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Psychological costs of currency transition: evidence from the euro adoption

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A B S T R A C T

This paper assesses the perceived individual psychological costs of adhering to the Euro. We use the difference-in-differences approach (DD), comparing individual levels of satisfaction with the economy in Slovakia immediately before and after the introduction of the Euro, with similar individuals in neighboring Czech Republic, which did not adopt the Euro. Both countries were economically and politically integrated for decades, and display similar macroeconomic behavior before and after the currency change in Slovakia. What we assess is not the actual, economic, costs stemming from the Euro adoption, but the change in utility as perceived by the individuals. There is evidence of substantial psychological costs associated with currency transition, especially for the old, the unemployed, the poorly educated and households with children. Our results are robust to the use of alternative control groups and to estimation procedures using the DD matching approach. The significant perceived costs uncovered in this paper suggest policy-makers should not ignore them when considering a sweeping economic change such as the adoption of a new currency.

1. Introduction

In the wake of United Kingdom´s referendum on whether to remain in the European Union it has become evident how individual perceptions matter, whether or not based in actual facts and information. Policy decisions may be reserved to informed elites, or anchored in the legitimacy of the popular vote,[1] but the latter requires a deeper understanding of how individual perceptions in different demographic groups confound and even counter objective information. This paper is a contribution in that direction, by assessing the perceived individual psychological costs of moving to a new currency, the Euro, across different population groups.

European countries considering a transition to the Euro have more often than not met with considerable popular opposition. In some cases referenda were called on the issue, and the go-ahead for adhering to the Eurozone has often failed to pass the popular test. We believe opposition to a change in currency is not necessarily rational, nor easily explainable, but it exists. Currency is to the

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[1] For example, as far as adoption of the Euro is concerned, the two positions have been clearly stated. In the Baltic states, and facing popular resistance, politicians have relied on "geopolitical objectives", further suggesting that "(…) this issue should be decided not among the population but among the real decision makers". Poland, on the other hand, has held firmly to its own currency, with officials stating they "cannot imagine any government would want, or indeed could, steer Poland into the Eurozone without Poles accepting the move". See The Economist (2012), The Baltic Times (2013), Fontanella-Khan and Milne (2013), and Gelzis (2013).

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economy what language is to social life. Ubiquitous, both attribute value as well as assign meaning to exchanges. Changing one's language or currency entails considerable psychological elements that may affect well-being, beyond its practical implications and adjustments imposed to everyday life. However difficult, gauging the extent and distribution of the costs of currency change is a relevant and timely policy issue in the European context.

The nature of the psychological costs of currency changeover deserves a clarifying conceptual discussion. First, it is important to understand what psychological costs are not: they are not the actual material costs to the Slovak economy stemming from the Euro adoption. Instead, psychological costs are assessed in terms of utility changes as perceived by individuals, not assessed in real Euros or the growth rate of output.[2] Second, these costs may be associated not to an actual change in the level of satisfaction, but an expected change, dependent on individual risk aversion and individual assessment of the likelihood of uncertain events. Third, psychological cost are not entirely "rational", in the sense that they may depend not even on inferred probabilities and outcomes, but under or overvalue certain features of the currency transition.[3] In sum, we deal with psychological costs because they are perceived and not actual, affected by risk aversion, possibly affected by behavioral-type biases.

One may ask why would currency transition be prone to perception bias? In the first place, individuals tend to think of currency in nominal rather than real terms, since what they deal with in a daily basis are nominal rather than real prices and wages (Shafir et al., 1997). As a new currency is introduced, prices in that currency are perceived to be different from prices in an old currency, possibly entailing psychological costs. This effect is known as a "money illusion".[4] Another specific source of psychological costs in currency transition is rescaling, that is, the difficulty of converting prices from the new to the old currency (Marques and Dehaene, 2004; Marques, 2007). Using a familiar or old currency as a benchmark for assessing prices in a foreign or new currency is known as anchoring bias (Tversky and Kahneman, 1974).[5] There is also the cost of relearning, associated with the persistence in the consumer's memory of prices as denominated in the old currency. This complex process may be more costly than rescaling, as mapping items to prices involves the long-term memory (Marques and Dehaene, 2004; Marques, 2007). Finally, there are other important subjective costs as, with time, individuals build an emotional attachment to a currency.[6]

The literature on the impact of the Euro adoption on personal well-being is still very limited, especially in the case of new member states of the Eurozone. Wunder et al. (2008) identify a negative impact of the Euro adoption in Germany on personal satisfaction with own financial situation, while Chadi (2015) finds solid evidence of a relationship between concerns with the Euro and lower life satisfaction in Germany. Otrachshenko and Popova (2012) show that adhesion to the Euro increased life satisfaction in Cyprus, Malta, and Slovakia, but decreased it in Slovenia and Estonia.[7]

This study contributes to the literature in several distinct ways. First, it assesses the psychological cost of currency transition in terms of the individual level of satisfaction with the economy, a material domain of subjective well-being. As pointed out above, our focus is not the objective benefits of the Euro adoption, but the subjective perception of net benefits. Second, our investigation relies on a "quasi-natural experiment" involving the Czech Republic and Slovakia, where the two countries chose opposite paths vis-à-vis the Euro, following decades of deep political, economic, social and cultural integration. Third, while existing studies assume similar costs across all socioeconomic groups (Dowd and Greenaway, 1993; Wunder et al., 2008), we argue for and provide evidence of significant differences in perceptions across groups. Individual characteristics such as income, labor market access, gender, age, and educational level, seem to matter for perceptions. Finally, this study contributes to the literature by filling the gap concerning the impact of the Euro adoption on the well-being of individuals in a new member state. This is crucially important as several new member states are likely to soon confront the choice of adopting – or not – the common currency.

Our empirical findings suggest that the introduction of the Euro in Slovakia had important negative impacts on individual satisfaction with the economy. Furthermore, we present evidence that certain groups of the population do seem to be more vulnerable to the psychological costs of changing the currency. The most affected groups are the old, the unemployed, the poorly educated, and families with children. Such differences across groups as to the perceived costs of adopting a new currency should guide effective information campaigns when the issue comes to the fore. Our results suggest that, if not properly communicated, the adoption of a new currency will meet resistance – objectively justified or not – driven mostly by a few specific population groups.

Our paper is organized as follows. The next section presents the methodology. Section 3 discusses estimation results, while Section 4 presents robustness check. The final section concludes.

[2] The Central Bank of Slovakia published forecasts of the costs and benefits of adopting the Euro and suggested significant income and growth gains in the medium term, explicitly stating that "Euro adoption will have not only anonymous macroeconomic impacts, but it will be manifested in the life of all citizens.", and "The euro should be a benefit for majority of the citizens." (see Šuster, 2006). Fidrmuc and Wörgötter (2013) show that like other economies in the area, the Slovak economy saw its GDP fall hard in 2009, with the financial crisis, but, unlike the other economies, GDP in Slovakia rebounded rapidly, though the recovery did not translate into lower unemployment rates.

[3] This may occur in the exact same way that, as several studies documented, air travelers seem to overestimate the probability of an accident (Carlsson et al., 2004) and citizens overvalue the personal threat of terrorism because a few, very costly, outcomes gain preeminence and confound "rational" judgment. Exposure to terrorism, it seems, entails a decrease in utility that goes beyond the computable expectation of losses. Authors such as Becker and Rubstein (2011) and Sunstein (2003) suggest the perceived cost of terrorism greatly exceeds the "objective" discounted harm.

[4] See Amado et al. (2007), Hobijn et al. (2006), and Lotz and Rocheteau (2002). Gamble (2006) shows evidence confirming that the "Euro illusion" effect is more prevalent for lower-priced items, possibly more present in the consumption basket of lower income households.

[5] Mussweiler and Strack (2004) find that people compare prices of products in a single currency much more accurately than in different currencies, even if all the information, including exchange rates, is available. Further, Mussweiler and Englich (2003) find evidence that the less familiar individuals are with the new currency, the more likely they are to be less accurate in predicting prices in the new currency.

[6] This suggests a type of endogenous change in utility, which can be assessed empirically, as in Tyszka and Przybyszewski (2006).

[7] In a qualitative study exploring consumer attitudes towards the Euro just before its introduction in Estonia, Kerem et al. (2013) conclude for the presence of doubts and prejudices concerning the Euro.