The euro’s role in Eastern Europe

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The Euro and the Dollar in the Crisis and Beyond
Federal Reserve Bank of Dallas
March 17, 2010

The Euro in Eastern Europe

- While far from being the rival of the US dollar at the global stage, the euro is the dominant regional currency in Eastern Europe
  - Trade, Capital flows, Labor mobility, Financial systems, FX reserves, Anchoring of exchange rates
  - Euro adoption is an obligation

- But even more: “The euro, a symbol of European identity, is one of the strongest tangible symbols of European integration and the shared values of Europe, the European nations and Europeans themselves.” (European Commission)
Outline

1. Pre-crisis development model of Eastern Europe
2. Eastern Europe: hit the hardest by the crisis
3. The role of the EU in Eastern Europe’s crisis
4. Euro area enlargement in light of the crisis in Greece
5. Concluding remarks

1. Pre-crisis development model of Eastern Europe

- Unique model of transition and growth
- Integration into the EU
  - Political integration and institutional development
  - Trade integration
  - Financial integration
  - Labor mobility
2. Eastern Europe has been hit the hardest by the crisis, cont’d

- Yet the “worst problems from past crises”, such as currency overshooting, bank runs and banking system collapse, have been avoided
- Huge affect on average, but substantial variation across countries
  - More vulnerable countries suffered more
  - But even ‘prudent’ countries, such as the Czech Republic, Slovakia and Slovenia have suffered
3. The role of the EU in Eastern Europe’s crisis

- Deep trade and financial integration: exposure to the external shock originated in the developed world
  - Some direct assistance (e.g. IMF/EU loans, frontloading of disbursement from EU structural and cohesion funds, expansion of EIB and EBRD activities)
  - Indirect support through parent banks (e.g. ECB support for parent banks; the EU’s political commitment to supporting subsidiaries; coordination of parent bank behavior)
  - But: no consideration of regional issues; almost no support from ECB; adverse view of euro area enlargement

4. Euro area enlargement in light of the crisis in Greece

- Euro area prestige in the crisis:
  - 1st phase: gain in prestige (largely due to ECB actions within the euro area), despite pitfalls in crisis management and diverse crisis response
  - Greek debt crisis: pre-1999 critiques seem justified
- Euro area is a special creation: monetary union and an integrated market without political union, economic policy coordination, fiscal union, common banking supervision and crisis resolution, but with limited labor mobility
- It was assumed that no country can arrive at the verge of default and there are no crisis management mechanisms
4. Euro area enlargement in light of the crisis in Greece, cont’d

- The Greek debt crisis may substantially reduce the inclination for euro area enlargement → unfortunate because: new EU member states are ‘not Greece’
- Flawed adherence to ‘Equal treatment principle’
- In fact, keeping countries outside the euro is not in the interest of insiders:
  - allows for competitive devaluations
  - increases instability at the border of the euro area
  - increases migration to the euro area
  - reduces the attractiveness of the EU
- Applicants’ perspective: join soon or not?

5. Concluding remarks

- The euro is indeed not just the strongest tangible symbol of European integration...
- ...but the core of the integration model in most Eastern European countries
- The integration model is irreversible in new EU member states and largely irreversible in EU applicant countries
- The impaired integration model must be repaired: lot to do both at the domestic and EU/euro area level