

LEGAL ASPECTS OF THE INTRODUCTION OF THE EURO AS THE OFFICIAL CURRENCY IN THE REPUBLIC OF CROATIA*

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ABSTRACT

The 1992 Maastricht Treaty defined the conditions for the introduction of the euro as a common currency in the European Union. These are macroeconomic indicators that measure the level of nominal convergence achieved and thus the state's readiness to participate in monetary union. These conditions (convergence criteria) relate to price stability, stability and sustainability of public finances, which includes budget deficits and public debt, exchange rate stability and convergence of long-term interest rates.

In addition to nominal convergence, the degree of legal convergence is also assessed - the provisions of national legislation relating to the independence of the central bank, the ban on monetary financing and preferential access to state financing, and integration into the European System of Central Banks are assessed. Among the member states that have not yet adopted the euro, only the Republic of Croatia is fully harmonized in this regard.

On July 10, 2020, the Croatian kuna was included in the European Exchange Rate Mechanism (ERM II). Accessing the ERM II mechanism is often referred to as the euro waiting room. Despite the fact that the pandemic caused by the COVID-19 virus has not abated, the Republic of Croatia has not stopped its efforts to become a full member of the euro area. The paper will present the benefits of the introduction of the euro, but also the inevitable costs incurred during the conversion process. As the pandemic has not slowed down the conversion process and the moment of conversion is approaching, on the other hand, there are conflicting views on the introduction of the euro as the official currency, which are trying to be implemented through a referendum.

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The paper will discuss the legal aspects of Croatia's accession to the euro area and what measures are envisaged when exchanging the Croatian kuna for the euro, especially from the aspect of consumer protection, given the fact that Croatia has one of the highest euroization rates of all non-euro area EU member states.

Keywords: *Croatian kuna, euro, euro area, euroization, pandemic*

1. INTRODUCTION

The 1992 Maastricht Treaty defined the conditions for the introduction of the euro as a common currency. These are macroeconomic indicators that measure the level of nominal convergence achieved and thus the readiness of a state to participate in a monetary union. These conditions (the convergence criteria) relate to price stability, sound and sustainable public finances, including budget deficit and public debt, exchange rate stability and convergence of long-term interest rates.¹ In addition to looking back at each of these indicators for the last 12 months, convergence sustainability is assessed.

On 10 July 2020, the Croatian kuna was included in the European Exchange Rate Mechanism (ERM II). Admission to the ERM II mechanism is often referred to as the euro area waiting room. Despite the fact that the pandemic caused by the COVID-19 virus has not abated, the Republic of Croatia has not stopped its efforts to become a full member of the euro area. The paper will present the benefits of the introduction of the euro, but also the inevitable costs incurred during the conversion process. The pandemic has not slowed down the conversion process and the moment of conversion is approaching, but on the other hand, there are opponents of the introduction of the euro as the official currency, that are trying to implement their views through a referendum.

2. THE CREATION OF THE EURO AREA

The idea of introducing a common European currency, the euro, was initiated and proposed by the founding states of today's European Union (Belgium, France, Italy, Luxembourg, the Netherlands and Germany). The aim was to speed up the process of achieving the Economic and Monetary Union, a European Union project based on harmonisation of economic and monetary policies of Member States for the purpose of creating a single monetary area and introducing the euro as a common currency. The single monetary policy is determined by the European Central Bank (ECB) and complemented by coordinated fiscal and economic

¹ Šabić, A., *Pristupanje europskom tečajnom mehanizmu ERM II – važan korak na putu prema uvođenju eura*, Pravo i porezi, No. 9/20, UDK 336.748, Zagreb, 2020, p. 8

policies. These ideas were confirmed on 1 January 1999, when the new common currency was adopted by the following 12 EU Member States: Austria, Belgium, Finland, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Germany, Portugal and Spain. The euro payment system was introduced on 1 January 2002, when euro banknotes and coins were put into circulation, while the changeover from the national currencies to euro was completed by the end of February 2002. Greece formally joined the euro area in 2001 (when it met the convergence criteria), and it was followed by Slovenia (2004), Cyprus and Malta (2008), Slovakia (2009), Estonia (2011), Latvia (2014) and Lithuania (2015). Sweden and Denmark refused to join the euro area (the 2003 referendum and the 2000 referendum, respectively). Bulgaria and Romania have started the preparation process for joining the euro area, while Poland, the Czech Republic and Hungary have expressed no interest in starting the process.²

Table 1. Origin of the euro area

| | |
|-----------------------|---|
| 1.1.1999. | The euro is becoming the new common currency of 11 member states EU and replaces the currencies of their countries (Austria, Belgium, Finland, France, Ireland, Italy, Luxembourg, Germany, the Netherlands, Portugal, Spain). These states make up the so called euro area. Exchange rates between these currencies and the euro are irrevocable determined. The currencies of their countries remain denominations of the euro. Euro, introduced as book money (euro banknotes and coins) does not yet exist. Eurosystem (European Central Bank) and national central banks of the countries that introduced the euro, takes over determining and implementing a single monetary policy for euro area. |
| 1.1.1999.-31.12.2001. | Previous period: gradual changeover to the euro for the total economy in euro area countries. |
| 1.1.2001. | Greece introduced the euro. |
| 1.1.2002. | The “old” national currencies of the euro area countries do not exist more in the form of book money. All non-cash transactions must be in transacted in the euro, not the “old” national currencies of the euro area countries. In twelve EU Member States (Austria, Belgium, Finland, France, Greece, Ireland, Italy, Luxembourg, Germany, the Netherlands, Portugal, Spain), which make up the euro area, euro banknotes and coins were put into circulation. The beginning of the so-called period of “dual circulation“. |

² Vedriš, M., *Pripreme za uvođenje eura: optimalno polazište*, EKONOMIJA/ECONOMICS, Vol. 26, No. 1, Zagreb, 2019, p. 131

| | |
|-------------------------------|--|
| 28.2.2002. (at the latest) | Banknotes and coins of 12 EU Member States (Austria, Belgium, Finland, France, Greece, Ireland, Italy, Luxembourg, Germany, the Netherlands, Portugal, Spain - these countries represent the so-called euro area) have finally been removed from circulation - the end of the so-called "dual circulation" |
| 1.1.2007. | Slovenia introduced the euro. |
| 1.1.2008. | Cyprus and Malta introduced the euro. |
| 1.1.2009. | Slovakia introduced the euro. |
| 1.1.2011. | Estonia introduced the euro. |
| 1.1.2014. | Latvia introduced the euro. |
| 1.1.2015. | Lithuania introduced the euro. |

Source: Odar, M., *Izazovi financijskog izvještavanja pri ulasku u Eurozonu – iskustva Republike Slovenije*, RiF, UDK 657.2, Zagreb, 2019

In short, it can be said that the arguments of Poland, Hungary and the Czech Republic against the introduction of the euro can be divided into three groups. First, in terms of monetary policy independence in a broader sense, policy makers and the general public have recognised the importance of the exchange rate as a stability factor and a driver of growth. This can be particularly attractive in countries with a low degree of euroisation and in the ZLB environment. Good examples of such countries are Poland, Hungary and the Czech Republic, where credit euroisation is approximately 10%-25%. Due to its high degree of euroisation, Croatia does not belong to the group arguing against the introduction of the euro. Second, the experience of peripheral countries of the euro area during the euro area crisis highlighted the importance of real income convergence, structural convergence and adjustment mechanisms. Finally, support for the euro area fell significantly during the euro area crisis. Given that the crisis arose in the euro area and had the greatest impact on euro area countries, four non-euro area Member States believe it would be better for them to remain outside the single currency area.³

According to the results of the latest Eurobarometer survey on the euro area, a large majority (76%) of respondents believe that the single currency is good for the EU. This is the greatest support since the introduction of euro coins and banknotes in 2002. Furthermore, a majority of 65% of citizens in the euro area think that the euro is good for their country, which also represents the greatest support recorded so far. Therefore, euro area countries seem to see many benefits from the euro even after the post-2010 euro area crisis.⁴

³ Deskar-Škrbić, M., Kunovac, D., *Dvadeseta godišnjica eura: zašto se neke zemlje još ne žele pridružiti? Gledište ekonomista*, available at: [<https://euro.hnb.hr/documents/2070751/2104183/p-049.pdf/0e1ad796-d11b-e939-54d1-2a58161b75cf>], p. 13, Accessed 10 February 2022

⁴ *Ibid.*, p. 17

3. THE PROCEDURE AND THE IMPLEMENTATION CRITERIA

Croatia has already experienced currency exchange. When the kuna was introduced on 30 May 1994 after the stabilisation programme, it replaced the Croatian dinar as a temporary currency issued by the Ministry of Finance with the signature of the Minister. The CNB exchanged dinars on a regular basis until the end of 1994 and subsequently until the end of June 1995.⁵

However, the process of introducing the euro is extremely complex and poses a great challenge to potential new members of the euro area, which is why the European Commission published a special book - a guide on how to prepare countries for such changes.⁶

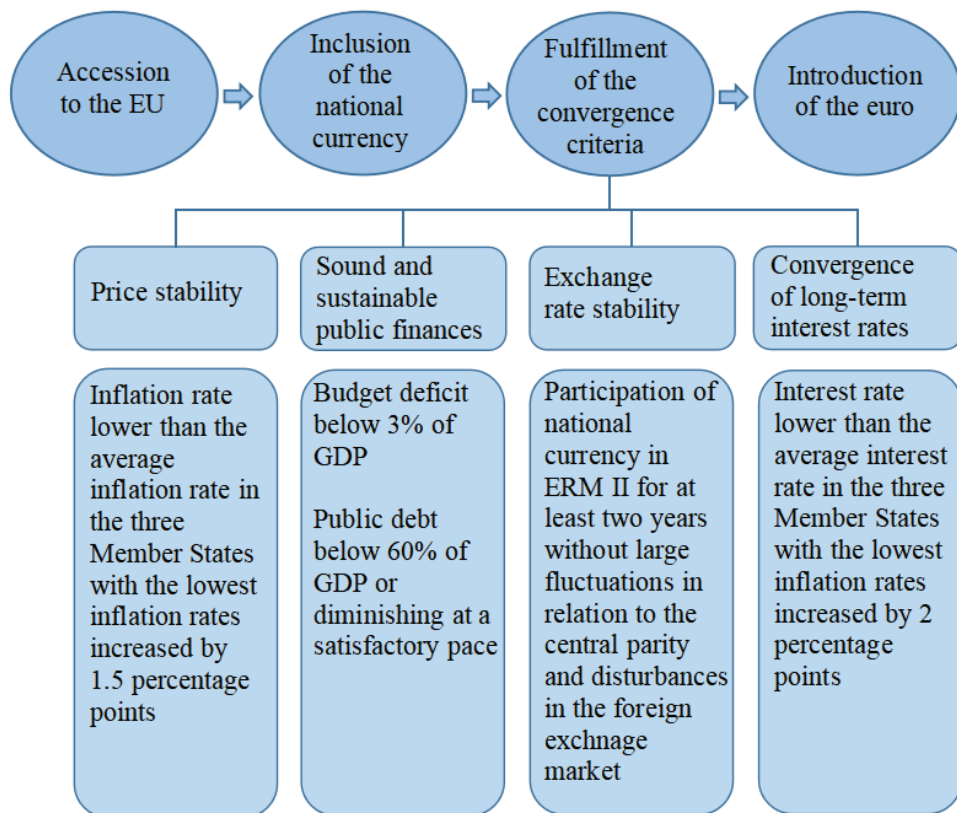
According to the price stability criterion, the inflation rate in a Member State must not exceed the average inflation rate of the three best performing EU Member States in terms of price stability, increased by 1.5 percentage points. Given the imprecise definition of the reference value, the European Commission and the European Central Bank have discretion in deciding which Member States are best performing in terms of price stability, which directly affects the decision on which countries meet this criterion. Nevertheless, it can be said that the lowest inflation rate is usually considered to be the best price stability achievement. The public finance sustainability criterion takes into account the general government deficit-to-GDP ratio, which must not exceed 3%, and the public debt-to-GDP ratio, which must be less than 60%, or if it exceeds this value, it must diminish at a satisfactory pace. In other words, in order for a Member State to be able to meet the public finance criterion, it must not be in the process of an excessive budget deficit. The exchange rate stability criterion will be considered met if the Member State has participated for at least two years in the exchange rate mechanism, and during that period there have been neither devaluations of the central parity nor large exchange rate fluctuations around the central parity. According to the criterion of long-term interest rates, the yield on long-term government bonds issued in national currency must not exceed a reference value equal to the average yield on bonds of the three best performing EU Member States in terms of price stability, increased by 2 percentage points.⁷

⁵ Blašković, A., *Novčanice kuna moći ćemo mijenjati trajno, ali za kovanice imamo ograničen rok, evo koliko je drugima ostalo 'ispod madraca'*, Poslovni dnevnik, 31 December 2021, available at: [<https://www.poslovni.hr/hrvatska/novcanice-kuna-moci-emo-mijenjati-trajno-kovanice-3-godine-4319266>], Accessed 10 February 2022

⁶ Vedriš, *op. cit.*, note 2, p. 132

⁷ Šabić, *op. cit.*, note 1, p. 9

Figure 1. Criteria for the introduction of the euro



Source: Šabić, A., *Pristupanje europskom tečajnom mehanizmu ERM II – važan korak na putu prema uvođenju eura*, Pravo i porezi, No. 9/20, UDK 336.748, Zagreb, 2020, p. 9

Since 2016, the Republic of Croatia has met all the convergence criteria, with the exception of the exchange rate stability criterion. Although it has been recording a stable exchange rate for more than a quarter of a century, it has not officially participated in ERM II for at least two years and this criterion has not been met. Among the nominal convergence criteria, the criterion referring to sound and sustainable public finances, i.e. public debt exceeding the reference value of 60% of GDP, has been until recently the biggest obstacle for Croatia. However, the consolidation achieved increases the chances that all criteria will be met in the near future. Namely, according to EU rules, the public finance sustainability criterion can be met even if the debt exceeds the reference value level, but provided that it diminishes at a satisfactory pace.⁸

⁸ Vedriš, *op. cit.*, note 2, p. 138

According to this year's reports on the convergence of the European Commission and the European Central Bank, among non-euro area Member States only Croatia and Sweden meet all economic convergence criteria, except the exchange rate criterion, as they do not participate in the ERM II exchange rate mechanism.

It is worth adding that in addition to nominal convergence, the degree of legal convergence is assessed - the provisions of national legislation relating to central bank independence, the prohibition on monetary financing and preferential access to finance and integration into the European System of Central Banks are assessed. Among the Member States that have not yet adopted the euro, only the Republic of Croatia is fully harmonised in this respect.

Table 2. Convergence criteria – Republic of Croatia

| Description | Inflation rate (04/2019-03/2020) | Participation in ERM II in the last two years | Public finance criteria | | | Long-term interest rates (04/2019 - 03/2020) |
|-----------------|----------------------------------|---|---------------------------------|---|------------------------------------|--|
| | | | Budget balance, % of GDP (2019) | Public debt, % of GDP (2019) | Excessive budget deficit procedure | |
| Croatia | 0.8 | No | 0.4 | 73.2 | No | 1.3 |
| Reference value | 1.8 | | -3% | 60% (or reduction at a satisfactory rate) | | 2.9 |

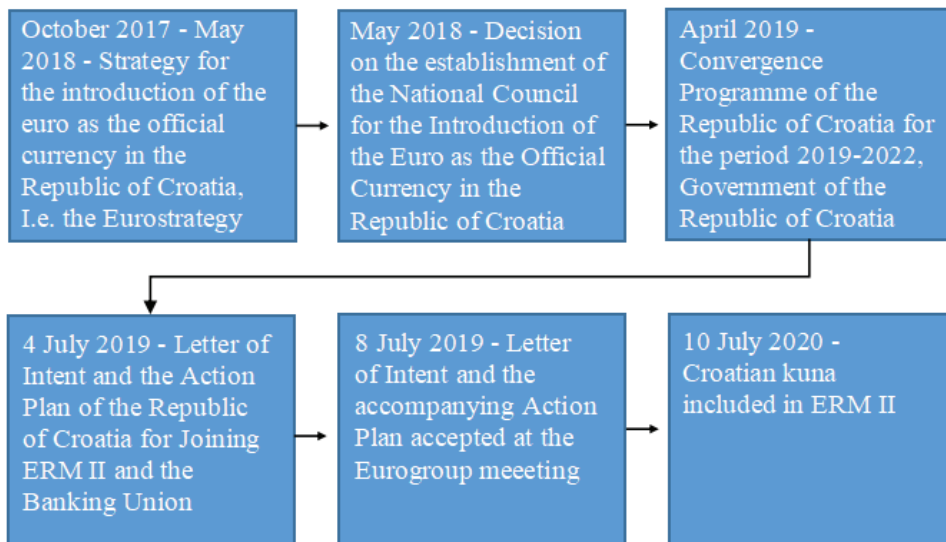
Source: European Commission, Convergence Report, Institutional Paper 129., Brussels, June 2020

The first activities aimed at preparing for ERM II entry and the introduction of the euro were launched in October 2017 by the presentation of the Strategy for the introduction of the euro as the official currency in the Republic of Croatia, which provides a cost-benefit analysis of the introduction of the euro, and describes the process of introducing a common currency and economic policy and adjustments before the introduction of the euro.

Membership in the ERM II exchange rate mechanism is an important step in determining the overall dynamics of joining the euro area. Now, after joining the ERM II mechanism, for which there are no official requirements in the European Union legislation, in the next phases leading to the final introduction of the euro, there is no room for political influence, but only criteria and procedures clearly specified in this respect.⁹

⁹ Šabić, *op. cit.*, note 1, p. 6

Figure 2. Croatia's letter of intent to join ERM II - measures and activities



Source: Author's research

Given strong growth in exports, a significant surplus in the current account of the balance of payments as well as budget deficit reduction and a gradual decline in the public debt-to-GDP ratio due to the implementation of fiscal consolidation measures combined with economic recovery, in October 2017, the Government and the Croatian National Bank prepared the Strategy for the introduction of the euro as the official currency in the Republic of Croatia¹⁰ (the so-called Eurostrategy), which was adopted in May 2018. For the needs of part of the professional, and even more so the general public, the document contains an overview of possible benefits and costs after the introduction of the euro as a national currency.

Consequently, in order to implement the Eurostrategy itself, on 10 May 2018, the Government adopted a Decision on the establishment of the National Council for the Introduction of the Euro as the Official Currency in the Republic of Croatia,¹¹ which defined reform measures that Croatia should implement as a precondition for joining the European Exchange Rate Mechanism II, i.e. the Exchange Rate Mechanism II (ERM II). The content of the letter of intent and the accompanying Action Plan of the Republic of Croatia for Joining ERM II and the Banking

¹⁰ Strategy for the introduction of the euro as the official currency in the Republic of Croatia, Government of the Republic of Croatia and Croatian National Bank, Zagreb, April 2019

¹¹ Official Gazette No. 43/2018

Union¹² were adopted at the last session of the National Council held on 3 July 2019, after which, based on the decision made at the 164th session (held on 4 July 2019), they were sent by the Republic of Croatia to the Member States of the euro area, Denmark and the institutions of the European Union, thus formally initiating the procedure for the introduction of the euro.¹³

In this context, the economic policy of the Government of the Republic of Croatia will focus in the medium term on the following three pillars: high-quality investments, efficient structural reforms and macroeconomic stability and sustainable public finances.

In summary, the National Reform Programme, the Convergence Programme of the Republic of Croatia for the period 2019-2022, the Strategy for the introduction of the euro as the official currency in the Republic of Croatia, and the Economic and fiscal policy guidelines for the period 2020-2022 are the documents that provide a fundamental framework for change important for doing business in the Republic of Croatia in a simpler and more efficient way.¹⁴

Joining ERM II is part of the implementation of the Strategy, and in order for Croatia to join ERM II, it was necessary to initiate formal requirements, i.e. procedures, which was done even before the aforementioned session of the National Council, which essentially confirmed everything previously agreed upon with the European Commission (EC), the European Central Bank (ECB) and Eurostat.

The importance of the process of preparation of the letter of intent and the Action Plan with reform measures for Croatia's international perception can be illustrated by the fact that the process of preparation for entry into ERM II, and consequently the euro area, is one of the important elements that contributed to raising Croatia's credit rating to the investment level. In this context, it should be mentioned that on 7 June 2019, the second of the world's three most important credit rating companies, Fitch, assigned Croatia a BBB investment grade rating, with a positive outlook. The importance of this is shown by the fact that the last time Croatia was at that level of investment credit rating was 14 years ago.¹⁵

¹² Action Plan of the Republic of Croatia for Joining ERM II and the Banking Union, [<https://vlada.gov.hr/UserDocsImages/Vijesti/2019/07%20srpanj/08%20srpnja/HRVATSKA%20AKCIJSKI%20PLAN%20HR.pdf>], Accessed 10 February 2022

¹³ Savić, Z., *Hrvatska na putu u ERM II i uvođenje eura*, EKONOMIJA/ECONOMICS, Vol. 26, No. 1, Zagreb, 2019, p. 113

¹⁴ Vedriš, *op. cit.*, note 2, p. 145

¹⁵ Savić, *op. cit.*, note 13, p. 113

However, it is especially important that the paper starts from the basic hypothesis that Croatia's entry into the euro area is determined not only by formally meeting the criteria, but by realistically considering the ability of the national economy to participate in such a strong environment in terms of the level of efficiency. All this and more, bearing in mind the fact that, measured by a number of globally and EU-relevant ranking lists of development and efficiency, the Republic of Croatia is often placed at the bottom of these lists by the level of its performance to achieve economic growth.¹⁶

After the letter of intent was defined and agreed upon, the letter of intent on Croatia's accession to the European Exchange Rate Mechanism II¹⁷ was accepted at the Eurogroup meeting held on 8 July 2019 in Brussels together with the Croatian Action Plan of the Republic of Croatia for Joining ERM II and the Banking Union. This was the first step towards participation in ERM II, which precedes the introduction of the euro as the official currency. Namely, in the letter of intent, Croatia commits itself to a number of reforms implemented by the Government and some other institutions as well, such as the CNB and the Central Bureau of Statistics, whose results should have a positive impact on the quality of institutions, but also on perseverance in implementing reforms in the period before joining ERM II. Specifically, the following 9 institutions are in charge of the implementation of the 19 measures listed in the Action Plan:

- Ministry of Finance,
- Ministry of State Property,
- Ministry of Justice and Public Administration (in cooperation with the Ministry of Finance),
- Ministry of Economy, Entrepreneurship and Crafts,
- Ministry of Health,
- Ministry of Construction and Physical Planning,
- Croatian National Bank,
- Central Bureau of Statistics.

Given that 9 institutions are responsible for 19 measures, the implementation of measures from the Action Plan is coordinated by the Prime Minister's Office.¹⁸

¹⁶ Vedriš, *op. cit.*, note 2, p. 147

¹⁷ Letter of Intent on Croatia's Accession to the European Exchange Rate Mechanism II, available at: [https://euro.hnb.hr/documents/2070751/2600163/hp04072019_RH_Pismo_namjere_ulazak_u_ERM-II_mehanizam_i_Akcijski_plan.pdf/94520ded-ba4a-4446-f5a8-efe2e1850ce0?t=1562657291529], Accessed 12 March 2022

¹⁸ Savić, *op. cit.*, note 13, p. 114

All measures listed in the letter of intent and the Action Plan must have been implemented by April 2020 at the latest, after which the EU institutions assess whether the measures have been adequately implemented and it is expected that after receiving a positive assessment, Croatia will commence its participation in the Exchange Rate Mechanism II (for at least two years), which precedes its entry into the euro area. In other words, in its letter of intent, Croatia expressed its expectations for joining both ERM II and the Banking Union by mid-2020, following positive assessments by the EC and the ECB of the effective implementation of previous commitments.

Most adjustments will begin once the EU institutions determine that the criteria for adopting the euro have been met.

4. WHAT IS ERM II?

The Exchange Rate Mechanism ERM II provides a framework for the movement of the national currencies of EU Member States against the euro to ensure that fluctuations between the euro and EU currencies that have not yet adopted a single currency do not jeopardise economic stability of the EU single market. On the other hand, the aim of ERM II is to prepare Member States for participation in a monetary union, which is why it is often called a waiting room for euro adoption. The European Exchange Rate Mechanism II was established on 1 January 1999, at the beginning of the third phase¹⁹ of the European Economic and Monetary Union (EMU), which introduced the euro as a single currency.

Participation in ERM II is voluntary for all EU Member States that have not yet adopted the euro. However, participation in ERM II for at least two years and without major fluctuations in the central parity and foreign exchange market disruptions is one of the criteria for the introduction of the euro (the convergence criteria or the Maastricht criteria).

Successful participation in the exchange rate mechanism proves that the state is capable of functioning in the conditions of a stable exchange rate against the euro.

¹⁹ The EMU was established progressively in three stages. In Stage 1 (that began in 1990), the free movement of capital between EU Member States was established, cooperation between central banks was increased and coordination in the field of fiscal policies was enhanced, while in Stage 2 (that began in 1994), the predecessor of the European Central Bank, i.e. the European Monetary Institute, was established, and the independence of central banks was improved. Finally, in Stage 3 (that began in 1999), the single currency, i.e. the euro, was introduced, exchange rates were irreversibly pegged (fixed conversion rates were set), the exchange rate mechanism was established and fiscal policy coordination was further strengthened through the adoption of the Stability and Growth Pact

4.1. What are the main determinants of ERM II regarding the Republic of Croatia?

The main elements of ERM II participation are the central parity - the exchange rate of the national currency against the euro against which exchange rate stability will be assessed is determined by mutual agreement between the euro area countries and ERM II participants, the European Central Bank and the European Commission, and the acceding country, and - fluctuation margins in relation to the previously defined exchange rate level. These two values are, therefore, important because participation in the exchange rate mechanism, i.e. success in maintaining a stable exchange rate, is assessed in relation thereto. A standard fluctuation margin is $\pm 15\%$ of the central parity, and it is possible to unilaterally commit to or jointly agree on narrower limits.²⁰ While participating in the exchange rate mechanism, the exchange rate of the national currency must be stable in relation to the previously agreed central parity against the euro. Devaluation of the central parity is not allowed; in the event of devaluation or weakening of the central parity, participation in ERM II would be considered unsuccessful, i.e. the country would not be able to maintain exchange rate stability, and the time period of participation in the mechanism would be interrupted. On the other hand, in case of revaluation, which does not increase a country's competitiveness, but quite the contrary, such a situation would not nullify the time spent in ERM II.²¹ The central parity should be determined as close as possible to the equilibrium real exchange rate. Its importance is also evidenced by the fact that the fixed conversion rate decided by the Council of the European Union when adopting the euro is usually equal to the value of the central parity.²²

For a positive assessment of participation in ERM II it is actually necessary to keep the exchange rate as close to the central parity as possible. In the case of significant appreciation, such an approach to the fluctuation margin will not be considered problematic, but if there is any significant weakening of the exchange rate or depreciation, it will be considered that the state does not meet the exchange rate stability criterion.

The condition for joining ERM II is the simplest way to keep a Member State considered incompatible outside the euro area. However, once a country enters ERM II and meets clearly defined convergence criteria, there is no way to prevent

²⁰ Savić, *op. cit.*, note 13, p. 114

²¹ An example is Slovakia, which changed its central parity twice during its participation in ERM II (revalued by 8.5% and 17.6%, respectively), also in agreement with the euro area, other ERM II participants and the EU institutions

²² This was the case for all Member States except Slovakia

that Member State from adopting the euro. It can be said that time until entry into the monetary union and the introduction of the euro starts to run on the day of joining the ERM II mechanism.

Following a positive assessment by the European Commission and the European Central Bank, the country may formally request entry into the ERM II exchange rate mechanism.

The letter of intent to join ERM II was sent on 4 July 2019. In the letter of intent, the Republic of Croatia undertook to implement a total of 19 measures in the following six areas: further strengthening banking supervision by entering into close cooperation between the Croatian National Bank and the European Central Bank, strengthening the macroprudential policy framework, strengthening the framework for anti-money laundering and countering the financing of terrorism, improving the collection, production and dissemination of statistics, improving public sector management, and reducing administrative and financial burden on the economy. Prior to that, in May 2019, a request was sent to the European Central Bank to establish close cooperation between the Croatian National Bank and the European Central Bank. Both of these elements, i.e. the measures previously taken by the ERM II candidate country to be implemented before its entry into ERM II and close cooperation established with the European Central Bank, are part of a new approach to the ERM II accession negotiations. In accordance with the plan, all reform measures were implemented by May 2020, thus fulfilling the conditions for submitting a formal request to join the exchange rate mechanism in July 2020.

In particular, the Croatian authorities undertook to implement 8 measures in 4 areas following the reform measures implemented before entry into ERM II, namely strengthening the anti-money laundering framework following the transposition of the Fifth Anti-Money Laundering Directive, further reducing administrative and financial burden on the economy, strengthening corporate governance in state-owned enterprises, and strengthening the national bankruptcy framework. They are planned to be implemented by March 2022. In its request to join the ERM II mechanism, the Republic of Croatia proposed that the central parity should be at a level that corresponds to the market exchange rate on the day of submitting the request and that standard fluctuation margins of $\pm 15\%$ should be applied. A joint agreement with the finance ministers of the euro area Member States, the finance minister and the governor of the Central Bank of Denmark as a member of ERM II, and the president of the European Central Bank decided on 10 July to include the kuna in ERM II.

In such a defined process, two Member States, i.e. the Republic of Croatia and Bulgaria, joined ERM II together in July 2020.

4.2. What are the main determinants of participation of the Croatian kuna in ERM II?

There are two main determinants of participation of the Croatian kuna in ERM II, i.e. the central parity set at the level of 1 euro = 7.53450 kuna and a standard fluctuation margin of $\pm 15\%$ around the central parity. The central parity corresponds to the reference nominal exchange rate or the market exchange rate on the date of entry into the ERM II mechanism. At this level of the nominal exchange rate, the real effective exchange rate of the kuna is in line with macroeconomic fundamentals.

4.3. What are the next steps towards the introduction of the euro in the Republic of Croatia?

In the coming period, it is necessary to participate in the ERM II exchange rate mechanism for at least two years and meet other criteria for the introduction of the euro.

An assessment of whether the Republic of Croatia meets all conditions for the introduction of the euro is given by the European Commission and the European Central Bank in their regular reports prepared by these two institutions every two years or at the request of a Member State. On the basis of a positive assessment, when it is assessed that the convergence criteria are in line with Article 140 of the Treaty on the Functioning of the EU, the Council of the European Union adopts a decision on the introduction of the euro and sets a fixed conversion rate in the Convergence Report. This decision is made approximately half a year before the date of the introduction of the euro. At the same time, the Republic of Croatia needs to prepare for the practical aspects of the introduction of the euro.

5. DEGREE OF EUROISATION IN CROATIA

Experiences with high inflation have proven to be a crucial reason for a loss of confidence in the domestic currency and the presence of a high degree of euroisation in many countries. For example, those countries in Central, Eastern and Southeastern Europe that recorded the highest annual inflation rates during the transition period maintain on average higher degrees of deposit euroisation in the banking system in the post-transition period.²³

²³ Savić, *op. cit.*, note 13, p. 101

Croatia has the highest deposit euroisation of all non-euro area EU Member States. In addition, Croatia is strongly trade-integrated with the euro area (>50% of merchandise trade).

Its stability was extremely high during the entire period of its existence, and it was maintained by implementing the so-called managed floating exchange rate. Despite this stability, Croatian citizens keep and express higher values (such as real estate or cars) in euros. In addition, Croats enter currency risks in borrowing, which is still predominantly in kuna linked by a currency clause to the euro, although current circumstances are more conducive to borrowing in kuna. The high degree of deposit euroisation can also be illustrated by the fact that the savings of Croatian citizens in euros have never been less than 66% of the value of total savings, and on average, in the last eight years it amounted to more than 70%. This is the highest deposit euroisation in all EU countries that are not part of the euro area.²⁴ For example, in Poland and the Czech Republic, euro savings are around 10% (Poland) and around 5% (Czech Republic), and this is the main reason why these countries have not yet adopted the euro. For the same reasons, the interest of their savers regarding the introduction of the euro is much lower than that of Croatian savers.

In one group of countries (including Croatia, Bulgaria and to some extent Romania), high degrees of deposit euroisation have led to credit euroisation as a result of hedging.²⁵

Household savings are primarily kept in euros, not in kuna, and they account for 66% of the population's savings and time deposits. Although this is the downward trend as this share has gradually fallen from around 76% in late 2010 to around 66% in the first half of 2019, it is still maintained at high levels.²⁶

Household savings in euros have never been below 66%, averaging 76% over the last 9.5 years, confirming the high degree of deposit euroisation, which is highest among Central and Eastern European countries.

For the purpose of comparison, the share of foreign currency deposits in total savings and time deposits in the countries of Central and Eastern Europe comparable to Croatia is significantly lower. In Bulgaria, for example, the level is gradually declining to less than 45%, in Romania it is falling towards 30%, in Hungary it

²⁴ Savić, *op. cit.*, note 13, p. 101

²⁵ Dumičić, M.; Ljubaj, I.; Martinis, A., *Perzistentnost euroizacije u Hrvatskoj*, Pregledi P-37, [<https://euro.hnb.hr/documents/2070751/2104183/p-037.pdf/d98fb3cf-a191-45c4-b93e-92de959914ea>], Accessed 12 March 2022

²⁶ Savić, *op. cit.*, note 13, p. 101

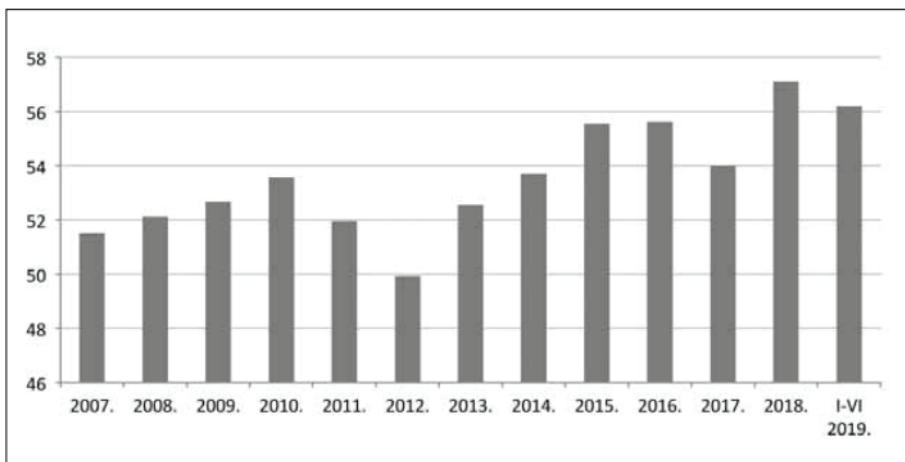
is maintained at more than 10%, whereas in Poland it is around 5% and slightly more than that in the Czech Republic.

The currency structure of loans to households shows that about 46% of loans are in kuna with a currency clause in euros. In the last 9.5 years, loans granted in kuna with a currency clause in euros have averaged 54%, with the share never dropping below 45%. It should be noted that the trend of this share has been declining for several years.²⁷

Euro loans have been granted predominantly. The Croatian experience with the loans in Swiss francs influenced the strengthening of repayment security, i.e. the perception of greater security of stable annuities in the case of pure kuna loans. Therefore, since mid-2013, and more intensively since the end of 2015, there has been a pronounced trend of decreasing the share of foreign currency loans to households in total loans, while, as expected, the share of kuna loans in total loans is on the rise. In mid-2018, the share of kuna loans reached and exceeded the share level of foreign currency loans. Then, at the beginning of 2019, they reached and exceeded the share level of 50%, with a tendency to move upward.

It should be noted that exports to euro area countries are dominant in total merchandise exports and reached 56% of the value in 2018, and this level was maintained in the first half of 2019.

Graph 1. Share of exports to the euro area by years, in percentage

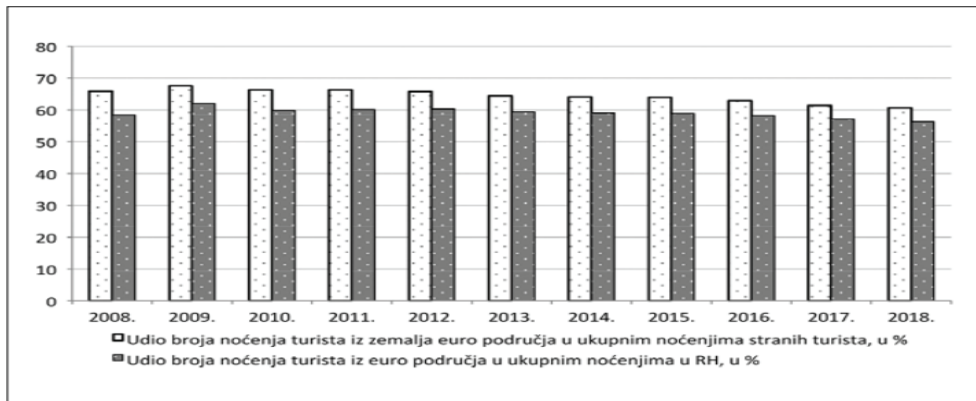


Source: Savić, Z., *Hrvatska na putu u ERM II i uvođenje eura*, EKONOMIJA/ECONOMICS, Vol. 26, No. 1, Zagreb, 2019, p. 109

²⁷ Savić, *op. cit.*, note 13, p. 102

Tourism also shows heavy reliance on the euro area countries, i.e. the area that is the most important emitting market. This is confirmed by the basic tourism indicators, i.e. overnight stays and spending. Overnight stays of tourists coming from the euro area countries account for 61% of total overnight stays of foreign tourists. In addition, overnight stays of tourists coming from the euro area countries account for 56% of all tourist overnight stays, and about 66% of expenditure by foreign tourists is generated from visitors coming from the euro area countries.²⁸

Graph 2. Share of overnight stays of tourists coming from the euro area, in percentage



- Share of the number of overnight stays of tourists from euro area countries in total overnight stays of foreign tourists, in %

- Share of the number of overnight stays of tourists from euro area countries in total overnight stays, in %

Source: Savić, Z., Hrvatska na putu u ERM II i uvođenje eura, EKONOMIJA/ECONOMICS, Vol. 26, No. 1, Zagreb, 2019, p. 109

Based on the Croatian experience, it can be concluded that high euroisation is extremely difficult to eradicate.

The key reason is the fact that in the past period, i.e. in more than two decades, the national currency was closely linked first to the DEM exchange rate, and then since the full introduction of the euro (in 2002) with the euro exchange rate. It was a highly managed exchange rate conducted by the CNB and with small nominal oscillations in a very narrow (nominal) corridor.²⁹

²⁸ Savić, *op. cit.*, note 13, p. 109

²⁹ Vedriš, *op. cit.*, note 2, p. 130

6. BENEFITS FROM THE INTRODUCTION OF THE EURO

The greatest benefit of the introduction of the euro is the elimination of currency risk. Total foreign currency debt, including debt with a currency clause, exceeds HRK 500 billion (approximately 150% of GDP), and more than 90% of this amount is linked to the euro.

Furthermore, the introduction of the euro in the Republic of Croatia will bring interest rates closer to their levels in the euro area, which will increase the competitiveness of the Croatian economy.

In addition, the likelihood of costly banking crises will be reduced and the risk of a currency crisis will disappear completely.³⁰

The introduction of the euro will also eliminate currency exchange or transaction costs because it will no longer be necessary to execute exchange transactions, i.e. convert euros to kuna and vice versa. Furthermore, when the euro becomes legal tender in the Republic of Croatia, charges for national payments in euros should be reduced to the level of current charges for national payments in kuna. Thus, the introduction of the euro will have a positive impact on e.g. the competitiveness of Croatian exporters. Having the euro as a common currency can help boost international trade and investment. More favourable conditions for international trade arise from reduced transaction costs, greater transparency and easier price comparison, as well as the elimination of uncertainties related to exchange rate movements. Furthermore, after the introduction of the euro in the Republic of Croatia, the Croatian National Bank (hereinafter: the CNB) will gain the right to participate in the annual allocation of monetary income at Eurosystem level, which should have a positive impact on the excess of CNB revenues over expenditures paid into the state budget. By joining the euro area, the CNB will be entitled to a share in the total monetary income of the Eurosystem, but will also retain the majority of its international reserves in the form of an investment portfolio based upon which it will continue to generate income. By joining the monetary union, Croatia will also gain access to the European Stability Mechanism (hereinafter: ESM), which serves to provide assistance to members facing financial difficulties. If access is not possible, the Republic of Croatia will be able to request a loan conditional on the implementation of a macroeconomic adjustment programme. The ESM has a maximum lending capacity of EUR 500 billion, obtained by issuing securities on the financial markets. So far, the ESM has disbursed a total of

³⁰ Korda, Z., *Uvođenje eura kao službene valute u Republici Hrvatskoj*, Informator, No. 6522, Zagreb, 2018, p. 8

EUR 79.3 billion in financial assistance to three euro area Member States, namely Greece, Cyprus and Spain.³¹

Table 3. Benefits from the introduction of the euro

| | Importance | Time effect |
|--|------------|-------------|
| Currency risk elimination | Great | Permanent |
| Interest rate reduction | Medium | Permanent |
| Elimination of the risk of a currency crisis and reduction of the risk of a banking and balance-of-payments crisis | Medium | Permanent |
| Lower transaction costs | Little | Permanent |
| Encouraging international trade and investment | Medium | Permanent |
| Participation in the allocation of monetary income of the Euro-system | Little | Permanent |
| Access to euro area financial assistance mechanisms | Little | Permanent |

Source: Vedriš, M., *Pripreme za uvođenje eura: optimalno polazište*, EKONOMIJA/ECONOMICS, Vol. 26, No. 1, Zagreb, 2019, p. 135

7. THE COST OF INTRODUCING THE EURO

With the changeover to the euro, the central bank loses the ability to independently manage the exchange rate as the main instrument of monetary policy. Instead, the CNB, together with other national central banks (NCBs) of the Euro-system, will participate in the conduct of the European Central Bank's common monetary policy.

Table 4. The cost of introducing the euro

| | Importance | Time effect |
|---|------------|-------------|
| Loss of independent monetary policy | Little | Permanent |
| Risk of rising price levels during conversion | Little | One-off |
| Risk of excessive capital inflows and growth of imbalances | Little | Permanent |
| Conversion costs | Little | One-off |
| Transfer of funds to the European Central Bank | Little | One-off |
| Participation in the provision of financial assistance to other Member States | Medium | One-off |

Source: Strategy for the introduction of the euro as the official currency in the Republic of Croatia, Government of the Republic of Croatia and Croatian National Bank, Zagreb, April 2019

³¹ Korda, *op. cit.*, note 30, p. 9

The business cycle in the Republic of Croatia is harmonised with the business cycle in the euro area. However, the expected rise in prices is the main argument against the introduction of the euro, and one of the objective reasons for a price increase is shifting conversion costs to clients. Furthermore, in the conversion phase, entrepreneurs, as a rule, round up prices.

The conducted analyses show that the effects of the introduction of the euro on inflation were relatively small and temporary. The effect of the conversion of national currencies into the euro on overall consumer price inflation in euro area countries was mild. At the same time, a somewhat more pronounced increase in prices was mainly recorded in the service sector and with a smaller number of goods that are purchased more frequently. Several important factors are mentioned in the literature that explain why the conversion of national currencies to the euro may spur price increases. Thus, one of the reasons is the spillover of conversion costs, which include, for example, costs that a firm incurs as a result of changing its prices (so-called menu costs) and IT support costs, onto consumers. Furthermore, it is known that a significant part of prices is formed at the so-called attractive level, which implies price rounding that makes payment practical (such that not many coins/banknotes are needed as change), or setting prices so that they end in 9 (so-called charm or psychological pricing), which affect consumers by underestimating the cost of the purchased product. Therefore, the next factor that may lead to price increases at the time of conversion refers to the possibility that companies do not round prices symmetrically (either downward or upward) to make their amount in euros reach a new attractive level, but rather round them up.³²

Transport prices and prices in restaurants and hairdressing salons increased in Slovenia after the introduction of the euro, while in Slovakia, the prices of food and construction works increased.³³

Research has shown that these are mostly products that do not affect lower-income individuals but rather those with higher incomes, such as accommodation, restaurants, and sports services, and these are usually services used by higher-income individuals, as explained by Mavriček.

It should be emphasised that the growth of prices following the introduction of the euro was lower in countries with the dual pricing obligation (i.e. prices in-

³² Pufnik, A., *Učinci uvođenja eura na kretanje potrošačkih cijena i percepcije inflacije: pregled dosadašnjih iskustava i ocjena mogućih učinaka u Hrvatskoj*, Zagreb, October 2017, PREGLEDI P-34 [<https://euro.hnb.hr/documents/2070751/2104183/p-034.pdf/f996270d-b35b-4be2-ae90-5a39b3145a36>], Accessed 12 March 2022

³³ Odar, M., *Izazovi financijskog izvještavanja pri ulasku u Eurozonu – iskustva Republike Slovenije*, RiF, UDK 657.2, Zagreb, 2019, pp. 36-42

licated in both the national currency and the euro) prescribed for the period several months before and after the day of conversion. Experience has shown that in the process of conversion, the highest increases in prices have been recorded in catering services (i.e. restaurants, cafés and the like), accommodation services, hairdressing services, various repairs, dry-cleaning services and recreational and sporting services.³⁴

After the introduction of the euro, there will be one-off costs related to the production of euro banknotes and coins, their distribution and withdrawal of kuna banknotes and coins. The costs of system harmonisation should also be taken into account, such as cash payment adjustments (for example, ATMs and other cash deposit machines), adjustments of information systems and accounting and reporting systems for business entities, as well as legal adjustments to ensure the continuity of contracts and financial instruments. One-off costs also include expenditures for information campaigns and training of employees, especially of financial institutions, with the aim of better informing the general public. According to the experience of countries that have introduced the euro so far, one-off conversion costs could amount to around HRK 1.8 billion (i.e. 0.5% of GDP). The conversion costs are expected to be slightly lower than in other Member States, given a high degree of euroisation of the Croatian economy, but also the importance of the tourism sector, which generates large cash inflows in euros. Furthermore, after joining the monetary union, the CNB will have to pay the appropriate amount to the ECB for capital and reserves and transfer part of its international reserves to the ECB. The amounts of these liabilities are determined according to the share of the Member State in total population and GDP of the European Union. For the CNB, the capital subscription key is currently 0.6023%.³⁵

By introducing the euro, the Republic of Croatia will have to pay the remaining 62.8 million euros. The CNB is also obliged to contribute to the ECB's reserves by making payments to the revaluation account and to the reserve account.

In addition to paying capital and reserves, the CNB is obliged to transfer HRK 350 million of foreign exchange reserves to the ECB, which represents about 2% of current gross international reserves. By joining the monetary union, the Republic of Croatia also acquires the right to make use of financial assistance, but at the same time it is obliged to participate in the costs related to solidarity assistance to other members of the euro area. The main cost relates to the payment of an additional amount to the ECB's share capital. The costs of participating in assistance

³⁴ Pufnik, *op. cit.*, note 32

³⁵ Korda, *op. cit.*, note 30, p. 9

mechanisms for euro area member countries, assuming that the Republic of Croatia joined the euro area in 2016, would be around EUR 425 million.

This amount, which includes an adjustment of capital due to relatively lower income compared to the EU average, should be paid by the Republic of Croatia from the state budget over several years, i.e. in five installments of approximately 85 million euro.³⁶

8. THE CHANGEOVER FROM THE KUNA TO THE EURO

The Republic of Croatia will most likely introduce the euro as its currency in 2023, and the burning question is what this transition will look like. Tihomir Mavriček, Executive Director of the CNB's Cash Department, says that the goal is to introduce the euro on 1 January 2023, but the final decision is made by the Council of the European Union.

The exchange rate will be around 7.53, but it will be finally determined in May or June 2022 and will be valid from 1 January 2023. The commercial currency exchange rate will be valid until 31 December 2022.

8.1. Timeline for the conversion of the kuna to the euro

As for the storage of the kuna to be replaced by the euro, Mavriček said that since the introduction of the kuna, the CNB has produced 2.8 billion kuna coins.

“If we lined them up side by side, vertically, we would get 4,500 km of coins, i.e. the distance between Zagreb, Croatia, to Riyadh, Saudi Arabia. These coins weigh about 10,000 tons. Based on the experience of other countries, we expect about 35% of coins or 1.13 billion pieces of coins to be returned. That is about 5,200 tons, which corresponds to the weight of 124 new Zagreb trams. If a truck can load 20 tons of coins, we are talking about approximately 260 trucks of kuna coins,” Mavriček explained.

All kuna accounts will automatically converted to accounts in euros.

Unlike kuna banknotes that will be exchanged into euros indefinitely, the exchange of coins will be possible up to three years after the introduction of the euro. In the first year, everyone will be able to exchange kuna for euros free of charge in banks, Financial Agency (FINA) and the Croatian Post offices, and after that exclusively in the Croatian National Bank. It should be stressed that banks are not

³⁶ Korda, *op. cit.*, note 30, p. 9

required to accept more than one hundred banknotes and one hundred pieces of coins in one transaction.

According to the experience of other countries that have joined the euro area, the central bank expects that when exchanging the kuna for the euro, about 36% of the coins in circulation will be returned, or 1.1 billion kuna coins, and 99% of the banknotes, or more than 500 million pieces of kuna banknotes.³⁷

The experiences of European countries are diverse. It is estimated that twenty years after euro coins and banknotes started to be used for payments on a daily basis, there are still around 8.5 billion euros left in the former national currencies. For example, according to the information from the Deutsche Bundesbank, a huge amount of German marks remained in many places. According to some estimates, there are almost six billion marks. Even today, German marks can be converted into euros.

Table 5. National plans for replacement of national currencies with the euro

| National central bank | Banknotes are valid up to | Coins are valid up to |
|-----------------------|-------------------------------|------------------------|
| Austria | unlimited | unlimited |
| Belgium | unlimited | deadline expired 2004. |
| Cyprus | deadline expired 31.12.2017 | deadline expired 2009. |
| Estonia | unlimited | unlimited |
| Finland | deadline expired 2012. | deadline expired 2012. |
| France | deadline expired 2012. | deadline expired 2005. |
| Greece | deadline expired 2012. | deadline expired 2004. |
| Ireland | unlimited | unlimited |
| Italy | deadline expired 2012. | deadline expired 2012. |
| Latvia | unlimited | unlimited |
| Lithuania | unlimited | unlimited |
| Luxembourg | unlimited | deadline expired 2004. |
| Malta | deadline expired 31.1.2018. | deadline expired 2010. |
| Netherlands | deadline expires on 1.1.2032. | deadline expired 2007. |
| Germany | unlimited | unlimited |
| Portugal | deadline expired 28.2.2022. | deadline expired 2002. |
| 200Slovakia | unlimited | deadline expired 2013. |
| Slovenia | unlimited | deadline expired 2016. |
| Spain | deadline expired 31.12.2020. | deadline expired 2020. |

³⁷ Blašković, *op. cit.*, note 6

Source: European Union, available at: [https://european-union.europa.eu/institutions-law-budget/euro/exchanging-national-currency_en], Accessed 10 March 2022

As for savings and loans, they will also automatically be converted into euros, and after 1 January 2023, salaries and pensions will also be paid in euros.³⁸

The Croatian National Bank has also prepared a special vault where it will store and keep all collected money until it is destroyed.

Coins will be stored in the premises of the Ministry of Defense of the Republic of Croatia, while banknotes will be located in a safer place - in vaults, which have already been built for that purpose.

It is estimated that there will be fewer euro coins, but not because of the exchange rate. There is a conversion methodology that was developed by the European Monetary Institute, which is based on the fact that there is more or less the same number of coins and banknotes as for the national currency, but the number of banknotes still prevails.

The euro becomes legal tender in Croatia on the day of its introduction, and the conversion rate is fixed.

The conversion of cash, deposits, loans, prices and other monetary values will be carried out free of charge by applying a fixed conversion rate. In the conversion process, cash, prices and all other amounts expressed in HRK will be converted into euros by applying the full numerical expression of the fixed conversion rate, i.e. including all of its five decimals and then rounding the obtained amount to two decimal places. The conversion of monetary values by applying a short form of the fixed conversion rate will not be allowed.³⁹

Most kuna coins and banknotes will be converted into euros within 2 weeks following the introduction of the euro, and the CNB will exchange banknotes without anytime limit. Banks will exchange kuna banknotes and coins into euros one year after the date of the introduction of the euro. In the first six months, banks will provide cash exchange services free of charge, and in the next six months, they

³⁸ MojPosao.net - Uvodimo euro, promjene već idućeg ljeta. Evo kako će se mijenjati kune, krediti... [<https://www.moj-posao.net/HR/Articles/Details/81328/Uvodimo-euro-promjene-vec-iduceg-ljeta-Evo-kako-ce-se-mijenjati-kune-krediti/#ixzz7UJtHdtlj>], Accessed 10 March 2022

³⁹ Guidelines for the adjustment of the economy in the process of replacing the Croatian kuna with the euro, Coordination Committee for Economic Adjustment and Consumer Protection, January 2022, [https://euro.hnb.hr/documents/2070751/2104255/h-smjernice-zamjena-hrvatske-kune-eurom_sijecanj-2022.pdf/41a06aed-f094-7d7e-d5e4-fbdf5c8f4584?t=1642409233015], Accessed 10 March 2022

may charge a fee for this service. In the first six months (starting with the day of the introduction of the euro), it will also be possible to exchange kuna cash for euro free of charge at FINA and Croatian Post offices.

The CNB will exchange kuna banknotes for euro for an unlimited period of time, while kuna coins will be exchanged for up to three years following the introduction of the euro. After the expiry of the period during which banks, FINA and the Croatian Post are planned to provide cash exchange services, citizens will be able to exchange their cash exclusively at the CNB. The central bank will exchange banknotes free of charge for an unlimited period of time, and coins for up to three years from the introduction of the euro. Despite very long periods of time for the exchange, the kuna cash exchange process is expected to be particularly intensive in the first two weeks after the introduction of the euro.

8.2. Conversion of kuna assets in bank accounts

The conversion of kuna assets in bank accounts into the euro will be performed instantaneously on the day of the introduction of the euro. All kuna assets in current, giro and savings accounts with domestic banks will be changed over to euros free of charge on the day of the introduction the euro. Hence, unlike cash, whose exchange is time-consuming and logistically challenging, the money held in bank accounts will be converted into euros quickly and easily, with no need for a transitional period. This is the reason why citizens will be invited in the months leading to the introduction of the euro to deposit as much cash as possible into their bank accounts. As all kuna assets in bank accounts will be converted to euros on the day of the introduction of the euro, starting from that day all non-cash payment transactions will be executed only in euros.

As of the date of the introduction of the euro, all kuna loans and loans with a currency clause in euros will be considered as loans in euro. The introduction of the euro will not necessarily lead to amendments to existing loan agreements, regardless of whether these are kuna loans or loans with a currency clause in euros, since the question of their conversion will be regulated by the act regulating the introduction of the euro in the Republic of Croatia (hereinafter: the Euro Act⁴⁰). Specifically, according to this act, loan agreements shall remain in force, and the amounts expressed in kuna in these agreements shall be considered as amounts in euro. In so doing, these amounts shall be converted at a fixed conversion rate free of charge for borrowers. If the personal loan interest rate is fixed, it will continue

⁴⁰ The Euro Act will be the basic legal framework with which 46 acts and about 70 by-laws will be amended

to be applied after the introduction of the euro. On the other hand, if the loan was agreed with a variable interest rate linked to a specific parameter, pursuant to the Euro Act provisions, this parameter will be modified as necessary, which will be regulated by the Euro Act. In so doing, the financial position of borrowers shall not become worse. Banks will notify their clients of upcoming changes a few weeks prior to the official euro changeover date.

8.3. Dual circulation of the euro and the kuna

Both currencies, i.e. the kuna and the euro, will be in circulation in the first two weeks after the introduction of the euro and after the expiry of that period, only the euro will have the status of legal tender. For the purpose of ensuring a smooth transition to the new currency, both the kuna and the euro will have the status of legal tender during a short transitional period. In other words, in the first two weeks after the date of the introduction of the euro, citizens will be able to use any of the two currencies to pay for their purchases. However, retailers will be expected to give change exclusively in euro. This implies that retailers will exchange part of the total amount of kuna cash in circulation to euro. A rule will be laid down under which a retailer will not be obliged to accept more than 50 kuna coins per one transaction with a buyer. After the two weeks following the date of the introduction of the euro, the euro will become the sole legal tender in the Republic of Croatia.

The competent authorities will undertake a number of measures aimed at protecting consumers from unjustified price increases and an incorrect price conversion. Public opinion polls have shown that there is fear among Croatian citizens that the introduction of the euro will lead to a strong one-off price increase. However, experiences of countries that have already introduced the euro have indicated that such fears are unfounded, especially if the competent authorities undertake adequate measures aimed at consumer protection.

8.4. Obligation of dual price display

The results of a survey published by the European Commission⁴¹ show that citizens in Croatia, similarly to other EU countries that have committed themselves to adopting a common currency, are largely afraid that the introduction of the euro could result in price increases and pricing abuses. In order to limit the effect of conversion on price increases, certain measures are planned to be taken to be ef-

⁴¹ Flash Eurobarometer 453, May 2017, available at: [<https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/ResultDoc/download/DocumentKy/78338>], Accessed 29 November 2021

fective in countries that have already adopted the euro (the Strategy). Thus, one of the effective ways to prevent the growth of consumer prices due to currency conversion proved to be the measure of mandatory dual price display in shops in the old and new currency for some time before and after the euro changeover, which reduces the efforts of citizens pertaining to price recalculation and facilitates the detection of unfounded price increases. Furthermore, it is useful to develop detailed instructions for price rounding, which companies should adhere to.⁴²

Dual display of prices will be the key measure for consumer protection in the process of introducing the euro. The obligation of dual price display is a key measure aimed at preventing unjustified price increases and incorrect price recalculations. The introduction of a new currency may temporarily make price comparisons more difficult, which some retailers might try to use to increase their profits at the expense of consumers. In order to prevent such practices, by adopting the Euro Act and amending relevant regulations, the Government of the Republic of Croatia will introduce the obligation of dual price display, which will be in force in the period from 30 days after the EU Council decision on the introduction of the euro in Croatia to 12 months after the day of the introduction of the euro. The obligation of dual price display will facilitate identification of retailers and service providers who have increased prices with no justifiable reason or have incorrectly converted them to euros. It will be possible to report cases of unjustified price increases or of incorrect price conversion at the official website dedicated to the introduction of the euro (www.euro.hr) and via other channels.

The companies will have to display dual prices on price lists and promotional materials published on websites and in the media. Each company's cash registers will also be adjusted to dual price display so that the prices of individual products and the invoice total due amount are shown in both currencies. During the period of dual display of prices, the price lists must not contain unnecessary information that could confuse the consumers. Thus, for example, in addition to the price in kuna and euro, the labels in shops may only contain a fixed conversion rate (as a full numerical expression, i.e. in all six digits), so that customers can check up whether the prices have been converted correctly.

In the period of mandatory dual display of prices (starting on the first Monday in September 2022 and ending on 31 December 2023), business entities must report the price and other monetary values in both euros and kuna.⁴³

⁴² Pufnik, *op. cit.*, note 32

⁴³ Guideline for the adjustment of the economy in the process of replacing the Croatian kuna with the euro, [https://euro.hnb.hr/documents/2070751/2104255/h-smjernice-zamjena-hrvatske-kune-eurom_sije-canj-2022.pdf/41a06aed-f094-7d7e-d5e4-fbdf5c8f4584?t=1642409233015]

The competent authorities will closely monitor compliance with the dual price display requirement and, where necessary, punish violators if prices are not displayed in both currencies or if the fixed conversion rate is not applied correctly (as a full numerical expression). Indeed, in conversion and dual display of prices, it is not allowed to reduce/round the fixed conversion rate, which must be applied as a full numerical expression, i.e. with all six digits.

The Ministry of Economy and Sustainable Development will cooperate with business associations and invite retailers and other companies to participate in the campaign to promote fair conversion without rounding up, and in return they will be given the right to use a campaign label that tells their consumers that prices are converted correctly into euros.

The companies that will try to use the process of introducing the euro to increase their prices in currency conversion to the detriment of consumers will bear the consequences and be placed on the list of violators (“blacklist”), which will be published through various information channels. Citizens themselves will also be able to contribute to the creation of these lists. Namely, citizens will be able to submit their complaints, together with evidence of infringements, to the authorities responsible for consumer protection.⁴⁴

9. CONCLUDING REMARKS

As a unit of account, the euro was introduced on 1 January 1999, and on 1 January 2002, euro banknotes and coins entered into circulation in 12 EU Member States. It was the largest cash exchange in history.

The euro has established itself as the world’s second most important currency, which is evidenced by the fact that about 60 countries directly or indirectly peg their currency to the euro. Since its inception, the euro has been introduced by 19 Member States, and the process continues.

Like all new Member States, Croatia has committed itself by its Accession Treaty to introducing a common currency once it meets the conditions. The Government decides on the moment of initiating the procedure, based on a detailed analysis of economic benefits and costs and an assessment of timeliness. In so doing, one of the basic tasks is to raise the level of competitiveness of the national economy to become able to be an equal member of the euro area.

⁴⁴ Introduction of the euro in the Republic of Croatia, CNB, available at: [<https://euro.hnb.hr/-/kako-ce-se-provoditi-nadzor-dvojnog-iskazivanja-cijena->], Accessed 15 March 2022

The results of numerous studies show that the effect of the conversion of national currencies into the euro on the growth of consumer prices in the euro area countries was generally mild and one-off. Thus, it is estimated that the largest contribution to the overall increase in prices due to conversion could be made by accommodation services and catering services (in the case of indebted poor countries) or recreational and cultural services and catering services (in the case of indebted poor countries). Furthermore, the introduction of the euro could have a slightly more pronounced effect on higher-income citizens, given that the share of goods and services whose prices could rise significantly (e.g. catering, recreational and cultural services, vehicles) in their basket of goods is higher. On the other hand, conversion to the euro could have a smaller impact on the price of goods and services bought by lower-income citizens, such as pensioners or the unemployed.

Inflation, which will be measured from April last year to April this year, has been singled out as the most problematic criterion so far. Looking at the average of all euro area countries, inflation was 4.3 percent and is slightly higher than in Croatia. It is to be expected that the common problem - energy and food prices whose growth is the result of global disturbances will be taken into account.

Rising prices during conversion can often be the result of the spillover of conversion costs onto consumers, frequent rounding up of prices to reach a new attractive level and the company's belief that consumers ignore small price changes while getting used to the new currency, which requires extra effort to recalculate prices, recalling old prices, etc., and hence they try to take advantage of this situation to increase their profit margins. On the other hand, there are factors that can act in the direction of reducing prices due to greater competition within the euro area, supported by improved price transparency and due to reduced transaction costs and exchange rate risk.

It should be emphasised that of all EU Member States that are not in the euro area, i.e. which have not introduced the euro yet, Croatia has the highest degree of deposit euroisation, which has its roots first in the German mark and today in the euro and is extremely difficult to eradicate.

The greatest benefit of the introduction of the euro is the elimination of currency risk to which the population, businesses and the state are extremely exposed, and the introduction of the euro will reduce the risk of a banking and balance-of-payment crisis and eliminate the risk of a currency crisis. Lower interest rates, lower transaction and exchange costs and stronger protection in the event of economic disruption will lead to additional benefits from the introduction of the euro. However, at the moment, the dynamics of the euro introduction process largely

depends on the implementation of the Action Plan of the Republic of Croatia for Joining ERM II and the Banking Union as a precondition for joining ERM II.

It is also necessary to emphasise the importance of conducting an appropriate information campaign, i.e. good communication with the public, in order to avoid misconceptions made by citizens about price movements during the conversion to the euro.

Available data and previous experiences of euro area members related to the introduction of the euro show that the benefits of adopting the euro outweigh the disadvantages. However, given the current situation regarding inflation in terms of prices for goods and services, as well as the crisis caused by the COVID-19 pandemic and the war turmoil in Europe, it is difficult to predict the real consequences of the introduction of the euro.

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