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Slovenia
Welcome to the euro area

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Editorial

Klaus Regling, Director-General of the Economic and Financial Affairs DG

Dear Reader

Welcome to this January issue of *European Economy News*, the magazine of the Directorate-General for Economic and Financial Affairs, and a happy New Year to all our readers. The start of 2007 has been an occasion for several welcoming events. One of these is the accession of Bulgaria and Romania to the European Union. These two Member States have made great strides in meeting the accession criteria and we look forward to seeing their economies continue their catching-up trajectory from within the Union. Another significant event is the entry of Slovenia into the euro area, the first of the recently acceded Member States to do so – but not the last.

These events are reflected in the content of this issue. Bulgaria and Romania are presented in the regular section on the economies of the Member States. Both are showing the rapid economic growth that characterises the economic catching-up process, but over the coming years they will need to maintain their efforts as their economies converge towards EU and euro-area norms – this will require careful management on their part, as experience from other Member States have shown.

The adoption of the euro by Slovenia is a particularly welcome event. All the recently acceded Member States are committed to adopting the single currency, which requires them to meet the Maastricht convergence criteria. It is not a race, but Slovenia is the first of them to join. In this issue you will find an article on the practical preparations for adopting the euro in Slovenia on New Year's Day. On a related theme we present a recent Communication from the Commission, prepared by DG ECFIN staff, summarising five years of living and working with euro banknotes and coins. These are important symbols of the unity of the EU. Their design, production and protection involves many of the EU institutions and the Member States, as the article describes.

Every autumn, DG ECFIN economists produce the *EU Economy Review*, a closely researched document on a subject of timely importance to the economy of the Union. The 2006 Review looks at divergences within the euro area – such as differing growth rates and inflation rates. Under EMU it might be expected that the economies of euro-area Member States would be roughly similar, and would react in the same way to positive and negative shocks, as divergences disappear over time. However, these divergences stubbornly remain. To explain this persistence, the Review looks at the dynamics of how euro-area Member State economies adjust to economic shocks, and reveals cases where adjustment mechanisms are not working efficiently. However, the Review is not an academic exercise; it is part of DG ECFIN's continuing surveillance and monitoring work that will not only inform policy for current euro-area members but also provide lessons on good and not-so-good practice that can guide other Member States as they follow the convergence path to the euro over the coming years.

Last but not least, this New Year marks the completion of *European Economy News*' first year of existence. We want to hear your views about the magazine and are including with this issue a short questionnaire designed to enable us to better understand your interests and needs. We look forward to hearing from you!

Klaus Regling
Director-General, Economic and Financial Affairs DG

Editorial information

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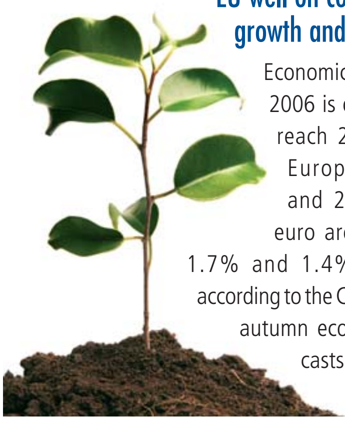
What's new from ECFIN

EU well on course for growth and jobs



Economic growth for 2006 is on course to reach 2.8% in the European Union and 2.6% in the euro area, up from 1.7% and 1.4% in 2005, according to the Commission's autumn economic forecasts. "After years of disappointing results, the European Union economy in 2006 will be at its best since the beginning of the decade," said Joaquín Almunia, the Economic and Monetary Affairs Commissioner, in a statement. He urged Member States to capitalise on this momentum, delivering growth and jobs alongside economic reform and budgetary consolidation. The forecast comes on the back of better-than-expected half-term results in 2006, fuelled by strong domestic demand and investment and a buoyant global economy. The EU as a whole is expected to create 7 million new jobs over the period 2006-2008 (5 million in the euro area). Inflation is also forecast to drop below the European Central Bank's 2% inflation threshold in the euro area in 2008. For more information see the autumn 2006 economic forecasts in the 'publications' section of the DG ECFIN website.

Landscaping Asian integration – the euro experience

Interest in greater Asian integration is on the rise. To explore the landscape for developing perhaps an Asian equivalent to the European Community, the so-called East Asian Community, leading speakers from the worlds of banking, academia and major international institutions, including the European Commission, gathered last October in Osaka, Japan. Marco Buti, Deputy Director-General, Directorate-General for Economic and Financial Affairs, gave a keynote address during the session 'Eight years of the euro and the road ahead'. He recounted the EU experience and how fiscal and economic policies helped shape the European economic and monetary union (EMU) of today. The symposium, entitled 'Asian Regional Integration: Learning from Europe and the Euro', was co-organised by Osaka City University and the European Commission Delegation to Japan. For further information see the symposium website: www.pac.ne.jp/ocuis2006/e/index.html

Osaka, Japan

Convergence report

On 5 December 2006 the European Commission adopted a Convergence Report assessing progress with convergence towards the requirements of EMU in nine Member States (the Czech Republic, Estonia, Cyprus, Latvia, Hungary, Malta, Poland, Slovakia and Sweden). Lithuania and Slovenia had already been assessed in May 2006. The report examined whether the Member States met the convergence criteria on price stability, the government budgetary position, exchange rates and interest rates, and whether their legislation was compatible with euro membership. The report concluded that none of the countries examined fulfilled all conditions for adopting the euro, and therefore there should be no change in the status of the nine countries assessed as a "Member State with a derogation". The Convergence Report can be downloaded from the 'publications' section of the DG ECFIN website.

What the future holds for corporate finance

At a one-day workshop organised by DG ECFIN on 27 November 2006 participants considered 'The future of corporate financing in an integrating EU financial market'. Researchers, policy-makers and market representatives explored how corporate financing might evolve as progressively integrated EU financial markets offer opportunities for more efficiency, more investment and, ultimately, more economic growth. Key questions covered included how these efficiencies might be realised, the implications for corporate governance, and how the process could be supported by financial market regulation. More information on the workshop can be found in the 'events' section on the DG ECFIN website.

Fiscal rules and fiscal governance

How does the nature of national fiscal institutions and fiscal rules affect the outcomes of national budgets? This question was addressed on 24 November 2006 at a DG ECFIN workshop where participants considered to what extent the wider institutional setting can influence the balance of national revenue and expenditure that produces surpluses or deficits. Possible country-specific features were discussed, including electoral systems, the size of a country, and its organisation – for example unified or federal. The workshop then discussed what might be the desirable characteristics of national institutional settings that would help the appropriate conduct of fiscal policy. Workshop participants agreed that fiscal rules and independent fiscal institutions cannot on their own ensure the appropiate conduct of fiscal policy. However, subject to some preconditions, both rules and institutions were considered instrumental in supporting sound and sustainable budgetary positions. But their success depends on the existence of a strong political commitment to fiscal stability as well as a suitable design, which is largely a country-specific issue (e.g the insituitional and economic setting, the nature of the fiscal problem etc.). The workshop gave evidence of the positive influence of well-designed fiscal rules and institutions to achieve better budgetary outcomes and limit pro-cyclical fiscal policies. More information on the workshop can be found in the 'events' section on the DG ECFIN website.

Euro-area update

The European Commission released this year's 4th issue of its 'Quarterly Report on the Euro Area' on 18 December. This periodic report helps to foster a better understanding of economic developments in the euro area and to improve the quality of the public debate surrounding the area's economic policy. The fourth-quarter report assesses the recent positive economic developments in the euro area and short-term prospects. It further discusses estimations of the non-accelerating wage rate of unemployment (NAWRU) for the euro area as well as the question whether the effects of a US slowdown will spill over to the euro area. It also contains two focus sections, on the widening current account differences within the euro area and on fiscal sustainability in the euro area in view of an ageing population. The first report for 2007 is due out in March. The Quarterly Reports can be downloaded from the 'publications' section of the DG ECFIN website.

Cyprus eyes up euro


President Tassos Papadopoulos

Cyprus hopes to adopt the euro on 1 January 2008. Progress is being made, according to the 'Fourth report on the practical preparations for the future enlargement of the euro area', but further measures are still necessary to boost consumer confidence that the changeover will not push prices up. These are some of the issues that Cyprus' political leaders discussed, on 30 November, with their EU colleagues at an event entitled 'EMU governance and the euro changeover – Cyprus on the path to the adoption of the euro', attended by the Cypriot President Tassos Papadopoulos and the European Commissioner for Economic and Monetary Affairs, Joaquín Almunia. For further information see the fourth report under the 'publications' section of the ECFIN website.

Reforms bearing fruit

On 13 December 2006, the European Commission published its latest Annual Progress Report (APR) on the Lisbon Strategy, the partnership between the EU and the Member States to make structural reforms that focus on employment and productivity so as to create a more dynamic and competitive European economy. This year's APR was the Commission's first opportunity to assess Member State progress in implementing reforms. The Commission based its overall assessment on analyses of reforms reported in the 25 Implementation Reports submitted by Member States in October 2006, which identified strengths in different national programmes as well as areas with shortcomings. Reforms to improve the long-term sustainability of public finances, microeconomic reforms and labour market reforms were considered separately. The Commission then used these analyses to propose concrete country-specific recommendations to guide the future evolution of national reforms. The APR also takes a horizontal look at progress in four areas considered Community high-priority areas: investment in education, research and innovation; freeing up SMEs; employment policies to get people into work; and guaranteeing a secure and sustainable energy supply. It concludes that earlier structural reforms are bearing fruit, especially on the labour market.

Further information
The latest news and press releases from DG ECFIN are available at:
http://ec.europa.eu/economy_finance/news/whatsnew_en.htm

Looking ahead

January-March 2007

Under the Stability and Growth Pact, towards the end of each year Member States submit updated **stability or convergence programmes**, on which the Commission prepares assessments and recommendations for Council opinions. Euro-area members submit stability programmes, while convergence programmes are presented by Member States that are not part of the euro area. The Commission expects to publish its assessments in the first quarter of 2007.

February 2007

The Commission will issue its third **interim economic forecasts**. These 'light' forecasts are issued twice a year between the fully-fledged spring and autumn economic forecasts. They are model-based updates of the outlook for real GDP growth and HICP for the six largest Member States, the EU-25 and the euro area for the current year (whereas the spring and autumn forecasts includes a full set of variables for two years ahead). DG ECFIN will publish the next interim forecasts on 16 February 2007.

February 2007

The ECOFIN Council will finalise the examination of the Member States' stability and convergence programmes and prepare the European Council meeting on 8/9 March.

March 2007

To celebrate the 50th anniversary of the Treaty of Rome a **commemorative two-euro coin** will be issued in March by the Member States of the euro area. The winning design was selected by means of a competition and shows the Treaty document signed by the six founding countries in 1957 against a background evoking Michelangelo's paving design for the Piazza del Campidoglio where the signing ceremony took place.

March 2007

Following the adoption of the new Council Decision granting a Community guarantee to the European Investment Bank (EIB) for projects outside the Community, which is expected to be adopted by the Council by January 2007, the Commission and the EIB must establish the terms of such a guarantee in a **contractual agreement**. The projects concerned are part of EU aid and development programmes and the aim is to enable the EIB to offer loan financing, for example for infrastructure projects, to support these efforts.

A European round-up

Euro ... sure, but when?

"Euro-area enlargement represents a significant new chapter in the history of European monetary integration, and today I will consider Hungary's place in this ongoing process," began Joaquín Almunia, the Economic and Monetary Affairs Commissioner, in his speech at the 'Euro but when – connecting our goals' conference on 9 November 2006. Recapping the benefits of euro-area membership, he sounded a realistic note: "where there are benefits to reap, there could be certain costs to pay. In this case ... the loss of an independent monetary policy and the exchange rate instrument." But the benefits outweigh the costs, he assured delegates in Budapest, as long as the right conditions are met before joining, such as macroeconomic stability and sound economic polices accompanied by flexible labour and product markets. For more information see the Commissioner's website:
http://ec.europa.eu/commission_barroso/almunia/index_en.htm

German EU presidency, looking ahead

"Together Europe can succeed" according to the motto of the German EU presidency, scheduled for the first half of 2007. Pulling together means building on Europe's shared historical and cultural foundations. "Europe can only be what the European nations and their governments make of it," a government statement read. Marking 50 years since the signing of the Treaty of Rome, the German presidency is exploring ways to drive forward the constitutional process. Among other goals, safeguarding Europe's economic future and the foundations of its social security systems are priorities. For this, existing resources must be mobilised, growth and employment strengthened, and conditions improved to help Europeans be more innovative and competitive. Energy security and climate change are also high on the agenda.

Germany's long-run fiscal foray

Demographic change in Germany will enter an acute phase from 2010 onward when baby boomers start retiring. Structural economic reform is vital to sustaining Germany's public finances over the long term. The symposium, 'Long-run fiscal sustainability in Germany', on 20 November 2006 in Berlin, addressed the key issues: what is the extent of the problem, what are the risks involved, and how are policy-makers addressing it? The event also explored the experiences of other countries implementing potentially radical economic and social measures to tackle the problem. Servaas Deroose, who heads the 'Macroeconomy of the euro area and the EU' Directorate at the Directorate-General for Economic and Financial Affairs, took part in the closing session. For more information see the IMF website: www.imf.org

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'Europeanised' social security – a matter of fact?

Europe's social model is facing perhaps its biggest challenge: working towards the Lisbon Agenda of more growth and jobs with a workforce that is ageing. Globalisation, new technology, ageing populations and changes to the family structure all play a role, delegates learned at a conference last November, held under the auspices of the Finnish EU presidency to examine the need for a new balance of social policy between the EU and Member States. While a 'Europeanised' version of social security – i.e. greater collaboration at EU-level – is worth considering, Member States are keeping to the 'subsidiarity principle'. Either way, the Finnish presidency felt it was an issue that had to be discussed, sooner rather than later. For more information see the Finnish Presidency website: www.eu2006.fi

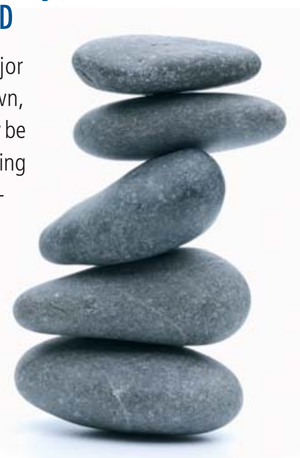
ECON resolution on 2006 euro-area report

In plenary session in Strasbourg on 14 November the European Parliament passed a resolution on the 2006 annual report on the euro area prepared by DG ECFIN on behalf of the Commission. The resolution was based on a report by José Manuel García-Margallo y Marfil of the EP Committee on Economic and Monetary Affairs (ECON). Pointing to structural deficiencies as a major drag on economic growth in the EU, the resolution called for work to start "without delay" to adapt the euro-area economy to the new global scenario through greater coordination of European economic policies as well as those policies which remain under the competence of the Member States. For more information see the plenary sessions on the EP website:
www.europarl.europa.eu

"Euro area in good shape"

This was the message the Eurogroup Chairman Jean-Claude Juncker gave to the ECON Committee of the European Parliament on 22 November 2006 in a regular exchange of views. The Prime Minister of Luxembourg pointed to accelerating growth, controlled inflation and the structural reforms already undertaken in the euro area as good signs, but warned that unemployment remains unacceptably high at 8%. Oil prices, the Lisbon Agenda, economic imbalances and the social dimension to European policy were also discussed, as were the challenges of demographic change. On the latter, Prime Minister Juncker said that demographic change will lead us to a brick wall in the next 20 years unless we prepare public finances for it – highlighting that the reform of the SGP had been undertaken with this in mind. For more information see the website of the European Parliament. www.europarl.europa.eu

A "smooth rebalancing", explains the OECD



Rather than a major economic slowdown, what the world may be facing is a rebalancing of growth across regions. This is the conclusion of the latest 'Economic Outlook' from the OECD that points to slowing activity in the US and Japan while Europe's economy is gathering speed. The central scenario for the next two years is one of stable growth if supply and demand can be balanced without generating unsustainable current account imbalances. However, warns the report, more fiscal and structural reforms are needed in the large OECD countries, and regrettably these do not seem to feature high on political agendas. The 80th Economic Outlook can be found on the OECD website:
www.oecd.org

Slovenia: a new year, a new currency

The curious among us occasionally flick through the coins in our purse while at the supermarket checkout – just on the off chance of finding something rare like a Vatican euro coin, or to admire the Greek owl or Italy's Dante. Now we will have something new to look out for as on 1 January 2007 Slovenia adopted the single currency – the first of the newly acceded Member States to do so. Euro-area citizens can now look forward to seeing new euro coins engraved with Mount Triglav, storks and a portrait of France Prešeren, Slovenia's national poet. Slovenia's entry date to the euro area was confirmed in July 2006. Since then, the country has intensified and finalised its practical preparations for the cash changeover, an activity that involved many stakeholders and which, as well as building on the experience of the first-wave introduction, will also provide lessons for future enlargements of the euro area.

"Slovenia meets all the convergence criteria, an achievement which results from a track record of stability-oriented policies and reforms...," said Commissioner Joaquín Almunia on 16 May 2006 as he announced the Commission proposal for Slovenia to adopt the euro. EU Finance Ministers approved this proposal on 11 July 2006 and set 1 January 2007 as the entry date. Today, Slovenia is the first of the ten Member States which acceded to the EU in 2004 to have joined the euro area. The confirmation of the entry date back in July 2006 took the focus away from macroeconomic convergence indicators and turned attention to the practical preparations on the ground in Slovenia. These preparations had started much earlier in fact.

In January 2005, the Slovenian Government and Central Bank kicked off the 'Masterplan for the euro changeover' – a roadmap for getting euro cash into Slovenian pockets and withdrawing the old currency, the tolar, from circulation. Slovenia chose a scenario for introducing the euro that differs from the one used when the euro was first launched.

Introducing the euro with a bang

While the same convergence criteria apply to all Member States that are preparing to adopt the euro, there are significant differences in the euro adoption scenarios. The launch of the euro in 1999, the greatest monetary changeover in history, was to a certain extent a leap into the dark. A gradualist approach, known as the Madrid scenario, was adopted then.

In the Madrid scenario the euro first appeared as a unit of account – book money – in 1999 (and in 2001 in Greece). During a three-year transitional period (a one-year period in the case of Greece) both the euro unit and the national currency unit could be used. However, as the euro only existed in scriptural form, the national banknotes and coins retained their status of legal tender within each country. Dual display of prices in euro and in the national currency unit was applied in most countries to familiarise citizens and enterprises with the single currency. The transitional period also served to complete the adaptation of all financial, administrative, accounting and related systems with a view to the euro. The euro coins and banknotes were finally introduced on 1 January 2002.

EU Finance Ministers and Economic and Monetary Affairs Commissioner Joaquín Almunia celebrate the decision welcoming Slovenia to the euro area on 11 July 2006.

In contrast, today's euro-area candidates are joining a single currency area that already exists. Euro banknotes and coins circulate and people throughout the EU are acquainted with the euro, which now constitutes the main unit of account for trade and finance in the single market. In view of this situation, Slovenia chose the 'Big Bang' scenario for euro adoption, as other countries may in the future. Under this scenario the length of the transitional period is reduced to zero. The introduction of the euro as the currency and the introduction of euro cash therefore coincide (see figure).

Slovenia implemented the necessary practical, administrative and legal preparations with respect to the euro in the years preceding the adoption of the euro. The dual display of prices has been mandatory since 1 March 2006, notably in shops, and will continue until June 2007. The 'dual circulation period', during which both euro cash and tolar cash can be used for payment purposes, will end quite quickly, on 14 January 2007. From 15 January 2007 only euro banknotes and coins are legal tender in Slovenia. However, tolar cash can still be exchanged for euro cash free of charge at commercial banks until 1 March 2007. Moreover, the Bank of Slovenia will exchange tolar coins until the end of 2016 and tolar banknotes without a time limit, free of charge.

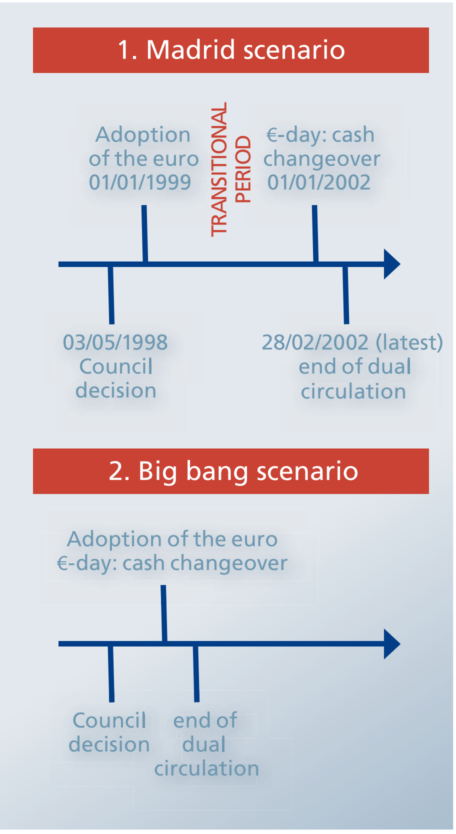
The nitty gritty of adopting the euro

To manage the complex process of introducing the euro the Slovenian Ministry of Finance and the Bank of Slovenia set up a coordinating committee for the technical preparations for the changeover in 2004. This committee included all relevant stakeholders, notably the Chamber of Commerce and the Slovenian Consumers' Association, and prepared the masterplan for the changeover, which was approved in January 2005. The amendments to national law needed for the euro mainly related

"We would like to help you become familiar as soon as possible with the euro – our future currency, part of our common European future."

Dr Andrej Bajuk, Minister of Finance, during Slovenia's communication campaign

Scenarios for adoption of the euro



to the status of the Bank of Slovenia, the dual circulation period, the exchange of tolar cash into euro cash, salary payments, the redenomination of securities and the continuity of contracts. Most of these amendments were adopted in 2006, notably in an umbrella law – the Introduction of the Euro Act – passed in October of that year.

From tolar and stotin to euro and cent

The tolar was introduced upon Slovenia's independence in 1991 to replace the Yugoslavian dinar. The name 'tolar' harks back to the medieval tolars and thalers that later inspired the name 'dollar'.

Slovenia decided on the design of the national sides of its euro coins early on. A public competition launched in 2004 produced 699 proposed motifs. A jury of Slovene artists, designers and cultural experts made final recommendations and the Bank of Slovenia and the Ministry of Finance approved the successful designers and designs in 2005. Designer Miljenko Licul and sculptor Janez Boljka who, along with Maja Licul, were responsible for the designs chosen, also both contributed to the tolar designs in 1991. With the designs approved, since Slovenia does not have its own national mint, the Mint of Finland was chosen to produce the Slovenian euro coins in preparation for 1 January 2007. On that date around 300 million coins bearing Slovenian images and 100 million banknotes were ready.

The logistical process of getting this cash gradually into the consumer frontline – first into banks, and subsequently shops and automated teller machines (ATMs) – began in September 2006 when banks received the first deliveries of 155 million euro coins, followed by 42 million banknotes in December. This 'frontloading' to banks was followed by 'sub-frontloading' to retailers during December when euro coin starter-kits were also made available to Slovene citizens. Since 1 January 2007, ATMs in Slovenia issue only euro banknotes and retailers are required to give change for purchases only in euro.

'The euro for all' communication campaign

Experience from the launch in 1999 shows that public support for the euro during and after adoption largely depends on the degree of public awareness about the currency and the changeover process. Further, in many euro-area Member States there is a perception that the introduction of the euro caused price rises – even though the evidence shows that the impact on prices in the first-wave changeover was marginal. Therefore, as more countries move towards euro adoption, communication campaigns aimed at informing the general public and answering their concerns are of crucial importance.

Successive Eurobarometer surveys have shown that Slovenes are the most euro-savvy among the citizens in the ten new Member States – partly due to a communication strategy that the Slovenian authorities launched back in 2005. The campaign aimed to inform the public about the steps in the 'Big Bang' scenario for introducing the euro and to build confidence to ensure a smooth changeover. In this process the Slovenian authorities benefited from the help of the European Commission, which concluded a partnership agreement with Slovenia on 8 November 2005, under the terms of which it gave financial support as well as implementing a broad range of activities on the euro. The Slovenian authorities' Dutch counterparts also contributed by sharing their experiences through a twinning arrangement. The preparatory stage in 2005 included information campaigns to explain dual display of prices as well as launching the public euro-information website on www.evro.si. In 2006, as the adoption date neared, the campaign was stepped up with the emphasis on ensuring the public was aware of the new coin and banknote designs and the way in which they would be exchanged for tolars.

Eurobarometer surveys during Slovenia's preparations demonstrate that the information campaigns have paid off. They show that from the start of the campaign in 2005, Slovenes became progressively more satisfied with the prospect of the euro replacing the tolar, and they felt increasingly well informed as the adoption date approached.

'Ask for your change'

However, the same Eurobarometer surveys also showed that fears of abuses and cheating on prices remained the main concern of 66% of Slovenes. The Slovenian authorities addressed these fears. For example, the relatively low value of the stotin meant that the smallest denominations were often ignored or rounded off in daily transactions – but with the exchange rate at 239.640 tolars to one euro, the smallest euro coin (the one-cent coin) is worth much more. The publicity campaign took pains to ensure that people were aware of the difference and changed their habits accordingly. Further, to identify unjustified price rises, the Statistical Office of the Republic of Slovenia, together with the Slovenian Consumers' Association, are running the 'Pricewatch' project which is monitoring the retail prices of baskets of goods and services to identify abuses – with the intention of naming and shaming those who increase prices excessively. This project will run until June this year when the requirement for dual display of prices ends. Early results in 2006 showed no significant rises – but Pricewatch remains vigilant. ■

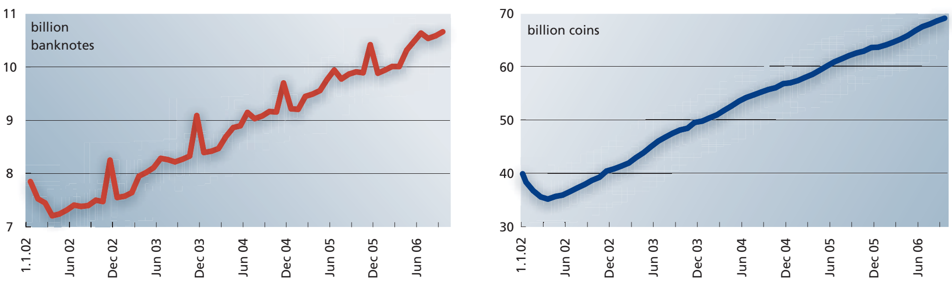
Euro cash: five and familiar

It is already five years since euro cash was first introduced in January 2002. Euro banknotes and coins have now become an accepted part of life for the citizens of the 12 Member States that were the first to introduce euro cash. The euro is also used outside the euro area, notably in neighbouring countries and regions, as well as in tourist destinations all over the world, and has established itself as a major international currency.

The Commission's recent Communication on five years of euro banknotes and coins presents the main developments with regard to euro notes and coins over the past five years and raises some policy issues with regard to the future evolution of the system. An accompanying Staff Working Paper provides more detailed information on the main issues raised in the Communication, including circulation figures, institutional and legal developments, changes in designs and the evolution of public opinion.

Euro banknotes and coins are now an established and familiar part of life for over 300 million people living in the euro area – and to some extent even for people outside it. And, indeed, there is a lot of euro cash around. The number of euro banknotes and coins in circulation has been climbing constantly over the past five years, reaching an estimated level of almost 11 billion euro banknotes worth around 590 billion euro, and over 68 billion euro coins worth almost 18 billion euro in October 2006 (see figure 1).

Figure 1: Total number of euro banknotes and coins in circulation



Following a strong supply of euro cash to the commercial sector in advance of the cash changeover period, there was an initial decrease in circulation, followed by a steady increase marked by clear peaks in circulation figures around Easter, the summer holidays, and particularly Christmas, when demand for cash is typically higher. The Eurosystem (for euro banknotes) and Member States individually (for euro coins) continue to produce a significant yearly volume of new banknotes and, to a lesser extent, coins to cope with the growing demand, and also to replace notes and coins which have become unfit for circulation. Some 7 billion new notes were produced in 2006.

On the whole, cash is still by far the dominant means of payment for day-to-day purchases. Estimations suggest that cash payments still account for over 80% of the total number of transactions at retail level, although there are considerable variations between countries. Cash, therefore, will be with us for a good while yet.

Designs and denominations

The present series of notes and coins, designed by Robert Kalina of the Austrian central bank and Luc Luycx of Belgium's national mint, has, in general, been widely accepted, with few challenges. A small number of countries, notably those used to having low-denomination notes in the past, expressed interest in introducing low-denomination euro banknotes (1-euro and 2-euro notes). After careful consideration, the European Central Bank's (ECB) Governing Council decided not to pursue this request given, inter alia, the costs involved for the retail sector and the vending machine industry, as well as insufficient support from citizens in the euro area.

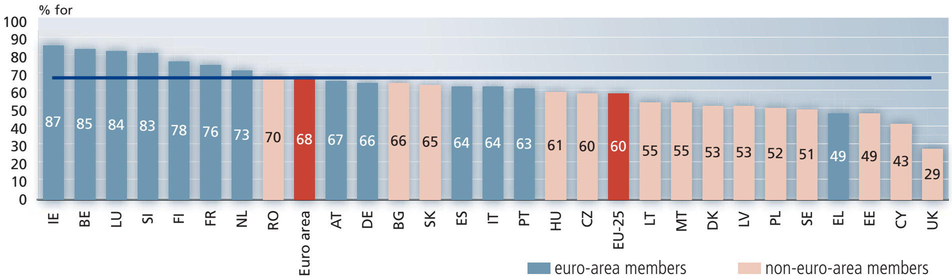
With regard to the coins, the 1-cent and 2-cent coins met with resistance in Finland and the Netherlands. In both countries, prices are rounded to the nearest 5 cents – in Finland by law, and in the Netherlands on a voluntary basis following a recommendation from the retail sector and consumer organisations. A majority of euro-area residents are satisfied with the current value structure.

In terms of value, the 500-euro note accounts for some 34% of the total value of notes in circulation. In quantitative terms, however, the 50-euro note is by far the most widely used (32% of all notes), followed by the 20-, 10- and 5-euro notes. For coins, the share in value relates directly to the face value of the coin, with the 2-euro coin accounting for the highest share in value, while in terms of quantity, the share is inversely related to the face value of the coin, with the 1-cent coin being the most numerous.

Although produced on a decentralised basis by the different national central banks (NCBs) of the euro area and authorised printing works, euro notes all look alike. However, it was decided that euro coins would have a common European side and a 'national' side which, with just a couple of provisos (e.g. the obligation to display the 12 European stars surrounding the design), was left to the country in question to design. There is a moratorium on changes to the national sides until the end of 2008. Since enlargement, it was agreed to produce a new common side for the five highest denominations of euro coins (10-, 20-, 50-cent and 1- and 2-euro), which depicts the European continent rather than the European Union of 15 Member States. Slovenia is the first to introduce the new common sides, but all euro-area countries will change over to the new design in the course of 2007 or 2008.

Overall, the euro is successfully protected against counterfeiting

Figure 2: Support for EMU and the euro



In addition, it was agreed that a number of commemorative coins could be issued to mark significant events (such as the Athens Olympic Games). To avoid confusion in the early years, commemorative coins were not allowed until 2004. And they are subject to certain restrictions: only 2-euro coins can be used for commemorative issues, and Member States may only issue one such coin per year in limited quantities. Since 2004, 21 commemorative coins have been issued and 15 are planned so far for 2007, including a joint commemorative coin to mark the 50th anniversary of the signing of the Treaty of Rome which, exceptionally, can be issued in addition to another 'regular' commemorative coin.

The number of national sides already exceeds 150 and will continue to increase with the enlargement of the euro area and future commemorative editions. For this reason, Member States agreed, in 2005, on a number of common guidelines(1) for future euro coin production so as to ensure continued coherence of the system. These should be followed for all new coin productions. In its Communication, the Commission announces that it will prepare the Council's future decision on the moratorium on changes to the national sides by launching a euro-area survey in 2007 to collect people's views and preferences.

Hard currency – euro cash outside the euro area

In a very short time, the euro has established itself as an international currency comparable to the US dollar and the Japanese yen. General confidence in the euro is high and euro banknotes, and to a lesser extent euro coins, are widely used outside the euro area. The ECB estimates that between 10% and 20% of the total value of euro banknotes in circulation is currently held outside the euro area.

In certain countries, the euro is being used as a regular means of payment, as in Monaco, San Marino and Vatican City (by monetary agreement) and in Andorra, Montenegro and Kosovo (on a unilateral basis). The euro is also used as a parallel currency for payment transactions and/or for savings purposes in many other countries and regions, particularly in neighbouring areas. In addition, there are many countries, also outside Europe, where the euro is accepted for purchases in tourist areas.

Defeating counterfeiting

The introduction of euro banknotes and coins as the official currency in 12 EU Member States, as well as in a number of third countries, meant that a concerted effort needed to be made to protect the currency against counterfeiting. While Member States continue to be primarily responsible for ensuring the protection of the euro, a transnational structure has been put in place to support anti-counterfeiting efforts. Duties are shared between the European Central Bank (ECB), the European Commission/European Anti-Fraud Office (OLAF), Europol, Eurojust and Interpol.

In addition, a number of legal acts have been adopted at European level to increase the general level of protection and harmonise national legislation in this area. National analysis centres for counterfeit notes (NAC) and coins (CNAC) work closely with the ECB's Counterfeit Analysis Centre (CAC) and the Commission's/OLAF's European Technical and Scientific Centre (ETSC) to identify, analyse and withdraw counterfeit notes from circulation. On the whole, the number of detected counterfeit notes has been stable since mid-2003, at approximately 600 000 per year. This is extremely low in relation to the number of notes in circulation, and is lower than the levels recorded for the US dollar.

Changing perceptions – thinking in euro?

Support for EMU and the single currency has remained relatively stable since its introduction, according to the regular Eurobarometer surveys carried out for the European Commission. The latest surveys (autumn 2006) show that 68% of citizens in the euro area (60% in the EU as a whole) support the idea of EMU and the single currency (see figure 2). There are, however, some significant differences between countries, with the highest level of support for the euro in Ireland (87%) and the lowest in the UK (29%). When asked whether they considered the adoption of the euro advantageous for their country overall, 48% of respondents believed that the euro had brought advantages overall, (against 38% believing it to be disadvantageous). On the downside, this figure has been declining and, in addition, a large majority (93%) of respondents believe that the euro has added to price increases. This is a clear misperception, as annual price inflation in the euro area has never exceeded 2.4% since the introduction of the euro in 1999. This survey result is behind the Communication's recommendation for renewed public information efforts on the euro.

So are we thinking in euro yet? Getting used to using the euro every day has been rather slow, but well over half of survey respondents (57%) say that they are now calculating in euro for day-to-day purchases. Larger purchases, such as cars and houses, however, still send most back to their old national currency. This suggests that the mental conversion to thinking in a new currency is a long process, but does not indicate any problem with the currency itself, which seems to have been very well accepted generally. It is encouraging that a clear majority of those surveyed consider themselves fully at ease using euro banknotes and coins. ■

Further information

The Communication on five years of euro banknotes and coins can be found on the DG ECFIN website:

http://ec.europa.eu/economy_finance/publications/euro_related/2006/eurorelated_fiveyears_banknotescoins_en.htm

(1) Commission Recommendation of 3.6.2005 on common guidelines for the national sides of euro circulation coins, OJ L186 of 18.7.2005, endorsed by the Ecofin Council of 7 June 2005.

The 2006 EU Economy Review: adjustment dynamics in the euro area

The* EU Economy Review *is published annually by DG ECFIN and each year it presents an in-depth study of a topical issue in EU and euro-area economics. In this year's Review, DG ECFIN economists take a close look at 'adjustment dynamics' in the euro area. In an ideal euro area, given the single monetary policy and tightly coordinated budgetary policies and constraints, one might expect that individual euro-area economies would behave in much the same way in response to events, such as common external shocks. But they do not. While some euro-area Member States show above-average growth rates and inflation, others show persistent low economic growth often with higher unemployment. The Review investigates the factors underlying such divergences. In particular, the authors look at adjustment mechanisms in euro-area economies and seek to identify possible policy lessons to ensure the smooth functioning of the euro area in the years ahead.

A key question for the designers of Economic and Monetary Union (EMU) was whether the euro area, with exchange rates irrevocably fixed between the currencies of participating Member States and a one-size-fits-all monetary policy, would allow sufficient freedom for the economies to adjust to economic shocks that could hit individual countries differently. A particular point of contention among economists was whether EMU would lead to convergence or divergence of the economic structures in euro-area countries.

Convergence, argued some, might be inherent in EMU, generating the conditions necessary for harmonised economic structures and business cycles between its members – so economic shocks would be felt in the same way and adjusting to them would follow similar paths. Divergence, on the other hand, might arise from industrial diversification as members sought competitive advantage – but in this case economic shocks might affect some industrial sectors more than others, so they would be more country-specific, and the necessary adjustments would be different.

Channels for change

The 2006 Review takes a close look at how adjustment mechanisms have functioned in the euro area since its creation. Before participating in the euro area, a country had at its disposal a range of adjustment mechanisms that could be used to mitigate the effects of economic shocks like a rise in energy prices. Significantly, two of these are now unavailable: exchange rate policy and monetary policy. Monetary policy is now decided at the euro-area level for the benefit of the area as a whole, and an individual euro-area Member State can no longer devalue its currency or influence interest rates to stimulate economic activity. However, there are economic tools that remain at the disposal of or under the control of Member State governments and the Review's authors take a close look at the more important ones, namely:

- Market adjustment channels, such as changes in relative competitiveness and (expected) real interest rates in the euro-area Member States; and
- Policy-based adjustment channels, such as taxation, public spending and structural policies in labour, product and financial markets.

To study these 'adjustment channels' in action, the Review first gives an overview of them and related indicators for the euro area as a whole. It then considers several types of economic shock that individual or groups of euro-area Member States experienced during their preparations for the euro and subsequently in the first seven years of the euro area. Examples include German unification, the large falls in interest rates experienced by some countries as they approached euro adoption, and the impact of tourism and migration on housing markets in certain countries. Some of these shocks led individual economies to diverge from the euro-area average. The Review then investigates how the various economic adjustment channels, in particular the market channels, operated to bring the economy back into line with the rest of the euro area. Some examples from the Review's work are provided below.

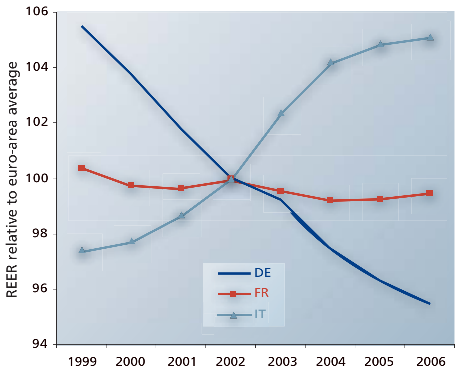
The competitiveness channel

Changes in a country's competitiveness are a key adjustment channel for bringing an economy back into line when monetary policy is determined centrally, as in the euro area. So, if an economy enters a boom phase relative to the euro area then the pressures on resources cause costs to rise, including wages. This raises the 'real effective exchange rate' (REER) – which measures price differences between countries (with respect to a base year). This in turn makes the country's production and exports more expensive, which leads to a slowdown in economic activity until the economy falls back in line with the euro-area average.

To study these effects, the Review compares competitiveness indicators that provide information about relative prices, which reflect input costs such as wages and energy. One example is the REER based on unit labour costs. Such indicators reveal that, while some Member States have seen an increase in competitiveness, others have observed a loss. For

Many euro-area countries have not yet fully adapted to life in a monetary union

Figure 1: Real effective exchange rate developments (index: 2002=100)



Note: The real effective exchange rate index is based on unit labour costs.

example, comparing REER developments between Germany, France and Italy in figure 1 shows that, while French competitiveness has remained stable since the euro was introduced, Germany has seen important gains and Italy important losses in their relative competitive positions.

Sticky costs

The authors then go further and look at the relative rigidity of labour costs by rating the hiring and firing restrictions of the different countries and then comparing these to the changes in growth rates of unit labour costs. This complicated comparison is seen in figure 2, which essentially shows the ability of an economy, in particular its labour costs, to adjust quickly to upward and downward movements in the economic cycle.

Figure 2 suggests that in Italy, Portugal, Greece and Finland, the rigidity of unit labour costs delays adjustments to swings in growth. What's more, relative unit labour costs respond asymmetrically in Italy, Portugal and Greece – rising more in an upturn than they fall in a downturn – so there is a trend towards higher relative labour costs which reduce competitiveness further.

In Germany and Austria unit labour costs are less rigid – they adjust more quickly to economic swings and, although asymmetric, strengthen competitiveness because there is a bias towards labour-cost moderation during downswings. This interpretation of figure 2 links well with the REER developments shown in figure 1, where the moderate wage demands seen in the German economy have improved its competitive position, while higher costs in Italy, not matched by improved productivity gains, have eroded competitiveness.

Challenges to competitiveness

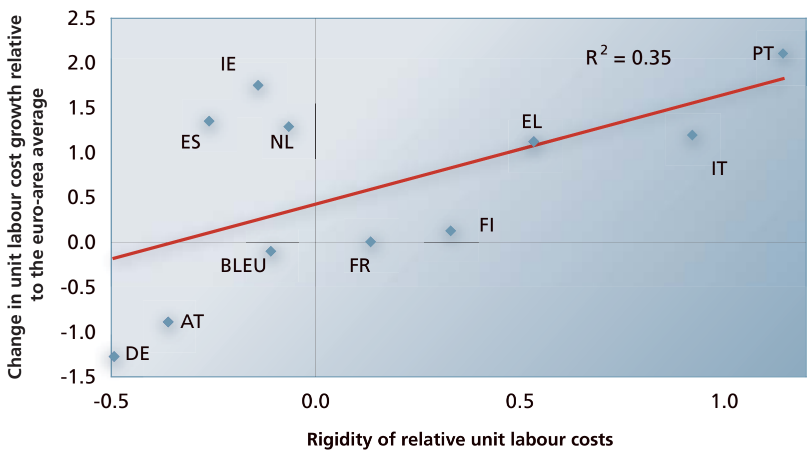
In the conclusions on the operation of the competitiveness channel, the authors point to this heterogeneity across countries as an important feature. Before the creation of the euro area, wage demands were the main cause of loss of competitiveness. Since 1999, nominal wages have converged but these have not always been matched by productivity gains – which has harmed some countries' competitiveness.

Further, the 'stickiness' of labour costs, their inability to respond to economic swings quickly enough, and their asymmetry, means that persistent differences in cost competitiveness are building in some euro-area Member States, paid for in higher unemployment and more volatile trade performance. This, the authors suggest, is the result of wage-bargaining structures and regulations that protect employment in the firm rather than workers in the market, and that these need to be adapted to reflect the need for more efficient economic adjustment.

The real-interest-rate channel

A lower real interest rate makes investment and consumption more attractive, thereby stimulating economic activity. This linkage has raised concern that in a monetary union, the cyclically more advanced countries experience above-average inflation rates and thus below-average real interest rates which provide an additional unwarranted growth stimulus. The Review looks at the experiences in the euro area in this context. Figure 3 shows that real interest rates declined substantially in the run-up to the third stage of EMU, suggesting considerable differences in the monetary impetus to demand across economies. The results are similar for ex-post and ex-ante measures, i.e. real interest rates calculated using inflation expectations. Persistent inflation differentials are sustaining real-interest-rate differentials. However, the Review presents several reasons why national real interest rates are becoming less important over time as citizens adapt to life under the single currency.

Figure 2: Growth rates of unit labour costs and their rigidity – euro-area countries



Note: 'Rigidity' is the difference between the elasticity of ULC growth with respect to positive and negatives output gaps, respectively.

Action is needed to ensure the smooth functioning of the euro area

Overall adjustment is stable

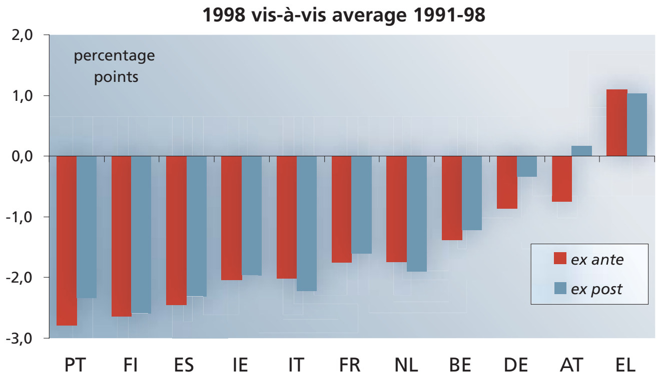
Empirical analysis combining model simulations and country case studies provide evidence of several channels of adjustment that interact with each other in determining the pattern of inter-country adjustment. Some emerging features deserve particular attention in terms of resolving puzzles about recent experience as well as highlighting issues with relevance for the future European policy agenda:

- The adjustment process is dynamically stable. The competitiveness channel emerges as strongly dominant over the medium term, despite evidence of perverse real-interest-rate effects. But the latter are less powerful than suggested in some earlier assessments.
- Country-specific developments play an important role. Country-specific "shocks" disturb factors that affect output and prices and contribute to the explanation of protracted differences in economic growth. Disturbances can be mutually reinforcing and spillover effects are found to be potentially important. Moreover, the dynamics of catching-up have varied considerably across countries.
- Several factors are crucial for the pace of adjustment. There can be wide variations in the responsiveness of wages and unit labour costs to changes in national output gaps – and in some cases, there was a weak response to the emergence of cyclical slack, which retarded adjustment. The role of financial markets has been more prominent than expected and financial integration has unlocked potentially large gains in formerly credit-constrained economies. Marked differences exist in the way that policy and market developments in euro-area economies interacted to dampen or amplify fluctuations in output and prices.

These findings raise a number of policy issues that deserve further exploration with a view to improving adjustment efficiency in the euro area. These concern the scope for enhancing adjustment through structural reforms in labour and product markets; the role of fiscal policy in helping to assure efficient adjustment outcomes; and the ways in which financial flows interact with real sector adjustment in a setting of ever-closer market integration.

In presenting over 250 pages of research and analysis, the Review takes an in-depth look at macroeconomic differences and adjustment in the euro area and how these have arisen. But the aim is not only to look backwards; it is also to identify the lessons for the future in this complicated field of 'real world' economics.

Figure 3: Real interest rates in the euro-area Member States



Improving adjustment dynamics

The experience of the first eight years in the euro area shows that many countries have not yet fully adapted to life with the single currency. It is true that the euro has established itself as a strong and stable currency, and that the euro area, as a whole, has responded well to common economic shocks, such as the rise in oil prices and the financial market volatility of the dotcom crash. It is also true that interest rates and inflation rates have been at historically low levels for a prolonged period of time – allowing companies and citizens to benefit from favourable credit conditions for investment and consumption. However, concludes the Review, the euro area remains sub-optimal in some aspects – in particular, the ability of individual member economies to adjust to changing economic challenges, as shown by persistent differences in economic growth and inflation rates.

In response, the Review points to well-functioning market adjustment channels as important elements marking the way forward, particularly improved competitiveness, but also policy channels. The quality of public spending should be reviewed to ensure it supports growth-enhancing investments in R&D, innovation and education, it suggests.

More progress on the integrated financial market would help smooth economic shocks where they hit the hardest, and implementation of the recent Services Directive will help increase competition in this important sector and improve productivity and competitiveness. The authors also look briefly at the lessons for catching-up economies, such as those of the recently acceded Member States preparing for the euro. The credit expansion seen in some current euro-area members might also be expected in these Member States as they adjust their economies for euro adoption.

Further, for the economy to remain competitive, say the authors, it is important for wage-price developments to reflect productivity gains – and economic actors, such as governments, businesses and trade unions, need to take this into account in wage bargaining and look to long-term competitiveness as a common aim. Lastly, it is essentiel that politicians explain clearly the overwhelming benefits of the euro to citizens, such that they are fully behind efforts to equip the euro area to face the challenges and opportunities of globalisation. ■

Further information

The EU Economy 2006 Review with the associated press release can be found on the DG ECFIN website:

http://ec.europa.eu/economy_finance/publications/the_eu_economy_review_en.htm

The economies of Bulgaria and Romania

New EU Member States Bulgaria and Romania have hit the ground running as they endeavour to narrow the economic gap between them and their peers. Despite the very real challenges facing the two countries, robust economic and investment growth are making the painful transition period in the early 1990s following the collapse of the Soviet bloc an increasingly distant memory.

Bulgaria and Romania both entered the European Union on 1 January 2007, bringing some 30 million new citizens into the EU fold. This fifth enlargement round means the Union is home to half a billion people and is the world's largest economy, which has been the case since the 2004 expansion.

"Romanians have a reason for national pride," Romanian Prime Minister Calin Popescu Tariceanu said when his country's entry was confirmed in September 2006. Bulgarian President Georgi Parvanov indicated his country's interest in fulfilling the remaining requirements identified by the European Commission in its final pre-accession monitoring report, which called on the two countries to step up their judicial reform process and combat corruption.

While there are differences between Bulgaria and Romania – particularly in terms of economic size, the level of industrialisation and macroeconomic performance – the two new Member States do share several common features. They both faced a significant outflow of labour in the wake of the economic upheavals in the 1990s. Today, they are both undergoing rapid economic growth (see figure), yet are suffering from relatively low employment levels and serious labour shortages in certain high-skill sectors.

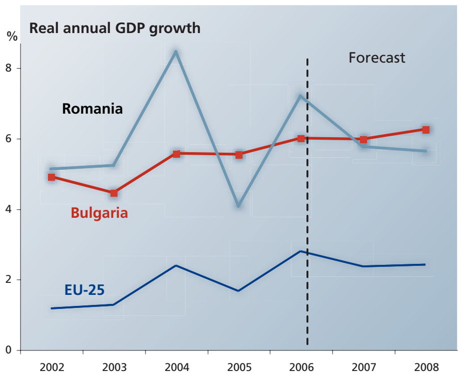
The Bulgarian economy

The 1990s were tough for Bulgaria, faced, as it was, with the loss of its main export markets in the Comecon (the economic counterpart to the Warsaw Pact), the disintegration of neighbouring Yugoslavia and a deep financial crisis in 1996/97. Sanctions against Serbia and Iraq also hurt the Bulgarian economy. Painful reforms and EU assistance helped Bulgaria navigate its way out of the quagmire and start to improve on pre-1990 living standards.

Nowadays, Bulgaria's real economic growth rates are more than double the EU average. Real annual GDP growth stood at 5.5% in 2005 and accelerated to 6.1% in the first half of 2006, compared with 1.7% and 2.8% respectively for the EU-25. Along with investment, consumption, which grew by 6.4%, was the main driver of growth. Despite this progress, Bulgaria still has a long way to go before its economy catches up with the rest of the Union. In 2005, Bulgaria's per capita income was 32.1% of the EU-25 average.

Bulgaria is one of the few European countries running a public sector surplus. For 2006, this is likely to exceed 3% of GDP. This kind of fiscal discipline has helped Bulgaria to lower taxes and to contain a high and growing external deficit. It also means that the country already meets the budgetary conditions for euro introduction. But other challenges remain, for example, in terms of inflation.

High growth in Bulgaria and Romania



Employment has also been growing steadily. By the second quarter of 2006, unemployment had fallen from just over 10% in 2005 to 9% of the workforce. However, the employment rate is still lower than the EU average.

Although the growth of exports outpaced that of imports, the trade deficit rose slightly again in the first half of 2006 to 20.5% of GDP. This pushed the deficit in Bulgaria's current account up further, to 13.9% of GDP.

Bulgaria (България)

Currency: lev

Population: 7.4 million (2006)

GDP per capita in purchasing power standards (EU-25=100): 32.1% (2005)

Real GDP growth rate: 5.5% (2005)

Public sector deficit (as % of GDP): +3.25% surplus (2006)

General government debt (as % of GDP): 25.8% (2006)

Source: *European Commission*

Credit where it is due

Bulgaria's most glowing achievement in recent years has been the stability it has brought to its economy. Following the financial crisis of 1996/97, the government introduced a Currency Board to anchor the economy and facilitate the implementation of important structural reforms – moves which boosted investor confidence.

"Bulgaria's ambitious structural reforms and very prudent fiscal and wage policies have helped the country to achieve a remarkable level of macroeconomic stability," explained Peter Grasmann, Head of the DG ECFIN Unit for economic affairs within the candidate countries. Despite this enviable level of stability, challenges remain in terms of Bulgaria's large current account deficit and high credit growth rate, both of which are fairly common manifestations of rapidly growing economies.

Overall, the future looks promising. "Economic growth is expected to accelerate further in 2007 and 2008 as strong investment growth and ongoing enterprise restructuring continue to bear fruit," the ECFIN autumn forecast predicted. Real GDP growth is expected to top 6% in 2008 and the increasing absorption of EU transfers together with continued

Bulgaria and Romania have hit the ground running

Romania (România)

Currency: new leu

Population: 22.3 million (2006)

GDP per capita in purchasing power standards (EU-25=100): 34.7 (2005)

Real GDP growth rate: 7.2% (2006)

Public sector deficit (as % of GDP): - 1.4% deficit (2006)

General government debt (as % of GDP): 13.7% (2006)

Source: *European Commission*

strong foreign capital inflows will help to sustain relatively high rates of investment growth of around 14% per year.

The unemployment rate is expected to drop further and is likely to reach around 7% by 2008. At the same time, a rapidly ageing and declining population limits the potential for further employment growth. Increases in real wages are expected to keep pace with productivity gains. EU membership will also bring its own challenges: implementing the remaining reforms necessary for eventual euro entry and ensuring the efficient use of Structural Funds.

The Romanian economy

Four decades of central economic planning, an obsolete industrial base and a focus on self-reliance (i.e. trying to produce everything locally) brought Romania's economy to the verge of economic collapse in the final years of the Soviet bloc. The 1990s were a veritable economic roller-coaster ride for Romania, and it was not until 2000 that the economy began to grow on a sustainable basis.

Today, Romania is in the midst of a robust rebound. In 2004, the economy grew by an impressive 8.4% – which slowed somewhat to 4.1% the following year – and, in 2006, growth was expected to bounce back strongly to 7.2%, "driven by a broad-based recovery in industrial activity, construction and agriculture", according to the ECFIN autumn forecast. It is also underpinned by a significant rise in private consumption – which grew by nearly 10% in 2005 – and in investment, which increases by 13%.

Foreign direct investment – lured by accelerating structural reforms and an improving business environment – has played a particularly important role. It has increased from less than 3% of GDP in the period between 1995 and 2000 to almost 5% of GDP between 2001 and 2005. "Foreign investors have helped pull Romania up the value chain, as demonstrated by the notable change in the make-up of exports towards higher-value-added products," observes Peter Grasmann.

Employment has only recently started to grow, due to the long contraction of several labour-intensive industries, and employment rates remain relatively low. Unemployment amounted to about 7.6% in 2006. Over the next two years, it is expected to remain stable at around the same level, despite robust economic growth.

Growth in imports outstripped the increase in exports, causing the current account deficit to widen to 8.7% of GDP in 2005 and to about 10% in 2006. However, 75% was offset by net foreign direct investment in 2005. This trend was likely to continue in 2006. For both years, the public sector deficit has hovered around 1.5% of GDP. In 2007 and 2008, it is expected to widen due to accelerated public investment, social transfers and wage expenditure following EU accession. This is not a cause for undue concern, since Romania has a low level of public debt of around 15% of GDP.

Staying on track

One major challenge Romania needs to tackle is to continue structural reforms and sound fiscal policies after accession. Large quasi-fiscal deficits and payment arrears were an endemic phenomenon throughout Romania's economic transition, but efforts to improve fiscal transparency have been stepped up in recent years – as a special ECFIN Country Focus [1] describes. However, Romania's similarly good performance when it comes to budget revenues needs to be matched by an equal improvement in the quality of public spending.

Roman catholic church in Tirgu-Mures, Romania

Romania struggled in transition to turn around its obsolete industrial base. Having now taken large strides in this area, manufacturing is set to become one of its key strengths once it successfully converges with the rest of the EU. The country's considerable potential rests on its broad industrial base, rich agricultural land, diverse energy sources and well-trained workforce. Over the next two years, real economic growth will remain robust at 5.8% (2007) and 5.6% (2008) and domestic demand will remain buoyant. But an attractive business environment and the efficient use of a growing pool of available resources will be crucial for preserving momentum in the economic catching-up process.

Further information

More information can be found on the Member States' country pages on the DG ECFIN website:

http://ec.europa.eu/economy_finance/about/activities/countryeconomy/main_en.htm

[1] *Payment arrears in Romania: is a hard budget constraint yet to come? Country Focus, Volume III. Issue 12, October 2006, European Commission, Brussels.*

Recent research and analysis published by DG ECFIN

Global trade integration and outsourcing: How well is the EU coping with the new challenges?

By Karel Havik and Kieran McMorrow of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No. 259, October 2006, European Commission, ISBN 92-79-01200-2

Trade integration has been a striking feature of the world economy over recent decades and one important component of global trade is supply chains, where intermediate goods and services are shifted and outsourced around the world adding value in many locations. This article asks how well the EU is meeting the challenges of an integrating world economy. Complacency must be avoided, conclude the authors, and policy-makers need to remain vigilant on potential medium- to long-term challenges to the EU's present hegemony in world trade.

Monitoring short-term labour cost developments in the European Union: which indicators to trust?

By Gilles Mourre and Michael Thiel of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No. 258, October 2006, European Commission, ISBN 92-79-01199-5

Tracking labour costs is important because of their impacts on industrial competitiveness and profitability and on household purchasing power, which influence the economy through investment and spending. For this reason, various indicators are used to monitor labour costs developments, for example compensation per employee or hourly labour costs. In this article, the authors review the available indicators used in the EU. The article recommends using composite sets of indicators which, analysis shows clearly, outperform single indicators.

Labour migration patterns in Europe: recent trends, future challenges

By N. Diez Guardia and K. Pichelmann of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No. 256, September 2006, European Commission, ISBN 92-79-01197-9

Issues of international migration are receiving increasing attention as net migration into the EU is rising. This is paired with major changes in migration patterns compared to the past. This article reviews current immigration patterns and draws tentative economic conclusions from the sparse data. Overall, the economic situation of immigrants is vulnerable, and the EU is less successful than the US in efficiently absorbing immigrants and lags in attracting highly educated groups.

Monetary and exchange-rate agreements between the European Community and Third Countries

By Baudouin Lamine of DG ECFIN. EUROPEAN ECONOMY, ECONOMIC PAPERS, No. 255, September 2006, European Commission, ISBN 92-79-01196-0

The paper examines the exchange-rate links between the Community and two African monetary unions, the monetary agreements with the Vatican, Monaco and San Marino, the particular cases of Saint Pierre-et-Miquelon and Mayotte, and the informal monetary regimes of countries using the euro de facto such as Andorra, Montenegro and Kosovo. It also looks at links with some of the EC Member States' overseas entities and territories, and countries using the currency of non-participating Member States.

After introductory sections on the general characteristics of the monetary and exchange-rate agreements concluded by the Community, the paper provides a brief institutional and historical overview for each zone, country or territory, as well as the type of and economic rationale for each monetary link.

What do the sources and uses of funds tell us about credit growth in Central and Eastern Europe?

By the staff of DG ECFIN. EUROPEAN ECONOMY, OCCASIONAL PAPERS, No. 26, November 2006, European Commission, ISBN 92-79-01353-X

Central and Eastern Europe has been experiencing a credit boom in recent years. This study sheds light on the dynamics of these high credit growth rates. It emphasises the role of resource allocation in building a more sophisticated and deeper understanding of credit growth. Countries with large credit growth rates, the report finds, have experienced large current account deficits. However, this is partially offset by large productivity gains in the region. This suggests that high credit growth can stimulate economic convergence if channelled into the productive sectors.

Country study: growth and competitiveness in the Polish economy: the road to real convergence

By the staff of DG ECFIN. EUROPEAN ECONOMY, OCCASIONAL PAPERS, No. 27, November 2006, European Commission, ISBN 92-79-01354-8

After significant recent reforms Poland now has a vibrant, modern economy. However, to win 'pole' position, Poland needs to go up a gear. This report finds that Poland can achieve strong and broadly based gains in income and employment over the next decade, but it stands at a crossroads. "Policy-makers have a critical opportunity now to engage a virtuous circle of job creation, sustained productivity gains and enhanced macroeconomic stability," the study notes. It maps out a fast-convergence track for Poland that avoids a slow-growth, low-employment trap, with regional disparities persisting and restructuring challenges hard to absorb.

The Directorate for Economic and Financial Affairs publishes frequently on economic research relevant to the European Union; only a selection of these articles is reported here. A complete list of downloadable publications is available at http://ec.europa.eu/economy_finance/publications_en.htm

Selected upcoming publications:

- Steps towards a deeper economic integration: the internal market in the 21st century (Economic Papers)
- Country study. Raising Germany's growth potential (Occasional Papers)
- Provisions of the welfare state: unemployment protection versus unemployment insurance (Economic Papers)

KC-AJ-06-005-EN-C

For your diary

The 2007 EIB Conference on Economics and Finance, in Luxembourg on 25 January 2007

An efficient, sustainable and secure supply of energy for Europe

How can we ensure an efficient, sustainable and secure supply of energy for Europe? The annual European Investment Bank (EIB) conference on economics and finance seeks answers to this question. Philippe Maystadt, President of the EIB, will open the conference. Among the topics are EU policy objectives and energy investment decisions, barriers to investment in energy efficiency, and an energy security policy for Europe. The papers presented at the conference will be published in volume 12 (2007) of the EIB Papers. See events on the EIB website. http://www.eib.eu.int/index.asp

EP debates with national parliaments in Brussels on 28 February to 1 March 2007

The euro zone – converging or drifting apart?

The European Parliament is holding a series of debates with national parliamentarians between 28 February and 1 March 2007. The Committee on Economic and Monetary Affairs (ECON) is hosting a session on challenging questions about the euro area. Pervenche Berès, chairwoman of ECON, will open the session. Contributions from political and business leaders will shine light on how to deal with divergence and the role of the euro in a globalised world. Joaquín Almunia, the Economic and Monetary Affairs Commissioner, will speak during the governance and convergence (the state of play) session. For more information see the ECON website. http://www.europarl.europa.eu/comparl/econ/hearings/default_2007_en.htm

A conference in Berlin on 22 to 23 March 2007

Fiscal policy challenges in Europe

Fiscal policy in EMU centres on maintaining fiscal sustainability in all Member States and providing the right environment for high growth and cohesion. On this premise, Germany's Federal Ministry of Finance and the Centre for European Economic Research (ZEW) are hosting a conference on fiscal policy challenges in Europe. The event will cover theoretical, empirical and institutional issues under the following broad headings: quality of public finances, fiscal reform and the Lisbon objectives, and public-sector efficiency and performance. For more information see the ZEW website. ftp://ftp.zew.de

An ECFIN conference in New York on 17 April 2007

The euro and the dollar – pillars in global finance

This high-level conference, organised by DG ECFIN together with the Commission's Delegation to the US, will be organised back-to-back with the spring meetings of the IMF/World Bank. Targeting economists and financial market analysts in the US, it will focus on recent experience of financial market integration following the introduction of the euro, and look at implications for the US. For more information see 'events' on the ECFIN website.

An IMF conference in Washington on 26 to 27 April 2007

New perspectives in financial globalisation

The IMF's Research Department and Cornell University are sponsoring a conference, on 26-27 April in Washington, DC (USA), to present recent theoretical and empirical research on the macroeconomic implications of financial globalisation. Topics include the links between trade and financial integration, policies for containing sudden financial crises, the links between financial integration and policy coordination, and more. The conference will bring policy-makers, academics and the business world together to discuss these issues. For more information see the IMF website. http://www.imf.org

The Brussels Economic Forum, in Brussels 31 May to 1 June 2007

Global adjustment and EMU

The BEF is DG ECFIN's premier conference on European economic issues. The 2007 BEF looks at EMU in the world through three sessions: unwinding global imbalances, adjustment and integration dynamics in EMU, and fostering catching up and cohesion in the EU. Conference contributors will come from countries and international organisations from across Europe as well as the US and Asia. More information on the 2007 Brussels Economic Forum can be found in the events section of the DG ECFIN website.

And to Istanbul for the OECD World Forum, 27 to 30 June 2007

Measuring and fostering the progress of societies

The second OECD World Forum on Statistics, Knowledge and Policy, organised in co-operation with the European Commission, the UN and the World Bank, will be held on the Bosphorus in 2007. The conference will provide opportunities for in-depth discussions on measuring progress in the face of climate change, health concerns and economic globalisation. Commissioner Joaquín Almunia will join other high-profile speakers in contributing to this international dialogue on identifying gaps in our knowledge, and how these might be closed through new, widely applicable indicators for progress. More information is available from the OECD website. http://www.oecd.org

Further information

A list of the events organised by ECFIN is available at:

http://www.economy_finance/events_en.htm

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