



## The euro's role in Eastern Europe

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### 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

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## 1. Pre-crisis development model of Eastern Europe

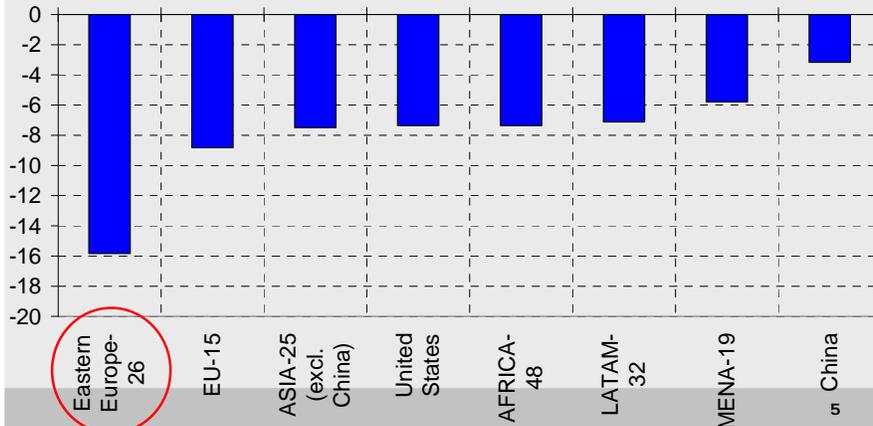
- Unique model of transition and growth
- Integration into the EU
  - Political integration and institutional development
  - Trade integration
  - Financial integration
  - Labor mobility

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## 2. Eastern Europe has been hit the hardest by the crisis

**Downward revision of GDP level forecasts for 2010:  
percentage difference of October 2009 forecast from  
October 2007 forecast**



## 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

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### 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

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#### 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?

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#### 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

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