



# Weekly Briefing

**Croatia Economy briefing:**  
**Croatia prepares to join the Eurozone**  
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## **Croatia prepares to join the Eurozone**

### ***Summary***

*By joining the European Union, Croatia also agreed to join the Schengen area and the Eurozone once it meets the necessary criteria. By completing these Croatia would finalize the two outstanding obligations that it accepted at the moment it formally joined the EU on 1 July 2013. While Croatia announces that it will complete the preparation for Schengen at the end of 2018, fulfilling criteria for joining the Eurozone will take several more years. The Croatian National Bank was always on a position that it is in the Croatian interest to join the euro as soon as possible.*

### **Introduction**

In the 1960s, the idea of the euro as a unique currency for the European Union was born. When the Maastricht Treaty entered into force in 1993, the European Union made a goal to create an economic and monetary union by the year 1999. At that time the European Union consisted of 12 member states, but the United Kingdom and Denmark decided not to accept the euro. Since the Maastricht Treaty came into force, accepting the euro became one of obligations for every new member state of the European Union. In 2002, the euro began to circulate as a new currency of the European Union. As of today, 19 member states have the euro as the official currency while eight do not.

Croatia joined the European Union in the 2013 but it is not in the Eurozone. Essential conditions that all the candidates must satisfy before entering the European Union are political and economic criteria alongside administrative and institutional capacity to approximate the national legislation with the legislation of the European Union. Introducing the euro is the last step in fulfilling the economic criteria.

## **Criteria to join the Eurozone**

There are four criteria that Croatia needs to fulfill before introducing the euro. The first is stable prices. It means that the inflation rate must not exceed the inflation rate in more than 1,5 percentage points in top three member states. The second is a sustainable public debt. The state debt must not exceed 60 percent of the GDP and it needs to show a solid reduction path. The third is to participate in the ERM II (Exchange Rate Mechanism) at least two years without significant deviation from the ERM II central exchange rate. The last criterium is interest rates. Long-term interest rates must not exceed a rate of the three best performing member states.

Thus far, Croatia fulfilled three criteria except for participation in the ERM II. Therefore, it still does not meet all the criteria to adopt the euro. The European Exchange Rate Mechanism is a system that reduces exchange rate variability and tries to achieve monetary stability before introducing the euro. “ERM II mechanism can serve as an important policy credibility anchor and motivate policy makers to pursue prudent policies in order to shorten the stay in the ERM II mechanism (aiming for minimal two years) and introduce the euro as soon as possible. For example, analyzed convergence and economic indicators show that the ERM II had generally positive effects on Slovenian and Slovakian fiscal balances, growth trajectory and unemployment rates.”<sup>1</sup>

The European Commission explains that “the euro does not bring economic stability and growth on its own. This is achieved first through the sound management of the euro-area economy under the rules of the Treaty and the Stability and Growth Pact (SGP), a central element of Economic and Monetary Union (EMU). Second, as the key mechanism for enhancing the benefits of the single market, trade policy and political co-operation, the euro is an integral part of the economic, social and political structures of today’s European Union.”<sup>2</sup>

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<sup>1</sup> <https://hrcak.srce.hr/file/281862>

<sup>2</sup> [https://ec.europa.eu/info/about-european-commission/euro/benefits-euro\\_en](https://ec.europa.eu/info/about-european-commission/euro/benefits-euro_en)

The Croatian government announced in the spring of 2018 its intention to join the ERM II. At a minimum countries spend two years in the ERM II.

"It is important that the Croatian public knows that all analysis clearly shows that as a state we will have considerable and permanent benefit by introducing the euro, while costs will be relatively low, in most cases onetime," explained Croatian prime minister Andrej Plenkovic. He also stated that introduction of the euro would reduce risks of financial and macroeconomic instability, as well as interest rates and transaction costs.<sup>3</sup>

Plenkovic also added that all this would contribute to faster economic growth, higher employment, increased investments and enhanced resilience of the financial and economic sectors to different kinds of external shocks. There is a need to sensitize the public on this topic and for this purpose the government will establish a National Council for Introducing the Euro, explained the prime minister.<sup>4</sup>

Except for the party Zivi zid (Living Wall) all other political parties support the introduction of the euro. Zivi zid is a euro-sceptic party and has three seats in the 151 seats parliament. Most economists and other experts also support the introduction of the euro in Croatia. However, some fear consequences. Ljubo Jurčić, a professor at the Faculty of Economics of the University of Zagreb, is worried that the current efficiency of the Croatian economy does not support the introduction of the euro. In his opinion, Croatia needs at least ten more years of economic growth as high as seven percent just to gain the necessary predispositions for the introduction of the euro. For citizens with the lowest income, retirees and weak social protection, the introduction of the euro probably will not have positive consequences. Željko Lovrinčević, a researcher at The Institute of Economics in Zagreb, said that, on the one hand, introducing the euro would be a good opportunity to curb the grey economy. As results of other EU member states show, introduction of the euro led to the higher

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<sup>3</sup> <https://www.jutarnji.hr/vijesti/hrvatska/hrvatska-je-spremna-zapoceti-proces-uvodenja-eura-plenkovic-na-vladi-govorio-o-ulasku-u-eurozonu-dalic-otkrila-koliko-bi-mogle-rasti-cijene/7341546/>

<sup>4</sup> Ibid.

conversion towards the non-cash trade. On the other hand, it will limit the government to act as a crisis manager. In his opinion Croatia suffers from weak institutions and thus entering the Eurozone can be an opportunity to make positive changes in the institutions and regulatory framework.

### **Dispelling myths about the euro**

Croatian economic analyst Velimir Sonje described and dispelled four myths that exist about the euro in the Croatian public. The first myth says that the Eurozone is falling apart. The Eurozone is not falling apart. New stabilization funds are created to finance adjustment of the states in the Eurozone when the financial crisis hits. The second myth says that small states cannot compete with bigger states in the European Union. On the contrary, almost every small state in the Eurozone had faster growth and lower unemployment rate than Croatia in the last few years. The third myth is about enormous increasing prices after a country introduces the euro. In 2007, when Slovenia joined the European Union, until 2015, prices in Croatia had increased faster than in Slovenia. It shows that without the euro Croatia had greater inflation despite recession. There are other tools to deal with the inflation but in the end, introducing the euro will not have any permanent price changes. Smaller member states are trying to become members of the Eurozone faster than big ones. The fourth myth revolves around time and value of the currency. Economic research shows that smaller countries gained more benefits from the Eurozone than without the Eurozone. When a country enters the ERM II, they make a central parity of the future exchange of national currency. Even then, the currency of kuna could flow +/- 15 percent. The candidate for the euro must be at least two years in the ERM II. However, it is possible to extend this period if Croatia decides that its economy needs more time to develop or resolve unexpected problems. When countries introduce the euro, they gain benefits from lower transaction costs, predictable and lower prices and weaker financial oscillations.

Professor Luka Brkić from the Faculty of Political Science at the University of Zagreb said that introducing the euro is not a question, but an obligation that Croatia agreed to when it joined the European Union. For him, the euro is an instrument for creation of a political union. In his opinion, smaller states like Croatia may have given up a possibility of independent actions, but they should take into account benefits the membership in the European Union brings. The creation of a political union is not necessarily a bad goal, but facilitating economic growth and improving people's living conditions needs to be the main goal of every government.

### **Conclusion**

Most experts and politicians in Croatia agree that the question is not should the country introduce the euro but when it should do it. The Croatian prime minister believes that the country is now ready to begin the process of introducing the euro. Some economists talk about the year 2022 while others rather take 2025, 2027 or even 2032 as the year for completion of the process and adoption of the euro. It is also understood that the process of introducing the euro should not be taken for granted and it should be carefully handled. A promise in the end is that everyone, citizens and businesses alike, will have benefit from the euro.