It is notable that officially Bulgaria has always maintained that the adoption of the Euro might proceed only according to the procedures of becoming a regular EMU member and not by unilateral Euro-ization. At the time of Bulgaria's negotiations to join the EU there was an active academic discussion about the ways of Euro-ization.: by unilateral Euroizastion, by achieving compliance with the EMU requirements for entry, by using the Euro as anchor of the Curency Board (Nuti,2002). Bulgaria has applied the Currency board and started the preparation for entry of the EMU. (Nenovsky, Christov,2004)

This view is fully consistent with the position of the Bulgarian Council of Ministers and the Bulgarian National Bank (BNB) as stated officially on November 25 of 2004. The 2004 Strategy for Bulgarian National Bank Development between 2004

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[3] The Europeanization described as a behavioural and institutional change transfer from Europe to other jurisdictions either of policy, institutional arrangements, rules, beliefs or norms, and secondly as capacity building in Europe, which also involves a transfer of policy, institutional arrangements, rules, beliefs or norms. (See: Flockhart, T. (2010) *Europeanization or EU-ization? The Transfer of European Norms across Time and Space*. JCMS 2010 Volume 48. Number 4. pp. 787–810.)

and 2009 established as a priority goal the preparations to join the European System of the Central banks and the ERM-II immediately after accession as an intermediate stage of the EMU (BNB, 2004). The BNB committed to operating within the existing Currency Board framework until its full accession to the Euro area and Eurosystem membership. During the pre-accession period of Bulgaria until 2007 two main prerequisites had been identified as providing a good basis on which to expect to join the EMU sooner upon accession: the Currency Board providing monetary stability and the fiscal consolidation providing stability of the public finance

The overall assessment of the Bulgarian economy reflected in the 2002 Regular Report of the European Commission was that Bulgaria *is a functioning market economy*. In the period (2001-2006) Bulgaria has achieved a high degree of macroeconomic stability and adjustments to market mechanisms have been set at work to allow for a better allocation of resources. Good progress has been made in structural reforms, especially as regards procedures for market entry, the restructuring of the financial sector and privatization, thus setting the microeconomic basis for a process of sustained growth following catching – up strategies in its EU accession process.

The preparation of Bulgaria to join the EMU has been dependent on the economic and political development as well as the impact of the Economic and Monetary Union (EMU), i.e. the process of Euro-ization. As the EMU has provided for the monetary and financial integration of EMU member states, the politics of Euro-ization have widened the scope of their impact on the EUas a whole and especially on the EU members with a derogation. The preparation for EMU entry has involved not only requirements to comply but also a process of adjustment to these requirements.

The economic integration and preparation of Bulgaria to join the EMU allows to distinguish five stages as follows:

First stage (1995-2000) – In terms of monetary integration, the introduction of the Currency Board in Bulgaria in 1997 was a crucial step toward aligning with the Economic and Monetary Union (EMU). Initially, the Currency Board was anchored to the Deutsche Mark at a fixed exchange rate, and following the Euro's introduction, it was subsequently pegged to the Euro. The need for macroeconomic stabilization, coupled with the fixed exchange rate of the national currency, facilitated structural adjustments and ensured financial stability.

Since 1995, Bulgaria's association with the EU has significantly boosted trade with Member States through the progressive liberalization of industrial goods exchange. This was achieved by accelerating the reduction and elimination of trade tariffs in accordance with the EU's Common Trade Policy. The association agreement also promoted Bulgaria's economic harmonization with the EU and led to the establishment of a free trade zone with the then 15-member bloc.

During this association period, Bulgaria undertook substantial legislative reforms in the economic sector, amending existing laws and drafting new ones to align with EU standards. As a regular member of the World Trade Organization (WTO) since 1994, Bulgaria had already begun adjusting its trade policies and practices to harmonize with the EU's Common Trade Policy. Any steps taken toward adopting and implementing the EU's Common Commercial Policy at the time of accession were conducted in full compliance with WTO principles and regulations.

Thus, the association agreement played a pivotal role in preparing Bulgaria for integration into the EU Single Market for goods, services, labor, and capital. It supported the country's transition to a market economy and facilitated the resurgence of private ownership and entrepreneurship that had been emerging since the early 1990s.

Second stage (2000-2007) – Based on the progress with the implementation of the Association agreement with EU, Bulgaria has been invited to open accession negotiation for regular membership of the EU by the Helsinki European Council of the EU in December 1999. In 2000 the negotiations were officially launched under explicitly defined 30 Chapters for achieving agreement for Bulgaria's EU entry. The negotiations on Chapter 11 treated the accession to the Economic and Monetary Union as inseparable part of the full membership under the Treary with the EU excluding the opt-out of EMU option.

After the Copenhagen European Council of the EU(15) in December 2002 had defined the political framework for the achievement of membership of Bulgaria in the EU in 2007, the Bulgarian Government concentrated its efforts to provide all necessary resources in order to finalize the negotiations on the accession in 2004.

In May 2005 the Treaty of Bulgaria's Accession to the EU was signed giving the opportunity to achieve the aim of full membership in the EU as from January 2007. Bulgaria is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 109 of the Treaty. Since the accession to the EU in 2007 the Currency Board arrangement (CBA) has been seen as an opportunity for achieving Bulgaria's compliance with one of the Maastricht criteria concerning the two years adherence to the fixed official rate of the Bulgarian currency (the BGL) to the Euro before joining the EMU. Bulgaria has been under CBA since 1997 and it's maintainance of the fixed rate to the Euro has been preserved automatically so far.[4] The compatibility of the CBA with the requirements for an ERM-II membership has been considered a logical consequence for raising the expectations

[4] The Currency Board in general provides an even stronger peg of the BGL to the Euro. Thus for Bulgaria until 2009 the entry into the ERM-II has not been considered to be problematic after the accession to the EU.

for its entry. The expectations for Bulgaria's entry in the ERM-II have been based on the good record of public finances and the sustainability of the CBA. (Houbenova, 2002). The development of Bulgaria's markets of commodities, labour and capital had proceeded under the fixed exchange rate regime of the BGN to the Euro allowing to diminish the risks of currency substitution and its pro-inflationary effects.

The EU-ization of Bulgaria's public finances has started during the pre-accession period and continued further when the country was given EU membership on 1 January 2007. The fiscal rules for EMU entry as requirements to converge to the Maastricht criteria have become crucial for preparation of the EMU entry.

The third stage (2007-2010) starts with the full EU membership of Bulgaria with two main economic goals to be achieved:

The first goal is to strengthen the discipline of compliance with the EU single market of free movement of goods, services and capital. The freedom of movement of labor is a derogation, due to the agreed 6-years' period of transition to full application of the freedom of labour movement. But this practice does not restrict significant labor migration to the old member states, although there was no formal mutually agreed freedom of the labor force in search of work in the old member states.

The second goal is to achieve full compliance with the Maastricht criteria for macroeconomic convergence as a conditionality for admission to the EMU.

Until the end of 2008 Bulgaria has consistently applied the Strategy of the Bulgarian National Bank for adopting the Euro by 2010. In spite of the fact that substantial progress has been achieved as regards the stability of public finances of Bulgaria, due to the non-compliance with some other criteria of the conditionality for the EMU (including price stability and inflation rate), Bulgaria has not been admitted to the procedures of the EU for joining the EMU.

As barriers to convergence with the Maastricht criteria for the EMU the Convergence Report of 2008 pointed to the higher rate of inflation as well as the inflexibility of labor markets and other economic problems in constructing market mechanisms. (EC,2008)

The fourth stage (2009-2015) is characterized by a gradual slowdown in the overall

EU integration process due to impact of the Global and financial European crises. Albeit with a certain lag the effect of the EU crisis on the Bulgarian economy is reflected in the decline in economic growth and rising unemployment. Due to this, as well as to the worsening of the European Sovereign debt crisis as of 2010, the crisis in some of the Euro area countries has triggered a downward trend in EMU countries and the accession to EMU has been postponed for a later stage of integration.

The initial strategy of Bulgaria for entry into the Eurozone was reconsidered and domestic policies did not make the adoption of the Euro a priority as the European sovereign debt crisis continued to deepen.

After 2010 Bulgaria undertook further adjustment to the EMU in order to implement new approaches to economic governance in the EU by introducing the "European semester" as an instrument for fiscal policy reforms and to foster the anti-crisis policies of the EU. Overcoming the crisis in the EMU, the EU has started building the new institutional and legal framework for an accelerated and deeper budgetary and fiscal coordination and surveillance in the Euro area. While preserving the unity of the policies pursued at EU-27, not only about the Single Market but also in connection with the EMU, the EU institutions have deepened the so called “differentiated” integration by introducing new and more strict prudential regulation for fiscal discipline and for the financial sector.

For Bulgaria and other EU Member States outside the EMU the accession to the newly introduced institutional and financial regulation for the deepening of the EMU is considered feasible when appropriate. This main trend of re-regulation of the EMU presents a novelty in the integration process for the EU member states like Bulgaria. Such an approach has deepened the trend towards the differentiated integration in the EU.

At the same time Bulgaria has joined the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), which was signed on March 2, 2012 by twenty-five Member States and includes the Fiscal Pact. The aim is to commit to a deeper budgetary and fiscal coordination and Community budgetary surveillance as a part of the upgraded EU law within five years of its entry into force and to deepen and strengthen the EMU including the launch of a European banking union and deeper Community budgetary coordination and supervision.

The Fifth Stage (2016-2024) is characterized by even greater challenges before the alignment with the EU. The multi-annual budget programming in the EU for 2014-2020 and for 2021- 2027 have introduced new instruments and initiatives for a further shift towards stimulating growth at European level in an unfavorable external environment due to the ongoing economic stagnation in Europe and worldwide. Bulgaria faced increased challenges due to the delayed exit from the economic crisis across the EU.

Since 2020, Bulgaria's inclusion in the Exchange Rate Mechanism II (ERM II) of the EMU has provided a solid foundation for advancing its roadmap toward euro adoption. The country continues to uphold fiscal consolidation and ensure compliance with EU laws at both macroeconomic and sectoral levels.

However, challenges remain, particularly regarding the risk of macroeconomic imbalances and the slow pace of structural reforms. Addressing these issues requires continued efforts in alignment with EU policies and close cooperation with European institutions to implement necessary reforms in a coordinated and systematic manner.

The unfavourable impact of the crisis in the Eurozone makes the integration process highly dependent on the choice of more adequate policies at the national level alongside and in parallel with the effective implementation of European policies – valid both for those that are Common policies (the Trade and the Agricultural policies) and Community policies (Industrial policy, Energy policy and etc.).

The *general characteristics of the main stages* of Bulgaria's economic integration to the EU include the following:

- *Firstly,* there is a comprehensive reorientation of economic policy of Bulgaria to achieve compliance with established strategic directions and objectives of the economic development of the EU on the basis of:
  - implementation of the National Plans for socio-economic development for 2007-2013, Plans update for 2014-2020 as well as the National Plan for 2021-2027'which is now in progress to be accomplished. Bulgaria's institutional capacity is strictly involved also with the updating the National Reform Programme and the Convergence programmes with the EU;
  - continuous updating the priorities of development of Bulgaria has taken place in accordance with the Lisbon Strategy of 2001 and the Europe 2020 Strategy of the EU. Bulgaria actively participates in the development and implementation of new approaches to economic governance within the EU. This includes adopting EU policies and recommendations aimed at fostering innovation-driven economic growth, enhancing employment, and strengthening the EU's international competitiveness.

The country has benefited from EU funding both as a candidate nation—under the Multiannual Financial Framework (MFF) 2000-2007—and as a full EU member through the MFF 2007-2013 and MFF 2014-2020. Since 2021, Bulgaria has been operating under the MFF 2021-2027.

In response to the unprecedented crisis caused by the COVID-19 pandemic, the EU Recovery Plan for Europe, launched on May 27, 2020, introduced two key financial instruments: the NextGenerationEU recovery fund and the MFF 2021-2027. Under these frameworks, Bulgaria is responsible for co-financing EU-funded projects using resources from its national budget, in alignment with EU priorities and public funding requirements.

In assessing Bulgaria's macroeconomic development within the European integration process, the implementation of both the National Reform Programme and the Convergence Programme is evaluated simultaneously to ensure a comprehensive understanding of their interdependencies.

- *Secondly,* Bulgaria's integration into common EU policies and the implementation of Community policies have progressed significantly, driven by ongoing administrative and institutional reforms. These reforms allow for a degree of national policy flexibility while ensuring alignment with EU legal requirements. Moreover, the impact of regulatory changes related to EU policy implementation can be assessed based on Bulgaria's overall economic development, as well as through specific criteria and indicators. These indicators serve as threshold values within the EU's public accountability framework, ensuring compliance and transparency in key policy areas at the European level.
- *Thirdly, since* the 2007 accession of Bulgaria as a regular member of the EU there has been a procedure for the the European Commission to implement a **Mechanism for cooperation and verification** in order to help our country to overcome the shortcomings and problems in the area of judicial reform, the fight against corruption and organized crime, which undoubtedly hinder the integration process. Monitoring and evaluation of progress in these areas on a regular basis under 6 criteria are interrelated and are long-term oriented towards judicial reform, fight against corruption and organized crime. In practice, institutional and legal and regulatory changes in the areas under consideration are essential to economic development in mind their role in the integration process.

Since 2022 Bulgaria has had a **new Partnership Agreement with the European Commission** concerning the investments of European structural and investment funds for the 2021-2027 period. Under the new rules of the Multiannual Financial Programme for 2021-2027 Bulgaria is obliged to develop and implement Strategic plans with investment priorities relating to these five funds for smart, sustainable and inclusive growth. The choice of proper national policies at sectoral level will be crucial to achieve the strategic goals as integration deepens (Kaplaner, 2023).

In summarizing the main trends influencing Bulgaria's integration to the EMU, one may underline the concerns that the EU integration process did not generate higher centripetal force for improving the rates of growth. Thus there is a need to foster new model of growth in the transformation to climate neutrality. The enlargement of the EMU may proceed further driven by shared policies for convergence support to the "catching-up" development of the new member states from Central and Eastern Europe.

At the present stage the EU faces challenges to implement a comprehensive programme to consolidate the Single market and the Economic and Monetary Union. By choosing priorities for further deepening of integration in the EMU through completion of the Banking and Capital Union and completing the further development of the Single Internal Market European Union’s leadership has laid the focus on policies to boost growth and the competitiveness of the Union.

In the context of the ongoing difficulties in the Eurozone and the EU as a whole out of the economic depression and overcoming the crisis, the medium-term prospects for restoring economic growth are important. Delayed recovery of economic growth in the EU inevitably has an adverse effect on the Bulgarian economy for which the external environment and European integration dependencies do not provide positive incentives for post-crisis development, but much rather determine the necessity of rethinking the alternatives to stimulate the national economy by domestic demand and economic co-operation and trade with all EU partner countries.

As major problems facing the prospects for economic growth in the EU and implications for Bulgaria can be viewed the following structural aspects:

- the challenges facing Bulgaria in relation to structural reforms in the EU post-crisis are determined by the development of the integration concept for Europe of "two speeds". Economic growth in the EU has sustained lower rates. Unemployment reached high levels which lead to profound changes in the social policy of nation states towards the implementation of the European Pillar of social rights introduced since 2017. Economic convergence in Bulgaria has to proceed further by taking into consideration the social cohesion and active labour policies.
- the transition to long-term investment and growth as a priority for economic governance in the EU is crucial for Bulgaria. The question remains how to foster growth and raise competitiveness in order to avoid the risk to enter the second “lost "decade due to low economic growth.

III The Macroeconomic performance of Bulgaria and the nominal convergence with the Maastricht criteria

The issues of the entry criteria for the EMU as a set of Maastricht criteria from the first stage of the EMU in the 90s have raised a number of questions about the proper *“fitness” of a country to comply*. As regards the set of Maastricht criteria of convergence for example, Kozluk (2005, p. 439-474) finds that some of the EU accession countries are better prepared for the single currency membership than some of the more established members had been at the introduction of the EMU.The differentiation between the strictness of Maastricht criteria for EMU entry, on one hand and the reconsidered since 2005 framework of the Stability and Growth Pact applied to member states of the EMU allowing flexibility to adapt, has been considered with regard to some recommendations for unification of fiscal deficits requirements for both EU members and the EMU entry (Nuti, 2006).

But the compliance with the fiscal sustainability criteria has gained new aspects of importance as the European sovereign debt crisis has evolved since 2010. As previewed by Mongelli (2002, p.34) the costs from negative external effects have become "very high for the EMU because not one, but more, member countries were to run sizeable and protracted budget deficits, accumulating an unsustainable public debt, eventually some pecuniary externalities might ripple through the currency area." The negative consequences of the crisis have made the compliance with *the nominal and real convergence indicators* need a much more essential prerequisite for the EMU entry.

As the COVID-19 crisis has hit hard the European economies and the recovery has been slow and not good enough (in spite of significant differences among countries) to stimulate growth. The questions about the growth model and the reforms of the European integration have been raised again. The EU membership of Bulgaria could not facilitate the the catch-up model of growth due to the multifold crisis implications as well as because of the ongoing search of proper national policies. These policies are a decisive factor for differences among the growth performance of the countries of Central and Eastern Europe as EU member states. Bulgaria's integration to the EU is important as it supports sound fiscal and financial policies by the strengthening of the EU's current macro-finance assistance arrangements and economic governance improvements. However, the role of proper fiscal policy has become more important not only as instrumental for the EMU entry but because it has to take into account the need to stimulate economic growth. (Becker et al., 2010).

The fiscal vulnerability often arises from implicit liabilities towards the financial sector and for this reason sustainability assessments should also consider private-sector fragility. EU countries' budgets have been involved with providing great amounts of state aid to rescue banks and non-financial intermediaries. The post crisis institutions newly created to tackle the financial instabiliy provide new capacities for of the EMU. Thus for the EU member states like Bulgaria being 'outs' to the EMU, it is important to join the EMU as it may help growth by joining new cooperation agreements that are targeted to increase competitiveness and financial stability. The implementation of the Banking and Capital Union is designed to help break the vicious circle between the public debt and banking sector's debt and improve the fiscal consolidation in favour of the EMU (Zimmermann, 2015). By joining the Banking Union in 2020 Bulgaria has undertaken the implementation of banking regulations in favour of financial and fiscal stability.

III.1 Problems of Bulgaria's economic growth in the preparation to the EMU

Economic growth remains a key concern in discussions about Bulgaria's readiness to join the Economic and Monetary Union (EMU). The period before Bulgaria's EU accession (1997–2006) marked the first sustained phase of economic recovery following the turbulence of the transition to a market economy. Growth during this time was driven by increased private consumption, rising foreign direct investment (FDI), and expanding exports. Bulgaria's economic stabilization was further supported by favorable global and European economic conditions. After 2002, accumulated FDI and rising domestic consumption significantly contributed to GDP growth, although foreign capital inflows also led to economic overheating and a continuous rise in real estate prices.

The Currency Board Regime, introduced in 1997, played a stabilizing role in economic and fiscal policy. With a budget surplus of 3% of GDP, Bulgaria maintained financial discipline, allowing for tax reductions aimed at attracting foreign investment. The lack of an independent monetary policy was offset by the accumulation of foreign exchange reserves at the Bulgarian National Bank (BNB), which served as a buffer against internal and external shocks. Bank lending supported industrial modernization, increased production, and job creation, while rising domestic consumption further strengthened demand. However, inflation and the value of the Bulgarian lev (BGN) appreciated against the Deutsche Mark and later the Euro.

Between 2005 and 2008, Bulgaria's foreign trade volume expanded, with imports outpacing exports. However, a growing current account deficit emerged, posing risks to macroeconomic stability and reflecting deeper economic imbalances. These imbalances were closely linked to the economic, social, legal, and institutional reforms undertaken as part of Bulgaria's EU integration process.

Like other Central and Eastern European (CEE) countries, Bulgaria experienced economic growth and an increase in productive capacity relative to more developed Western European economies. In the context of economic cohesion, Bulgaria's higher pre-crisis growth rates suggested a trend of convergence with the Eurozone. However, this trajectory was interrupted by the Global Financial and Economic Crisis (GFEC).

Bulgaria's EU accession on January 1, 2007, coincided with the onset of the global financial crisis, which had an immediate and negative impact on the country's economy. Orders from key trading partners declined, FDI inflows shrank, and industrial production slowed. Rising unemployment and weakened domestic consumption further exacerbated the downturn. Banks tightened credit conditions, leading to higher interest rates on loans and increased debt burdens for businesses and households. In response, Bulgarian authorities pursued policies focused on reducing budget deficits and public debt. By contrast, other CEE countries—such as the Czech Republic, Hungary, Latvia, Lithuania, Poland, and Romania—adopted expansionary fiscal policies to stimulate GDP growth, despite accumulating large structural budget deficits in 2007.

In the post-crisis period, economic growth stagnated around 1%, with many sectors struggling to recover due to low levels of investment, weak domestic and external demand, and sluggish consumption. By 2014, private consumption had begun to stabilize, aided by lower interest rates and declining oil prices (2015). However, a concerning indicator of economic stagnation was that gross fixed capital formation (GFCF) had remained unchanged since 2012. While employment improved in key economic sectors, youth unemployment—particularly among less-educated and low-skilled workers—remained high, as many job opportunities lost during the crisis had not returned.

The contraction of domestic demand led to a period of deflation, with the average annual inflation rate falling from 1.0% in May 2013 to -2.1% in February 2014, before stabilizing at -1.3% in April 2014. This deflationary trend reflected continued production stagnation, weak consumption, limited bank lending, and declining prices for raw materials and energy. Weak domestic demand remained a key constraint on economic growth. Meanwhile, the trade deficit narrowed to approximately 5%, largely due to reduced domestic consumption and lower industrial output.

Between 2014 and 2016, Bulgarian exports averaged EUR 3.7 billion and showed an upward trend. Export-oriented companies focused on specific niches in international markets, but this temporary increase did not indicate a sustained long-term trend.

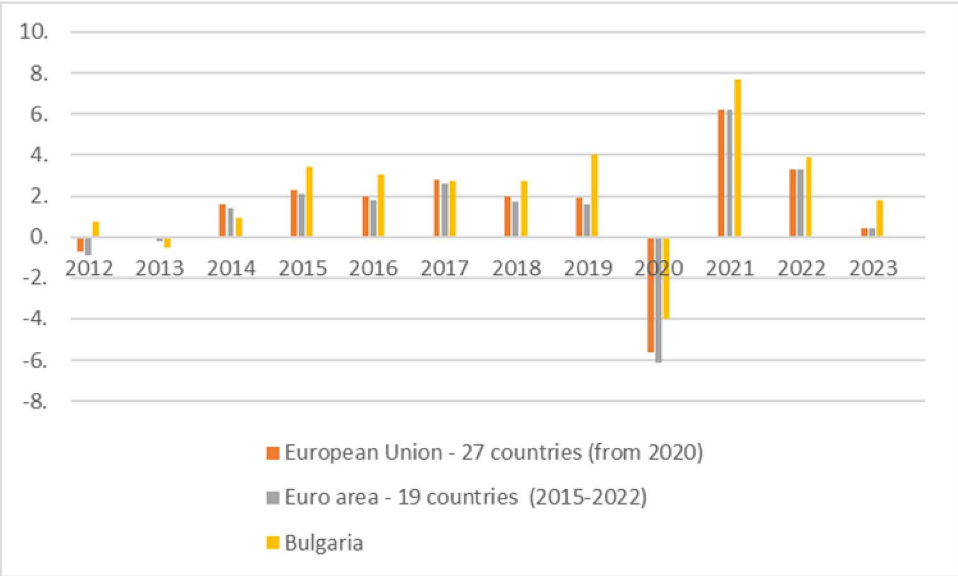
Over the past two decades, Bulgaria has achieved macroeconomic stability and positive GDP growth. Between 2000 and 2008, economic growth followed a steady upward trajectory, driven by increased aggregate supply and consumption, fiscal consolidation, substantial foreign capital inflows, and the maintenance of monetary discipline under the Currency Board system (since 1997). During 2005–2008, Bulgaria's GDP grew at an average annual rate of 6.4%, one of the highest rates among EU member states.

Since the early 2000s, Bulgaria's rapid economic growth raised both expectations and concerns about the sustainability of its "catch-up" growth model after EU accession. Foreign and domestic investment was concentrated in construction, real estate, tourism, and services -sectors that contributed to economic overheating. Although GDP expanded significantly between 2005 and 2008, the Global Financial and Economic Crisis (GFEC) of 2008–2009 reversed this trend, leading to a 5% contraction in GDP in 2009. The following years were marked by slow recovery and, at times, negative economic growth.

A gradual recovery began in 2010, but at a very slow pace:

- 2010: GDP growth at 0.7%
- 2011: Growth increased to 2%
- 2012: Growth slowed to 0.2%
- 2013–2014: Modest growth of 1.1% and 1.7%, respectively

Figure 1: Bulgaria compared to EU and Euro-area: Real GDP growth rate for (2012 -2023) (annual , in %)



Source: Eurostat,2024.

It took five years for Bulgaria's economy to recover to pre-crisis levels. In 2015, GDP growth accelerated to 2.9%, showing signs of stronger economic performance.

From 2013 to 2018, real GDP growth was revised downward from an average of 2.8% to 2.1%, mainly due to weaker household consumption. While the economy showed modest growth in 2019, it slowed again in 2020 due to the effects of the

COVID-19 pandemic. The real GDP contraction in 2020 was revised from 4.2% to 4.4%, reflecting declining consumption, lower exports, and reduced investment and imports.

The Bulgarian economy performed relatively well during the COVID-19 and the energy crisis. GDP rebounded strongly by 7.6% in 2021 after output contracted by 4% in 2020. In parallel, inflation rose in the second half of 2021, driven by increases in fuel and food prices. Economic expansion continued in 2022 with GDP growth of 3.4% despite high inflation and political uncertainty. Consumer spending and exports supported GDP growth, while fixed investment declined in 2021 and 2022.

High employment levels, combined with strong increases in wages and welfare benefits and the government's energy support measures, supported consumer spending. The rapid increase in exports in 2022 was supported by the opportunity to meet shortages in the supply of energy, food, metals and other materials caused, among other things, by the war in Ukraine.

Signs of persistent inflation and supply constraints emerged. While the initial surge in inflation was largely driven by external factors such as high energy and food prices, domestic factors have become increasingly important. This has led to some persistence of inflation. Average annual consumer price inflation (HICP) was 13% in 2022, well above overall EU inflation of 9.2%, but still below inflation levels in the Baltic states, as well as Poland, the Czech Republic and Hungary.

Nominal wages have grown by 16.4% in 2022, well above the rate of inflation. Rapid wage growth creates the potential for spillover effects and greater inflation resistance.

The banking sector, dominated by foreign-owned banks, is profitable and well capitalized. New lending continued to grow strongly in 2022, particularly in the mortgage sector. Credit expansion was supported by an increase in bank deposits, income growth and still low nominal interest rates. The change in the interest rate cycle and the possible cooling of the real estate market will test the resilience of the banking sector.

Structural factors continue to weigh on investment and potential economic growth. Fixed capital investment declined by a cumulative 12.3% over the past 2 years, with private and public investment contributing to the decline. In an environment of dynamic economic activity, with relatively favorable financing conditions and growing corporate debt, the contraction of investments indicates structural barriers to more intensive capital accumulation.

In addition to high economic uncertainty, factors such as limited inflows of FDI, lagging and differential performance of public investment, including investment supported by EU funds, unfavorable business environment and overconcentration of economic activity in a single region weigh on aggregate investment

Technology uptake and transfer are hampered by the low share of business and public R&D spending, the fragmented public research system and low patent activity. In addition to support from the Recovery and Resilience Facility (The Recovery and Resilience Plan is underway), Bulgaria also benefits from significant EU Cohesion Funds (€11 billion, representing around 13% of GDP in 2022). The implementation of Bulgaria's recovery and sustainability plan and cohesion policy programs is to be of key importance but uncertainties persist due to the political turmoil and crisis of the political system.

Macroeconomic performance has allowed to maintain stability but the rate of growth has remained low in recent years. The unsatisfactory growth record has been accornpanied by relatively modest fiscal deficits, low inflation and a stable currency. Growth has been deprived of new capital inflows from abroad as direct and portfolio investments have fallen considerably as result of the Global and the European sovereign crisis. The economic growth has become largely dependent on domestic factors and only to some extent driven mainly by growth in services and manufacturing, the latter aided by an expansion in exports of labor-intensive goods. The acceleration of economic growth is considered a necessary prerequisite to diminish the gap between the GDP per capita of Bulgaria and the average GDP per capita of EU-27 in the period (2003-2023). Since 2012 Bulgaria has performed some improvement of the indicator GDP per capita (PPP) and it has been raised from 47 per cent in 2013 to 64% in 2023 of the average GDP per capita for the EU. but still this is the lowest level among the EU27.

III.2 Government finances' compliance with nominal convergence criteria

As a new EU member state Bulgaria has no opt-out choice as regards the EMU and thus has the status of a Member State with a derogation. The convergence with the EMU requirements has been most pertinent by the gradual process of alignment of Bulgaria's *fiscal polic*y with EU requirements. With the efforts for the implementation of Maastricht criteria for EMU Bulgaria has achieved progress towards macroeconomic nominal convergence (criterion on price stability, sound public finances, exchange rate, short-term and long-term interest rates).

Objectively the economic growth in terms of positive rates since 2004 has made it possible to *maintain the public finances adequately* and to achieve a Government budget surplus from 2004 to 2009. At the same time complex political and economic reasons justify the postponement of Bulgaria's participation in ERM II as the Convergence report points to the need to decrease the external imbalances and improve the labour market. In practice, the deterioration of the indicator for government deficit for 2009 up to 4.3% of the GDP led to the imposition by the European Commission to Bulgaria a procedure for excessive deficit. In the subsequent years, by adhering to the new rules and requirements to the government finances, the compliance with the fiscal criteria was renewed during the period (2010-2013).

But due to the higher level of public expenditures in 2014, the Government budget deficit was increased to 5.4 % of GDP (Table 1). In 2015 Bulgaria has again restored the compliance with Maastricht criterion by adhering to consolidation of fiscal policy and improving the discipline of execution of the Government budget.

Table 1: Bulgaria compared to EU27 and Euro area: Government budget deficit/surplus (2014-2023) (as % of GDP, annually)

	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Bulgaria	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.9	-1.9
European Union – 27 countries (from 2020)	-2.5	-1.9	-1.4	-0.9	-0.4	-0.4	-6.7	-4.7	-3.4	-3.5
Euro area – 19 countries (2015-2022)	-2.6	-2.0	-1.5	-1.0	-0.4	-0.5	-7.0	-5.2	-3.7	-3.6

Source: Eurostat, datasets Government deficit/surplus, debt and associated data, 2024,gov_10dd_edpt1

Between 2015 and 2019, Bulgaria maintained steady economic performance and strict fiscal discipline, ensuring compliance with the Maastricht criteria—a key objective of the government's fiscal policy outlined in its Convergence Programmes.

However, since 2020, the COVID-19 pandemic and the war in Ukraine have had a negative impact on Bulgaria's fiscal position. To mitigate the economic downturn, the government introduced temporary fiscal support for businesses and households, leading to a rise in the budget deficit.To protect households from surging energy costs, the government implemented regulated pricing measures: In December 2021, energy prices were frozen at July 2021 levels until March 2022. In the second half of 2022, electricity prices increased by 3.4%, while heating costs rose by 24%. Additional heating price adjustments included an 8% increase in July 2022, followed by a 14% increase in November 2022.

These fiscal and regulatory measures were part of Bulgaria's broader response to economic shocks stemming from global crises.

Targeted heating aid for the heating season linked to income has also been introduced. Non-household consumers were compensated through a support scheme that applied to all companies, regardless of their consumption. The scheme currently covers all non-domestic consumers for electricity costs above €102/MWh. The scheme to support non-household consumers was partially financed by a special levy on windfall profits of certain state-owned enterprises in the energy sector in 2022. Bulgaria applies the EU solidarity levy in the implementation of Council Regulation (EU) 2022/1854.

From January 2023, the country also applies caps on the profits that energy producers can receive from the wholesale market. These caps include approximately EUR 90/MWh for nuclear power plants and EUR 180/MWh for renewable electricity generators. The revenues from this measure are transferred to the "Security of the Electricity System" Fund.[5] Although energy prices have decreased, uncertainty remains, which requires continued efforts to structurally reduce gas demand.[6]

The public deficit was 2.8% of GDP in 2022, a decrease of more than 1 percentage point compared to the previous year. Revenue growth more than offset spending growth in part due to higher prices for some products subject to indirect taxes, such as food and energy. Continued wage increases also contributed positively to revenues through higher labour taxes. Measures to minimize the impact of high energy prices had a net budgetary effect of around 1% of GDP in 2022, as they were partly financed by a tax imposed on the windfall profits of state-owned enterprises in the energy sector.

Bulgaria has reduced considerably the Government deficit in 2022-2023 and being below the EMU threshold is among the countries with moderate fiscal risks. The primary budget deficit on a cash basis for 2023 is 1.5% of GDP. The low level of interest costs of Govennment debt (0.4% of GDP for 2023) explains the still weak pressure of servicing the government debt. This helps better maintainance of fiscal capacity. According to the European Commission Spring Forecast for 2024 the budget deficit is projected to reach 2.8% and 2.9% in 2024 and 2025, driven mainly by increased public expenditures on pensions and wages. General government debt is set to increase to 24.6% of GDP by 2025. (EC, 2024)

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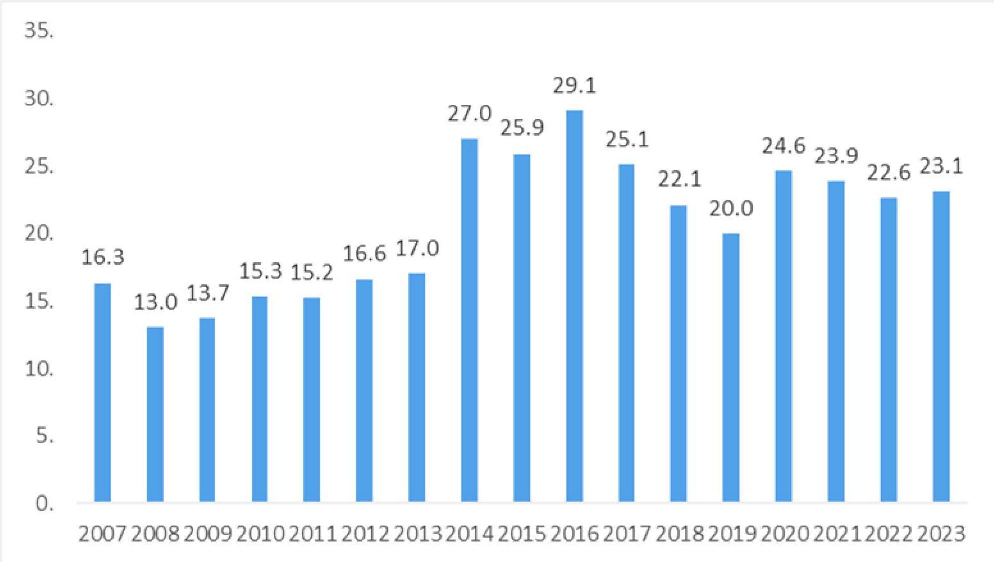
[5] Bulgaria has taken steps to guarantee the security of energy supplies. It fulfilled its gas storage obligations, filling 91.53% of the only Chiren underground gas storage facility by November 1, 2022. It secured supplies of liquefied natural gas (LNG) to compensate for natural gas supplies interrupted by Gazprom in April 2022, the operation of the gas interconnector between Greece and Bulgaria began in October 2022, while the construction of the Kostinbrod natural gas pipeline to connect Bulgaria and Serbia began in February 2023.

[6] COMMISSION STAFF WORKING DOCUMENT, 2023 Country Report – Bulgaria,{COM(2023) 602 final}

As regards the *EMU criterion for an average annual rate of growth of the public debt-to-GDP* Bulgaria has had consistently consolidated its fiscal policy throughout the period (2011-2023) and fiscal discipline has been much strict to keep much lower level of Government debt than the EMU treshold of 60 percent of GDP. (See Fig.2)

Figure 2. Bulgaria: Government debt as % of GDP, annual)

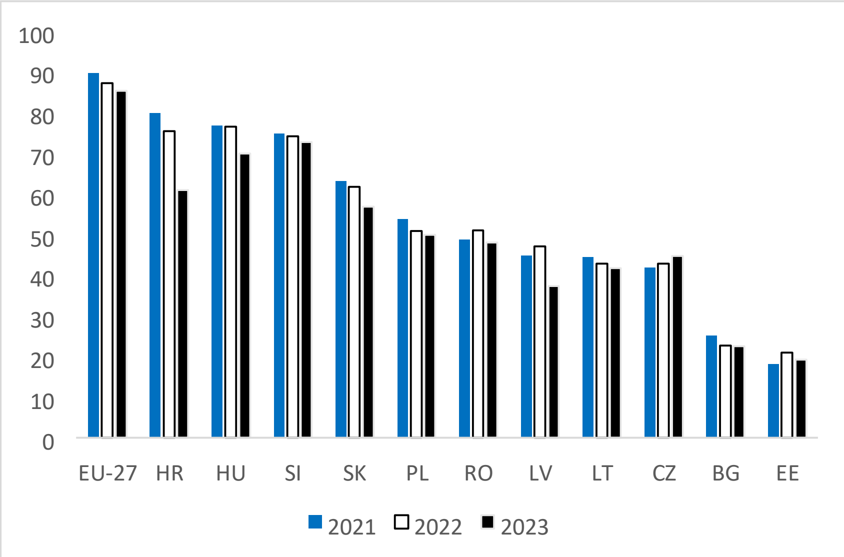


Source: Eurostat (2024).

The need to provide state aid to cover the deposit guarantees repayments after the closure of Corporate commercial bank and to apply the liquidity support for other 2 domestic banks in crisis had caused rapid increase of the Government debt-to-GDP ratio in 2014 to 26 %. The steep rise of this ratio caused the assessment of Bulgaria as a country with imbalances by the European Commission's Alert mechanism for greater macroeconomic imbalances for 2014. In 2016 the Government debt raised up to 29.1 % of the GDP which is the highest level reached since Bulgaria's accession to th EU.

In the period (2027-2020) Bulgaria followed medium-term path of maintaining the fiscal stability by the implementation of the Convergence Programmes of the Ministry of Finance until 2022. As seen on Graph 5 the ratio of Government debt to GDP of Bulgaria is lower compared to EU member states from Central and Eastern Europe. According to the 2023 Convergence programme, the general government debt-to-GDP ratio is expected to increase from 30.7% at the end of 2024 to 37.1% by the end of 2026.The forecast set in 2024 by the Convergence programme forecasts that the level of Government debt of Bulgaria will increase over the next three years (2025-2027) both in nominal terms and as a ratio of GDP under the assumption to secure the fiscal capacity by larger volumes of new debt financing. (Ministry of Finance,2024)

Figure 3. Bulgaria: Government Debt in comparison with EU27, Euroarea and EU Member States in Central Europe, 2021-2023 (% of GDP)



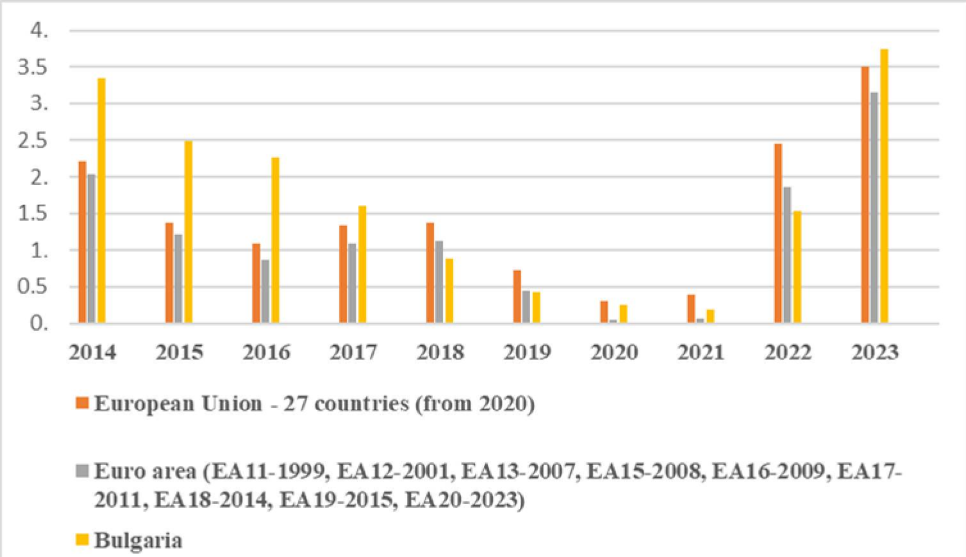
Source: Eurostat, 2024.

According to the EU Spring Forecast 2024, Bulgaria's General Government debt-to-GDP ratio is projected to increase to 27.3% in 2025, 30.0% in 2026, and 30.7% in 2027, with an average annual growth rate of 1.9 percentage points over the period 2025–2027 (European Commission, 2024).

Long term interest rates

The Maastricht EMU convergence criterion series related to interest rates for long-term government bonds denominated in national currencies is indicative of the financial integration.Compared to EMU and EU average data for Government long term **bond yields,** the trend of Bulgaria's government bond yields on the secondary market, gross of tax, with a residual maturity of around 10 years.are shown on Figure4.

Figure 4. Interest rate: EMU convergence criterion bond yields of Bulgaria compared to EU and Euro area (2014-2023)



Source:Eurostat, 2024

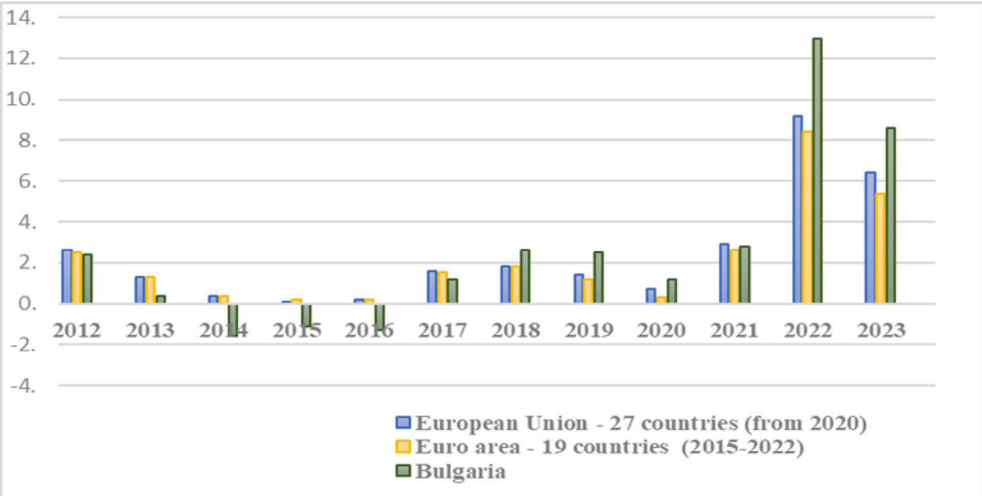
Bulgaria has performed progress of convergence of the long term interest rates on the Bulgarian Government debt. Bulgaria has had average long-term interest rates that were – to different degrees in separate years – much below the reference value for the interest rate convergence criterion.

As seen on Fig.6, since 2015 up to 2022 the long term interest rates on the Bulgarian Government securities have fallen considerably which had also been a factor to lessen the pro-inflationary impact of both servicing the debt as well as resorting to issuance of new debt. The higher level of the values of the long term interest rates on the 10-th year Government securities of Bulgaria since 2022 reflects the overall change of the inflation trends in the EU but may be regarder as a consequence of the specifics of Bulgaria's worsened economic situation and political uncertainty in this period.

Price stability and convergence have been key objectives of the Bulgarian Government and the Bulgarian National Bank (BNB) since the pre-accession period and remain a priority today. To assess inflation as a nominal convergence criterion for the Economic and Monetary Union (EMU), the Harmonised Index of Consumer Prices (HICP) is used, in accordance with Article 121 of the Treaty of Amsterdam. Bulgaria has fully aligned with Eurostat's methodology for measuring the HICP. A comparison of Bulgaria's HICP trends with those of the Euro area and EU-27 highlights both differences and similarities in price adjustments, reflecting the ongoing process of economic integration.

For the period (2004-2008) Bulgaria has not accomplished the price criterion as the inflation was higher than the referent valueof EMU threshold. The structural readjustment and credit expansion related to the higher rates of Bulgaria's growth caused higher rates of inflation in the period (2004-08). The economic decline had caused a reversal of this trend since 2009 onwards by the recorded relatively stable process of deflation.

Figure 5. Bulgaria compared to EU27 and Euro area: HICP- Inflation in 2012-2023 (as rate of change, annual)

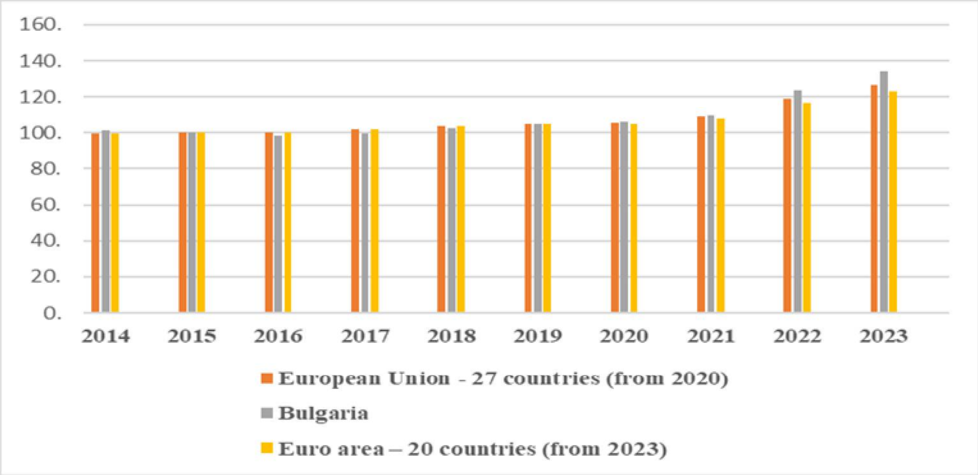


Source: Eurostat,2024.

The fall of the Bulgaria's HICP index since 2014 was partly a result of lower commodity prices and the overall deflation trend due to the slow recovery after the Global and European sovereign debt crisis,. Since 2014 the external factors have played a bigger role in the domestic price formation of Bulgaria due to the high openness of the Bulgarian economy and the high degree of import dependencies that influence the import prices. Energy and food prices have been a major component of imported inflation especially if it is taken in consideration that these commodities have large share of the Bulgarian basket of the Harmonised index of Consumer Prices (HICP). Their influence on the price level in Bulgaria is big and due to this, after the Global crisis the observed decline of international prices of oil, energy resources and foods has been reflected in the prolonged deflationary trends in Bulgaria in 2014-2016.

In 2021 -2023 the inflation gradually picked up again, largely reflecting increases in commodity prices,wage growth and sharp increases of energy prices, etc. Domestic factors (especially including labour shortages and tight labour market) led to sharply rising nominal unit labour costs. After risding for several years, the wage growth has been the highest in the EU in recent times. The level of domestic inflation has become important for the nominal convergence as it has a double risk. On the one hand, the higher rate of inflation affects negatively cost competitiveness as compared with the euro area trading partners and the rest of the EU. On the other hand, the wage growth is indispensable for narrowing the income gap between Bulgaria and the rest of the EU. The HICP and core inflation-based real effective exchange rates have followed a trend of appreciation, with nominal appreciation playing only a small role under the Currency Board arrangement and the large share of trade with the euro area.

Figure 6: Harmonised index of consumer prices (HICP): Bulgaria compared to EU and the Euro area (2014-2023) , average index and rate of change annually



Source of data: Eurostat, 2015 (Bulgaria – HICP – Overall index, Annual rate of change, Eurostat, Neither seasonally nor working day adjusted, Unit Percentage).

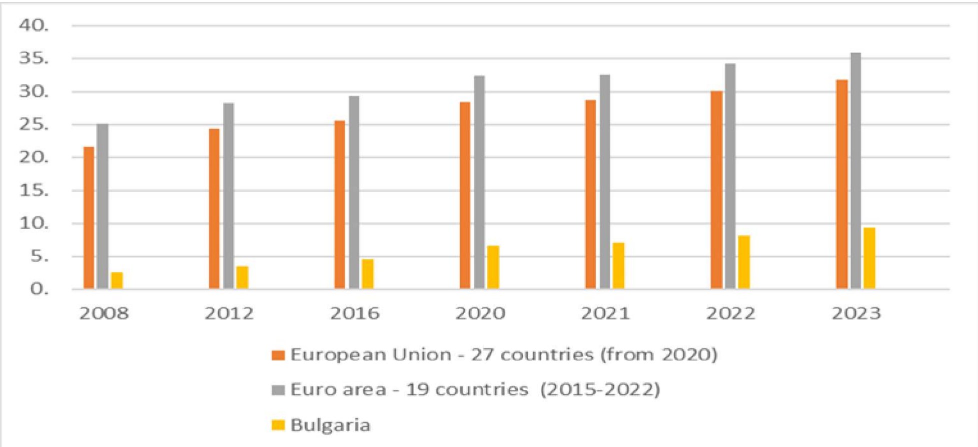
In 2020-2023 the increased values of HICP of Bulgaria reflect a higher rate of inflation as a result of the economic slowdown due to the COVID-19 and the war in Ukraine. Domestic factors of inflation include labour shortages, lack of adequate market competition and incomplete regulation of consumer protection. Following certain moderation, the inflation has followed a declining trend in 2024 but the risks of uncertainty of the international and domestic environment remain. There is still a risk of core inflation being persistent. The convergence adjustments could take the form of further increases of energy and services'prices as well as a rise of nominal wages.

Bulgaria's overall trend of price convergence reflects its growing interdependence with the Euro area, which has led to price and income adjustments, particularly during economic crises (Fig. 6). However, regarding euro adoption, the challenge of pro-inflationary factors and their evaluation remains a critical issue in forecasting medium- and long-term inflation trends and in the ongoing adjustment of the Bulgarian economy to global developments.

Many new EMU member states have experienced inflationary pressures after joining the euro. Within a monetary union, several factors can exert upward pressure on inflation, potentially making inflation self-sustaining and leading to abrupt adjustments. Since the nominal interest rate is set at the union level, any inflationary shock that exceeds the union average will reduce real interest rates, which could further stimulate credit expansion and amplify inflationary pressures.

However, remaining outside the EMU also carries risks, particularly due to imported inflation. These risks can be even higher for a non-euro country, considering exchange rate fluctuations and their impact on import prices in euros and US dollars. Such exchange rate risks can amplify inflationary trends, affecting economic stability and price levels in Bulgaria.

Figure 7. Bulgaria compared to EU27 and Euro area: Labour costs in the period (2008 – 2023), (annual data – NACE Rev. 2)

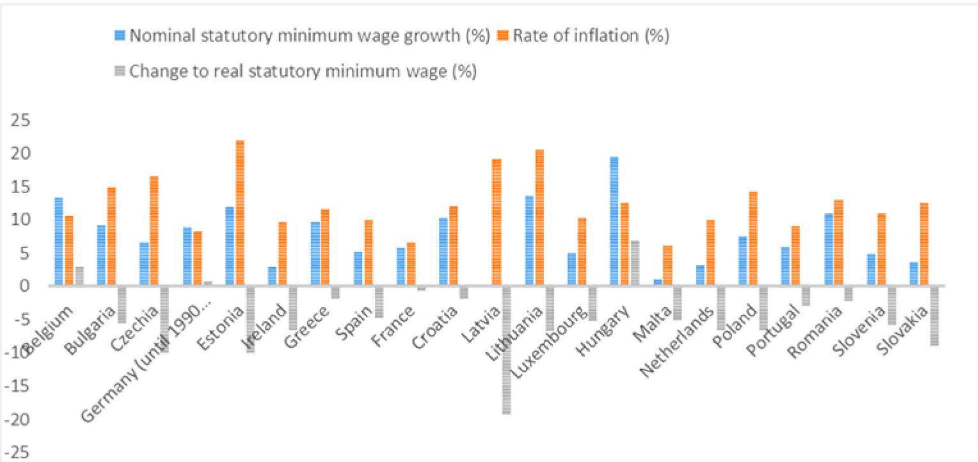


Source: Eurostat,2024. Last data update 11/04/2024. Labour Costs (D) cover Wages and Salaries (D11) and non-wage costs (Employers' social contributions plus taxes less subsidies: D12+D4-D5)

The data shown in Fig, 7 confirm the great differences of labour costs per hour in Bulgaria compared with the average values of this indicator for the EU27 and the Euro-area.This indicator shows the low level of labour costs in the country during the last decade as a factor of stagnation of wages and incomes and inadequate labour policies.The resulting differences have caused higher labour migration out of the country as well as labour shortages that exert pressures for wage growth and are pro-inflationary because of need to raise the wages.

In Bulgaria, the situation is indicative of the negative impact of the inflation since 2021, not only because of the lowest amount of the statutory nominal minimum wage compared to EU member states, but also because of insufficient increase of the nominal minimum wage by 9.2% from April 1,2022 as it was already "consumed" by the rising inflation. As of June, 2023 the purchasing power of the statutory nominal minimum wage actually decreased by 6.6% compared to the same period in 2022. Almost 1/5 of the persons employed under the labour and public service legal contracts earn wages anchored to the nominal statutory minimum wage. Thus the workers and employees assigned to the statutory minimum wage have encountered serious difficulties to adjust to the rising cost of living, as the inflation has increased at higher rate due to the rising prices of energy and essential goods and services, which have a high share of expenses in the households'budgets.

Figure 8. Rate of Inflation and its Impact on the Nominal Statutory Minimum Wage growth and on the Statutory Minimum Wage in EU Member states in 2022



Source:Eurostat, 2024

As the Fig.8. shows that in Bulgaria the statutory minimum wage is set so low that it left workers living at risk of poverty even before the cost-of-living crisis began.

Since 2021 the inflation, also driven by huge increases in profit margins, in addition to supply-side issues, has pushed the value of minimum wages down to a record low.

The lowering of inflation rate in Bulgaria will be challenging in the medium term, given the limited scope for any active monetary policy under the existing currency board arrangement. Active labour policies are on the agenda of improving the flexicurity of the labour market in line with the policies of the European Pillar of social rights.

Due to the fact that the GDP per capita in Bulgaria is significantly lower than in the euro area, it is difficult to foresee the exact size of the inflation effect resulting from the structural adjustment of incomes and wages that is underway. On the Government agenda is to introduce an increase of the minimal wage from 2025 onwards as well as to proceed further with the liberalisation of the market for energy supplies which may cause higher inflation. In medium term the economy is expected to grow at a higher rate and as the income convergence proceeds, price level convergence is to continue. The outcome will depend also on the choice of the model of growth of the Bulgarian economy.

The costs of entering the EMU have grown as a result of the post crisis reforms in the integration not only due to enhanced needs of compliance with new legal provisions. The integration within the EMU gives solid grounds for better access of the EMU member states to the new EMU institutions for sharing the risks and costs of financial integration and its new modalities. The challenge is that the EMU is at a stage to be completed by common policies to ensure a well-functioning monetary union. For Bulgaria as EU state which is out of the EMU would be necessary to encounter the implications of the "shift from rules to institutions" in the EMU in the process of further deepening the Monetary Union.

Thus by joining the Euro zone Bulgaria's preparation for the EMU has to take into consideration the role of the sustainability of its fiscal capacity under the present state of EMU 0.2. Surely, the present state of the EMU raises the requirements and the mechanisms and instruments for a higher degree of common system of sharing the burden of making the EMU a more effective and robust functioning Union. The costs of entering the EMU have grown as a result of the post crisis reforms in the integration not only due to enhanced needs of compliance with new legal provisions. The integration within the EMU gives solid grounds for better access of the EMU member states to the new EMU institutions for sharing the risks and costs of financial integration and its new modalities. The challenge is that the EMU is at a stage to be completed by common policies to ensure a well-functioning monetary union. For Bulgaria as EU state which is out of the EMU would be necessary to encounter the implications of the "shift from rules to institutions" in the EMU in the

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IV Real economic convergence in Bulgaria and the Eurozone

The implementation of the single monetary and exchange rate policy, have as their main objective the maintenance of price stability and the support of EU common economic policies, in accordance with the principle of open market economy and competition. From the point of view of investors and entrepreneurs, the technical benefits of the introduction of the euro are related to the reduction of transaction costs and better access to financial markets.

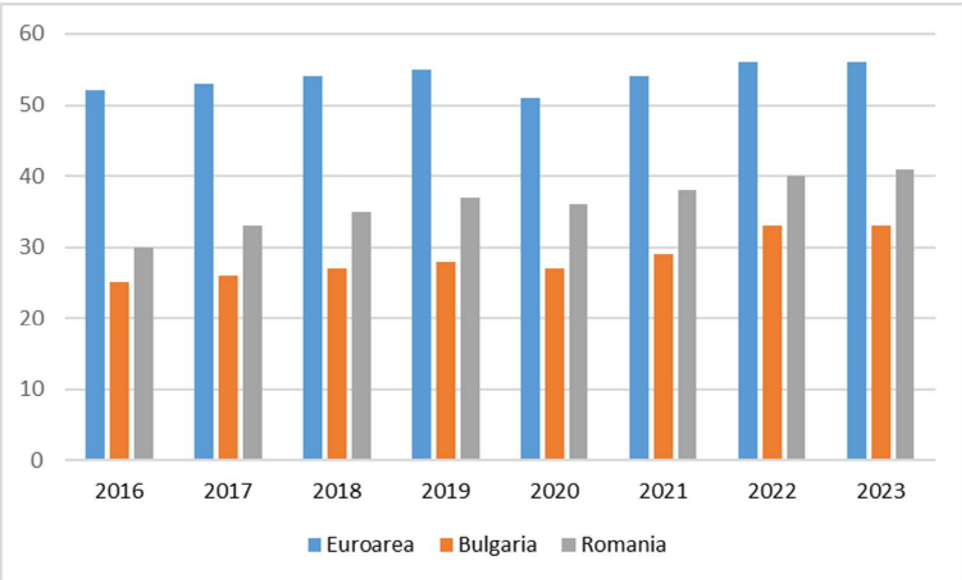
Also, the risk premiums resulting from the presence of the national currency will be removed, the costs of the banking sector to maintain liquidity and buffers will be reduced and, accordingly, conditions will be created for the reduction of domestic interest rates (taking into account the phase of the monetary policy cycle regarding interest rates), possibly lowering the country's risk premium and reducing the government's funding costs. In the Baltic states, the adoption of the euro had a positive effect on the rise of the countries' credit rating. The same effect is observed in Croatia.

In the economic literature on economic growth, real economic convergence is usually referred to as ß-convergence and δ-convergence.The first type (ß-convergence) is the catching-up of relatively less developed economies with developed economies. This means that higher incomes should be closer to those of the richer European countries. A well-known measure of ß convergence is relative GDP per capita, calculated on the basis of purchasing power standards (PPS). The second concept (δ-convergence) is expressed by reducing the dispersion of income levels across EU countries. This means that a less-developed economy should achieve a higher sustainable economic growth than developed economies, so that the incomes of the countries converge after a certain time within the regional bloc. EU Member States should increase GDP per capita in line with ß-convergence, while δ-convergence expresses the effects of the increase in relative GDP per capita of the less-developed economies. (Christova-Balkanska,2009)

Real sustainable convergence is a process by which the GDP per capita of a lower-income country actually catches up and moves closer to more developed economies. Income convergence means sustainable economic growth and the ability of the less-developed economy to counteract external shocks. According to ECB, real convergence, between the twelve countries that adopted the euro before 2002, did not occur to the extent desired between 1999 and 2014. For the countries that adopted the euro after 2002, there are signs that demonstrate the beginnings of cohesion and real convergence. The comparison between GDP per capita based on purchasing power parity (PPP) of the Central European EU Member States and Bulgaria shows that this indicator increased the most in Poland and Slovakia in 2004-2015. During this period, GDP per capita remained almost at the same level in Hungary and the Czech Republic. This indicator is also increasing in Bulgaria, but is lagging behind the other countries.

GDP per capita in Bulgaria amounted to 45.7% out of 100% in the euro area in 2016, compared to 42.7% in the period 2008-2017. In 2023, Bulgaria had the lowest level of GDP per capita in the EU, behind Greece, Latvia and Slovakia. Bulgaria was the EU Member State with the lowest GDP per capita, at 36 % below the EU average.

Figure 9 GDP per capita based on PPP for the euro area countries, Bulgaria and Romania



Source: https://tradingeconomics.com/romania/gdp-per-capita-ppp

A number of doubts remained in Bulgarian society about when is the right time to adopt the euro and how this change would affect the Bulgarian economy and the purchasing power of the Bulgarian population. The official position in Bulgaria is that after the euro adoption, the high inflation will decrease. In Croatia, for example, with the adoption of the euro (1.01.2023), the inflation is decreasing gradually, i.e. the adoption of the euro has little impact on consumer prices.

A key issue is how joining the Eurozone would affect faster convergence to average level of European incomes. In the period 2014-2023, the total income of the Bulgarian household on average increased by 53.72%, wages on average by 53.18%, and pensions by 43.55%. [7]

Increasing rates of economic growth have a positive impact on the production and consumption of goods and services. They should grow faster in a weaker economy compared to the rates of development of production in a developed economy. The objective is convergence towards the levels of production and consumption in the EU. The basis for this evidence lies in the increase in labour productivity and the added value created by a worker in one hour of work. The real change in labour productivity demonstrates the country's capacity for economic convergence. Bulgaria Labor Cost Index is at a current level of 159.40 during the second quarter of 2024, and up from 140.50 one year ago (Q2)2023). This is a change of 13.45% from 2023. (Eurostat) Labour productivity is increasing in Bulgaria, but this depends on several factors, such as demographic trends, labour force qualification indicators, the level of innovation and new technologies in industry. Low labour productivity is an obstacle to the process of convergence of Bulgaria's incomes with other EU member states. Bulgaria's membership in the EMU is clearly not a fundamental factor that will automatically lead to an improvement in labour productivity. What matters are other factors related to the structure of production and the prospects for its development. However, overall real labor productivity increased after 2012, driven by manufacturing. Nominal labor productivity per hour worked is 53.4% of the EU level in 2022 (purchasing power standards). (Eurostat)

It seems that when compared with other Central and Eastern European EU member states, the increase in wages in Bulgaria does not correspond to the level of labour productivity, which affects cost competitiveness. In 2023, the minimum wage in Bulgaria is BGN 933 (about EUR 460). The average gross monthly salary in Sofia is around BGN 2.800 (about EUR 1.400), resulting in a net salary (after tax and social contributions) of about BGN 2.200 (EUR 1.000). In the rest of the country, the average gross salary is around BGN 2.000 (about EUR 1.000), but with important regional diversity. The average salary in Bulgaria has thus increased by

[7] Calculated on data of National Statistical Institute of Bulgaria

about 50% over the last 5 years, and it even increased by 20% in a single year from 780 BGN in 2023 to 933 BGN in 2024.

In Bulgaria, an employee costs in average 7 euros per hour, which is 4 times less than what it costs in Luxembourg or Belgium or France. The wages per hour of work in Bulgaria do not mean that the country is acquiring good competitive positions in comparison with its counterparts in the EU, even if labour productivity is increasing. Bulgaria has still not overcome the macroeconomic imbalances accumulated before and during the pandemic crisis with COVID 19, which influences export competitiveness. The increasing real effective exchange rate show that competitiveness is deteriorating, which suggests a slowdown in the process of real economic convergence in Bulgaria. For Bulgaria,improving labour productivity and competitiveness of production is an important challenge for its economic catch-up and full European monetary integration.

Table 2: Development and structure of the Bulgarian economy compared to the average level of the EU27 and of companies in Bulgaria for 2023

	Bulgaria	**EU27**
Implementation and structure of Economy for 2023		
GDP per capita (PPS)	18,600	32,600
Average annual GDP growth (%)	6.4	4.4
Employment share Manufacturing (NACE C) (%)	18.7	16.4
Of which high and medium technologies (%)	23,1	38,0
Share of employment in services (NACE G-N) (%)	41,3	41,1
of which knowledge-intensive services (%)	28,8	35,8
Share of turnover of SMEs (%)	45,9	34,1
Share of turnover of large enterprises (%)	31,4	49,6
Foreign enterprises – share of added value (%)	17,4	11,8
Business and entrepreneurship		
Birth of enterprises (10+ employees)(%)	1.6	1.0
General entrepreneurial activity	6.0	6.8
Net FDI inflows (% of GDP)	3.6	3.1
Enterprises with the largest R&D expenditures of 10 million population	0.0.	20.3

Source: European Innovation Scoreboard 2023 Country profile Bulgaria, https://research-and-innovation.ec.europa.eu/statistics/performance-indicators/european-innovationscoreboard_en

Productivity growth is the driver of Bulgaria's long-term economic convergence with the economic structures of the EU. A major source of EU productivity improvement is a functional internal European market with effective competitiveness of European companies. The EU multinationals are relying heavily on stable supply chains and when disruptions occur in the chain, firms' productivity, employment, turnover, import-export operations are disrupted.

In 2023, there are a number of structural differences between the EU27 and Bulgaria. In Bulgaria, the per capita income is lower compared to the EU, but the country shows higher economic dynamism, which is not a permanent trend, considering the future economic changes in the EU economy. Industrial production occupies a higher share of the country's economy, compared to other EU countries. The relative share of Employment in the industry is higher compared to the EU average. Small and medium-sized enterprises in the non-financial economy, which are considered the "backbone" of the European industrial structure, form the basis of the Bulgarian industrial sector, judging by the higher share of the turnover of SMEs. Large enterprises also dominate the Bulgarian real economic sector, and the share of foreign enterprises in Bulgaria is higher compared to the EU average. The development of entrepreneurship and business does not deviate from the average evolution of EU countries.

The unstable internal and external political environment affects the industrial sector of Bulgaria, and the situation is complicated by a series of contradictory decisions in the country's energy sector, by the exacerbation of the energy crisis, which raised challenges to the production potential and competitiveness of Bulgarian companies.

Disruption of the synchronicity of supplies and supply of global value chains disrupts production links, exacerbates the challenges to the production potential and competitiveness of Bulgarian companies. Foreign and domestic direct investment in sectors such as machinery and equipment has been declining since 2021, partly due to increased political uncertainty and increased needs for infrastructure reconstruction or the lack of concrete measures to implement much-needed infrastructure projects.

Labour shortages, especially in the service sector, but also the inflation indexation of some nominal wages put upward pressure on wages and unit labor costs. Unit labor costs were the highest in the EU, but this was due to the long-term hold-up of wages in the real sector amid inflation.

Public investment is insufficient and this explains the delay (or suspension) of the implementation of infrastructure projects due to the political uncertainty in the country. Public investment growth is largely driven by European funding and is higher than the EU average over the past five years (1.2% vs. 0.5% of GDP).

Combined with the significant shortage of materials and labor, the increase in prices reduces the production capacity of Bulgarian companies. Global supply chain disruptions, also due to the war in Ukraine and expectations of further price increases, have led to stockpiling of raw materials, goods and finished goods. This partially explains the increased contribution of inventories to the annual GDP growth, especially in the first half of 2022. political factors burden reforms in the industrial sector. Investments in renewable energy sources and reduction of relatively high greenhouse gas emissions in the country are one of the main requirements of the EU.

Bulgarian companies experience a number of difficulties due to the influence of internal and external economic and political factors, which creates an uncertain economic environment, combined with the shortage of labor force. According to short-term business indicators (European Commission and NSI study), the two main factors are the shortage of qualified labor and the uncertain economic environment, which are obstacles to the growth of labor productivity and the competitiveness of production. (The availability of qualified personnel is a long-term obstacle to investment for 88% of Bulgarian companies (Investment survey of the European Investment Bank EIB.) Bulgarian SMEs from the non-financial sector face the same difficulties in hiring personnel, in improving the organization of the company, in diversifying The uncertain economic and political environment of Bulgaria as well as the energy crisis raises challenges for the productivity of the Bulgarian industry and competitiveness.

Quality investments in the industrial sector are of primary importance for the competitiveness of industrial production. In the context of the EU's New Industrial Policy from 2021, Bulgaria will have to comply with the development of industry towards EU requirements, for digitalization and for environmentally friendly industrial technologies, as well as to carry out a policy of strategic autonomy regarding strategic raw materials and assistance for stabilization and improving the functionality of the EP. For the implementation of these goals, the funds under the National Recovery and Resilience Plan (NRRP) should be directed to investments in priority industrial sectors, along with the financial support from the Cohesion Fund, although Bulgaria is currently lagging behind in the implementation of the goals set in the NRRP. According to the New Industrial Policy of the EU, Bulgaria must implement strategic industrial projects of pan-European interest, for entering the EU market of innovative technologies. The data on the development of high-tech production show that in terms of number of enterprises, accrued turnover, production and added value, Bulgarian companies are significantly behind in these indicators compared to the EU member states before the pandemic crisis.

Bulgaria's accession to the Eurozone was postponed several times over the years, as intentions for a faster integration of Bulgaria into the Eurozone were repeatedly expressed at the official level, bearing in mind that all the main documents shaping Bulgaria's admission were voted on.

The assessment of the ECB is that "Limited progress has been made by non-euro area Member States of the European Union on economic convergence with the euro area since 2022," including Bulgaria. Prices in Bulgaria are rising at an annual 5.1%, 1.8% higher than the requirement to join the currency union. With inflation falling, some improvement in supply and the economy can be expected. Attracting and increasing investment in digital technologies and innovative manufacturing processes remains essential to restructure the economy and increase investments in the real economy. Continued political uncertainty means that the Bulgaria's accession to the Eurozone will be not before 2026, although it may be technically possible that Bulgaria will join the single currency at some point in 2025.

V Conclusion

The main macroeconomic challenges to Bulgaria are: (i) how to sustain high GDP growth, and (ii) how to ensure that this growth translates into new employment opportunities. Success in both dimensions will depend on the country's ability to implement the necessary structural reforms. The implementation of the requirements for the EMU entry at the present stage of its new design as EMU 2.0 may be demanding higher costs before being admitted to the full membership. But it is much more rational to get on track of preparation for the EMU entry at a time when the reforms in the EMU are to be introduced

Bulgaria's accession to the euro area has been a strategic goal for over a decade. However, since mid-2015, the country has shifted towards operationally planned activities, making deliberate choices and allocating resources to achieve full integration into the European supervisory and financial architecture.

Bulgaria has actively participated in the institutional reform process, supporting deeper EU integration. However, these reforms have also increased the transitional costs of adapting to the new institutional framework required for full EU financial and economic integration.

The EMU has gone through a difficult but useful period of analysing the flaws in its original design, and has taken major steps to repair them. The new regulation contains tougher rules for fiscal policies, stronger oversight of macroeconomic imbalances, and a lender of last resort for sovereigns in the form of the European Stability Mechanism.The crisis has pushed the changes for the better to design prospective reforms by focusing on ensuring financial stability and in pursuing financial integration. The newly designed institutions and rules raise higher the requirements to comply with the EMU governance principles and institutions. The Single Market of the EU will be changing as the differentiated integration within the EMU proceeds further. Beyond this, it is equally crucial that the reforms will contribute to a more effective and robust functioning of EMU.

After a year of stagnating activity, the eurozone economy will continue to struggle to gain traction in the near term given multiple headwinds. But in the Eurozone a gradual recovery is awaited, that will gather momentum as consumers regain some of their lost purchasing power and financial conditions ease.

Inflation could fall faster than the market and the ECB expects. Following the current weak patch, easing financial conditions, a recovery in consumers' real incomes and strong household balance sheets, improved global demand, and a cyclical upswing in industry will lead to stronger growth in the near future. Fiscal policy will represent a rising drag to growth, as government priorities shift from providing support to deficit reduction.

Against a backdrop of serious geopolitical and economic challenges, EU leaders are shifting towards deregulation and cutting public spending. But in today's world and in the Eurozone, financial stability, sustainability efforts and public investment in climate, digital transition and autonomy are more important than ever. The renewed European Commission is trying to change Europe's course to adapt to the geopolitical and economic difficulties ahead. But difficulties remain. As T.Picketty wrote: "When the diagnosis is wrong, the cure can be worse than the disease. (Le Monde, 2024)

Challenges facing Europe have been exacerbated by underperforming Germany, which is hampering growth in the Eurozone and EU as a whole. The main problem, however, is the loss of competitiveness vis-à-vis China and higher energy prices since the start of the war in Ukraine.

Taking into account the current challenges, the changes in the geopolitical and regional context, the paper draws attention once again to the future role of the political stability of the Bulgarian Government elected after the last Parliamentary elections in 2024 in order to improve the governance of policies to accelerate all preparatory steps to support the process of Bulgaria's accession to the Eurozone, to adopt the necessary legal framework and to pursue a prudent and synchronized fiscal and monetary policy. This suggests that for Bulgaria, as a country that is on the threshold of the Economic and Monetary Union to join the Euro area, there are a number of goals to be achieved: be in a stable economic condition, have a clear perspective of socio-economic progress by proper investment policies for own and EU funds, sustain an optimistic political and economic climate and improve the competitiveness of Bulgarian production. The readiness of the country for the EMU does not mean that only the nominal Maastricht criteria are to be respected. Being aware of the global uncertainty the political and economic strengthening is ahead of Bulgaria, and the adoption of the euro could further assist in this direction.

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THE EURO – PROVIDER OF STABILITY IN THE INTERNATIONAL MARKETS

Simona Moagăr-Poladian

I Introduction

On January 1, 1999, a new chapter of the Economic and Monetary Union (EMU) was opened in Europe, where the euro became a reality. Most Member States of the European Union at that time (11 out of a total of 15) led by the core states, Germany and France, adopted the single European currency. Subsequent enlargements of the EU (2004, 2007, 2013) strengthened the EU and created the conditions for new countries to join the euro area, as they met the economic and financial convergence criteria laid down in the Maastricht Treaty. The provisions stipulated in the agreements of the new EU Member States after entering the third and final stage of EMU are different as their accession agreements impose that they are obliged to adopt the euro when they meet the economic and financial convergence criteria laid down in the Union Treaty (Maastricht Treaty of 1991).

In the 25 years since the euro was introduced, the euro area has expanded from 11 to 20 members, economic developments in the Member States have been affected by international financial crises, periods of modest economic growth, shocks caused by commodity and energy price hikes, military conflicts and health crises. At the same time, there have also been tests of the viability of the construction of the Economic and Monetary Union of the EU.

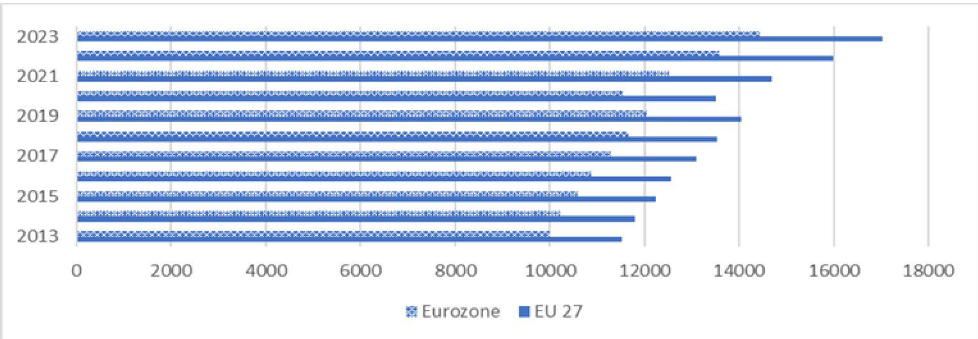
At present, only 7 of the 27 EU Member States have not adopted the single currency, and 6 have the status of Member States with a derogation, including Romania. By exception, Denmark is not obliged to adopt the euro, as is the United Kingdom, which, however, left the EU in 2020.

In total, the euro area is a European area with around 350 million inhabitants, with a combined GDP at purchasing power parity (PPP) of 12% of the world total and a GDP per capita of 37,400 dollars. It is worth mentioning that the standard of living *expressed in GDP/capita in 2023 was very close to the record level recorded one year earlier (https://tradingeconomics.com/euro-area/gdp-per-capita).*

Globally, since the introduction of the single currency and up to the present, we observe that its influence remains significant, with the single currency remaining in second place in the international monetary system.

From the outset, the euro project was not conceived as an alternative to the dollar, but it was intended that, once put into practice, it would be a binding force for EU economic integration. As a whole, the European Union, with its gradual enlargement from 6 to 28 and then to 27 Member States, represents an important economic space in terms of total GDP, its share in world exports of goods and services, and the level of wealth expressed in purchasing power. At the same time, the euro area accounts for around 85% of total EU GDP.

Figure 1 Comparative evolution of GDP in the EU and euro area, 2013-2023 (bn Euro)



Source: Figure by author, based on Eurostat Comext tet00066 data

The European single currency has triggered much debate since its inception, both in Europe and in other corners of the world, but mainly overseas, and there were not a few Eurosceptics who doubted the coin's longevity. Moreover, pessimists believed it was too early to take such a step and that this type of economic and monetary union would in fact widen intra-European development gaps. At the same time, proponents argued that in the construction of EMU, the single currency is actually the key to the success and increase of welfare in the EU.

This chapter, dedicated to the international role of the euro, begins by highlighting the main analyses produced and published even before the launch of the single European currency and continues with the evolution over time of its role as an international currency, looking at its use in official reserves of the world's countries, in international trade transactions, as a monetary anchor, and as a currency used by international investors.

Although the euroization process is unlikely to dethrone the US dollar, the euro has over time become a settlement currency for commercial transactions, primarily of the EU Member States and the euro area, but also for securities issues and as a reserve currency for central banks around the world.

Many times over the years, but especially in the first two decades after the establishment of the single currency, a series of analyses have been elaborated and published in the specialized literature on the subject of the rivalry between the US dollar and the euro, but also on the position occupied by the two currencies in the international monetary system.

Analysts and international investors' mistrust of the dollar stemmed from the chronic US current account deficit, seen as a vulnerable point for dollar supremacy. Statistics published by international financial institutions illustrate that in times of regional or international economic and financial crisis, investor demand for assets issued in the US is more accelerated, especially after periods of economic crises outside the US, such as the financial crisis in Southeast Asia, and whenever there have been limited opportunities for business development in the EU or other industrially developed countries, such as Japan. Taking this behaviour into account, one might infer that the US current account deficit is not a problem as long as the demand for US-issued assets remains high. This issue of covering the US current account deficit has raised much debate both domestically, within the US economy, and outside. On the one hand, some analysts were of the opinion that the source of this chronic deficit stems mainly from the need to supply US domestic demand for products that are manufactured in other countries. US current account deficits have turned the US from a creditor to the world's biggest debtor, as a result of rising debt and low savings.

It was against this backdrop that the single European currency was launched. Its emergence influenced the structure of international asset demand by increasing the supply of securities denominated in the single currency. A number of countries, mainly the Russian Federation, China, and the Arab states, have changed the structure of foreign exchange reserves by buying euro.

As economic powers, the euro area and the US have long been comparable after the single currency was launched. Despite sustained economic growth since 1999, the euro has not outperformed the US dollar because euro area financial markets have been less liquid, with investment diversification being much poorer in the euro area than in the US markets.

The situation would have been different if the United Kingdom had joined the Eurozone, with its City of London considered the financial centre of Europe, but the question arises whether in that hypothesis, the two financial markets, the eurozone and the US, would then have been comparable in terms dynamism and integration. To answer this question, we note that the European single currency lacks the military strength of the US, nor is it a currency that represents a single country, and the likelihood of either of these is virtually nil.

To enhance the euro's international role, the eurozone economy would need an institutional framework to provide greater and sustainable representation on the international stage. Looking to the not-too-distant past, let us recall the Constitutional Treaty of the EU. In France and the Netherlands, the negative response of the population who were called to the ballot box to express their will showed their rejection of the creation of a core of economically strong European states, which would have given the green light to the Eurogroup to be the single international voice negotiating the role of the euro externally.

At the same time, the dollar's supremacy is also due to post-Bretton Woods, as well as the size of the US economy, considered an important criterion in determining the choice of a reserve currency.

A number of factors continue to hamper the euro's growing role as the dominant reserve currency. The first is the lack of economic dynamism in the euro area relative to the US and the need, as seen during the recent crises, for adjustments and interventions in EU Member States. The second factor is the persistence of a major spread between the US and the euro area, and the third factor is the lack of progress in finalizing a fiscal and political union in the EU, leaving for euro the status of a stateless currency.

A formidable rival to the US dollar could rather become the Chinese currency, which is behind the world's strongest country by volume of international exports and which is fast approaching the US in terms of total GDP.

The 2018 speech of Juncker[1], President of the European Commission (EC) in 2014-2018, from the State of the Nation[2] series, highlighted for the first time the importance of the growing role of the euro internationally. It was his last speech in the series and was delivered ahead of the 2019 European Parliament elections, in a period of effervescence, with the future of the EU considered weakened due to Britain's imminent exit. In these circumstances, President Juncker's speech is all the more

[1] President Juncker's State of the Union Speech 2018, Strasbourg, 12 September, (https://state-of-the-union.ec.europa.eu/state-union-addresses-jean-claude-juncker_en)

[2] This type of speech, the State of the Nation, has been presented yearly every September since 2010.

important, as he presents his vision regarding the evolution of the EU until 2025, the EU strategy being focused on "*stimulating the openness, strength, and resilience of the EU's economic and financial system*". In his speech, Juncker presented a plan containing concrete measures to promote the euro in international payments. The objective was to use the euro as a means of payment for the purchase of energy resources and goods, but also to ensure the necessary liquidity for the EU capital markets in the form of securities denominated in euros. In addition, the European Commission should have been the support for the establishment of the single digital currency that would also create a solid support for the increase in the attractiveness of the euro (European Commission, 2021).

The echoes of Juncker's speech were felt in international currency markets, with increased demand for the euro for official foreign exchange reserves, but also through commercial transactions invoiced in euro, also being of interest for geopolitics and the global economy at the time.

II Opinions on the international role of the single European currency before its launch

The euro took over the international role of the German mark and the French franc before its launch on January 1, 1999. Many critics, particularly overseas, have analysed this role of the euro, with most of the debate focused on competition with the US dollar, even before its launch into circulation. The interest of international experts, particularly those from overseas, can be seen in the abundance of articles and statements from the preceding period. It was widely agreed that the introduction of the euro first and foremost produced the benefit of eliminating the exchange cost. A second important effect of the monetary integration was the reduction of uncertainty in the area of intra-European investment and trade, due to lower financial costs for European companies.

Barry Eichengreen[3], in the paper published in 1998, analysed from a historical perspective, but also by econometric calculations that the single European currency will become the rival of the dollar as a reserve currency, however, the process will be slow. Eichengreen's argument is that the choice of reserve currencies of central banks is directly related to their share of use in transactions, based on the network of externalities. The author argues that the dollar remains the preferred currency, being

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[3] The Euro as a Reserve Currency, Journal of the Japanese and International Economies, Volume 12, Issue 4, 1998, Pages 483-506, ISSN 0889-1583, https://doi.org/10.1006/jjie.1998.0411.; https://www.sciencedirect.com/science/article/pii/S0889158398904117

used the most in international transactions. Eichengreen states that to have a market with such great stability that it would be attractive to international investors, it would be necessary to have a continuous supply of liquidity, as well as to ensure the function of lender of last resort of the central bank. The fact that the Maastricht Treaty stipulates the separation of monetary policy and prudential regulation is, in the author's opinion, detrimental to the prospects of the euro as a reserve currency.

Another author of the period preceding the launch of the euro is Daniel Cohen[4]. His paper, appearing in the proceedings of a conference organized in Washington in March 1997, focuses on the future single currency in correlation with the Single Market. In Cohen's opinion, economic openness is defined by the share of substitutability of European goods with products from third countries. Being a less open economy leads to a more volatile exchange rate in the face of shocks from price determinants (Phillips Curve Shocks) rather than those affecting aggregate demand. Cohen in his work states that a single currency that replaces 6 or even 12 currencies will have significance on the currency markets, but he asks the question in which direction the euro will go, that is, how strong it will be, which is the real question that needs to be answered.

Also at the March 1997 conference in Washington, Xavier Larnaudie-Eiffel[5], referred to the statement by Camdessus, then IMF Director, who considered that the launch of the euro would be one of the greatest opportunities in the world, but the creation of EMU is seen in the perspective of the broader, ongoing process of European integration. Camdessus thus drew attention not so much to the political aspect of European integration, but rather to the fact that the complementarity brought by monetary integration with the Single Internal Market should not be neglected. It is not a coincidence that from a historical perspective, the Single Internal Market and the single currency are associated, drawing parallels with the situation in the USA. How would the US single market function if 14 different dollars were circulating in parallel?

At the same conference, W. Paul Jenkins, in the paper presented, referred, among other things, to the importance of the convergence criteria, the role the euro will play in increasing the credibility of the ECB, and the significance of the optimal currency area (OCA). Once the EMU is formed, the adjustment costs will depend,

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[4] How Will the Euro Behave?, Daniel Cohen în EMU and the International Monetary System, 1997, IMF, IMF I Editors, Paul R. Masson, Thomas H. Krueger,and Bart G. Turtelboom, ISBN 1-55775-664-3, proceedings of a conference held in Washington DC on March 17-18, 1997

[5] Roundtable on the Transition to EMU. în EMU and the International Monetary System, 1997, IMF, IMF I Editors, Paul R. Masson, Thomas H. Krueger, and Bart G. Turtelboom, ISBN 1-55775-664-3, proceedings of a conference held in Washington DC on March 17-18, 1997

among other things, on how the system itself will function. If several countries peg their exchange rate to the euro, the macroeconomic consequences for them are virtually identical to those they would have obtained in the case of joining the euro area, but they would not have the microeconomic benefits as a result of a common currency.

Agnes Benassy-Querre, in 1996, published a paper[6] on the euro from the perspective of its opportunities as an international currency. She refers to the internationalization function of a currency which generally starts with the payment function. Benassy- Querre gives the example of the coin of Alexander the Great which was widely used in Asia Minor in the 3rd century BC. The payment function (vehicle) was key to the process of internationalization.

In the 20th century, the Bretton Woods system based on fixed exchange rates against the dollar was associated with the Marshall Plan, which made the US the main trading partner of Europe. Capital flows had become, before the introduction of the single currency, 40 times larger than trade flows. This argues the importance of the payment function in international transactions, an important factor being the size of the market. The bigger the market, the lower the transaction costs and risks. Here the natural question arises: how does the size of a market influence the strength of a currency? In the author's opinion, 3 elements are crucial to ensure the payment function in international transactions, as follows:

- **Inertia**. A market with a large trading volume strengthens its position through transactions adding to existing ones that already have a cost advantage (through the exchange rate).
- **Store of value**. The international currency becomes, as a result of its use in international transactions, increasingly attractive for the formation of foreign exchange reserves.
- **Unit of account**. It reduces the risk of the volatile exchange rate and leads to increased demand for official reserves and interventions that contribute to market consolidation. By reducing the currency risk, the storage function, i.e., of the currency reserves, is strengthened.

It is difficult to assess the hierarchy of the functions of the international currency, as each function has some influence on the others, and there is a direct link between them. Previous studies on the international use of currencies have emphasized the hysteresis of the process of internationalization.

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[6] Agnès Bénassy-Quéré, 1996. "Potentialities and Opportunities of the Euro as an International Currency," Working Papers 1996-09, CEPII research center. https://ideas.repec.org/p/cii/cepidt/1996-09.html

Another aspect analysed by the author is the importance of the weight of the use of a currency in international transactions. In 1995, the dollar was used in 83% of all international foreign exchange transactions, while the German mark was used in only 37%, and the yen in 24%. The decline in the use of the dollar in international invoicing is visible, from 56% of the world total (1980) to 48% (1992), mainly as a result of the reduction in its use by OPEC member states. Moreover, the decline in the use of the dollar in international payments is also due to the fact that developed industrial countries have gradually increased invoicing imports in their national currency, in line with the increase in their exports in total world exports. Japan invoiced its exports in the national currency in an increasing proportion, from 29% in 1980 to 40% in 1992. The dollar, however, remained the only currency used as an invoicing currency in such a large proportion for commercial transactions other than the issuing country. In addition, the dollar is predominantly used for quotations for raw materials and energy, at the international commodity exchanges.

Looking back to the period before the single European currency, it is observed that the German mark was preferred as a means of payment in intra-community transactions (https://www.ecb.europa.eu/ecb), being the currency of the strongest economy in the EU, namely Germany. The table below illustrates this.

Table 1. Structure of the use of major currencies in world trade transactions in 1980, 1987, and 1992 (% of total)

	The main exporting countries			**Total world exports**		
	1980	1987	1992	1980	1987	1992
US dollar	55	46	47	56	48	48
German mark, Dutch guilder	16	19	17	16	19	18
Yen	4	7	8	2	4	5
French franc, Italian lira	15	15	15	15	15	15
Other	10	13	13	11	14	14

Source: Eurostat database, www.eurostat.com

In the years after the eighth decade of the twentieth century, we observe an abundance of specialized literature on the *external debt of states*. For economically less developed countries, borrowing is not done in their currency and therefore the risk of indebtedness is higher as a result of the uncertainty of exchange rate movements between the national currency and the currency used for borrowing. The authors[7] pointed out that unfortunately, there are cases where the economic activity of the debtor country may be disrupted, especially if the borrowing country does not have sufficient funds in the loan currency. The repayment of the debt of these countries, expressed in value terms, is dependent on exchange rate fluctuations, and it is not convenient to exchange when the exchange rate of the currency in which the loan was obtained rises against its currency.

The Bank for International Settlements (BIS) compared, over the period 1983-1988, the evolution of the debt of developing countries in parallel with that of the highly indebtedindustrialized countries. It shows that in Asian and Middle Eastern countries, the share of loans in dollars decreased by 15% (at 1988 exchange rates). Over the same period, the dollar exchange rate remained relatively stable in Africa, but from a low base (share of 40% in 1983). This development mainly benefited the yen in Latin America and Asia, where the share of yen-denominated loans rose from 15% in 1983 to 28% in 1988. The share of yen use was even higher if the BIS analysis included banking activity in Hong Kong and Singapore.

For a more complete picture, it is reproduced below the share of currencies in the structure of bank assets in 4 regions: Latin America, Asia, the Middle East, and Africa, in 1988 compared with 1983 (at the end of the period).

Table 2. Use of major currencies in the banking portfolio in 1983 and 1988 (% of total volume)

	US dollar		German mark		Yen		Pound sterling		French franc		Swiss franc	
	1983	1988	1983	1988	1983	1988	1983	1988	1983	1988	1983	1988
Latin America	86.9	75.5	3.9	5.3	2.4	6.8	1.4	2.3	2.2	2.7	1.4	1.8
Asia	67.2	52.1	4.2	5.1	14.5	27.7	2.7	3.5	4.8	5.5	2.9	2.1
Middle East, excluding OPEC countries	65.5	50.8	11.7	10.0	3.5	1.5	3.5	7.7	9.0	16.2	4.1	5.4
Africa	41.6	42.7	3.4	3.9	2.9	3.9	5.3	6.8	35.8	29.6	3.9	5.8

Sursa: BIS, www.bis.org

[7] Eichengreen, Hausmann, Panizza, 2005, 2007; Hausmann and Panizza, 2003; Kourtellos, Stegnos, and Tan, 2013; Panizza and Presbitero, 2014; Ranciere, Tornell, and Vamakidis, 2010; Reinhart and Rogoff, 2010, 2011.

Official statistics do not provide us with sufficient data for a comprehensive analysis of the structure of private portfolios, lacking data reflecting foreign asset holdings held by institutions other than commercial banks. Thus, the picture of the portfolio structure is not complete. But in the period before the euro, the share of dollar-denominated assets at the international level gradually declined from 62.3% in 1985 to 32.8% in 1995. In contrast, the share of yen-denominated assets increased from 17.7% in 1958 to 26.6% in 1995. The share of securities denominated in Swiss francs declined significantly, from 32.5% in 1985 to 1.7% in 1995, as a result of the future single currency.

The share of the dollar in *cross-border banks' portfolios* also fell from 75% in 1977 to 65.6% in 1985 and 47.9% in 1995. European currencies benefited most from this decline, with their share rising from 15.6% in 1977 to 18.7% in 1985 and 29.6% in 1995. During this period the yen's share remained low, standing at only 6.1% in 1995, compared with the expansion of activity in Japanese banks. This is explained by the fact that the yen is less widely used in lending by banks operating outside Japan, so deposits held by foreign investors in Japan are low.

Table 3. Structure of foreign currency portfolios held by commercial banks of the strong industrialized countries, 1977-1995 (% of total, end of year)

	US dollar	Yen	Pound sterling	**Other currencies of the SME***	Swiss franc	Other
1977	75.0	0.3	1.1	**15.6**	4.7	3.4
1978	72.9	0.8	1.2	**17.1**	4.3	3.7
1979	74.0	0.6	1.2	**14.7**	4.0	5.5
1980	75.3	0.9	1.2	**13.0**	4.6	5.0
1981	72.1	1.7	1.5	**14.9**	6.6	3.2
1982	72.4	1.6	1.3	**14.7**	6.1	3.9
1983	74.0	1.7	1.2	**14.6**	5.7	2.7
1984	73.5	2.1	1.4	**15.0**	4.9	3.1
1985	65.6	4.0	1.9	**18.7**	6.4	3.5
1986	63.0	5.1	1.9	**19.0**	6.7	4.3
1987	58.4	7.0	2.2	**19.5**	6.6	5.3
1988	59.0	7.1	3.1	**19.8**	5.1	5.8
1989	57.5	6.7	3.6	**22.1**	4.2	5.9
1991	51.6	5.9	3.8	**26.4**	4.4	7.9

	US dollar	Yen	Pound sterling	**Other currencies of the SME***	Swiss franc	Other
1992	53.3	4.5	3.4	**27.5**	4.1	7.3
1993	53.3	4.4	3.0	**27.9**	3.2	7.7
1994	51.2	5.2	3.2	**28.4**	3.3	8.8
1995	47.9	6.1	3.2	**29.6**	3.6	9.7

Source: BIS, Monthly Report, Table 4A *Note: SME=Western European Monetary System; were included here the French Franc, the Dutch Guilder, the Belgian Franc, the Italian Lira, and the ECU

The analysis of the structure of private foreign currency portfolios at the global level has also been studied in the literature by Emerson (1991) and the experts at the ECU Institute (1995). According to these studies, the share of the dollar in the global portfolio is estimated to have fallen significantly from 67.3% in 1981 to 44.3% in 1993. By contrast, over the same period, the share of EU currencies increased from 13.2% to 35.6%, and the share of the yen from 2.2% to 8%, respectively.

Official reports from the Bank for International Settlements (BIS) show that between 1976 and 1995, the share of the dollar in the official reserves of highly industrialized countries fell **from 93.3% to 63.6%**. This decline benefited the currencies of some developed EU countries, in particular the **German mark, whose share rose from 7.6% in 1976 to 20.3% in 1993**. This development can be explained by the increase in the share of European currencies in the official reserves of the highly industrialized countries that joined the Western European Monetary System. Official data show an increase from 52% in 1978 to 62% in 1979. In the years leading up to the launch of the euro, some Asian countries began to diversify their official reserves (Touzard, 1995 and Roche, 1995). In the case of Indonesia, for example, we see in the official reserves structure an increase in the share of the yen from 27% to 35% and a concomitant decrease in the share of the dollar from 52% to 49%. China has also announced its intention to change the structure of foreign exchange reserves, aiming to hold relatively equal shares of the dollar, the mark, and the yen. In 1994, the dollar's share was only 77% compared with a 90% share only a year earlier.

We see, therefore, that the internationalization of European currencies, mainly the German Mark, until the emergence of the euro and, to a lesser extent the yen, was a more pronounced process in terms of the reserve function. This is in line with the rapid development of capital flows and the increased diversification of portfolios made possible by the removal of restrictions in the 80s. Although the financial markets took good account of the fact that, in addition to the dollar, the German Mark and the yen were the world's other two trading powers at the time, data published by the BIS show that the internationalization of both currencies was nevertheless limited. These analysts are of the opinion that this situation was not the sole consequence of the dollar's declining international role more than two decades after the fall of the Bretton Woods system. The international role of the German Mark and the yen has delayed the decision by monetary authorities in Third World countries to link the exchange rates of their national currencies to other strong currencies. Here another aspect of a currency with international status comes into play, that of anchoring currency stability.

Table 4. Exchange rate regimes of IMF member countries surveyed in 1978, 1983, 1988, and 1994

Exchange rate regimes (number of countries that have pegged their currency to another currency)	1978	1983	1988	1994	Share of world GNP (1994 level)
Against the USD	43	34	39	25	1.53
Against the French franc	14	13	14	14	0.19
Against the Pound sterling	4	1	0	0	0
Against the Russian ruble[8]	-	-	-	1	0.01

Source: BIS database, www.bis.org

III Euro in international trade transactions

We note in the literature that there are authors who have focused on analysing the evolution of the use of various currencies in international trade transactions and the factors that have determined their market position. Analysing 55 countries, Katarzyna Twarowska-Mól[9] observes the changes in the positions of the major economic powers as the main effect of the economic advance of developing countries, showing that despite the decline in the share of the US economy and trade worldwide, the dollar remains the most widely used currency, still occupying first place in international trade transactions. The author argues that the main factors influencing the use of the dollar and its weight in the international monetary system are: the

[8] Tajikistan

[9] Twarowska-Mól, K. (2023). Factors influencing the choice of the invoicing currency in international trade: Panel data analysis for 55 countries. *Equilibrium. Quarterly Journal of Economics and Economic Policy*, *18*(1), 153-183. https://doi.org/10.24136/eq.2023.005

evolution of world trade with the USA, inflation in developing countries, and exchange rates against other representative currencies of the advanced economies. Of major importance is the trading power of a country, for example, China, which has been the world's leading exporter since 2008. The yuan has thus gradually strengthened its international position through substantial exports, both in absolute volume and in relative terms as a share of the world total.

Another paper[10] published in the Journal of International Economics in 2022 looks at the share of the use of major currencies in international trade transactions, with an extensive database of 115 countries accounting for about 75% of world trade since 1990. The conclusion from this study is the same: the dollar, although declining in share, retains its role as the dominant currency. In addition, the authors highlight, on the basis of the data available, the increasing use of the euro as the dominant currency in most of Africa. This paper, which is based on a much larger number of countries than previous papers, [11] also has the advantage of using data from countries at different levels of economic development, which contributes to the greater accuracy of the results. The data show notable changes in the use of invoicing currencies for several countries. In particular, we find that in the EU accession countries, EU candidate countries, and other European countries the use of the euro as a billing currency has gradually increased at the expense of the dollar, as previously emphasized by other authors[12]. These findings are consistent with most of the work that has appeared on the currencies used in invoicing trade transactions, including discrete events such as the establishment of monetary unions and large-scale institutional integration (see Devereux and Shi, 2013; Gopinath and Stein, 2020). Moreover, statistical evidence indicates that invoicing in dollars and euros has increased in value volume over time despite the declining share of the US and EU states in global trade. Second, while the dollar dominates in most emerging markets and developing economies outside Europe, we find that the euro is predominantly used in parts of Africa.

Looking back over the 25 years since the euro became a reality, we see that over the past 15 years, international financial markets have been influenced by crises that

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[10] Emine Boz, Camila Casas, Georgios Georgiadis, Gita Gopinath, Helena Le Mezo, Arnaud Mehl, Tra Nguyen, Patterns of invoicing currency in global trade: New evidence, Journal of International Economics,Volume 136, 2022,103604, ISSN 0022-1996, https://doi.org/10.1016/j.jin-teco.2022.103604. (https://www.sciencedirect.com/science/article/pii/S0022199622000368)

[11] A. Kamps, The Euro as Invoicing Currency in International Trade ECB Working Paper (2006), No. 665, L. Goldberg, C. Tille Vehicle-currency Use in International Trade J. Int. Econ., 76 (2) (2008), pp. 177-192.

[12] Kamps (2006), Goldberg and Tille (2008) and Ito and Chinn (2014).

have prompted the search for a new equilibrium. Both the international financial crisis and the sovereign debt crisis in the EU, as well as the pandemic and crisis caused by the military conflict in Ukraine, have highlighted the need to increase the EU's economic strength and energy independence, which can only be achieved through an appropriate set of EU policy measures and a higher degree of European integration.

An uncompetitive economy that switches to the single currency will find it difficult to cope with the external environment, both in the European single market and internationally, primarily because the capitalization of listed companies, the volume of credit, exports and imports denominated in the single currency are visibly lower than in the US.

An important peculiarity of the EU is the strong concentration of intra-EU trade. An analysis of trade in goods inside and outside the EU shows that for 15 of the 27 Member States, Germany is the largest trading partner. A closer look at the concentration of intra-EU trade shows that the EU Member States that are exceptions are located on the periphery of the EU, namely the Baltic States, Sweden, Ireland, Spain, Portugal, Greece, and Cyprus. In terms of imports, the US is the main trading partner for goods traded by Germany and Ireland, while for the rest of the EU, the main partners remain the neighbouring countries. Germany is among the top four trading partners of every EU country except Ireland, Cyprus, and Malta.

From 2022 onwards, the first place in total EU trade in goods (Imports and Exports) is taken over by China. Analysis by country reveals that in terms of extra-EU trade in goods, China is the most important trading partner for 9 out of 27 countries, while for 10 EU countries, it occupies one of the top 4 positions.

The years of international financial crisis from 2008-2010, but also pandemics, military tensions, the slow pace of international demand for goods and services, Brexit, and the commodities crisis have contributed to the development of a less confident international environment, a sentiment reflected in the policies of central banks, which have decided to increase foreign exchange reserves to record levels in search of payment security.

This increase can be seen by comparing the central banks' foreign exchange reserves in the pre-international financial crisis years (2005-2006), which totalled 4,250 billion dollars, with the level of over 12,300 billion dollars at the end of 2023 (https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4), which is a record increase of almost 3 times in the last 17 years.

Looking at the structure, the share of world currencies in the official reserves of countries has gradually changed, reflecting the economic position of the issuing countries.

Table 5. Share of currencies in total official foreign exchange reserves, 1965-2023 (%)

Year	US dollar	Pound sterling	Euro	Yen
1965	56.1	20	-	-
1973	64.5	4.2	-	0.1
1977	76.2	1.5	-	1.2
1982	57.9	1.8	-	4.1
1987	55.7	2.1	-	6.9
1988	55.1	2.5	-	7
1989	51.8	2.5	-	7.3
1990	50.1	3.1	-	8.1
1991	50.6	3.4	-	8.7
1992	54.7	3.2	-	7.7
1993	56.1	3.1	-	7.7
1994	53.1	2.8	-	7.8
1995	53.4	2.8	-	6.7
1996	56.8	3	-	6
1997	59.1	3.3	-	5.1
1998	62.6	3.5	-	5.4
1999	64.9	3.6	13.5	5.4
2000	66.6	3.8	16.3	6.2
2001	66.9	4	16.7	5.5
2002	63.5	4.4	19.3	5.2
2003	63.8	4.4	19.7	4.8
2004	65.51	3.49	24.68	4.28
2005	66.51	3.75	23.89	3.96
2006	65.04	4.52	24.99	3.46
2007	63.87	4.82	26.14	3.18
2008	63.77	4.22	26.21	3.47
2009	62.15	4.25	27.70	2.90
2010	62.24	3.94	25.76	3.66
2011	62.69	3.84	24.44	3.61
2012	61.50	4.04	24.06	4.09

Year	US dollar	Pound sterling	Euro	Yen
2013	61.27	3.99	24.21	3.82
2014	65.17	3.70	21.21	3.55
2015	65.74	4.72	19.15	3.75
2016	65.36	4.34	19.14	3.96
2017	62.72	4.53	20.16	4.90
2018	61.94	4.49	20.48	4.98
2019	60.75	4.64	20.59	5.87
2020	58.92	4.64	21.29	6.03
2021	58.8	4.81	20.59	5.38
2022	58.52	4.92	20.4	5.51
2023	58.41	4.62	19.98	6.72

Source: Table by the author, based on Eurostat data, IMF data, collected by the author. IMF Annual report of the respective years; M. Chinn. J. Frankel: "Will the Euro Surpass the Dollar as Leading International Reserve Currency". June 2005; B. Eichengreen. D. Mathieson: "The Currency Composition of Foreign Exchange Reserves: Retrospect and Prospect". IMF Working Paper No. 00/131. 2000. For 2004-2018 the data source is IMF: Currency Composition of Official Foreign Exchange Reserves (COFER). International Financial Statistics (IFS); for 2019-2022, the data source is Statista, accessed at https://www.statista.com/statistics/233674/distribution-of-global-currency-reserves/

There has been a change in the share of major currencies, with the US dollar reaching 58.41% at the end of the period under review, its lowest share since 1997. As for the euro, since its introduction on January 1, 1999, it continues to rank second after the dollar in official reserves. There was an annual increase of almost 5 percentage points in 2004 (see Table 5) as a result of the EU's enlargement to include 10 new countries, most of them from Central and Eastern Europe (the "big bang"). But the highest share of the euro in official international reserves was reached in 2009 (27.7% of the total), when the international financial crisis was also manifesting itself in most EU countries. At that time, an agreement was signed between representatives of the countries of the region and representatives of Western banks, which was aimed at preventing a domino effect of the bank failures that started in the U.S. The agreement is known as the "Vienna Initiative" and as a result, the parent banks decided to stop withdrawing their capital from the Central and Eastern European region in order to prevent a major crisis through "capital flight".

After the outbreak of the global financial crisis, officials in Brussels set up the European Financial Rescue Fund (EFSF), the forerunner of the European Financial

Stability Mechanism. The move boosted confidence that the eurozone would be able to cope with the sovereign debt crisis, especially for Greece, which had to ask for external help. European leaders managed to find solutions on bank recapitalization to resist the danger of contagion from the euro area and to increase the role of the EFSF to recapitalize banks and buy bonds on European markets. At the time, G-20 finance ministers called on the European Union at their meeting in Paris on 14-15 October 2011 to come up with a plan to recapitalize banks and to increase the EFSF's lending capacity.

Total foreign exchange reserves have increased eightfold in the last 25 years, the highest since the launch of the single European currency. **The top 10 countries by volume of foreign exchange reserves hold a combined 70% of the world's international foreign exchange reserves**, with China and Japan together holding some $4,722 billion, accounting for about a third of the world total on January 31, 2024. (https://www.google.com/search?client=firefox-b-d&q=the+volume+of+of+official+foreign+currencies+by+top+ten+countries).

One has to note that among the top 10 countries with the largest foreign exchange reserves, 7 are in Asia.

In recent years, as a reflection of economic weight in terms of GDP and export value, there has been a remarkable increase in the use of the currencies of the fast-growing emerging countries of South-East Asia, mainly China. The official reserves of emerging and developing countries, which account for almost two-thirds of the world's total official reserves, were analysed in the paper "The recent growth of international reserves in developing economies: A monetary perspective" by Goncalo Pina (https://www.sciencedirect.com/science/ article/abs/pii/ S026156061500149). This paper shows that the growth of reserves in these countries has been much faster than that of developed countries (https://www.sciencedirect.com/journal/journal-of-international-money-and-finance).

Since the late 1980s, there has been an increasing level of these reserves because of the need to provide liquidity to the banking sector in times of economic crisis. The correlation between the size of the financial sector and foreign exchange reserves has been observed. Developed economies are less dependent on this type of reserves because governments can issue securities (government debt) to borrow when needed in times of financial crisis, and the yields are convenient for this type of borrowing. In addition, it should not be overlooked that one effect of the development of bilateral trade relations between the US and the countries of Southeast Asia, mostly emerging economies with higher GDP growth, led by China, is the increase in trade volumes, but also in the chronic trade deficits of the US. This has led them to accumulate significant US dollar foreign exchange reserves over time. The question that arises is: why are the currencies of these Asian countries not appreciating in these circumstances? The appreciation of such currencies is not convenient for maintaining price competitiveness because the reaction of the markets would lead to reduced demand for traded products that would sell at higher prices on the US market. And then these countries, traditionally dependent on exports, would be left with excess production that could not be absorbed by domestic markets.

An important phenomenon that has had an impact on international demand for the euro is the increase in the yield on purchases of securities denominated in the single European currency, although the level has remained below that of most developed countries.

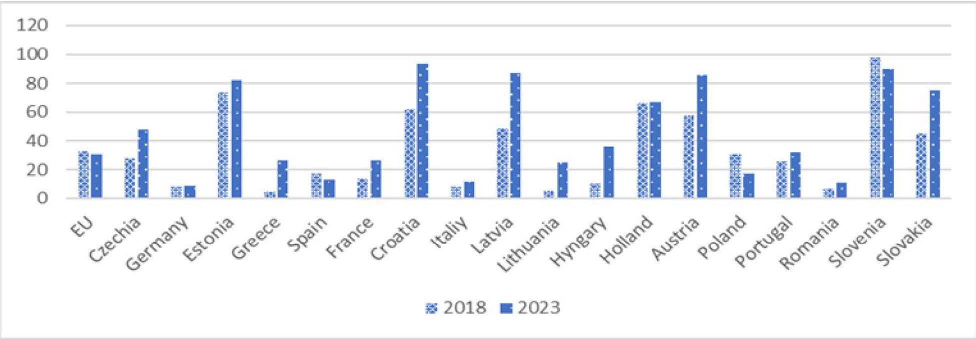
The large spread between 5-year yields and monthly deposit interest rates in the EU compared to the UK, Canada, Australia and the US is noticeable. This interest differential determines the level of confidence of international investors who prefer to buy securities that offer them the strongest returns.

IV Use of the euro as payment/invoicing currency in extra-EU trade

The study of total extra-EU trade shows a predominance of the use of the euro against the dollar for exports (52% compared to only 32% in 2023). For imports, the situation is somewhat reversed, with the dollar being used by 50%, with payments in euro accounting for 41% of the total (https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Extra-EU_trade_by_ invoicing_ currency).

According to the statistics published by the EU, in 2023, the 4 main importers of goods account for 2/3 of the total extra-EU volume, as follows: Germany (26.6%), the Netherlands (18.3%), Italy and France (11.2% each).

Figure 2. Share of euro use in invoicing of extra-EU imports in selected Member States, comparative situation in 2018 and 2023 (%)

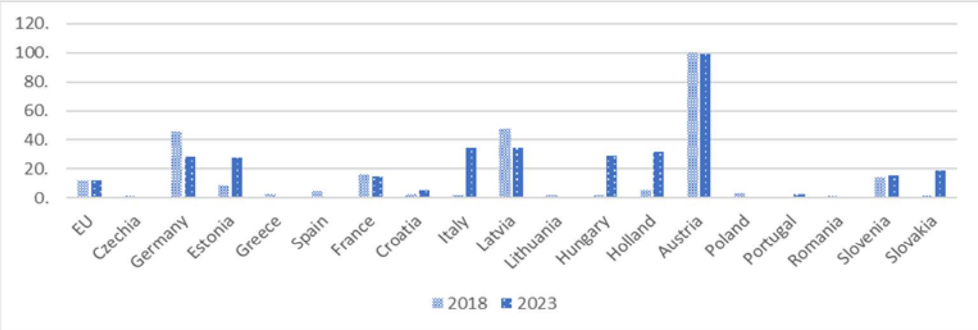


Source: Figure by the author, based on Eurostat data,
https://ec.europa.eu/eurostat/databrowser/view/ext_lt_invcur/default/table?lang=en

Figure 2 shows that in some EU countries, such as Germany, Croatia, Austria, Slovenia, Slovakia, Latvia, Italy, Estonia, Latvia and Slovenia, the share of euro in payments for imported products exceeds the EU-27 average (41%). Romania is close to the EU-27 average, with a share of 41.4% in 2023.

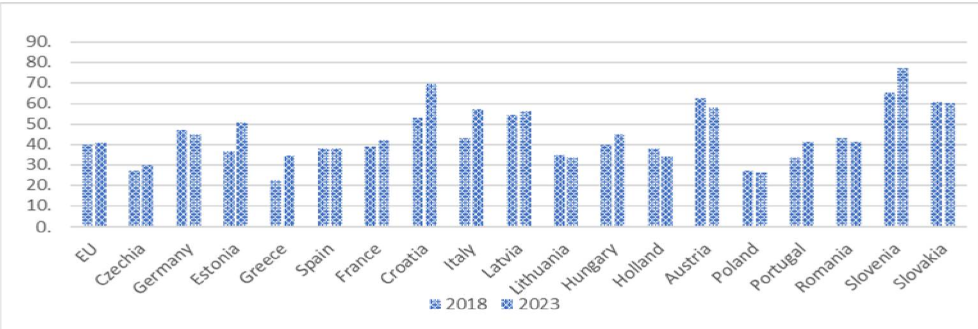
The analysis of imports of crude oil and derived products shows a low share of the use of the euro in payments for extra-EU imports over the period analyzed. Figure 3 shows precisely this low share, with the exception of Austria, which purchases more than 99% of these products in euros. In the case of Romania, the share of invoicing in euro for this category of extra-EU imports remains low (1.6% in 2019 and 1.1% in 2023).

Figure 3. Share of Euro use in invoicing of extra-EU imports of crude oil and derived products, in the EU and some Member States, in 2018 and 2023 (%)



Source: Figure by the author, based on Eurostat data, https://ec.europa.eu/eurostat/databrowser/view/ ext_lt_invcur/default/table?lang=en

Figure 4. Share of use of the euro in invoicing of extra-EU imports of industrially processed products, EU-27 total and selected Member States, 2018 and 2023 (%)



Source: Figure by the author, based on Eurostat data, https://ec.europa.eu/eurostat/databrowser/view/ext_lt_invcur/default/table?lang=en

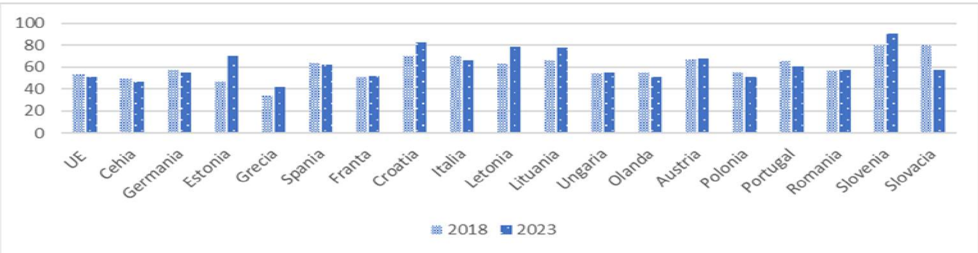
In terms of invoicing of imports of manufactured goods, there is a slight decline in the share of the euro in total currencies used at the EU-27 level, from 43.7% in 2018 to 41% in 2023, with this downward trend mainly due to the UK's exit from the EU in 2020.

Figure 4 shows that Slovenia has the highest share of imports invoiced in euro with more than 80%, followed by Croatia with 70% and Slovakia with 70%. With 66.2%, Romania is among the countries with a share of more than 50% of imports of industrially processed products invoiced in the single European currency, almost 10 p.p. above the EU-27 average.

The share of extra-EU exports invoiced in euros was higher than that of imports over the period under analysis. Eurostat data show that the same countries as in the case of imports rank among the most important European exporters, together accounting for 70% of the extra-EU total, as follows: Germany (34.1%), Italy (12.6%), the Netherlands (12.3%) and France (10.9%).

The evolution of payments of extra-EU exports in European currency decreased slightly from 53.3% in 2018 to 51% in 2023. Within the EU, Slovenia ranks first with 90.4%, followed by Croatia with 82.3% and Latvia with 78.8% in 2023, all the three countries being members of the euro area.

Figure 5. Share of euro use in invoicing of extra-EU imports in selected Member States, comparative situation in 2018 and 2023 (%).



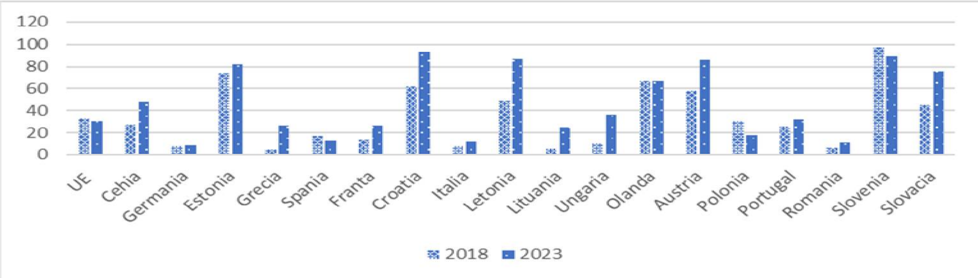
Source: Figure by the author, based on Eurostat data, https://ec.europa.eu/eurostat/databrowser/view/ext_lt_invcur/default/table?lang=en

As reflected in Figure 5, Romania uses the euro in invoicing extra-EU exports in a proportion of almost 60%, although it has not joined the euro area.

In contrast, the share of the use of the single European currency in the invoicing of extra-EU exports of crude oil and derived products is low, only 30.5% in 2023, as the international market for these resources was still dominated by the US dollar.

The high degree of euroization of Slovenia, Croatia, and Latvia is also observed here, with more than 80% of the total in 2023. A high share of euro use can also be observed for Austria, with 86% of the total in 2023 compared to only 58.1% in 2018. Romania has low shares of euro payments, only 6.5% in 2018 and 11.3% in 2023.

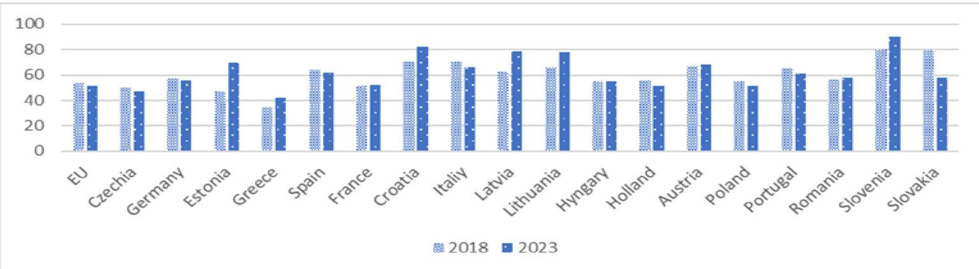
Figure 6. Share of euro use in invoicing of extra-EU crude oil and derived products exports, EU total and some Member States, 2018 and 2023 (%)



Source: Figure by the author, based on Eurostat data,
https://ec.europa.eu/eurostat/databrowser/view/ext_lt_invcur/default/table?lang=en

For industrially processed products, the share of extra-EU exports by member country, invoiced in euro, is close to that of the total volume of exports, reflecting the fact that this category of products has the highest share in the total value volume. The analysis by EU country shows that *Romania, with almost 91% of total invoicing in the single currency*, is in first place.

Figure 7. Share of euro use in invoicing of extra-EU exports of industrially-processed products, EU total and some Member States, 2018 and 2023 (%)



Source: Figure by the author, based on Eurostat data,
https://ec.europa.eu/eurostat/databrowser/view/ext_lt_invcur/default/table?lang=en

In the category of industrially processed products, it can be seen from the Eurostat data that the largest share is taken by the group of machinery and vehicles which dominates both imports and exports (2123 billion Euro in 2023 in total). Exports of such products account for 40% of the total value of extra-EU exports in 2023. Similarly, the value of this group has a share of 35% of total extra-EU imports. In absolute terms, the value of both imports of machinery and vehicles increased in 2023, increasing the trade surplus of the group from billion 114 to 172 Euro.

V Using the euro as an international currency anchor

Domestically, in the US economy, companies finance about 2/3 of their needs through bond issues and equity rather than through bank loans, as is the case in the EU, where bond financing amounts to only 1/3 of needs.

According to the publication "The International Role of the Euro", (https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202406~0b56ba4f71.en.pdf), escalating geopolitical tensions will cause major changes in the composition of international foreign exchange reserves over the next 10 years. This assertion is based on a survey prepared by HSBC[13] analysts and completed by 91 banks holding approximately 65% of global foreign exchange reserves as of April 2024. A full 80% of respondents believed geopolitics is one of the top 3 factors that will affect foreign exchange reserve management over the next decade. This survey result is important because, in 2021, only 20% of respondents gave this answer. Another new finding from the HSBC survey is that 40% of the world's central banks plan to increase their reserves of the renminbi, the Chinese currency, by more than other currencies over the next 10 years, explained by "reserve diversification" and "China's growing role in the global economy".

The unforeseen events since the introduction of the euro have also tested the ECB as it has adopted measures aimed at maintaining the inflation target. Since the outbreak of the global financial crisis in 2008, the ECB has modified its operational framework and applied a number of unconventional monetary policy instruments, all to avoid a collapse of the monetary system and to restore confidence. The 2008 crisis was a wake-up call, investors lost confidence and this was reflected in the losses on stock exchanges around the world. After decades in which risk-taking had become a fact of life because it was often accompanied by significant profits, the losses have eroded confidence on a large scale, with markets becoming increasingly sensitive to financial risks.

[13] HSBC is the acronym that comes from the name of its founding member, the Hong Kong and Shanghai Banking Corporation. Today, HSBC is a London-based banking group specializing in financial services and universal banking. It is the largest European bank with assets totalling $919 trillion (as of December 2023).

Optimistic expectations of a soft landing for the global economy underpinned the assessments of risk assets set out in the IMF's April 2023 Global Financial Stability Report (International Monetary Fund. 2023. Global Financial Stability Report: Financial and Climate Policies for a High-Interest-Rate Era. Washington, DC, April).

Overall, risks to global growth continue to diminish, similar to the IMF's April 2024 assessment. Revisions to the monetary policy outlook in the wake of rising inflationary pressures could lead to a possible repricing of assets. Acute stress in the international banking system eased in 2023, with only a small percentage of vulnerable banks remaining in some countries. In addition, in the event of a sudden tightening of financial conditions, tighter monetary policies could be implemented, which would be a further test of the resilience of the global financial system. In such a scenario, a number of economic sectors could be hit by the downturn, creating worrying fault lines in the economy.

Financial institutions are facing higher funding costs and a deterioration in asset quality, which could lead to both increasing losses and reduced credit for macroeconomic needs (mainly loans). Central banks in advanced economies have decided to gradually cut interest rates in 2024 in line with inflation. Investors are optimistic that central banks in developed economies are projecting a soft landing, which would be an important support to sustain economic growth.

For 2024, aggregate demand is expected to gradually pick up, labor market constraints to ease and price pressures to ease.

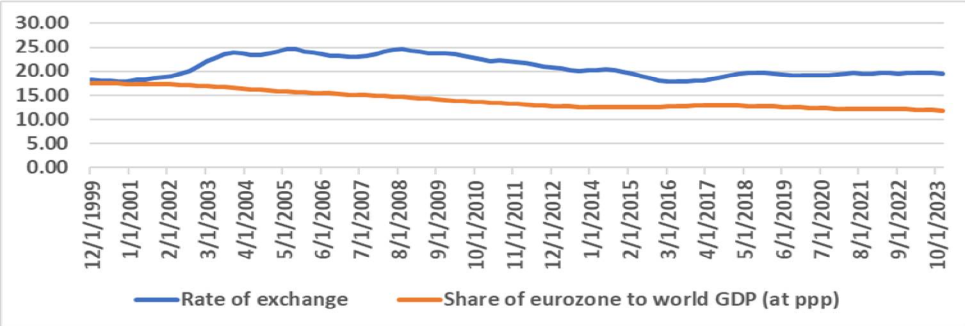
Empirical research shows that during periods when the dollar appreciates, official reserve managers sell part of their dollar-denominated securities in exchange for other major currencies, mainly the euro, but also pound sterling, Swiss francs, yen, and other currencies, to stabilize the composition of their portfolios. Changes in interest rates and inflation rates, and in particular the spread between them, are constantly analyzed by the managers of the official portfolios so that the structure of the official reserves provides as much certainty as possible.

By mid-2023, interest rates on short-term deposits in the euro area had risen by 330 basis points on short-term deposits and by 150 basis points on long-term deposits. The increase in euro area interest rates has not increased demand for the euro as a reserve currency as would be expected. This is explained by a substantial spread of 200 basis points compared to the US and of around 100 basis points compared to interest rates on deposits in major currencies other than the Japanese yen. This spread explains the falling demand for euro-denominated government securities.

Next, we turn to the composite index of the international role of the euro. The persistence of a wide spread between the yields of various securities and interest rates in the euro area and the US influences the structure of the official reserves of the governments.

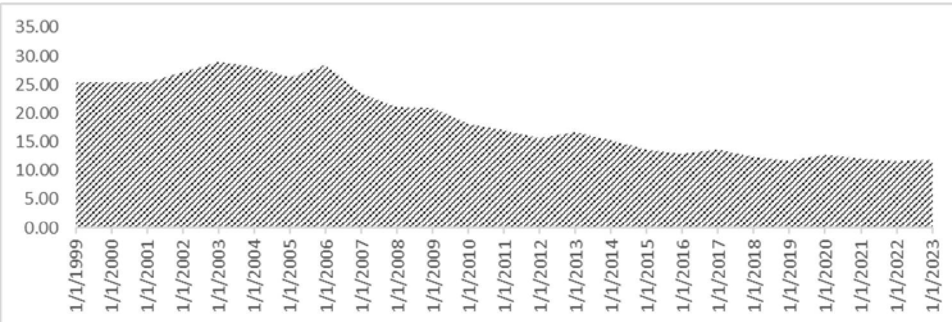
Factors that have also influenced the structure of foreign exchange reserves include the rise in the importance of emerging economies in the foreign currency securities market since the global financial crisis. This increase in the role of emerging countries partly explains the decline in the share of euro-denominated securities in the international market. Another factor negatively influencing the international role of the euro is given by geopolitical tensions, the impact of Brexit, and statements by some European political leaders on their countries' exit from the EU.

Figure 8. The Composite index14 of the international role of the euro and the euro area share in global GDP over the period 1999-2023



Sources: BIS, IMF, ECB databases, calculations Ilzetski, Reinhart and Rogoff (2019), CLS Bank
Note: The composite index is computed as the simple arithmetic average of the share of the euro at current exchange rates in international bond stocks, cross-border borrowing, cross-border deposits, global foreign exchange reserves, and foreign exchange payer arrangements.

Figure 9. Share of demand for government bonds to cover euro area debt, 1999-2023 (% of total)



Sources: BIS, IMF, ECB databases, calculations Ilzetski, Reinhart and Rogoff (2019), CLS Bank

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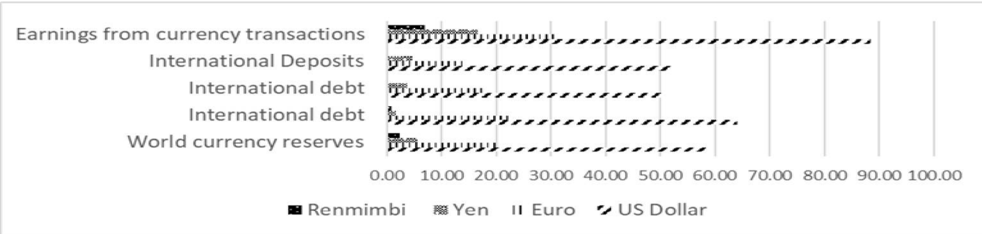
14 Ilzetzki, E., Reinhart, C.M. and Rogoff, K.S., "Exchange Rate Arrangements Entering the 21st Century: Which Anchor Will Hold?", NBER Working Paper No 23134, February 2017

Another factor influencing the international role of the euro has been the deleveraging of euro-area banks to restore equity capital, with the stock of cross-border lending in euro well below the peak reached before the 2008 international crisis.

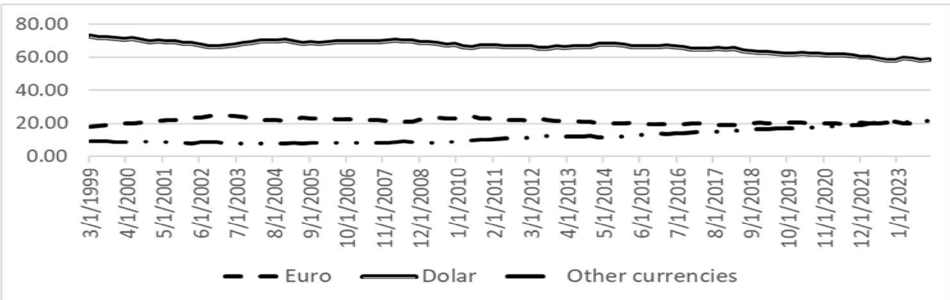
The value of the euro composite index remained low in 2023, close to the lowest level over the entire period analyzed (1999-2023), but the euro still retained its second place after the dollar. (The international role of euro, 2023).

Figure 10. International role of the euro compared to other dominant currencies in 2023 (%)



Sources: BIS, IMF, ECB databases, calculations Ilzetski, Reinhart and Rogoff (2019), CLS Bank

Figure 11. Evolution of the share of the single European currency, the US dollar and other currencies in global official reserves, 1999-2023 (%, constant exchange rates, fourth quarter)



Source: Figure elaborated by the author, based on ECB data, https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202406~0b56ba4f71.en.pdf

In absolute terms, the official reserves are estimated to have amounted to around €12.3 trillion at the end of 2023, up slightly from the previous year. (https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202406~0b56ba4f71.en.pdf).

Calculations by ECB experts, however, show that global foreign exchange reserve managers sold about 100 billion euros in 2023, buying instead assets denominated in US dollars, Japanese yen, Australian dollars, and Canadian dollars.

In addition, the explanation for the persistence of the significant gap between official reserves held in euro compared to those held in dollars also lies in the lower attractiveness of the premiums, due to the lack of supply of profitable assets and the centralized issuance of debt, which discourages investment in euro-denominated assets.

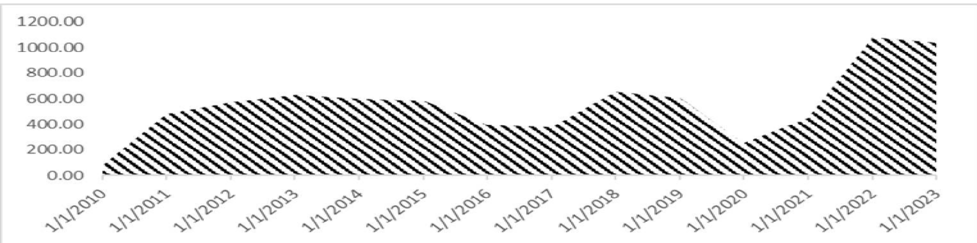
In relative terms, euro-denominated securities grew by 2.41 times, 2.17 times more than US dollar-denominated securities, but less than other currencies, which grew by 2.66 times over the period. As can be seen in the figure below, US dollar-denominated securities continue to dominate the world total by a wide margin.

In absolute terms, the evolution of the total value of bonds denominated in the main currencies, dollars, euro, and other currencies, shows how dollar-denominated securities have started to gradually decrease in value volume, while securities denominated in other currencies are on an upward trend since 2021.

Geopolitical risks visibly weigh on the composition of foreign exchange reserves

Data provided by the institutions mentioned (ECB and BIS) show that the volume of securities issued to finance debt was significantly reduced by 30% at the end of 2022 compared to 2021 (by $700 billion in absolute value). This substantial decline is due to a lack of confidence in the outlook for the global economy, the increasing restrictiveness of financial conditions in advanced economies, and the risks of geopolitical fragmentation that persist.

Figure 12. Evolution of central banks' gold reserves, worldwide, 2010-2024 (fine gold tons)



Source: Figure by the author, based on data published by the ECB, https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202406~0b56ba4f71.en.pdf

The dollar remains by far the dominant currency in terms of the share of foreign currency-denominated bonds internationally, with a total value in 2022 of $930 billion. By comparison, the share of the euro has remained relatively stable at 25% internationally in 2023. Overall, internationally, the dollar accounts for more than 57% of the value of bonds issued in foreign currencies worldwide. There is an increase in the share of bonds denominated in currencies other than the euro and the dollar to around 17% at the end of 2022.

Another element reflecting the growing imprint of uncertainty in international currency markets and in the evolution of the international reserve structure as a result of geopolitical turmoil is the growing preference for holding gold. Over the period 2010-2023, the volume of gold in central banks' reserves increased by 11.7 times! As shown in Figure 14, after the pandemic, but especially after the outbreak of military conflict in Ukraine, central banks' gold reserves increased by 2.3 times.

VI Influence of recent changes in the global economy on the international role of the euro

Since the outbreak of the war in Ukraine, the authorities in Moscow have embarked on a process of de-euroization and de-dollarization of its foreign trade, encouraging the use of the national currency, the rouble, in bilateral trade with other BRICS+ states, South East Asian and Middle Eastern states, as a way to get around the sanctions imposed on its oil exports mainly by the EU and the US (Barisitz and Evdokimova, 2023). Approximately 80% of the total value volume of the Russian Federation's trade with Iran is carried out in national currency (Frontier India, 2023). According to official statements, 20 states have joined the System for Transfer of Financial Messages (SPFS), which is a local alternative to SWIFT, developed by the Central Bank of Russia (Gopinath and Stein, 2021).

Despite Russia's efforts to promote the ruble, the renminbi, the Chinese currency is increasingly consolidating its position as an international vehicle currency.

On the other hand, in the framework of bilateral trade between Russia and India, it is worth emphasizing that India initially tried to promote its own currency. By mid-2023, most refineries in India started to use the Chinese renminbi for payments of Russian crude oil imports, leading to the redirection of Russian trade through China, which accounts for 40% of the total value of Russian foreign trade, thus avoiding sanctions imposed on Russia.

Effects of the growing role of China, the world's largest trading power, in international trade

In 2008, China became the world's largest trading power, ranking first in terms of export value. This situation has not changed and the effects are starting to show, particularly in terms of trade invoicing. As has been predicted for more than a decade, in the current international monetary system, the US dollar, the euro, and the renminbi take the podium, but the distances between them are significant.

In terms of trade in goods, the invoicing of goods in Chinese currency has risen to about a quarter of all Chinese transactions and a third of all Chinese trade in services in 2023. This growth has led to a new situation, with the total volume of renminbi-denominated trade transactions accounting for almost 5% of the global total.

If we compare the share of billing in US dollars, which is 83%, and in euros, which amounts to 7%, we see that the greenback has no competitor. The data on which this analysis is based covers not only international payments but also domestic, and national payments. At the regional level, however, in the South-East Asian region, China's currency is gaining ground against other currencies. For example, in Hong Kong, 80% of commercial transactions are carried out in Chinese currency, which also indicates a cautious, gradual development strategy promoted by Beijing for the use of the national currency in international invoicing. Thus, the Cross-border Interbank Payment System (CIPS) is gradually developing, which has already reached 4800 billion dollars by the end of 2023. The number of direct participants in the CIPS system has increased from 77 to 139 and the total number (direct and indirect) has increased from 1,300 to 1,500 during the period under review.

VII Internationalization of central bank digital currencies (CBDC) and implications for the euro area

A phenomenon that could not have been anticipated in the 1990s, before the establishment of the single European currency, is the launch of central bank digital currencies, whether of developed or emerging countries. Recently, a BIS analysis shows that 30% of central banks in advanced economies and 20% in emerging countries are already using digital currencies in cross-border operations in order to provide better payment security and minimize costs (Kosse and Mattei, 2023). In this context, it is important to consider the internationalization of central bank digital currencies, their influence on the international monetary system in general, and on the euro and the single European digital currency in particular. Starting with China, it should be noted that Chinese officials have avoided linking the development of the digital currency (e-CNY) to the internationalization of the yuan. However, there are visible efforts to use internationally the e-CNY digital currency, which is primarily designed for domestic use. Its architecture is easily adaptable for cross-border use applications (IMF, 2022).

Until widespread use, China is testing e-CNY applications through various initiatives and collaborations with partners outside the country. Recently, the Chinese authorities have lifted certain restrictions so that the e-CNY digital currency can be used by foreign tourists (China-Britain Business FOCUS, 2023).

At the BRICS group level, member states have announced their intention to develop the BRICS Bridge platform to link initiatives to launch a digital currency within the group. In March 2024, the Russian Federation's Tass news agency reported that within the BRICS group, work is underway on a crypto-currency, a kind of crypto asset based on blockchain technology for conducting international trade transactions. If these initiatives come to fruition, they will influence the currency patterns in global payments, which will decentralize the current monetary system, based on the US dollar which is predominant, but will also affect the role of the European single currency (Bowman, 2023 and Waller, 2024).

In the US, officials have not yet taken an official position on the implementation of legislation to launch a digital currency. Domestically, US authorities are analyzing the potential benefits and challenges of introducing such a central bank digital currency. The advancement of e-CNY and its potential internationalization is causing concern about China's growing international influence (https://www.congress.gov/bill/117th-congress/senate-bill/2543).

Recently, the Chairman of the Federal Reserve Board (the Fed Board) reiterated that he is far from supportive of the adoption of a digital currency (U.S. Senate, 2024).

In the eurozone, the launch of the digital single currency is seen as an empowering tool, especially in the current tense geopolitical situation. The draft legislative act contains specific provisions on the circulation of the digital euro outside the euro area, distinguishing between distribution (i) outside the euro area, but within the European Union; (ii) in third countries, i.e. outside the European Union; and (iii) in third countries or territories under a monetary agreement with the European Union. The proposal also includes provisions on payments between currencies for the purpose of trade or transfer of funds, in line with the G20 agenda. In its opinion on the legislative proposal, the ECB welcomed the fact that the proposed regulation would make the digital euro initially accessible to persons established or resident in the euro area, while access for non-residents, together with access for consumers and merchants in the European Economic Area and selected third countries, would be considered in the future.

The ECB clarified that a digital euro would enable cross-payments by establishing interoperability between the digital euro and other digital currencies, subject to agreements between the ECB and third countries. Such interoperability could be achieved either through an interconnection model based on common standards or by enabling the multi-currency exchange features of the digital euro.

In the UK, the Bank of England and HM Treasury launched a public consultation on the digital pound for use by households and businesses in February 2023. It was proposed that non-UK residents would be able to own and use digital pounds in the same way as UK residents. The majority of respondents to the consultation supported the proposal for access for non-UK residents, but it was felt that the launch of a digital pound should initially focus on UK residents.

In conclusion, a number of projects to launch central bank digital currencies, both in advanced economies and emerging markets, cover potential use outside the jurisdiction in which they are issued, including for cross-border purposes. In addition, the BRICS countries are exploring alternative payment options, including the potential development of a platform to link these economies' CBDC initiatives. China's recent efforts, if successful, could lead to greater international acceptance of e-CNY. Whether and how these developments will influence the current international monetary system remains to be seen. In parallel, IMF and BIS efforts could support the development of frameworks to facilitate the creation of digital currencies that would reduce frictions in cross-border payments and avoid fragmentation of the international monetary system. Moreover, support for proactive engagement with central banks in other jurisdictions is imperative to ensure that the possible international use of digital currencies, in particular for cross-border transactions, brings real benefits.

The issuance of securities denominated in US dollars, euros, and other currencies accelerated between 1999 and 2023, with the value of each of these securities more than doubling (2023 compared to 1999). The preponderance of securities issued in US dollars stands out, with a total global volume of 1054.96 billion dollars at the end of 2023, compared with only 403.65 billion dollars for those issued in euro and 325.87 billion dollars for those denominated in other currencies. Note, however, that although the dollar again maintained its dominance over the entire period analyzed, however, from 2022 onwards there is a reduction of almost $500 billion in absolute volume (from $1453.24 billion at the end of 2021 to $929.71 billion one year later).

The value volume of euro-denominated bonds **contracted by 72% in the group of emerging economies and by more than 40% in the US, the UK, and Japan**. In the EU Member States outside the euro area, as well as in the other developed countries of the world, **the total value of euro-denominated bonds increased by 6 and 8 p.p. respectively**.

In terms of green bond issuance, there was a significant decrease during the period under review. In absolute terms, the total amount of this type of bond issued in the world's major currencies fell by about USD 41 billion.

Green bond issuance fell by €11 billion (approx. $12 billion) to a total value of €34 billion ($36 billion) in 2022. Likewise, the value of dollar-denominated green bonds decreased from USD 80 to 59 billion over the period In relative terms, the share of dollar- and euro-denominated securities in the total volume issued remained relatively constant over the period under review, at 51% and 31% respectively.

VIII The international role of the euro as a liquidity provider

The use of euro banknotes outside the euro area reached a 10-year low in 2022. Specifically, the value of euro banknote deliveries outside the euro area was 11 p.p. below the 2001 level. The analysis of the demand for euro banknotes differed in 2022 over the two half-year periods. In the first half of the year, the net value of demand for euro banknotes outside the euro area increased by 8% compared with the same period in 2021, reflecting additional demand for cash caused by the war in Ukraine, which increased the appetite for cash as a safety measure in a number of nearby Central and Eastern European countries.

In the second half of 2022, the decline in euro liquidity demand is primarily due to the start of the normalization of the ECB's monetary policy, which has increased the cost of holding liquidity. The ECB's decision to increase the key interest rate in the last 2 years has led to a gradual decline in liquidity. Second, the geopolitical context has led to a significant reduction in sales of euro banknotes to non-EU Eastern European countries. Specifically, while in 2021 these countries accounted for 30% of the demand for euro banknotes, by 2022 this share had fallen to only 15%. In 2022, demand for euro banknotes remained relatively unchanged in the eurozone's neighbouring countries.

Since the Russian invasion of Ukraine, a series of punitive packages of measures have been decided against the invading countries, including the freezing of almost half of the official foreign exchange reserves held by the Bank of Russia and the exclusion of most Russian-owned banks from the Swift system, the main financial system used for fast cross-border payments. The risks of geopolitical fragmentation and their influence on the evolution of major currencies are growing.

As in a domino game, the sanctions have had other economic consequences in addition to the expected ones, including the declining role of the dollar and the euro in the international monetary and financial system. The reaction of the countries worldwide has been to reduce risks and, as a result, it has been decided to diversify official foreign exchange reserve portfolios. This explains the growing preference of international investors for emerging market currencies such as renminbi, rouble, and rupee, which are mainly used for invoicing in international trade. International statistics show that the Russian Federation uses the Chinese currency to a substantially greater extent than before the conflict broke out, in particular for trade and cross-border payments. Also as a result of the heightened international uncertainties, international demand for gold has risen to record highs, with China and Russia the main promoters.

International statistical data illustrate that the replacement of the pound sterling by the dollar as the world's first dominant currency has taken place gradually over several decades. Today, we observe that although the US share in world trade and finance is on a continuous downward trend, especially after the outbreak of the global financial crisis in 2008, the dollar continues to be the most widely used currency in official reserves and securities issuance, although its share in the world total is gradually decreasing.

But, as we saw in the 20th century with sterling, the process of handing over the baton is one of inertia and spans several decades. The difference with the last century is that international statistics show that the euro is the second most widely used currency internationally, but its share has remained relatively stable since its launch in 1999, with a peak during the 2008 international financial crisis. The currencies of dynamically developing emerging market countries, as outlined above, are lagging behind. Therefore, the situation is unlikely to be similar to the last century, when the US economy was by far the world's leading economic power. Coming in strongly behind are not other developed countries, but emerging countries, most of them, with China taking main stage.

A dominant currency confers many economic, financial, and strategic advantages on the issuing state. These advantages are multiplied over time by the development of financial and trade links, and cross-border lending to countries that choose that currency as the invoicing currency for commercial transactions, which contributes to increased confidence. As these links become more intense and global, the influence of the internationally dominant currency increases.

Empirical evidence shows that cross-border bank lending in US dollars, and in euro, in particular, is highly concentrated in a small number of countries. In the case of the role played by the single European currency, it can be observed that Brexit has influenced the decline in the use of the euro in lending to non-banks in the first place. The euro tends to be more of a regional currency, while the use of the US dollar in cross-border bank lending is global.

Maintaining the euro's role as the preferred invoicing currency in international trade is explained by ECB analysts by the high volume of trade between eurozone Member States and non-EU trading partners, thus lowering the costs resulting from foreign exchange. If the euro were no longer one of the preferred currencies for invoicing trade, it could send a negative signal of mistrust in the single currency.

A major impact of the role played by the single currency in the invoicing of international trade is the phenomenon of the relocation of economic activities to the EU as a result of the war in Ukraine (www.ecb.europa.eu).

Since the establishment of the single currency, the question has often been asked whether the EU would decide a leading international role for the euro. This means that apart from some of the benefits of being able to use its currency in financial transactions without currency exchange fees and other types of transaction-induced extra costs, what other benefits does such a role bring?

This raises the question of whether the ECB could issue more euro money supply than is needed for the euro area's needs, which would require additional senior funds. Rising international demand for the euro would increase prices in the domestic market of the issuing economy. An appreciation of the single currency would affect the export competitiveness of products. On the other hand, an increase in the exchange rate of the euro against major currencies would lead to cheaper imports, which would have a favorable effect on the trade balance.

A negative effect would be the inability to control monetary demand, i.e. the amount of money circulating outside the issuing area, as the euro area is not yet ready for such a move.

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POSSIBLE IMPLICATIONS OF THE DIGITAL EURO ADOPTION

Iulia Monica Oehler-Șincai

„… a digital euro can only be successful if it meets
the payment needs of Europeans today and in the future”.

2022, Fabio Panetta, former member of the
Executive Board of the European Central Bank
and former Chairman of the High-Level Task Force on the Digital Euro

I Introduction: Background to the launch of the digital euro project

The history of money is closely linked to the history of technical progress. In an increasingly digitized world, a total of 134 countries and currency unions, collectively accounting for about 98% of the gross global product, are currently exploring the possibility of launching a central bank-issued digital currency (CBDC) (Atlantic Council, 2024). In May 2020, this number was only 35. Of the 134, more than half (68 countries) are at an advanced exploration stage – development, pilot, or launch. Three countries have launched a CBDC, namely Bahamas, Jamaica, and Nigeria. The Eastern Caribbean Currency Union of 8 countries has stopped the availability of DCash due to technical problems and is developing a new pilot project. The digital euro is among the 44 pilot projects underway for a CBDC (including transactions settled in a controlled environment) (Atlantic Council, 2025; ECB, 2024a).

The Digital Yuan / Digital Renminbi (e-CNY) is still the world's largest pilot project for the adoption of a CBDC. As of June 2024, the total transaction volume has reached 7 trillion e-CNY (USD 986 billion) across 17 provinces in sectors such as education, healthcare, and tourism. This is almost four times the 1.8 trillion yuan (USD 253 billion) recorded by the People's Bank of China in June 2023 (Atlantic Council, 2025).

CBDC is a fiat currency issued by the central bank in digital form. Cash and CBDC are forms of fiat currency issued by the central bank, thus adding to banks' reserve deposits as liabilities of the central bank (Abad, Nuño, and Thomas, 2024). It should be emphasized that CBDC is a new form of fiat money only for retail (small-value) payments, as central banks already provide digital money in the form of reserves or balances of accounts held by commercial banks and other financial institutions with the central bank (CPMI and Markets Committee, 2018; Oehler-Şincai, 2022).

At the international level, a set of principles for CBDC for the general public and corporates have already been synthesized. For instance, the G7 emphasizes issues such as: maintaining financial and monetary stability; compliance with legal and governance frameworks; data privacy; operational resilience and cybersecurity; combating the financing of illicit activities; energy efficiency and environmental protection; and supporting the digital economy and innovation (G7, 2021). The Bank for International Settlements (BIS) emphasizes that (i) a central bank should not jeopardize monetary or financial stability by issuing a CBDC; (ii) a CBDC should coexist with and complement existing forms of money; and (iii) a CBDC should promote innovation and efficiency (BIS, 2020).

A new survey of 86 central banks conducted by the BIS in 2023 indicates that most central banks are testing both *retail* CBDC (general-purpose, intended for the general public and the business sector for day-to-day transactions) and *wholesale*, intended for financial institutions (commercial banks, central banks, and other financial institutions) (Di Iorio, Kosse, and Mattei, 2024). About 30% of central banks focus on retail CBDC and 2% on wholesale CBDC. At the same time, the likelihood of central banks issuing a CBDC in the next six years is currently higher for wholesale CBDC than for retail CBDC, with the main focus on wholesale CBDC being on facilitating cross-border payments by addressing current challenges such as high costs, low speed, limited access and insufficient transparency (Di Iorio, Kosse, and Mattei, 2024).

The rise of CBDC is evident. Auer, Cornelli, and Frost (2023) synthesize that "retail CBDCs are more likely where there is a larger informal economy, and wholesale CBDCs are more advanced in economies that have higher financial development". CBDC projects differ across countries, "both in their motivations and in their economic and technical design". Many central banks are pursuing models where a CBDC is "a direct claim on the central bank, but with retail payment services performed by private intermediaries".

The digital euro would fall into the category of retail CBDC. The first three arguments for the adoption of CBDC are related to (1) the need to adapt to the digital era, imposed by the acceleration of the digitalization of the international payment system with technological progress and the social distancing associated with the

Covid-19 pandemic, in tandem with the change in consumer payment behaviour; (2) Providing the general public and businesses with a digital means of payment that is risk-free (in contrast to cryptocurrencies), "cheap, efficient, available everywhere" and at the same time protects users' privacy (Panetta, 2021a; 2021b); (3) reducing over-reliance on payment service providers (PSPs) outside the EU, given that there is a sufficiently large number of European providers ready to develop solutions for the digital euro, which would strengthen the resilience of the European payments system (ECB, 2023a; 2023b; 2023c).

The introduction of the digital euro would therefore create a digital means of payment with “pan-European reach”, equivalent to taking the Single Euro Payments Area (SEPA) to “a new level”. It would solve three problems: the fragmentation of the retail market, dominated by a few non-EU players; the market power of BigTech companies such as Apple, with Apple Pay being the only mobile wallet that can use near-field communication (NFC) on iOS devices; and the high costs for consumers and merchants by using a few card schemes with international coverage (Cipollone, 2024).

Brunnermeier and Landau (2022) consider that the project to analyze the appropriateness of adopting the digital euro has generated expectations, questions, and pros and cons alike, given its complex effects and consequences. These consequences affect the population, the business environment, the reputation of the European Central Bank (ECB) and all the authorities involved in the design and marketing of the digital euro. Therefore, in the end, the digital euro adoption influences the very Europe's financial sovereignty and the international role of the single currency. Moreover, beyond the arguments for and against the adoption of the digital Euro, the success or failure of this new form of currency is ultimately determined by the degree of trust that users will have in it (Fugaru, 2021) and, by implication, the extent of its use. In this context, it is worth mentioning the Ecuadorian experience with Dinero Electrónico, operational between 2014 and 2018, which failed to reach the necessary critical mass both due to a lack of interest among the population (existing alternatives being attractive and advantageous) and due to the fear of private banks that public digital currency would pose a threat to their intermediation activities (Arauz, Garratt, and Ramos, 2021). This reveals that the adoption of a CBDC can only be successful if two cumulative conditions are met: (1) it is intensively publicized, explained, and understood, and (2) is supported by all economic actors, including consumers, producers, exporters, importers, local traders, public institutions, and the banking sector (Oehler-Şincai, 2022).

With all this in mind, the present investigation is structured around answers to the following questions: What is the legal and institutional framework for the digital version of the euro like at this stage? Is the business environment ready for the adoption of the digital euro and what would be the consequences of adopting this new form of fiat currency? What is the public's attitude towards the digital euro, is it sufficiently informed and ready to use the digital euro on a large scale? What are the benefits and risks in terms of financial stability?

Background to the launch of the digital euro project

Investigating the opportunity and preparing for possible adoption of the digital euro after 2025 comes at a turning point in international payments. On the one hand, non-bank actors have continuously increased their role in global payments. Payment systems of large technology companies are seen as accompanied by risks to financial stability and a level playing field, the migration from traditional means of payment (bank cards) to digital wallets is in full swing, and the risks associated with cryptocurrencies are increasingly evident (from high volatility to illicit transactions and the energy-intensive nature of "mining" some cryptocurrencies). Money from outside the banking system has increased its role at an unprecedented pace[1], at the expense of central bank and commercial bank money (Oehler-Șincai et al., 2024). On the other hand, there is a need to reduce the costs associated with cross-border payments, CBDC being a potential solution in this regard.

The European Commission (2020a; 2020b) considers that a digital euro, as a retail digital currency issued by the central bank, would protect the legal tender status of the euro. In other words, it would create a digital equivalent of cash in the age of digitalization (Demertzis, 2023). Moreover, it would promote financial inclusion. At the same time, the EU would make a "significant contribution to improving cross-border payments with non-EU jurisdictions, including money remittances", thereby supporting the international role of the Euro and the EU's "open strategic autonomy". It would also act as a catalyst for innovation in payments, finance, and commerce, in the context of ongoing efforts to reduce fragmentation in the EU retail payments market (European Commission, 2020a; 2020b). This argument should be coupled with the objective of creating a universal European payment method to reduce the EU's dependence on foreign payment service providers, which dominate the market (Demertzis, 2023).

In a context where card and mobile payments are dominated by non-European payment service providers, a market-supported (European Payments Initiative, EPI) and a public project (digital euro) have been outlined to strengthen the EU's strategic

[1] "Unbanked" money includes payments through large e-commerce platforms of BigTech companies (such as Amazon), payment applications (such as WeChat, WhatsApp, Grab, Gojek, M-Pesa), and decentralized finance (DeFi) platforms, which are based on distributed ledger technology.

autonomy (May, 2023). However, the digital Euro would not be just a new payment option, but digital cash, accessible through digital wallets, and the obligation to accept the digital euro and service digital wallets is not a guarantee that consumers will use it, given the less complicated available alternatives offered by the private sector (May, 2023).

Rossi (2025) goes even further and points out that CBDCs "can be used by banks as an instrument to maximize their profits, thereby further increasing financial instability of the banking sector as a whole. This is so much so in 'advanced' economies, where the banking sector has been exploiting its 'too-big-to-fail' position to privatize its profits and socialize the costs of a bank's bail-out by the government". However if CBDCs have fewer advantages than disadvantages for the common good can be influenced by the design and regulations of 'retail' CBDCs "by both monetary and supervisory authorities" (Rossi, 2025).

Opinions on the digital euro range from the absolute need for its adoption to no adoption at all. At the same time, there are different options for the digital euro, from various perspectives, such as the level of access (widespread or restricted, limited in the first stage, unlimited, available to non-residents or not), the degree of privacy, the technology (distributed ledger technology, a centralized technology or other technologies), etc.

The major EU institutions (ECB, the European Parliament, the EU Council, and the European Commission) support the need to adopt the digital euro. This position contrasts with that of some central banks, such as Denmark (which has opted to remain outside the euro area), which believes that the launch of the CBDC would turn the central bank into a direct competitor of commercial banks, without generating more efficient payment alternatives. Moreover, by adopting a CBDC, the central bank would become a retail bank for the private sector, which could jeopardize the stability of the financial system (Danmarks Nationalbank, 2017). That is why, given the strong consequences of adopting the digital euro, any decision must be well analyzed in terms of the potential effects on: the payment system as a whole, monetary and financial stability, monetary policy transmission and implementation, financial intermediation and cross-border payments (Oehler-Șincai, 2022).

II The digital euro – a European public good needed in the age of electronic money?

The case for the digital euro

Fabio Panetta, a member of the ECB's Executive Board from 2020-2023, believes that a digital Euro will make our money fit for the digital age. Just as the architects of the single currency were convinced that monetary union would only be complete with a tangible form of the euro, issued by the central bank, the digital euro would take their vision further into a digitized world (Panetta, 2023a).

The President of the Deutsche Bundesbank, Joachim Nagel, emphasizes that the adoption of the digital euro (money issued by the ECB in digital form) reflects adaptation to change. It is a natural response to changes in payment behaviour as cash usage declines and the share of card payments in the euro area soars. Moreover, in the context of geopolitical tensions, the adoption of the digital euro would exclusively involve European infrastructure, without relying on non-EU companies, thus strengthening strategic autonomy and increasing EU resilience. Potential technical obstacles can be overcome through joint efforts of central banks, merchants, IT and payment experts, and merchants (Nagel, 2024).

The BIS (2023) stresses the need to maintain confidence in public money, which has the capacity to facilitate financial inclusion, streamline cross-border payments, boost safety and innovation, maintain monetary sovereignty and support policy autonomy.

Nine months after the publication of the *Report on the digital euro* on October 2, 2020, the ECB announced the launch of the project to adopt the digital euro on July 14, 2021. During an initial 24-month investigative phase from October 2021 to October 2023, the ECB addressed the main issues regarding the design and deployment of the digital euro. In three Progress Reports (September 2022, December 2022, and April 2023), a general framework of possible digital euro design alternatives was set out and made available to the Governing Council of the ECB (ECB, 2022a; 2022b; 2023a).

In July 2023, the Fourth Progress Report on the investigation phase of the digital euro was released (ECB, 2023b). It highlights that in the view of the Eurosystem (the ECB together with the central banks of the EU Member States that have adopted the euro), a digital euro should offer basic services to citizens free of charge, reflecting its status as a public good and in line with the user experience with cash. To stimulate network effects, the Eurosystem considers that intermediaries should be compensated for the services they provide, as they are for comparable electronic payments. Beyond the basic free services, banks and PSPs could offer additional digital services to their customers, which may be for a fee (ECB, 2024b).

Based on the results of the phase of investigating the appropriateness of adopting the digital euro, the ECB's main decision-making body, the Governing Council, has decided to move to the preparatory phase of the adoption of the digital euro. This will run from November 2023 for a period of two years, when the Eurosystem will focus on further testing and experimentation while continuing to consult with all stakeholders (including the general public, merchants, payment service providers, and public authorities). ECB experts consider that the digital euro must meet "the highest standards of quality, security, and usability". The next steps will be determined by the outcome of the first and current preparation phase, which will end in October 2025, and the evolution of the legislative framework necessary for the adoption of the digital euro (ECB, 2023c). Given that the legislative process also includes the transposition of legislative changes into national law, it will be a lengthy process, which makes a partial launch in 2027 very ambitious in the event of a decision by the Governing Council of the ECB to adopt the digital euro (Grünewald, 2023).

So far, four basic principles of the legislative framework for the adoption of the digital euro have emerged: (1) As a public good, the use of the digital Euro by individuals should be free of charge. (2) Intermediaries should be compensated for the services they provide, similar to other digital payments. (3) The overcharging of merchants by intermediaries (payment service providers) should be avoided. (4) The Eurosystem bears its costs, as it currently bears its costs for cash (ECB, 2023b).

The compensation model for the digital euro should aim to ensure that all stakeholders can conveniently distribute, accept, and pay with the digital euro. On the one hand, this model should benefit end-users, i.e. primarily individuals (acting as payers) and merchants (acting as payees). On the other hand, it should incentivize PSPs to distribute the digital euro to their customers. Based on the balance between incentives and costs, network effects are achieved and the digital euro will be widely available and usable anywhere in the euro area, with the status of a European public good (ECB, 2023b).

The following table summarizes several arguments of central bank governors from euro area countries in favour of adopting the digital euro. There are also risks, however in this section, the focus is on benefits. Finland is among the central banks that are more cautious, besides the strengths and opportunities being emphasized also potential risks. **In addition to** the strengths and opportunities**, potential risks are also being emphasized**. At the same time, a number of researches by other eurozone **central banks** indicate both opportunities and risks. Simultaneously, certain conditions must be met for the adoption of the digital euro to be successful.

Table 1 The case for adopting the digital Euro, in speeches by Eurozone central bank governors

Country	Arguments generally in favour of the digital euro adoption
Germany	The digital euro is a natural response to the digital revolution (access to public money in a changing world), strengthening the EU's strategic autonomy and resilience. However, if the digital euro could be held in large amounts, a shift can take place from deposits to digital euro accounts or wallets, which is synonymous with a systemic bank run. However, there exists a very simple remedy for this risk: holding limits (only a limited amount can be withdrawn). This will "considerably reduce the risk of a bank run during times of distress".
The Netherlands	The digital euro is needed to keep pace with society, to achieve strategic autonomy, and to maintain access to public money in a digital world.
Austria	The digital euro will usher in a new era of the monetary union. For the first time, individuals will have access to central bank money digitally. The digital euro will ensure that disadvantaged people can also pay digitally using a free public means of payment. It will also create a Europe-wide payment system as an alternative to the current system dominated by a few private players.
Belgium	The digital euro is a normal reaction to developments in the private digital currency market, but the process of adopting it is lengthy and involves all stakeholders.
France	This "digital banknote" will have the same characteristics as existing cash: it will be accepted everywhere in the euro area due to its status as a legal means of payment; it will meet the highest standards of confidentiality; its basic functionalities will be free of charge for individuals. In addition, the digital euro will bring complementary advantages compared to banknotes: it will allow the use of central bank money in e-commerce, peer-to-peer remote payments, as well as conditional payments, and will stimulate financial inclusion in the digital age. The digital euro will be distributed through banks: central banks are not and will not become competitors of commercial banks and money will remain a public-private partnership.
Spain	The Eurosystem's motivations for designing a digital euro fall into three broad categories: supplementing cash in a rapidly digitizing environment; promoting innovation and efficiency in the European payments system; and protecting strategic autonomy and monetary sovereignty.
Italy	A digital Euro would be a digital form of cash that could be used for all digital payments throughout the Eurozone, free of charge, both online and offline. It would offer the highest level of privacy by default and allow users to settle payments instantly in central bank money. It could be used for person-to-person (P2P), point-of-sale, e-commerce, and government payments. No existing digital payment instrument offers all these features. The digital euro is about policy intervention, without which the increasing role of Big Tech companies in payments and financial services could have a strong negative impact on the financial sector.

Country	Arguments generally in favour of the digital euro adoption
Finland	An economy dominated by digital payments but without a strong monetary anchor would be inherently unstable. Tipping the balance in favour of digital money is welcome from the perspective of creating opportunities for innovation and financial inclusion. However, it poses a number of risks. Public authorities need to strike a careful balance between promoting innovation for the benefit of society and limiting risky activities.
Portugal	By issuing a digital euro, the Eurosystem could offer a risk-free, cost-free, and reliable digital means of payment. It would support Europe's drive towards continuous innovation and contribute to its strategic autonomy by offering an additional alternative to external payment providers for fast and efficient payments. The digital euro could lead to the strengthening of European sovereignty in a strategic area such as payments, where the smooth functioning of payments is essential for the conduct of monetary policy and the maintenance of financial stability.

Note: There is no relevant speech on the digital euro from the governor of the Central Bank of Luxembourg. In the author's opinion, Luxembourg is in favour of a wholesale rather than a retail CBDC, participating in tests by the European Central Bank and other international financial institutions. For example, the Banque de France and the Banque Centrale du Luxembourg ran a successful experiment using distributed ledger technology (DLT) in 2022. The two central banks jointly assisted the European Investment Bank (EIB) in the so-called *Venus* initiative.

Sources: Nagel (2024), Knot (2024), Holzmann (2024; 2023), Wunsch (2023), de Galhau (2023), de Cos (2023), Panetta (2023b), Rehn (2022), Centeno (2021).

In conclusion, there are several major arguments in favor of adopting the digital euro. The first is to maintain access to public money in a digital world. Second, it aims to create a Europe-wide payment system as an alternative to the current system dominated by a few private players (given the market shares of large non-EU technology companies), while at the same time encouraging strategic autonomy and resilience in the EU. The digital euro will be distributed through banks and the continuation of public-private partnership will prevent financial disintermediation. The digital euro is also a response to developments in the private digital currency market, offering an alternative to cryptocurrencies to avoid the risks associated with them. The ignition moment for the CBDC was the Facebook announcement of 2019 about the plan to launch a new cryptocurrency, namely Libra. Given the large Facebook (now Meta) community, it would have had a tremendous impact on payments.

Finally, it is also worth mentioning the experience of a country outside the euro area but within the EU – Sweden – which is among the most advanced worldwide in terms of pilot projects for the adoption of the CBDC. Six successive Pilot Project Reports have been published so far[2]. In September 2017, the Swedish central bank,

[2]https://www.riksbank.se/en-gb/payments--cash/e-krona/.

Riksbank, launched a project to investigate the need for a CBDC, e-krona, and the possible consequences associated with it. Similar to the Eurozone's experience, the Riksbank's initiative was motivated by the decreasing use of cash and the need for a secure and efficient digital payments system. The demarches are currently in the fourth pilot project phase and are continuing even though in 2023 a government-initiated study concluded that Sweden does not need a CBDC, as the social need for it is insufficient (Thomadakis, Lannoo & Shamsfakhr, 2023). The adoption of the CBDC is basically a political decision and the work of other central banks such as the ECB will influence this decision (Thomadakis, Lannoo & Shamsfakhr, 2023).

Arguments against the adoption of the digital euro

There is currently no unanimity on the need to adopt the digital euro. Demertzis (2023) argues first of all that the threat of cash disappearing does not exist. Second, more than 90% of the EU citizens have a bank account; therefore, the majority of the population has access to financial services. There will always be a segment of the population that is not digitally savvy, and therefore, more digital solutions will not respond to their preferences or needs (and therefore will not boost financial inclusion).

In general, opponents of the adoption of CBDC emphasize that the private sector already provides an adequate payments framework, and a public digital currency would be "a solution in search of a problem" (House of Lords of the United Kingdom, 2022). Moreover, opponents point to privacy concerns and fear that such a currency would lead to oversight of the payments system. In addition, many note the potential risk of bank disintermediation, which poses a risk to financial stability (BIS, 2023). Moreover, the trend of disintermediation is visible in crises, when the banking sector contracts (i.e. the share of total banking assets in GDP shrinks), with experts highlighting that CBDC would lead in certain scenarios of public digital currency adoption to bank disintermediation. Other experts reveal that the central bank's centralized ledger could become a key element of the national or regional critical infrastructure, thus becoming a target of attacks from hostile states and malicious non-state actors (House of Lords of the United Kingdom, 2022).

At the current stage of its design, it is not obvious that the digital euro will take over all three functions of fiat money: unit of account, medium of exchange, and store of value. The European Parliament, in its first draft Report on the proposed Regulation on the adoption of the digital Euro, confirms that it is the payment service providers who define the limits of holding the digital Euro, to limit the use of this new form of currency as a store of value (European Parliament, 2024). At the same time, electronic wallets will be used instead of accounts. Having in mind the pros and cons, one can conclude that the debate will remain open for a long time.

Angeloni (2023) points out that: the payments system is already efficient and is progressing steadily; there are no 'market failures' that suggest central banks should be directly involved; CBDC would fail to gain a foothold because central banks lack the expertise to conquer the market; CBDC may jeopardize financial stability; CBDC would distort and discourage private investment and innovation.

Brühl (2024) concludes that: "there is no obvious need for a digital euro, given the efficiency, safety, and innovation of existing electronic payment systems"; "the digital euro appears to be primarily a political project, symbolising a further deepening of the European currency area"; "a digital euro should be non-interest-bearing and subject to individual holding limits in line with average cash holdings in the eurozone close to a possible launch", "it is very likely that a digital euro would, on balance, have a negative impact on the refinancing costs and thus the profitability of the European banking sector", and "the disintermediation of banks must be avoided by excluding direct accounts of private users at the ECB".

Armelius, Claussen, and Hendry (2020) argue that commercial banks' money is sufficient if it is safe. In their view, measures such as deposit insurance, effective regulation, and supervision, together with sound public finances and macroeconomic policies, cause commercial banks' money to be safe up to the deposit insurance guarantee limit and often beyond. Thus, neither cash nor CBDC are essential where such measures are in place.

Bellia and Calès (2023) emphasize that high CBDC absorption could pose substantial challenges to bank profitability, especially for small banks, which rely heavily on deposits as a source of funding.

Thomadakis, Lannoo, and Shamsfakhr (2023) point out, among others, that the benefits of a possible digital euro and its added value for end-users (individuals, merchants, and businesses), compared to existing payment solutions, should be very clear, well communicated, and understood. A digital euro should offer *clear benefits in response to consumer needs*. The impact of its issuance should be discussed in detail with stakeholders and a deeper interaction between the public and private sector is needed. The digital euro should be cost-effective and economically viable, as well as contributing to efficient payments and a more competitive Europe. A holistic *cost-benefit* analysis would ensure that the launch of the digital euro does not lead to an unsustainable situation with high operational costs and new infrastructure investments that outweigh the benefits. Such an analysis should examine not only the costs and impact for banks/intermediaries but also for merchants (through the costs of accepting an additional payment method) and the ECB (staff, infrastructure, and services provided free of charge). The decision to issue the digital euro in the euro area (either retail or wholesale) cannot be taken in isolation from CBDC developments in other major jurisdictions, as it would have a significant impact on the attractiveness of the common currency, both as a means of payment against other major currencies and as a global reserve currency. Therefore, a high degree of cooperation and coordination between the major currency areas, in particular with the US, the UK, and Switzerland, is required. This is why, in the authors' view, *interoperability* between the digital euro and other major CBDC should be a feature of its design code.

Bofinger and Haas (2023) argue that the digital euro is not needed as a monetary anchor for the euro area. Indeed, from a legal point of view, commercial bank deposits should be fully convertible into central bank deposits. Since such convertibility is technically difficult to achieve with cash, convertibility into central bank digital deposits offers an easy alternative. For good reasons, however, the ECB envisages only a very low ceiling for digital euro accounts. What matters for the euro's role as a unit of account is not the use of CBDC in everyday payments, but a monetary policy that maintains price stability. Moreover, the example of several major central banks demonstrates that it is possible to develop a competitive national retail payments system without the need for CBDC.

In terms of the impact of CBDC on monetary policy implementation, banking intermediation, and macroeconomic developments, Abad, Nuño, and Thomas (2024) highlight the following. Currently, most central banks in advanced economies operate a system in which banks' demand for liquidity is saturated with a significant supply of central bank reserves ("excess reserves"), and benchmark interbank market rates are effectively controlled by the interest rate on overnight deposits at the central bank. The introduction of the CBDC has the potential to affect the operational framework for monetary policy and conditions in interbank markets if a sufficiently large fall in reserves is realized as a result of a reduction in bank deposits. The authors show, however, that while this may have important macroeconomic implications, both in the long run and in the transitory phase of the adoption of the CBDC, an automatic adjustment occurs through the two facilities offered by the central bank, namely the deposit facility and the lending facility.

Prerequisites for the digital euro to be a European public good

A just motivation for the digital euro adoption would be the goal to have the digital euro as a European public good. Taking into account the pros and cons of adopting the digital euro, as well as the general principles outlined by prestigious international institutions for the effectiveness of the CBDC, the following table summarizes five preconditions for the digital euro to be a public good in the euro area and beyond.

The bank run (situation reflecting the intense withdrawal of deposits due to the conversion into central bank digital money, synonymous with a liquidity issue) should be avoided. There are needed "prudential liquidity requirements and individual holding limits" to contain the amount of liquidity that could be withdrawn from the banking system (Lambert et al., 2024).

Table 2: Five preconditions for the digital euro to be a European public good

Precondition	**Description**
Security	What is needed is both a secure platform for transactions that prevents fraud and the security of personally identifiable information. A lack of security may not only lead to a loss of trust in the digital currency but also damage the reputation of the central bank (Hansen and Delak, 2022).
Acceptability, accessibility, widespread circulation, and ease of use	Without widespread acceptance and circulation of the CBDC, the reputation of the issuing central bank would be at risk (Soderberg et al., 2022). The digital euro should be user-friendly to promote digital financial inclusion. This would meet the needs of those who do not have access to a bank account or lack digital or financial skills (European Parliament, 2024).
Supporting the central bank's objectives of maintaining monetary and financial stability	Any CBDC should be designed in such a way that it supports the achievement of public policy objectives, does not hinder the central bank's ability to fulfil its mandate, and does not jeopardize monetary and financial stability (G7, 2021).
Boosting competition, efficiency, and innovation in payments	The CBDC should be a catalyst for responsible innovation in the digital economy while ensuring interoperability with existing and future payment solutions (G7, 2021). The CBDC has the potential to increase competition in the retail payments sector, which could help to reduce fees charged by payment operators, with a potentially favourable impact on consumers (House of Lords of the United Kingdom, 2022).
Privacy	Rigorous standards of privacy, accountability for the protection of user data, and transparency about how information will be secured and used are essential for trust in the CBDC (G7, 2021).

Source: Table by the author, based on the literature review.

At the same time, the final version of the digital euro must resolve the issues raised by international experts. The following table compares the pros and cons of adopting the digital euro according to the conclusions drawn above.

Table 3: The case for adopting the digital euro, balanced against potential risks

Pros	**Cons**
- Address the consequences of a sharp decline in demand for cash and adapt to	- There is no threat of cash disappearing;

Pros	Cons
digitalization; - Provide an alternative to cryptocurrencies to avoid the risks associated with them; - Meet payment needs in a digital economy, efficiently, stably, and securely; - Diminish the over-reliance on non-EU payment service providers, which would strengthen the resilience of the European payment system; - Reduce the fragmentation of the EU retail payments market; - Deter illicit use of money; - Strengthen the strategic autonomy and increasing EU resilience; - Facilitate cross-border payments; - - Boost financial inclusion.	- The private sector already provides an adequate payments framework, and a public digital currency would be 'a solution in search of a problem'; - There are concerns about privacy and fear that such a currency will lead to surveillance of payments; - The potential risk of bank disintermediation, which poses a risk to financial stability; - Possible costs and technical errors; - Lack of widespread acceptance and use may lead to the damage to central bank reputation; - More than 90% of EU citizens have a bank account and there will always be a segment of the population that prefers to remain outside the digital sphere, so the digital euro does not foster financial inclusion.

Source: Table by the author, based on the literature review

III Legal and institutional framework for the digital version of the Euro

In its initial report on the digital euro, the ECB stated that it would issue a digital euro based on Article 128 of the Treaty on the Functioning of the EU (TFEU) and Article 16 of the Statute of the European System of Central Banks/ECB if it were issued as an instrument equivalent to a banknote. Conversely, it will be taken into account Article 127(2) TFEU in conjunction with Articles 17 or 22 of the Statute if the digital euro is to be designed for more limited use (ECB, 2020). In other words, these legal bases allow for a different use/approach of the digital euro. The legal basis is chosen according to the objectives envisaged to be achieved by the digital euro (Grünewald, 2023).

According to the ECB statements, the primary aim is to strengthen the monetary anchor by maintaining public access to central bank money in an increasingly digitalized economy where the use of cash as a means of payment is declining. This objective supports financial stability and control over the implementation of monetary policy, which is associated with the ECB's primary objective of maintaining price stability. Other objectives, such as ensuring the strategic autonomy of the EU and financial inclusion, are considered to be secondary, without prejudice to the objective of ensuring price stability (Grünewald, 2023).

Further Grünewald (2023) notes that the digital euro needs to be as close as possible to the way banknotes work, so limiting its ownership to €3,000-4,000 per person and limited confidentiality, even if imposed by concerns about money laundering and terrorist financing, need to be reassessed. Grünewald (2023) emphasizes that just as cash is widely accepted and used as a means of payment, so should the digital euro. Regarding the proposal to remunerate the digital euro, this would increase competition with bank deposits and other low-risk assets, harming the banking sector, which should be avoided.

Lambert et al. (2024) consider that the digital euro should incorporate safeguards, such as holding limits, to minimise risks to banks' liquidity and to the financial system. These safeguards have two aims: (i) to ensure that the digital euro would not unduly worsen the liquidity risk profile of banks and (ii) to avoid large deposit outflows.

Demertzis and Lopez (2024) reveal that the ECB's rationale for applying a ceiling is to ensure that the migration of funds from retail bank accounts to CBDC accounts does not negatively impact private deposits in a way that would affect financial intermediation. However, the ceilings that central banks have reached differ significantly (expressed in euros: Bank of England €11,000-23,000, Canada €17,000, China €1,200). Citing Bindseil (2020), the authors reiterate that if each person transfers €3,000 from his or her bank account to his or her CBDC account in digital euro, this would imply a 15% reduction in deposits for each bank. This would represent about 1 trillion euros, which is also the value of banknotes in circulation in 2020. In addition, from a consumer perspective, 3,000 Euros represents the average monthly net income of households in the Eurozone. The same authors confront two issues.

The question of holding limits is generally asked in terms of the maximum amount that can be held without disrupting the financial system. But just as necessary is the question of the minimum amount for the digital euro to be a financial anchor in an increasingly digitalized payment system (currently the financial anchor is cash). The cascade approach proposed by the ECB complicates the issue of the minimum amount in digital euro that should be held. In addition to the automatic withdrawal of funds from a linked account if there are insufficient digital euro funds for a transaction, reciprocity will also apply: i.e. if a digital euro account receives funds in excess of its holding limits, the excess will be transferred to the linked account (the "reverse cascade" approach). This no doubt adds to the convenience of using the digital euro, but it also means that there is no need to actively transfer money to digital euro accounts, as this is done automatically.

On June 28, 2023, the European Commission put forward a legislative package to establish a general framework for the digital euro to ensure seamless access to and payment with physical euro banknotes and coins throughout the euro area. According to the European Commission (2023a; 2023b; 2023c; 2023d), the package includes three legislative proposals, on:

(1) Legal tender status for euro to protect the role of cash, ensure that it is widely accepted as a means of payment and remains easily accessible to individuals and legal entities throughout the euro area.

(2) Establish the legal framework for a possible digital euro currency to complement payments with euro notes and coins. The objective would be to ensure that central bank money with legal tender status remains available to the general public, while providing state-of-the-art and cost-efficient means of payment, ensuring a high level of privacy for digital payments, maintaining financial stability, and promoting affordability and financial inclusion.

(3) Provision of services in digital euro by payment service providers registered in a Member State whose currency is not the euro and amending Regulation (EU) 2021/1230 of the European Parliament and of the Council.

The digital euro would be a CBDC, which would be directly accessible to the general public and the private sector, with the status of a legal means of payment (*retail CBDC*). It represents an adaptation of the official forms of money to technological development, complementing cash. It helps to facilitate the development of pan-European and interoperable retail payment solutions, including the full introduction of instant payments.

The *Proposal for a Regulation of the European Parliament and of the Council on the introduction of the digital euro* states that: the digital euro shall be available to natural and legal persons for the purpose of retail payments. The European Central Bank shall be responsible for authorizing the issuance of the digital euro by the European Central Bank or the national central banks of the euro area Member States. Digital euro would not fall into the category of programmable money (used only to purchase certain types of goods or services or subject to time limits after which they are no longer usable). The Commission is empowered to set holding and trading limits, *which would exclude the risk to financial stability*. However, in the literature, it is underscored that the restricted use of the digital euro would decrease its attractiveness, which would raise questions about its acceptance by the general public and companies, and therefore even about the necessity and success of the digital euro.

With the accelerated digitalization of payments, an imbalance has been created between central bank money and private digital means of payment, to the detriment of the former. The share of cash payments in total payments is decreasing, both in terms of the number of transactions and their volume. The emergence of the CBDCs from other countries/regions and private digital currencies (cryptocurrencies such as Bitcoin, Ethereum, Ripple, Cardano, Solana, Filecoin, Litecoin, Polkadot, etc.) may contribute to a drastic decline in the role of the euro in payments, both in the EU and internationally. At the same time, there is a growing risk that confidence in the euro will decline in the absence of a form of central bank money that is adapted to the digital age and also widely available.

This would give citizens and businesses an additional option – on top of the current private options – to pay in the euro area with a *cheap, secure, reliable, and widely accepted* form of digital payment, complementing the private solutions that currently exist. Once adopted by the European Parliament and the Council, the proposal would establish the legal framework for the digital euro, with the ECB deciding whether and when to issue the digital euro.

The ECB opinion on the adoption of the digital euro on October 31, 2023 states that the ECB supports the addition of two elements to the Provision governing the negotiation and conclusion of international agreements between the Union and third countries for the distribution of the digital euro to natural and legal persons resident or established in third countries.

First of all, it should be made clear that the conclusion of a high-level agreement in principle between the EU Council and a third country should be complemented by an operational agreement between the Eurosystem and the central bank of that third country. It must be verified in practice whether the third country's central bank can comply with the Eurosystem's requirements, and the distribution of the digital euro must be conditional on the results of this verification. Second, to protect the integrity of the digital euro when it is distributed outside the Union, supervisory and regulatory requirements for PSP intermediaries established or operating in the third country distributing the digital euro need to be at least equivalent to those applied in the Union.

Similarly, as regards the distribution of the digital euro to natural and legal persons resident or established in Member States whose currency is not the euro or in third countries, the ECB emphasizes the importance of concluding an Agreement between the Eurosystem and the central bank of the third country for the distribution of the digital euro as a precondition for the distribution of the digital euro. Similar agreements are also considered necessary for cross-border payments. Such provisions pave the way for EU countries outside the eurozone (including Romania) to have access to the digital euro, with all the ensuing effects.

The digital euro project should be considered within an even broader framework, shaped by the European Commission's Regulations and Communications on Digital Finance and Retail Payments (European Commission, 2020a; 2020b; 2020c; 2020d; 2022; 2023), including the Markets in Crypto Assets Regulation (MiCA) and the Digital Operational Resilience Act (DORA). These, by boosting European competitiveness and innovation in the financial sector and enhancing opportunities for the provision of modern financial services and payments, coupled with consumer protection and financial stability, pave the way for the eventual adoption of the digital euro. The digital euro could in turn support their implementation.

IV Readiness of the population and businesses for the adoption of the digital euro and potential consequences

According to the latest Study on the payment attitudes of consumers in the euro area (SPACE), there is a marked decrease in the share of point-of-sale transactions carried out in cash, from 79% in 2016 and 72% in 2019 to 59% in 2022. These percentages, however, mask the existence of small-scale users, with 74% of people making at least one cash transaction per day in 2022, which highlights the continued importance of cash alongside digital payment options (Zamora-Pérez, Marini, and Honkkila, 2024). Zamora-Pérez, Marini, and Honkkila (2024) challenge the idea that cash is only used by people who are less connected to the digital world, illustrating the high use of cash even by people with access to digital payment tools. They also show that the adoption of digital payment instruments is not only driven by supply-side limitations, suggesting the significant role of personal choice and the persistence of payment habits despite the shock of the Covid-19 pandemic.

These results should be seen in conjunction with the Eurosystem Report on the public consultation on the digital euro (ECB, 2021). *Privacy* is considered the most important feature of the digital euro by both the general public and professionals, in particular merchants and other businesses. Among the preferred options for individuals, the following stand out: privacy, security, use throughout the euro area, no additional costs, and the possibility of offline use. Given a choice between an offline privacy-focused digital euro, an online one with innovative features and additional services, or a combination of the two, retail respondents generally opt for an offline privacy-focused solution, while professional respondents find a hybrid approach more appealing.

Among the main challenges associated with the digital euro, individual respondents are concerned about privacy, accessibility, and simplicity in using the new form of currency as a means of payment. Professional respondents identify similar challenges, plus poor internet connectivity in some areas. Both categories of respondents see a need to integrate the digital euro into current banking and payment solutions. Additional services should be added to the core services, of which programmability is particularly noteworthy (ECB, 2021). It should be emphasized that programmability is understood in the sense of *automatic payments, recurring payments*, etc., not of restricted purpose or duration, which explains why the ECB indicates that the digital euro will not be programmable, but could be associated with automatic payments (ECB, 2024b).

As regards cross-border payments, people consider the following to be important: the speed of cross-border payments (mentioning that instant payments should be possible), the cost and the transparency of exchange rates. The vast majority of individuals consider that the use of the digital euro outside the euro area should not be restricted, provided that safety and security are ensured, which is also the opinion of the majority of professional respondents. In addition, as far as cross-border payments are concerned, business respondents focus mainly on the issue of interoperability and the role of intermediaries (ECB, 2021).

The introduction of the digital euro is expected to have an impact both on the EU retail payments market and on deposits. On the one hand, the digital euro could reduce the market share of existing private electronic means of payment, leading to lower revenues for some PSPs. On the other hand, the distribution of the digital euro would also mean revenues for both retail payment service providers and acquirers. In addition, the possible conversion of funds placed with PSPs (especially credit institutions) into the digital euro may reduce the liquidity and the level of income through interest rates of the payment service provider and affect the provision of credit (European Commission, 2023c).

There is an intense debate in the literature about possible disintermediation due to customers withdrawing money from deposits against the digital euro. Petracco Giudici and Di Girolamo (2023) point out that a large substitution of deposits in favour of the CBDC could have consequences on banks' balance sheets, forcing them to reduce assets, which may lead to a contraction in lending to the real economy or an increase in wholesale funding, with possible implications for financial stability. While the imposition of a maximum limit on the amount in digital euro a person can hold does not pose risks to financial stability, the impact is asymmetric, with banks being affected differently depending on their size.

Panetta (2021b; 2021c) reveals that the effects of the digital euro on banking intermediation, financial stability, and the international financial system need to be considered (Panetta, 2021c). If not properly designed, in times of crisis a digital euro could accelerate the "digital flight" from commercial banks to central banks (Panetta, 2021c). To prevent excessive and sudden shifts from commercial money to central bank money, a balance needs to be struck between maximizing the attractiveness of the digital euro as a medium of exchange and limiting its use as a form of investment (Panetta, 2021b).

V Understanding payment habits in the euro area – case studies, Austria and the Netherlands

An opinion poll conducted for the European Commission by Kantar Public[3] to understand payment habits in the euro area and in particular the attitudes towards digital payment methods highlights the following (Kantar Public, 2022).

Unlike many other countries in the Eurozone, in *Austria* cash is still the preferred means of payment for all age groups among the general public and the tech-savvy. It is the most widely accepted method of payment. In addition, many shops and restaurants as well as vending machines accept cash only. The general public and tech-savvy people use bank transfers more than their counterparts in most other eurozone countries. The Covid-19 pandemic has led to an increase in contactless debit card payments across all age groups.

Those familiar with information and communications technology (ICT) have been using more digital methods such as e-banking, PayPal and Apple Pay, but even within this group there are people who use cash routinely in various payment situations. Ownership and use of credit cards are less common in Austria than in other countries. The general public and those familiar with ICT are satisfied with the options they use and see no need for a new payment method. Recent uptake of new payment methods has been rare and largely out of necessity, mainly associated with the increase in online shopping as a result of the Covid-19 pandemic.

For both the general public and the tech-savvy, safety and security are key priorities for a digital wallet, and it needs to be more secure than current payment options. As for the digital euro, awareness is low and it is not clear why the digital euro is dif-

[3] The renowned British market research company, which became Verian in November 2023. For the study, the respondents (1,898) are divided into four categories – the general population, those attracted by technology, merchants, those who rarely or not at all use banking services/ who prefer offline activities, with group interviews focused on the first three categories and individual interviews for the fourth.

ferent from the digitally transferred euro through the banking system. There is therefore no obvious benefit compared to the current system.

Among merchants, some are familiar with the digital euro, but awareness is generally low. Traders in Austria do not see a need for the digital euro. They do not expect customer enthusiasm and do not want to be part of the early adopters of this new form of the euro. There is skepticism about the ECB's ability to manage this process successfully, as the ECB is not seen as modern or innovative. Moreover, Austrian traders do not see the digital euro as an innovative tool, nor how it could give them any advantage.

Those who rarely or do not at all use banking services/ who prefer offline activities most frequently use cash and bank transfers, with occasional use of debit cards. Security is extremely important to this group. Regarding the digital euro, they have no information about this new form of euro and are skeptical about its adoption. They do not see any benefits of the digital euro compared to current payment options and prefer to stick to their current payment methods.

These results need to be correlated with the opinion survey of 2,006 Austrian residents aged 16 and over (ONB, 2022). There is a potential 'disconnect' (mismatch) between policymakers' ambitions for the introduction of retail CBDC and consumers' stated attitudes and demand for a digital euro. Almost half of the sample express no interest in the digital euro, and almost half of those who are interested say that cash should retain its current relevance. Austrian respondents are generally satisfied with the existing payment options. Overall, the data suggest that the introduction of the digital euro will not automatically be accompanied by its widespread adoption, since the concept of the CBDC is still exotic for a large proportion of potential users.

In contrast to Austria, stand out countries that are technologically mature markets when it comes to payments, with digital payment methods more intensively used than cash. These include Belgium, Estonia, Finland, Finland, Ireland, Luxembourg, Netherlands (Kantar Public, 2022).

In the *Netherlands*, satisfaction with existing payment methods is high and only a low percentage of those surveyed are willing to adopt a new one, especially those over 65. Most of the general public and those familiar with technology are not enthusiastic about adopting a digital wallet. They consider that the added value of a digital wallet is insufficient compared to existing payment methods (debit cards, mobile apps, etc.).

The most compelling feature of a digital wallet for the Dutch would be universal acceptance across Europe. This would facilitate a single payment option, offer a new level of convenience, and eliminate the need for cash abroad.

The new wallet should be secure to use and should allow individual choice when it comes to privacy levels. Respondents prefer biometric authentication, especially facial recognition. The most popular choice for a wallet is a phone or smartwatch, but some respondents also mentioned items such as jewelry or glasses, as well as chip implantation (Kantar Public, 2022).

A survey of a sample of 3,293 people recruited from CentERpanel (an online panel of Dutch residents aged 16+) confirms that the potential early adopters of CBDC are younger, better educated, and higher income earners. While the majority of respondents had never heard of the CBDC before the survey, in contrast, about 50% expressed a general interest in CBDC, both as a means of payment and as a savings instrument. It should be emphasized that the aforementioned survey confirms that satisfaction associated with current payment options is high (Bijlsma et al., 2021), implying that additional attractiveness elements for the digital euro are needed.

Results of a survey by the German Central Bank

A representative opinion poll conducted for the German Central Bank (Deutsche Bundesbank) in April 2024[4] reveals that although half of the respondents could generally imagine using a digital euro as an additional payment option, there are still gaps in the general public's knowledge about this new payment instrument. Of those surveyed, only 41% had already heard, read, or seen some information about the digital euro, while 59% knew nothing about it.

According to the survey, respondents are particularly concerned about privacy. More than three-quarters of respondents rated the privacy aspect of using the digital euro as very important or important. Of those surveyed, 59% said that the planned offline version of the digital euro, which aims to provide a similar level of privacy protection as cash, is very important or important.

The majority of respondents (72%) think it is important that the digital euro is based on a European infrastructure, meaning that it would operate independently of global political events or decisions. The fact that the digital euro, like euro cash, is a European means of payment, issued by the central bank, is considered important by 63% of respondents.

At the same time, the survey revealed a misunderstanding of the digital euro in many cases, even among the group that had already heard, read or seen information about the digital euro. Thus, 15% understand that the digital euro was intended to replace cash and 12% are under the impression that cash will be eliminated with the

[4] Carried out by Forsa (one of Germany's leading market research and opinion polling companies) on a sample of 2,012 people.

introduction of the digital euro. Only 17% correctly answered that the digital euro is a currency intended to serve as an additional means of payment and will be issued by the European Central Bank or the central banks of the euro area countries. Moreover, about 16% of respondents believe that the digital euro is a cryptocurrency. In other words, they do not differentiate between public and private digital money. Around 8% of respondents even believe that the digital euro was meant to monitor payment flows. All this reveals the need for information campaigns on the real functions of the digital euro as an additional means of payment. Given the technical, legal, economic, and social aspects of the adoption of the digital euro, on the one hand, and the insufficient level of understanding of the digital euro among the population, on the other hand, the German authorities estimate that the first payments with the digital euro will be possible in 2028 at the earliest (Deutsche Bundesbank, 2024).

VI Conclusions

The possible adoption of the digital euro in the near future is neither equivalent to a cashless society, nor a control of society in terms of financial transactions. The protection of data and privacy is one of the ECB's objectives, and even the possibility of using the digital euro offline is envisaged, which is tantamount to a level of privacy similar to cash payments in physical shops and between individuals. At the same time, online transactions offer even higher privacy standards than current digital payment solutions, while ensuring high end-user protection against fraud, including pseudo-anonymization, hashing, and encryption.

The Digital Euro Rulebook Development Group is expected to finalize the single set of rules on the use of the digital euro. The Governing Council of the ECB will decide on the possible issuance of the digital euro only after the relevant legislation has been adopted, as the legal framework is essential for the concrete functioning of the digital euro. According to Piero Cipollone, the new Chairman of the High-Level Task Force on the Digital Euro (composed of Eurogroup representatives), the preparation phase of the digital euro is progressing well. The digital euro is a joint European effort, therefore consultation with all stakeholders, including the European public, is necessary (ECB, 2024). In the event of the eventual adoption of the digital euro, its widespread acceptance and use is tantamount to the successful launch of this new form of currency, and the very reputation of the ECB depends on it.

The ECB aims primarily to strengthen the monetary anchor by maintaining public access to central bank money in an increasingly digitalized economy in which the use of cash as a means of payment is declining. By strengthening the monetary anchor, it also ensures financial stability and control over the implementation of monetary policy, associated with the primary objective of maintaining price stability.

In addition to the argument related to the need to adapt to the digital age, which favours the adoption of the digital euro, a number of other motivations are also noted, such as offering a digital means of payment that is risk-free in contrast to cryptocurrencies; protecting user privacy; reducing over-reliance on non-EU payment service providers, strengthening strategic autonomy and increasing EU resilience; discouraging the illicit use of money; facilitating cross-border payments; fostering financial inclusion.

At the same time, however, the adoption of the digital euro is also accompanied by risks, such as reputational risk in case of non-widespread adoption; risks related to the technical solutions chosen; potential costs for PSPs and end-users; additional costs for monetary authorities; possible bank disintermediation, with negative effects on credit allocation and financial stability; lower level of privacy than expected by the public and the private sector.

In general, people and business representatives are not enough wary of the digital euro. In most opinion polls, more than half of the respondents had never heard of CBDC before the survey, so awareness of this additional means of payment is low. There is still a high percentage among respondents who fear that cash will disappear, or believe that the digital euro is a form of cryptocurrency. Moreover, some of them understand that the digital euro will be designed to strictly monitor payment flows, with the possibility of penalizing users by the authorities if certain conduct is not respected, beyond actions to combat money laundering and terrorist financing. Given that the success of a CBDC depends on its widespread acceptance and use, there is a need for the general public and the private sector to understand the need for the adoption of the digital euro, and therefore for the central banks to be able to persuade them.

The general public, the tech-savvy, and merchants are satisfied with the options they currently use and see no need for a new payment method. According to respondents, in the event of the adoption of the digital euro, this new form of public money should be based on a European infrastructure to operate independently of global political events or decisions.

Public and business expectations of the digital euro are high. These include demands for: confidentiality, security, use throughout the euro area, no additional costs, possibility of offline use, accessibility (including in terms of internet connection). As far as cross-border payments are concerned, people consider speed, cost, and transparency of exchange rates to be important. For the digital euro to be a European public good, as stated by the Community authorities, a number of conditions need to be met: security, confidentiality, acceptance, accessibility, widespread circulation, ease of use, support for the central bank's objectives of maintaining monetary and financial stability, and fostering competition, efficiency, and innovation in the field of payments.

Considering also the arguments against the adoption of the CBDC and the reputational risk, as well as the need to finalize a detailed legal framework following public debates and taking into account the requirements of all stakeholders, we believe that the process of adopting the digital euro will be a lengthy one. As indicated by the results of the most recent Bank for International Settlements survey of 86 central banks, the likelihood of central banks issuing a CBDC in the next six years is currently higher for wholesale CBDC than for retail CBDC. Given that there are also concerns in the euro area about facilitating cross-border payments by addressing current challenges (such as high costs, low speed, limited access, and insufficient transparency), it appears that the adoption of the wholesale digital euro would be more useful than the retail digital euro at present. This is also supported by the fact that, at least in the first stage, a limitation on the holding of digital euros is envisaged to limit the use of this new form of currency as a store of value. This would jeopardize the adoption and widespread use of this new form of currency. The debate on the digital euro will certainly continue and it is unlikely that the digital euro as a retail CBDC will be widely adopted in the euro area in the current decade.

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Written outside of the Eurozone, the essays do not focus on the strengths and limits of the single currency, born from a unique construction – neither an optimum currency area nor a federation. The authors sought to comprehend the compatibilities of the aspirations of the societies they live in and the Euro offer. We should not take desires for will, especially when they do not belong to the same people. Solidarity has few chances of succeeding in an environment where subconscious pushes to trust other power than the one to which we engaged to add strength. Politicians don't value pro-European discourse, as if Europe's issues only concern technocrats, not the people who elect them.

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