

The future of the Euro at the Balkans

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BALKINT

Main objectives

- Speculate on the future of the Euro at the Balkans
 - ✓ In the light of the present crisis and especially South European and Greek experience
- Propose new solution for monetary architecture (avoiding errors form the current Euro zone design)
- Monetary reform is not sufficient, nevertheless money is a key social institution

Main thesis

- Avoiding the errors (Greece/current dilemma/bipolar choice)
 - **S1 Keeping only Euro** (lack of flexibility/full dependence from the EU core, austerity/or over liquidity)
 - **S2 Back to national currency** (discretion/lack of discipline, cronyism, nationalism...)
- Rethinking the EU monetary architecture/the process on Euro adoption by the NMS and the Balkans (ERM2 etc.)

Main thesis

New S3:

- Federative and complex structure
 - **Both Euro and national currencies**
(fiscal monies)
- Basic Principles
 - New geography of money, space, hierarchies, power
 - Monetary complementarity and competition
 - Subsidiary principles etc..
 - Diversity, flexibility, discipline

Main points of the presentation

Part I

- Balkans Monetary regimes (current situation)
- Greek errors and experiences

Part II

▪ **The Dual Solution**

(Euro and national fiscal currencies)

- Benefits and technical details
- Limits and feasibility

Part I
Balkans Monetary Regimes

Balkans Monetary Regimes

- (Some) diversity but in fact all are **externally oriented and depended from the ECB policy, subordinated moneys...**
- (Mainly) **Hard and Restrictive MR and ERR**
(pegged, fixed exchange rate (CR, SB), Currency Boards (BG, BH), or euroization (MN, KV)...
- **Serbia**, Albania, Macedonia and Romania (Inflation Targeting) ... but in... the *de facto* anchor is again the exchange rate

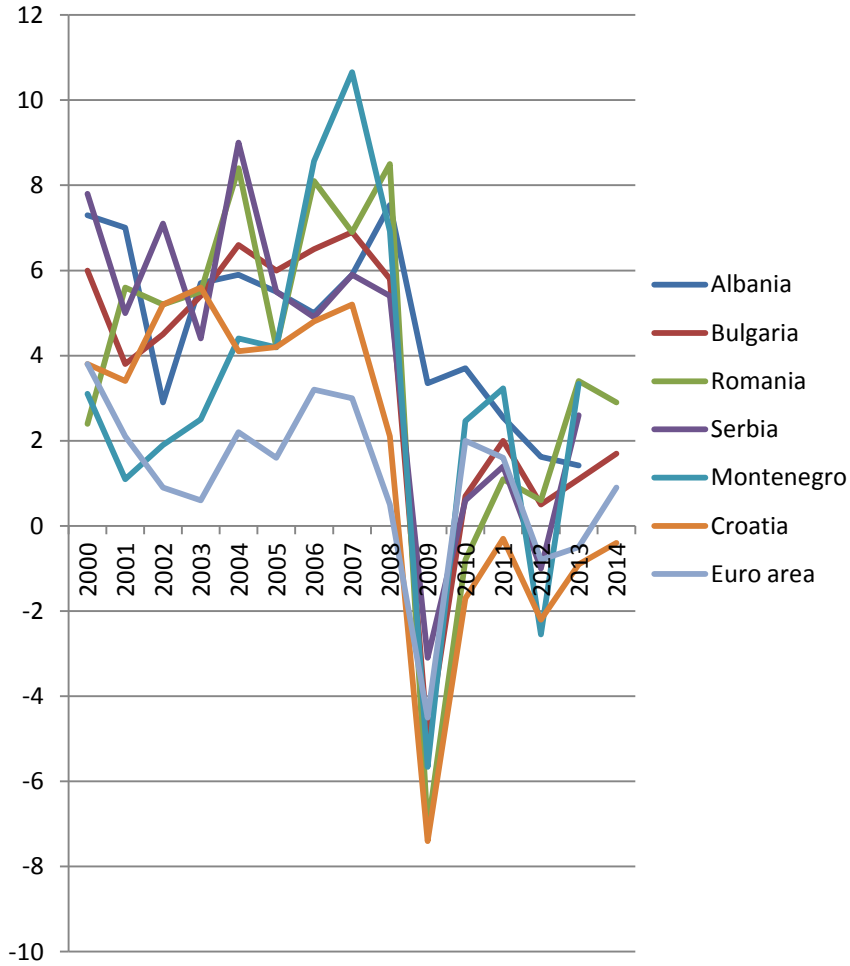
Balkans Monetary Regimes

- **Balkans periphery never had and could not have independent Monetary Policy**
(for economic and political reasons !)
- Ottoman Empire, LMU (1865-...), interwar period, Hitler, Soviet period etc...

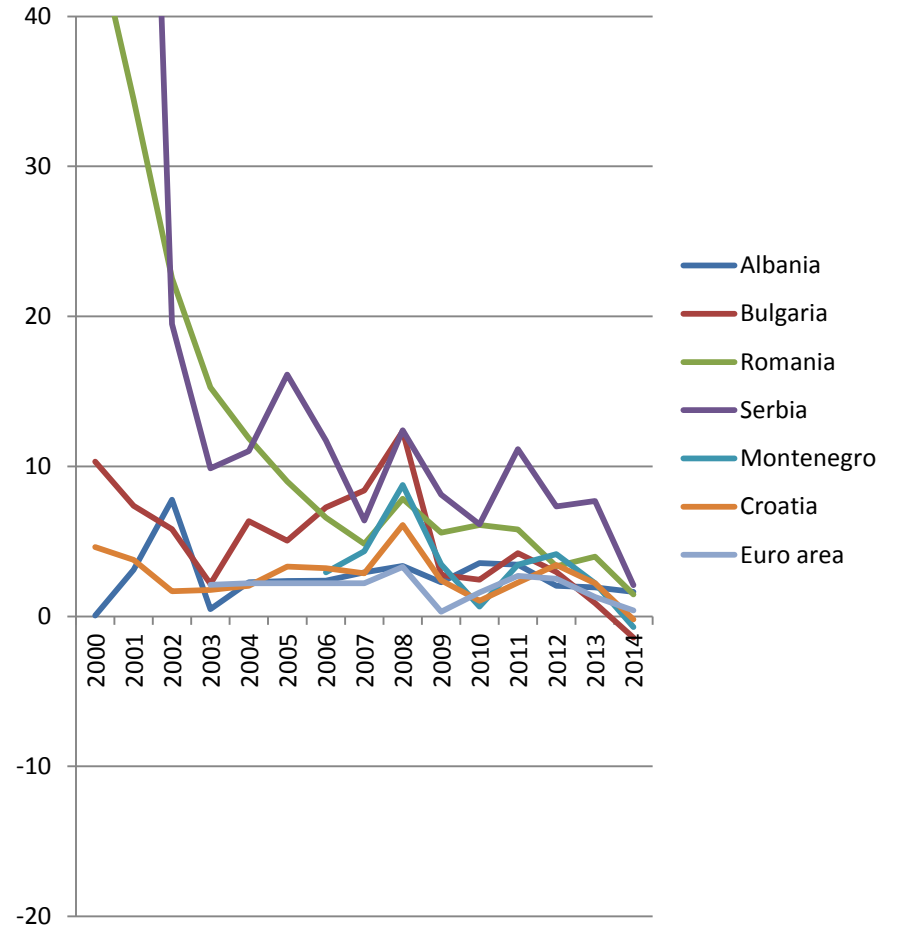
Balkans Monetary Regimes

- ***De facto* Euro circulates at the Balkans (OeN)**
 - Formally (cash, deposits, loans, debt denomination etc...) – **34% of deposits in Bulgaria are in euro and 50% of loans are provided in euro – as of end-2014**
 - Informally (cash, shadow economy ...)
- at the same time **ERM2 procedure still in kept**
 - (The curious case of MN and KV !)

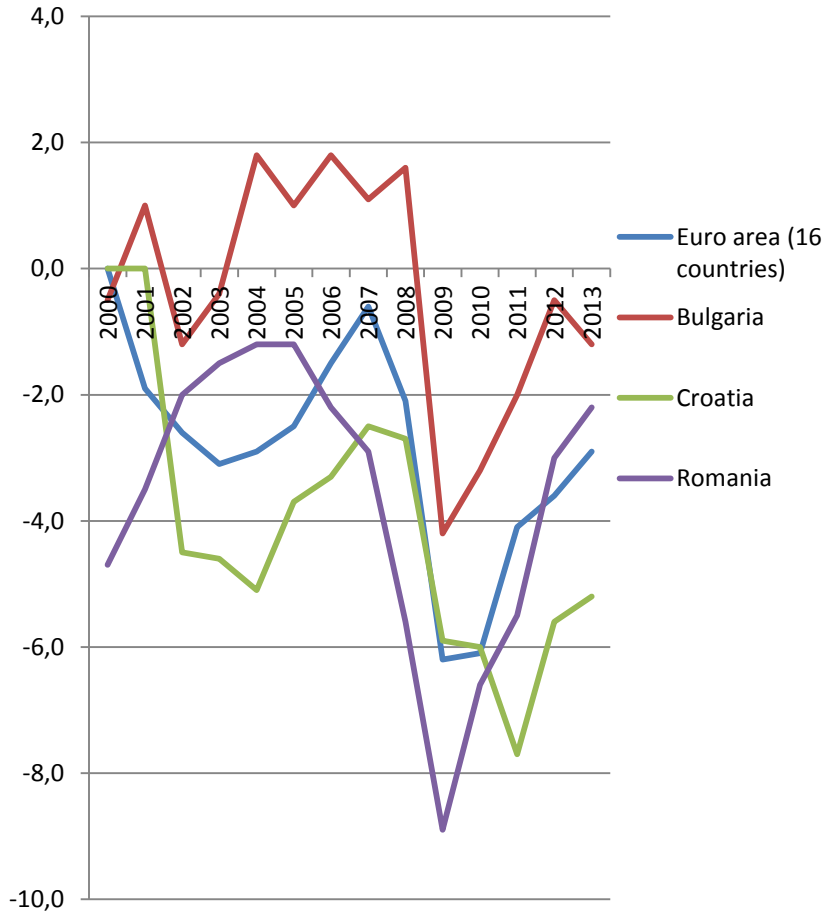
GDP growth (annual %)



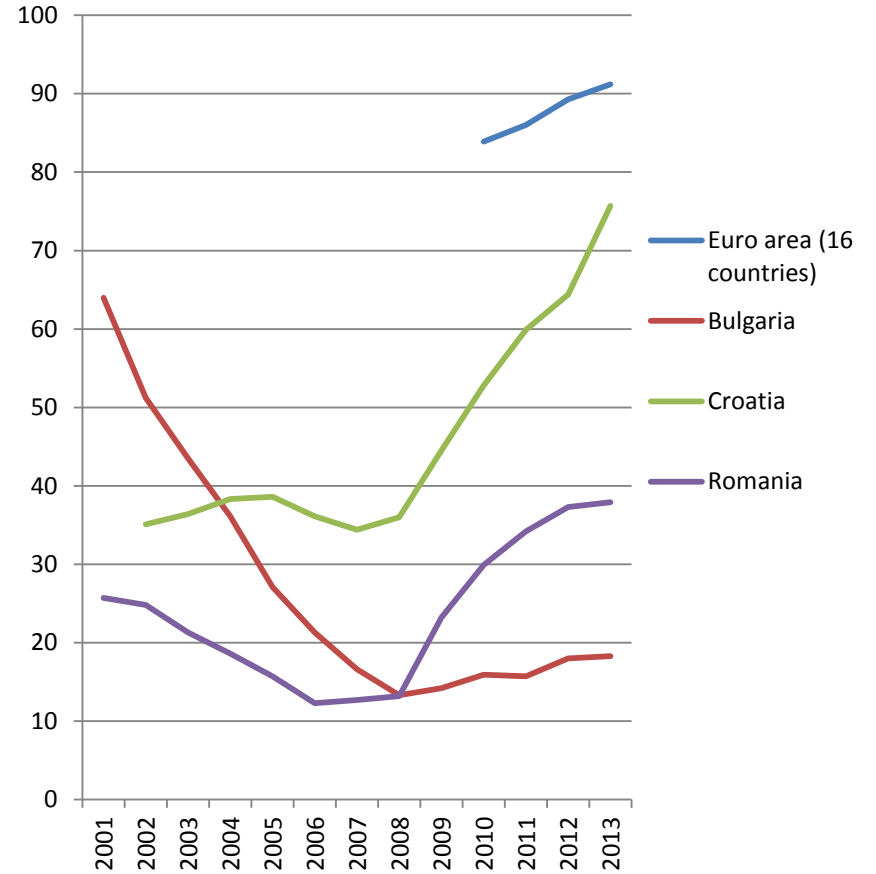
Inflation, consumer prices (annual %)



Government deficit/surplus



Government debt



Greek experience

Greek lessons

- **Current Dilemma (bipolar choice)**
 - S1 Staying at the Euro zone plus austerity measures

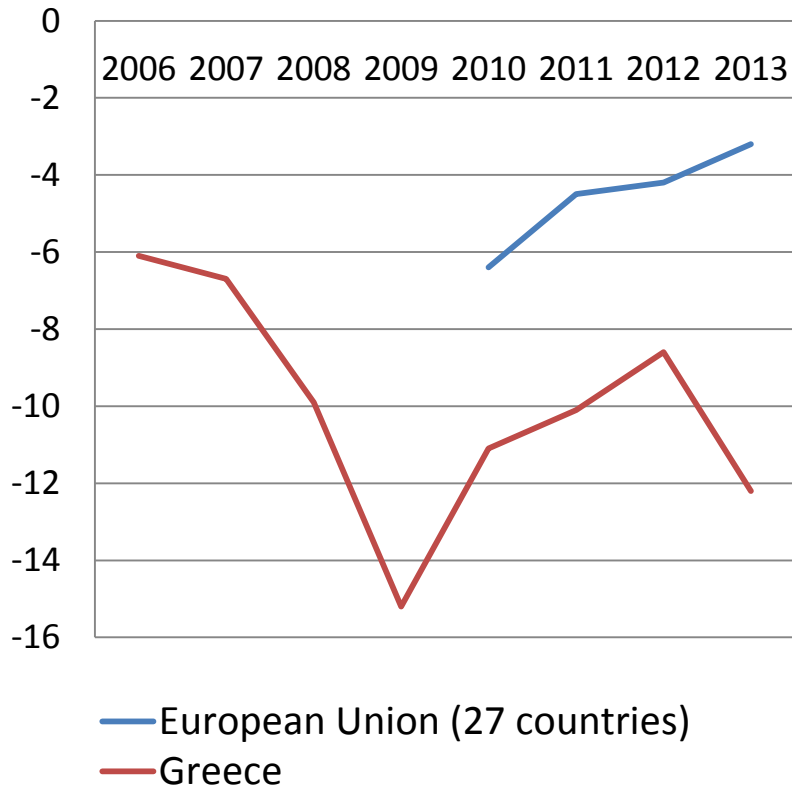
(... the question of “**the secondary depression**”, Keynes, Ropke, even Hayek...)
 - S2 Leaving the Euro zone and devaluating with all uncertain consequences for the country and for the whole Eurozone ...

Greek lessons

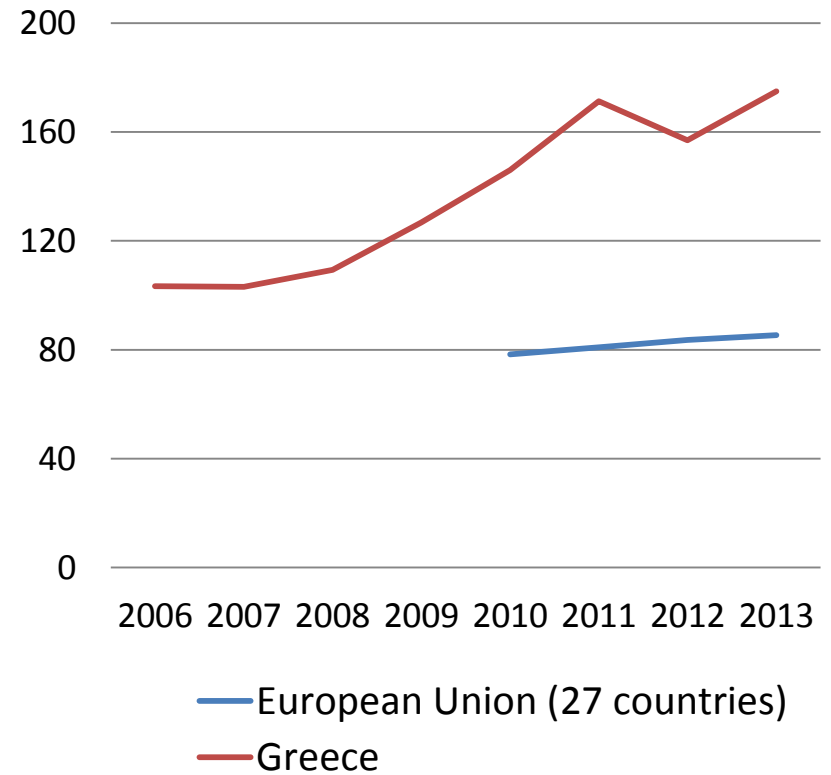
- **How Greece reached this situation?**
 - Lack of both - discipline and flexibility
 - Gigantic Moral Hazard driven by the common monetary policy (insurance, disappearance of the risk premium etc)
 - Many others ...
 - No buffers ... artificial simplification of monetary system...

Greece: Government deficit and debt

Government Deficit/Surplus (% of GDP)

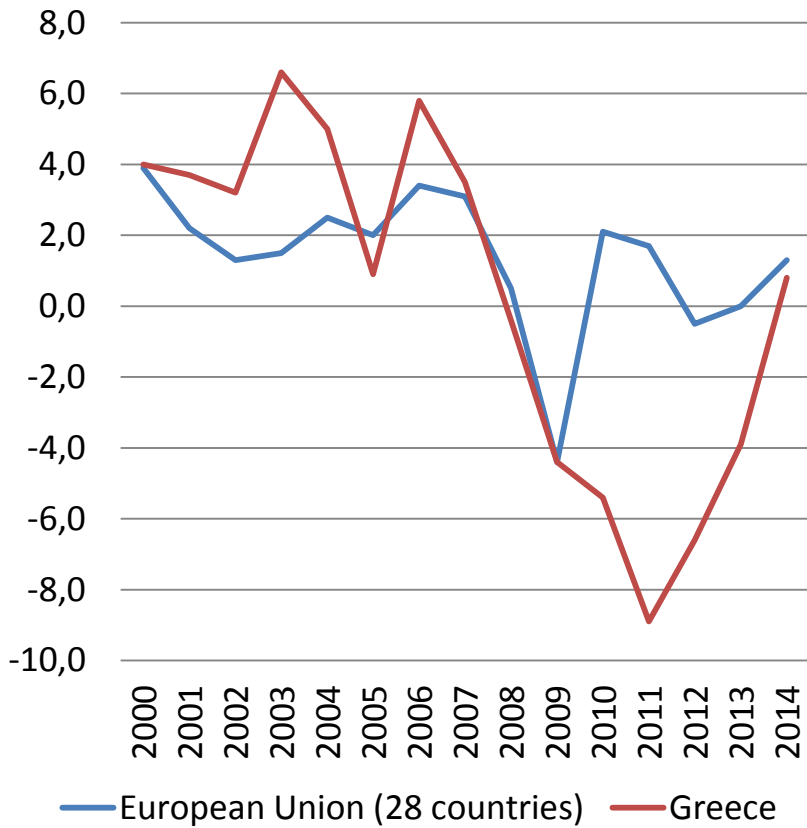


Government debt (% of GDP)

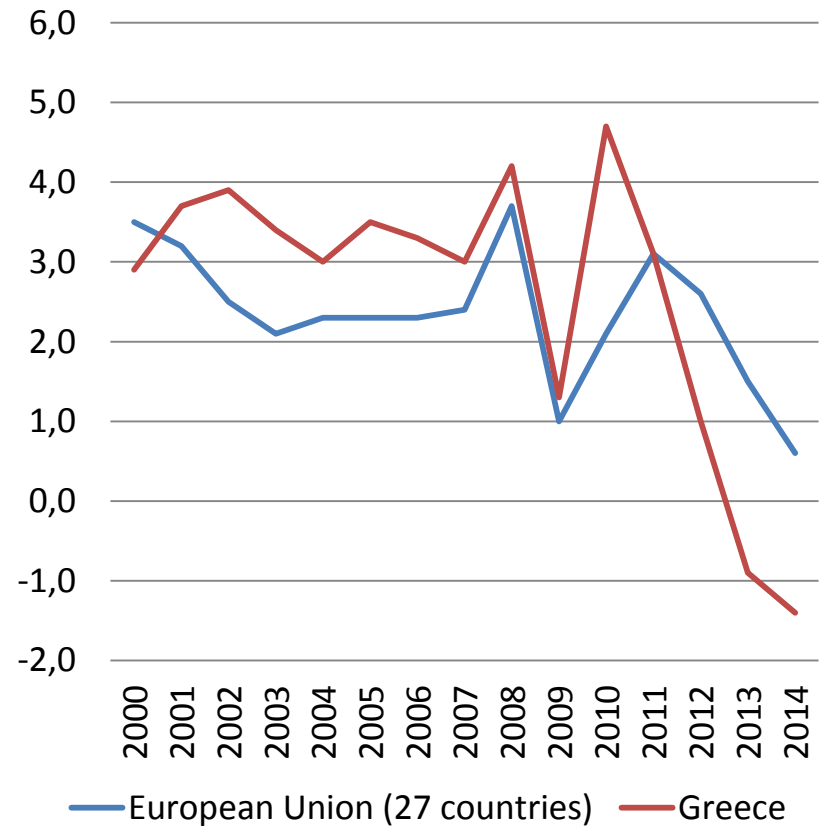


Greece: GDP and Inflation

GDP growth rate, %



Inflation



More lessons...

- The boom-bust cycle is more pronounced in Bulgaria and Romania, that in the Western Balkans (lending, and later capital outflows are weaker)
- More pronounced in Montenegro and Kosovo that in the other countries that have their own currencies
- This means – ECB common policy is **an institutional simplification** that provoke risky behaviour (indiscipline) and ... lake of flexibility to absorb chocks...

The Dual Solution

The Dual Solution

- Solution for Greece,
but for the **Balkans countries too !**
- Dual Proposal: Euro circulating alongside with National currencies
- **Euro** - interstate and international use,
Euro(Lev)...) - for domestic use .../**bimetallism** –
silver, gold, copper, ...)/feudal money/monetary
pyramid

The Dual Solution

- **National currencies**

- Fiscal currencies (domestic, special purpose money...)
- Issued by the National Treasuries (States)
- Covered by tax revenues (in anticipation)
- Injecting through the channel of wages, public services, pensions, social indemnities etc...

What does it mean?

- More realistic and complex monetary system
- Currency complementarity and currency competition – **two basic principles** in practice
- Circulation of **two parallel currencies**, two different monetary circuits (banking system and public finance)
 - **Fiscal money is many times repeated historical fact !**
 - Many historical experiences (tax anticipation script/USA 1930s; France (after the war), Argentina (*patacon, bocade...*/B. Theret)....
 - NEP/Russia/1924, (*tchervonets* and *sovznaks*)... Yugoslavia .../LMU (1865...)/ Cuba

Benefits

- **Short term** (ex: Greece):
 - **More liquidity and flexibility** (avoiding austerity, secondary depression), additional source of liquidity linked to circuit of the Treasury, to public finance
 - Revitalising national economic activities, reallocating national productive factors (employment), less Import, better CA...
 - As m^d of the new currency depend of taxes, the velocity of money could be accelerated with **monthly tax payment** etc...)

Benefits

■ **Medium and Long terms:**

- More fiscal discipline, balanced budget (keeping confidence in fiscal money)
- Less public debt
- More flexibility and buffers in case of crisis and asymmetric shocks
- Expansion of aggregate demand/cycle
- Coping with deflation - in some Balkan countries

More technical details

■ Exchange rate

- Fixed and full convertibility of the EuroLev **at fixed exchange rate**

(Euro will be unit of account, and the expression of price level)

- **In the case of Greece:** the question of **initial introduction of EuroDrachma** – crucial – to bring confidence (keep convertibility... later the convertible part will diminish and will depend of the public confidence...)

More technical details

- **In the case of Balkans, - different steps:**
 - Adopting Euro as a legal tender (and eventually becoming members of the Euro-zone)
 - But: **transforming national currencies** into fiscal one...
 - **Montenegro and Kosovo** could reintroduce national fiscal currencies alongside with the euro

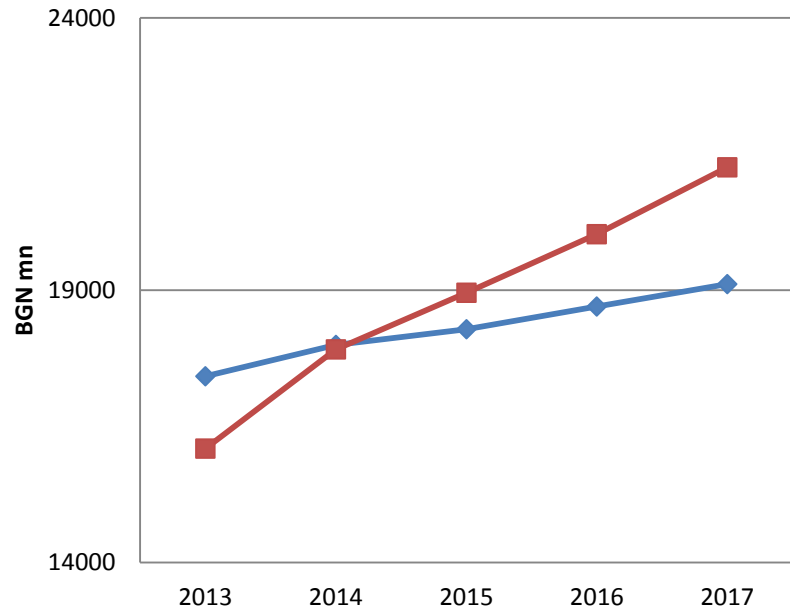
Bulgaria currency board

- Currency Board in Bulgaria differs from the orthodox currency boards by two elements:
 - Deposit of government
 - Deposit of Banking department in Issue department

Thus, higher coverage of monetary base by foreign reserves... higher foreign reserves to be used for ensuring convertibility of fiscal money in euro especially in the first years in order to gain credibility

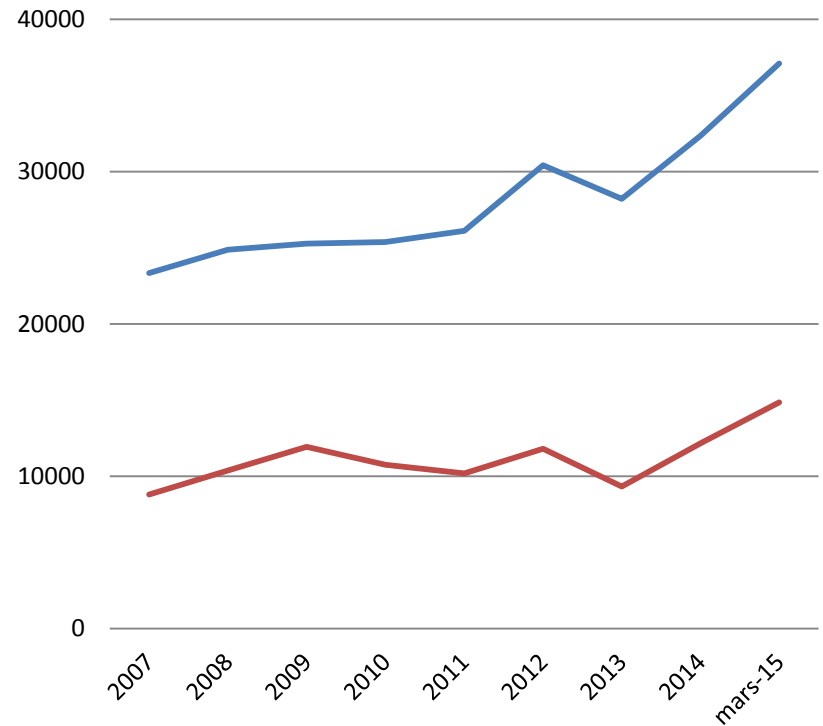
Bulgaria: Fiscal money

Tax revenues and Wages and social transfers



- ◆ Total compensation of employees and social transfers, excluding transfers in kind
- Tax revenues

Foreign reserves



- Foreign reserves
- Government deposit and Banking department deposit

Bulgarian case

- **Fiscal money** to be about BGN 18bn, taking into account future tax revenues, as well as payments by government in form of wages and social transfers
- **Design of the Bulgarian Currency board is favorable** to ensure enough coverage of the fiscal money by foreign reserves in order to keep convertibility

Obstacles and feasibility

Obstacles and feasibility

- Technical problems
- Political resistance
- Ideas and interests

Concluding remarks

- Current crisis confirm the limits of the Euro zone institutional architecture (**not flexibility, and not discipline..**)
- The new design could be more national friendly, based on federative and subsidiarity principles – **parallel circulation of banking (supranational, European) currency and fiscal (national) currency**

Concluding remarks

- Technically this is feasible, politically and ideologically difficult to realise

End

Monetary Regime change

- **Bulgaria** 1996/97 – banking crisis/hyperinflation/Currency board to DM/Euro
- **Romania** crisis (1996)/*de facto* fixed exchange rate
- **Albania** - pyramids (1996/1997 – 2000)/2/3 of the population/1/2 of GDP/ *de facto* fixed exchange rate
- **Montenegro/Kosovo** – crisis/DM legal tender in 1999/2001/Euro in 2002
- **BH** – 1997 crisis/Currency Board to DM/Euro
- **Serbia** – hyperinflation (1993/1995/Abramovich/fixed rate DM...), later again inflation ...

GDP growth (annual %)

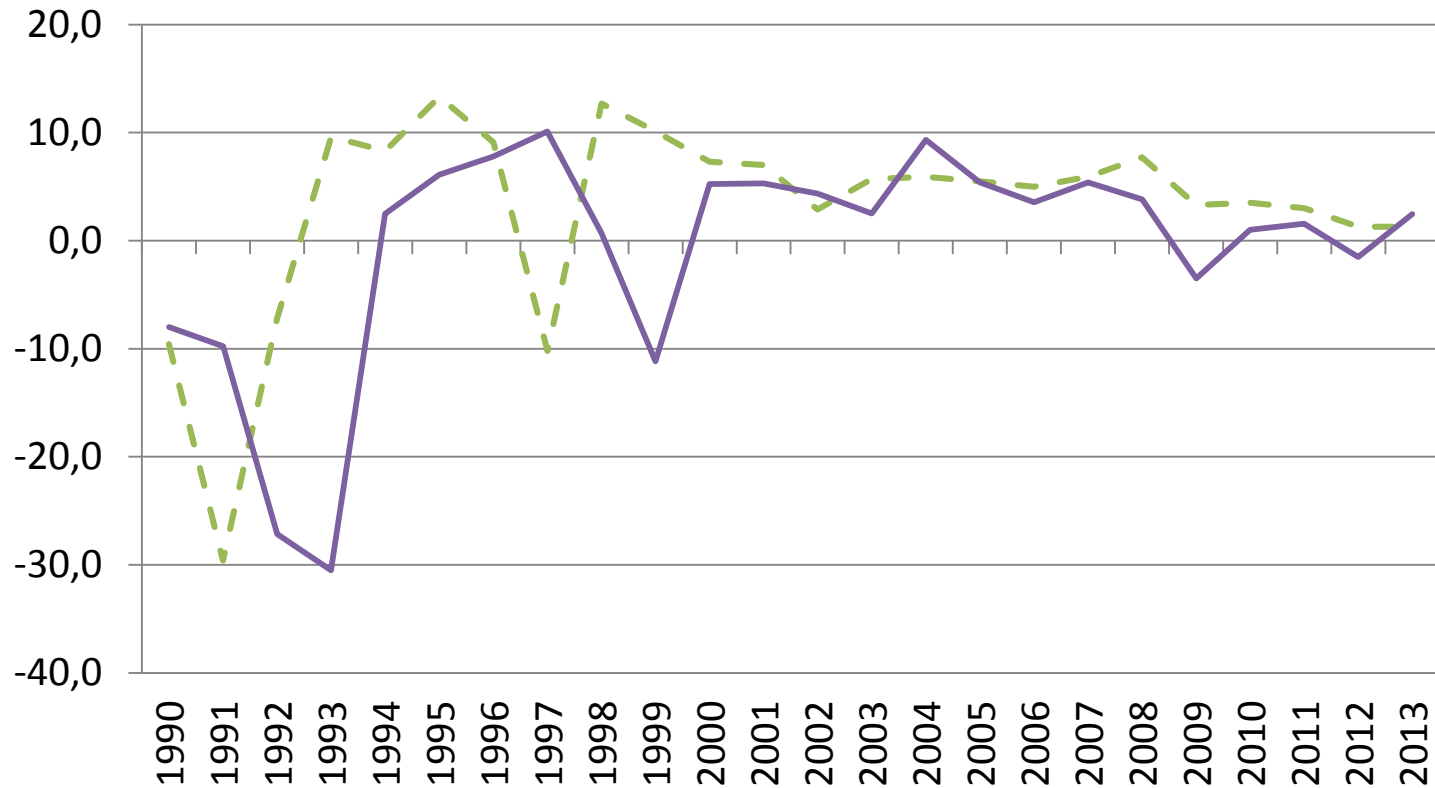


Source:WB

--- Romania

— Bulgaria

GDP growth (annual %)

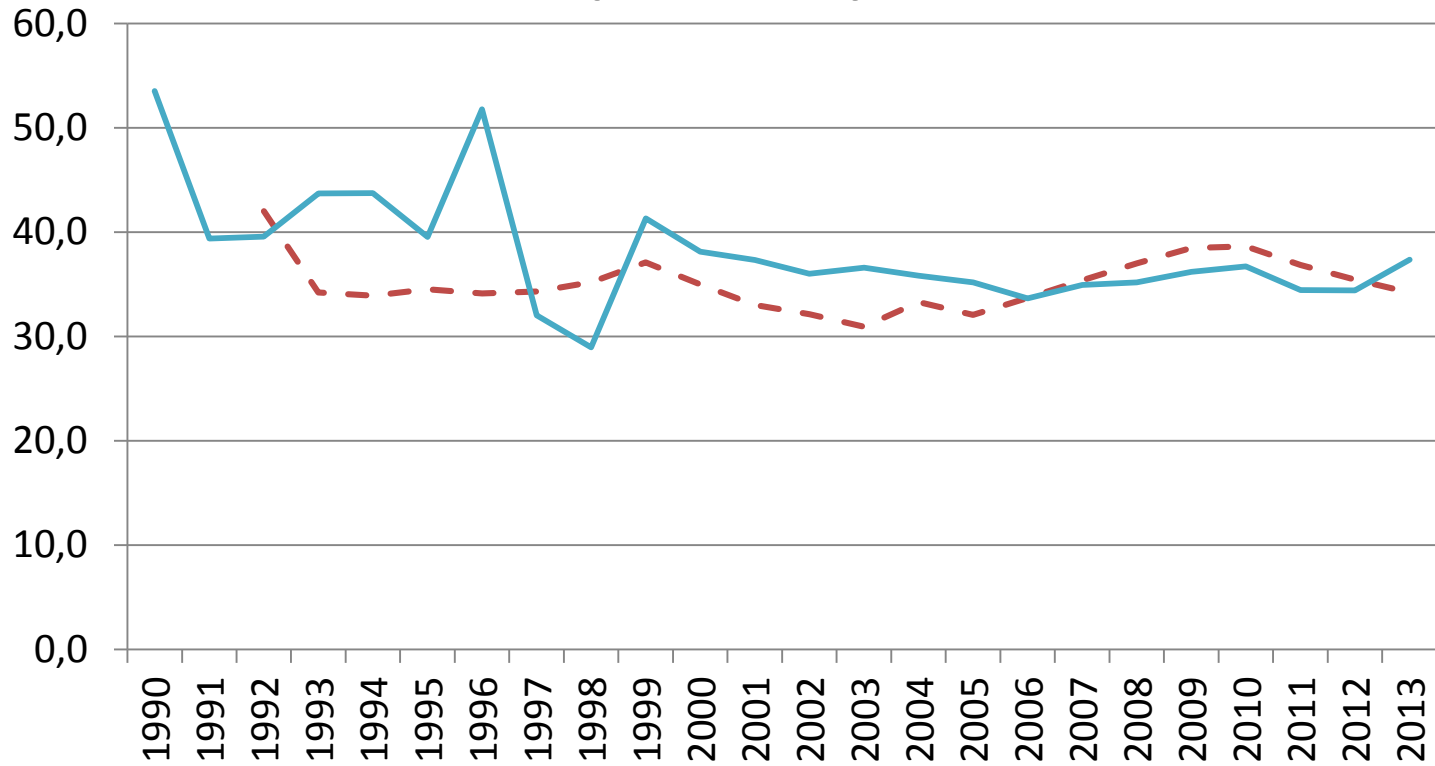


— Albania

— Serbia

Source:WB, Eurostat

Expenses (% of GDP)

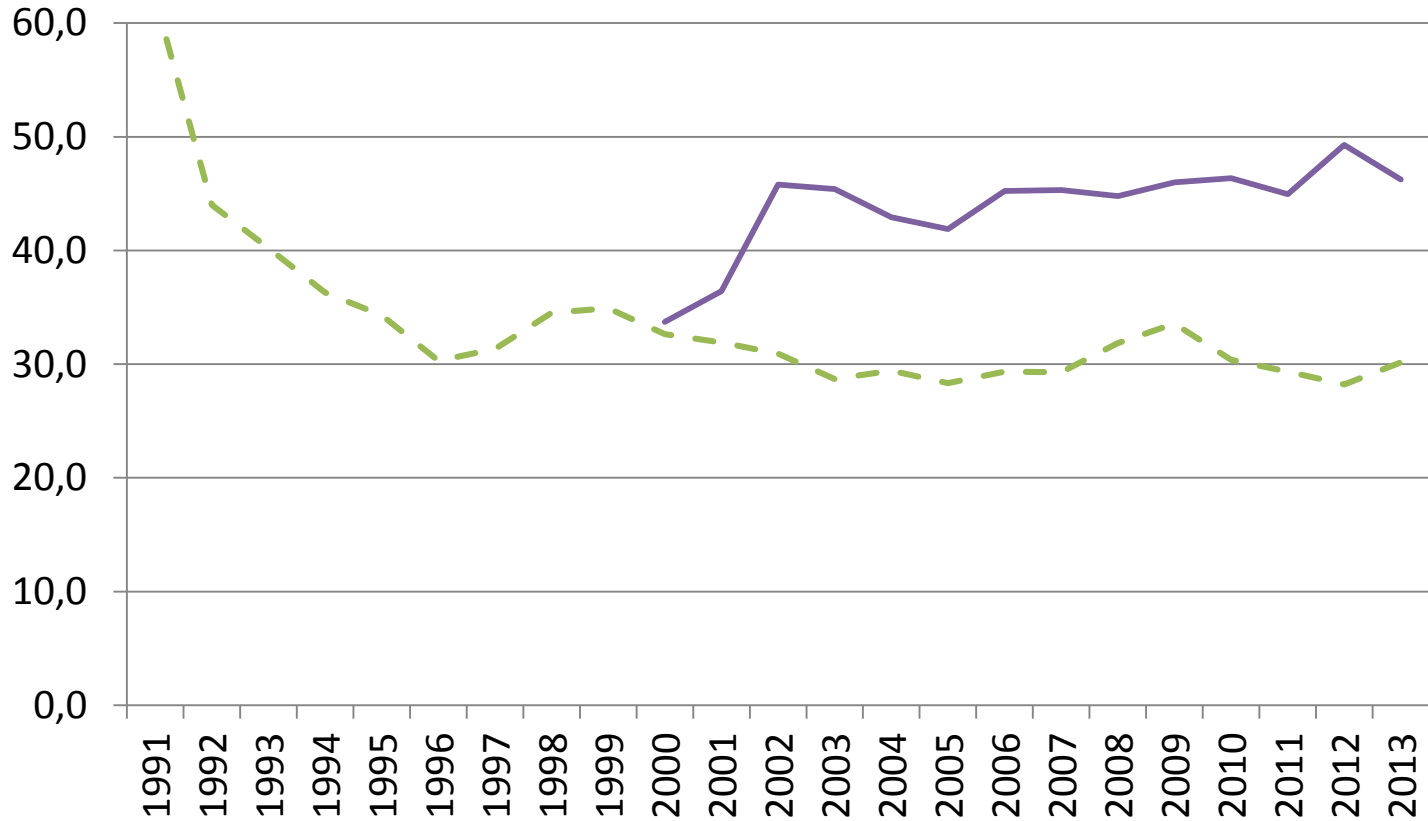


--- Romania

— Bulgaria

Source:WB, IMF

Expense (% of GDP)

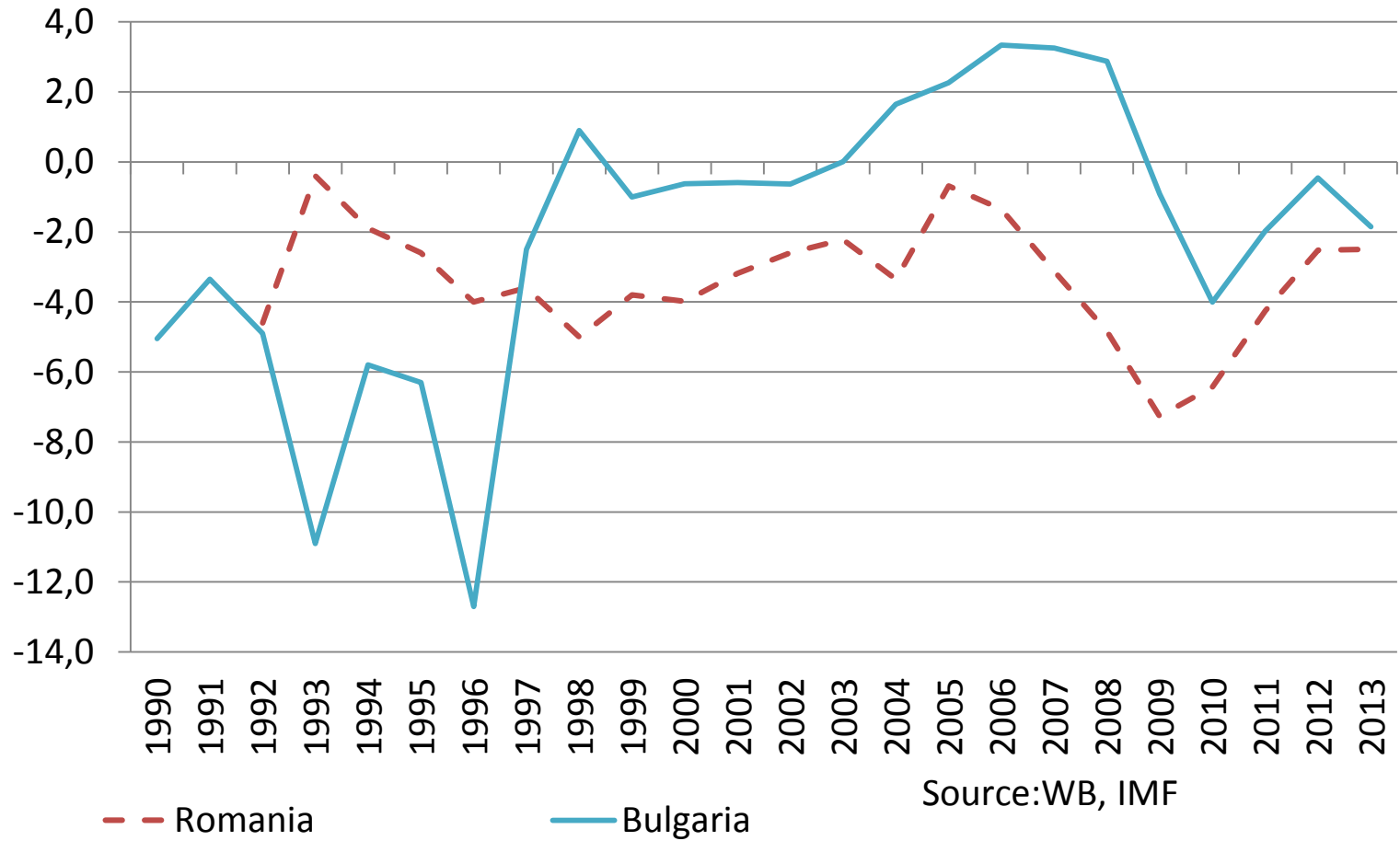


— Albania

— Serbia

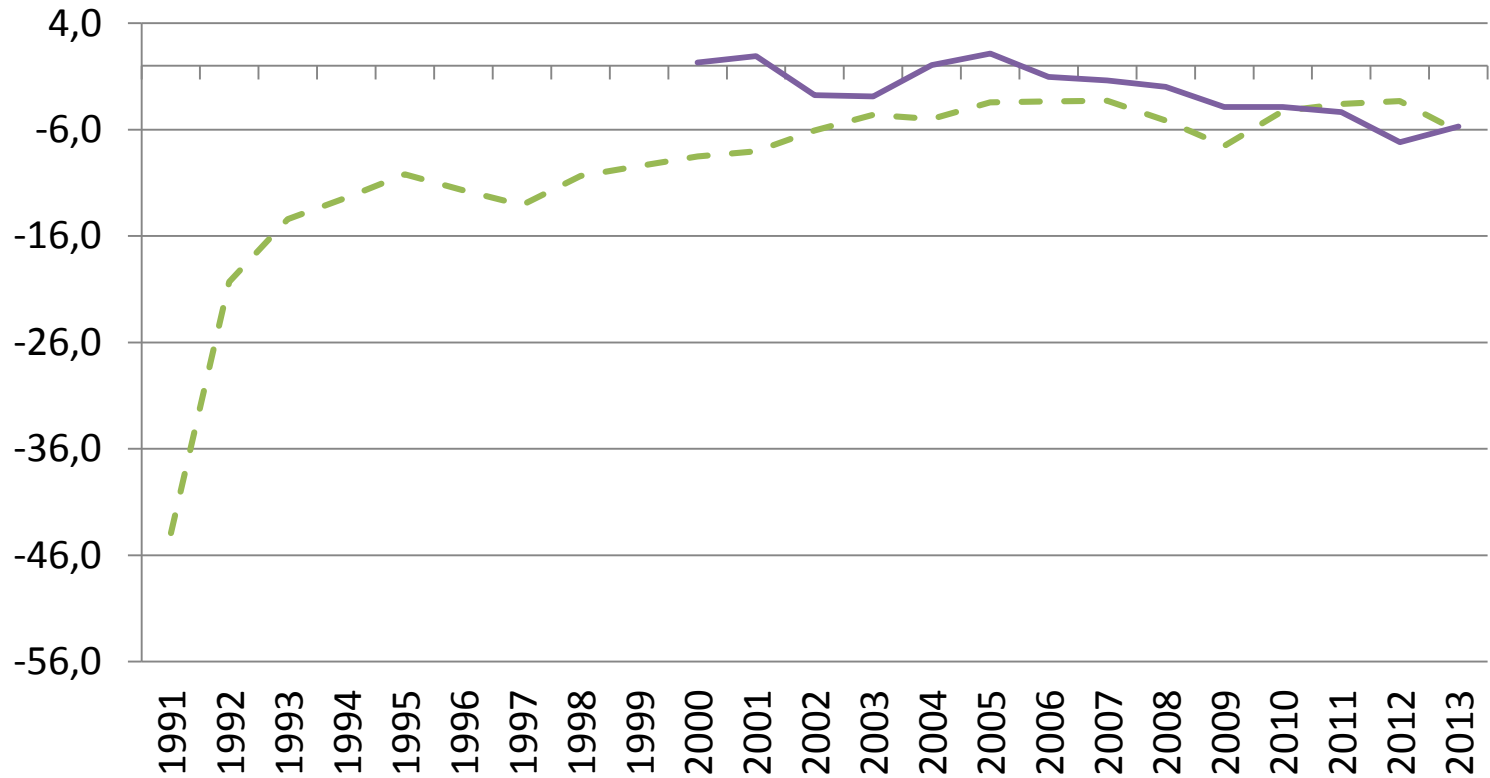
Source:WB, IMF

Cash surplus/deficit (% of GDP)



Source:WB, IMF

Cash surplus/deficit (% of GDP)

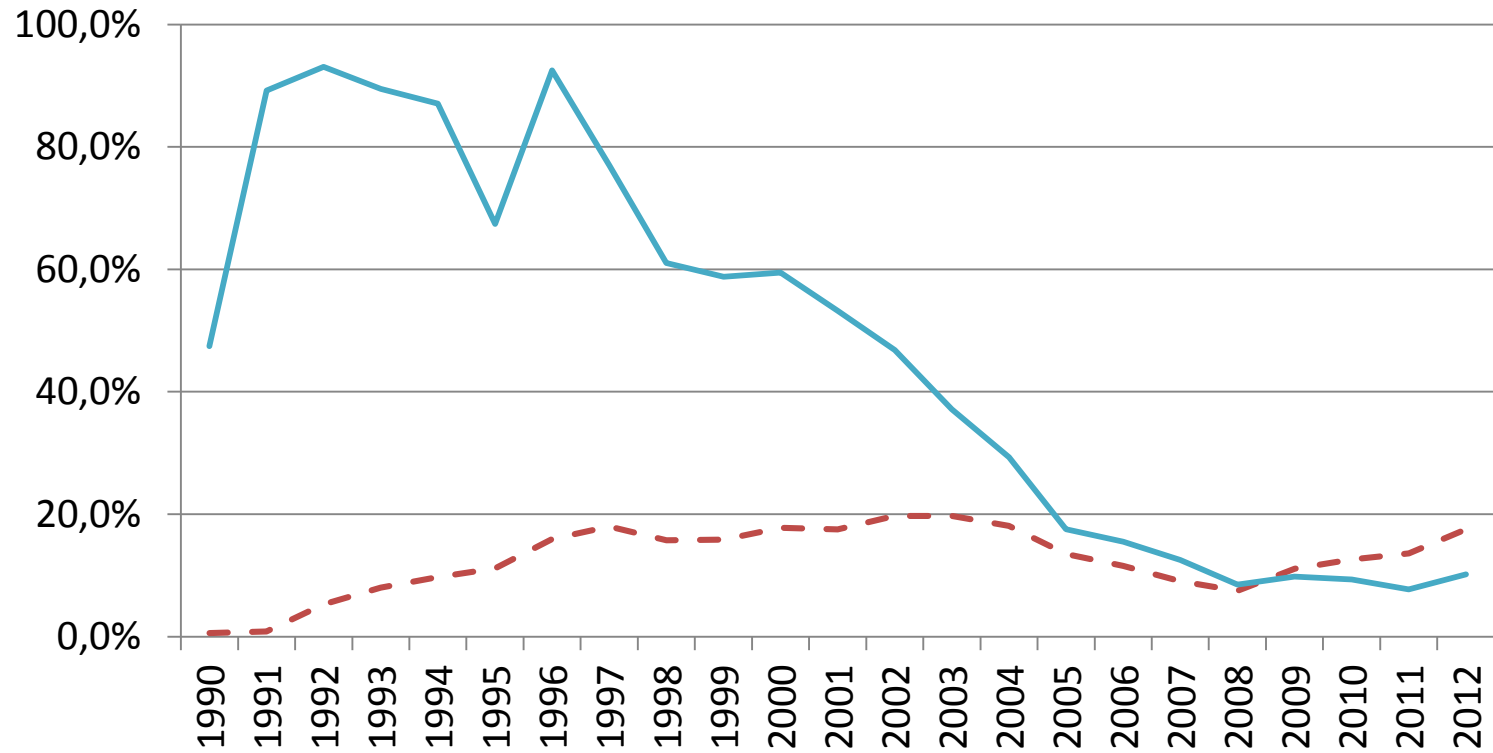


— Albania

— Serbia

Source:WB, IMF

External debt stocks, public and publicly guaranteed (% of GDP)

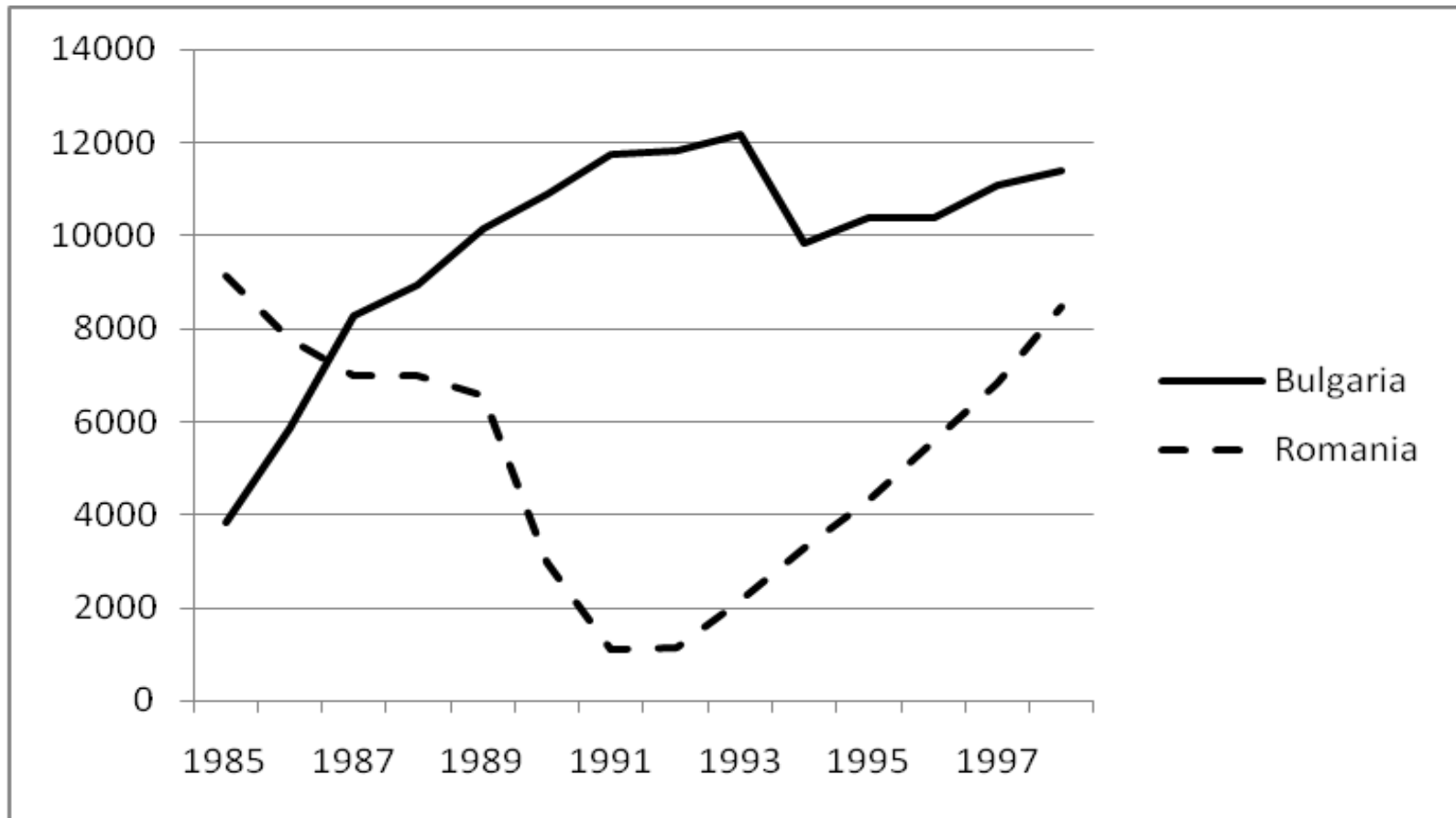


- - External debt stocks, Romania

— External debt stocks, Bulgaria

Source:WB

External debt (in millions of current US\$)



Source: World Development Indicators

External debt stocks, public and publicly guaranteed (% of GDP)

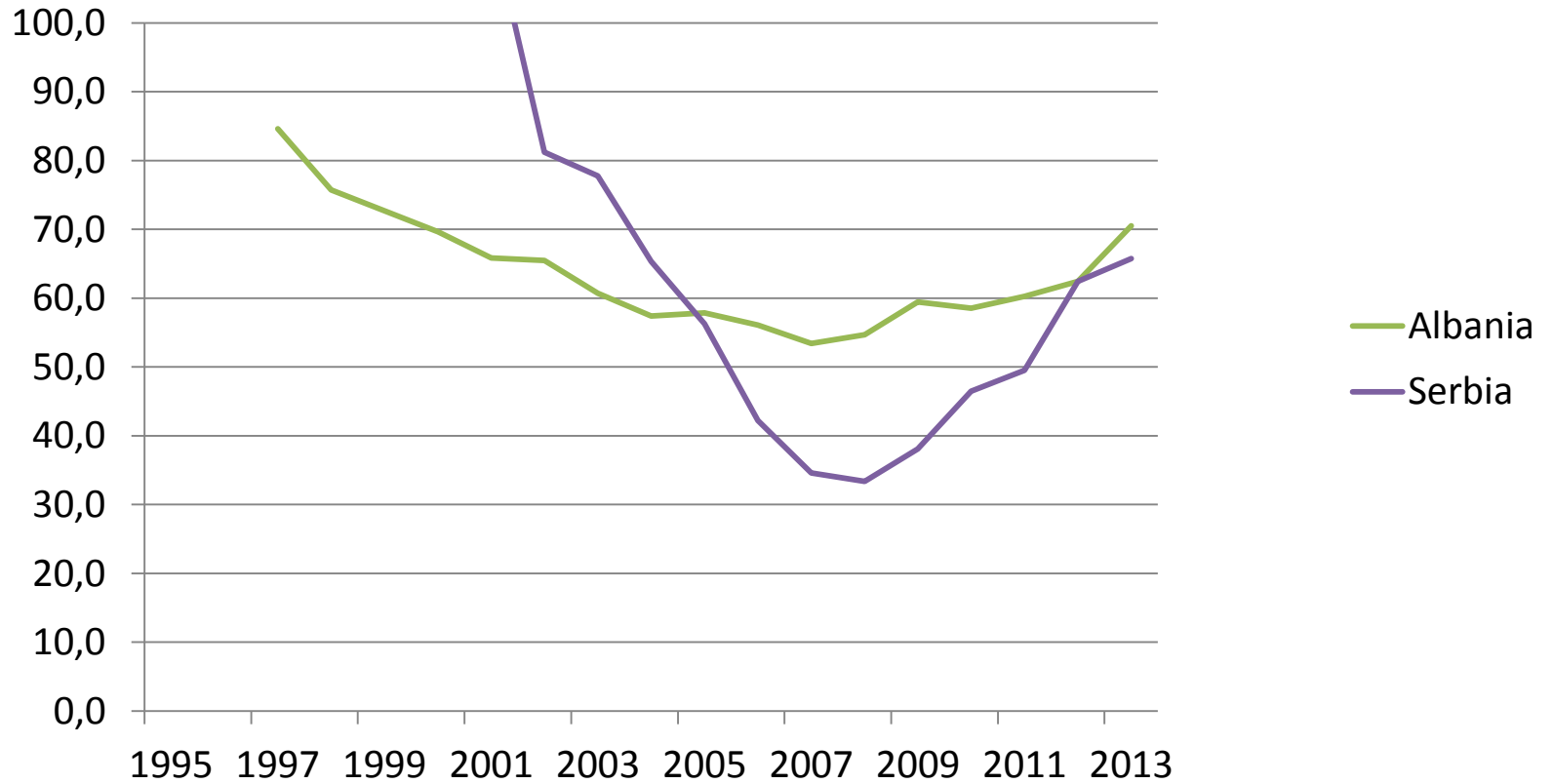


External debt stocks, Albania

External debt stocks, Serbia

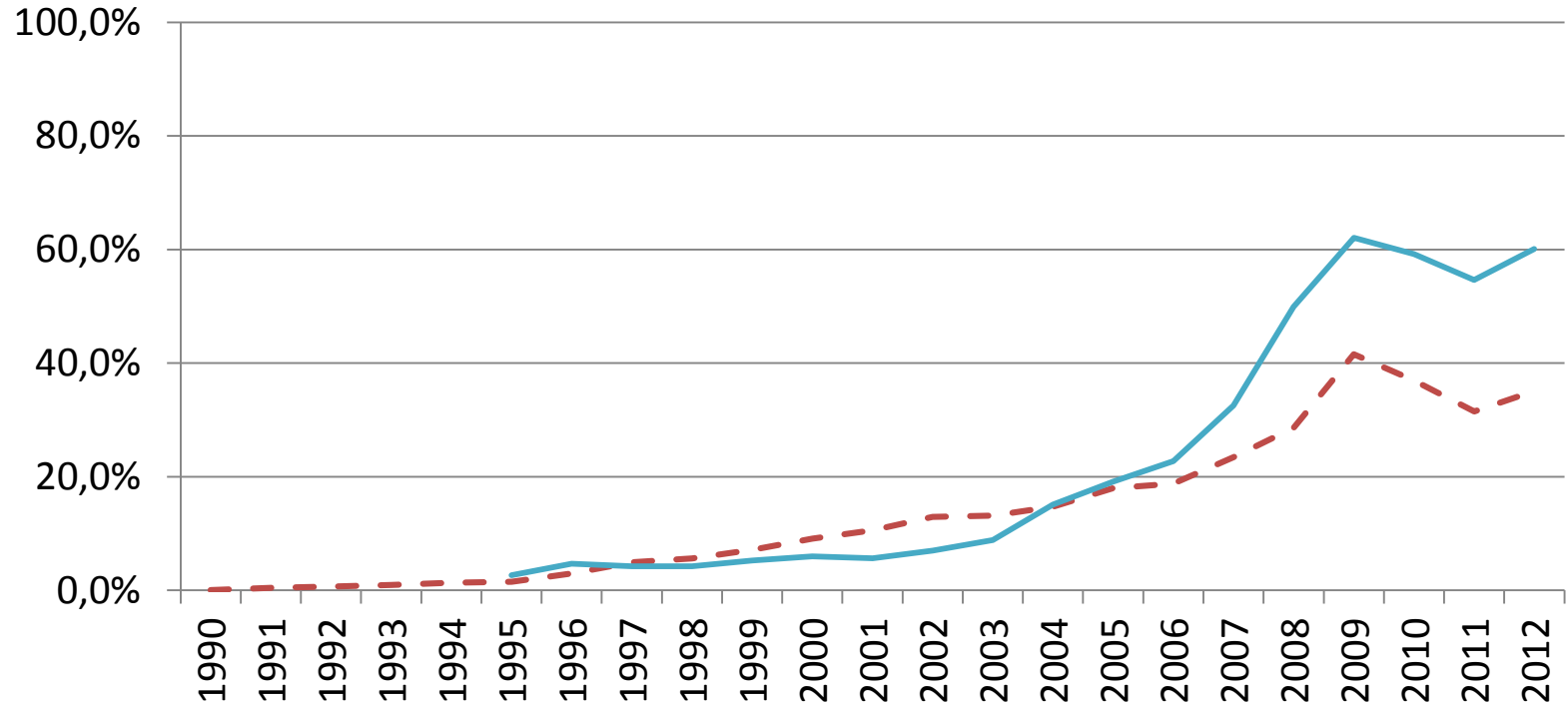
Source:WB

Public debt, % of GDP



Source: WB

External debt stocks, private nonguaranteed (% of GDP)

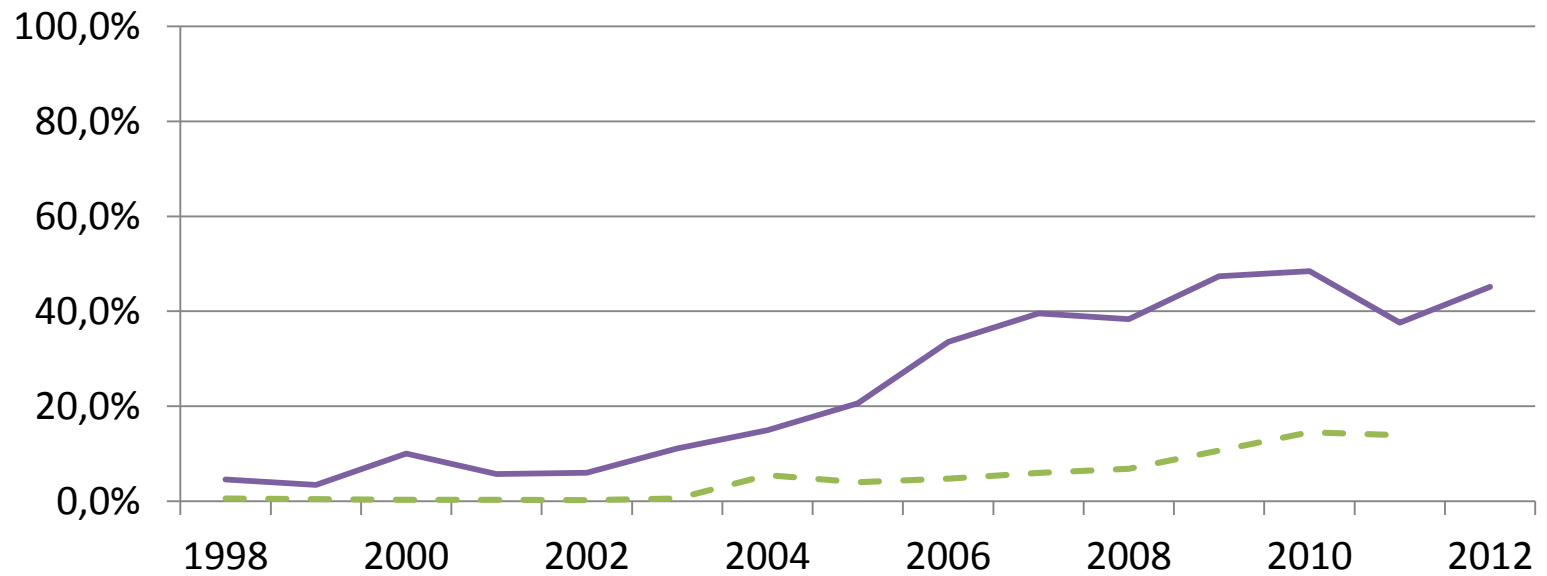


External debt stocks, Romania

External debt stocks, Bulgaria

Source:WB

External debt stocks, private nonguaranteed (% of GDP)

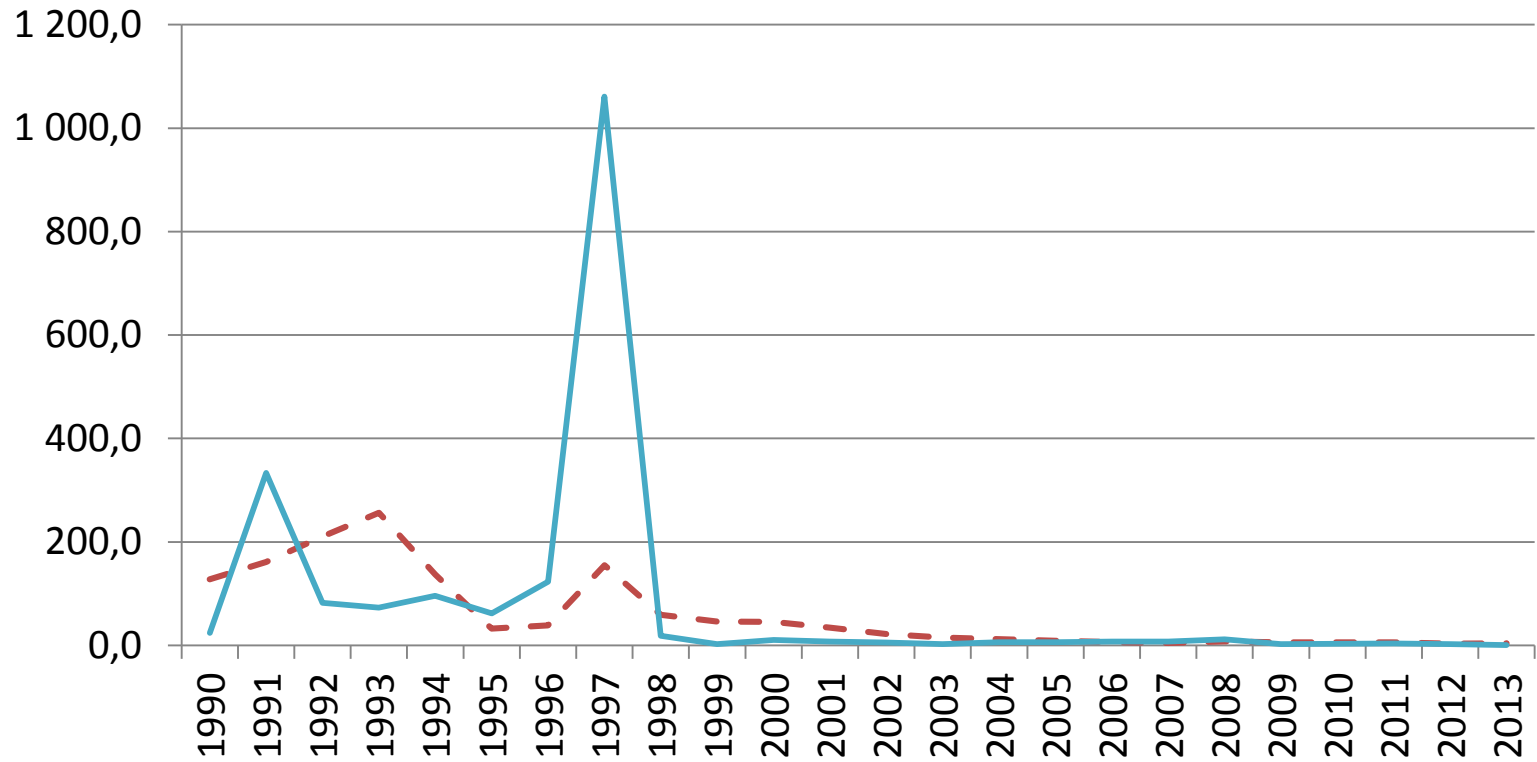


External debt stocks, Albania

External debt stocks, Serbia

Source:WB

Inflation, consumer prices (annual %)

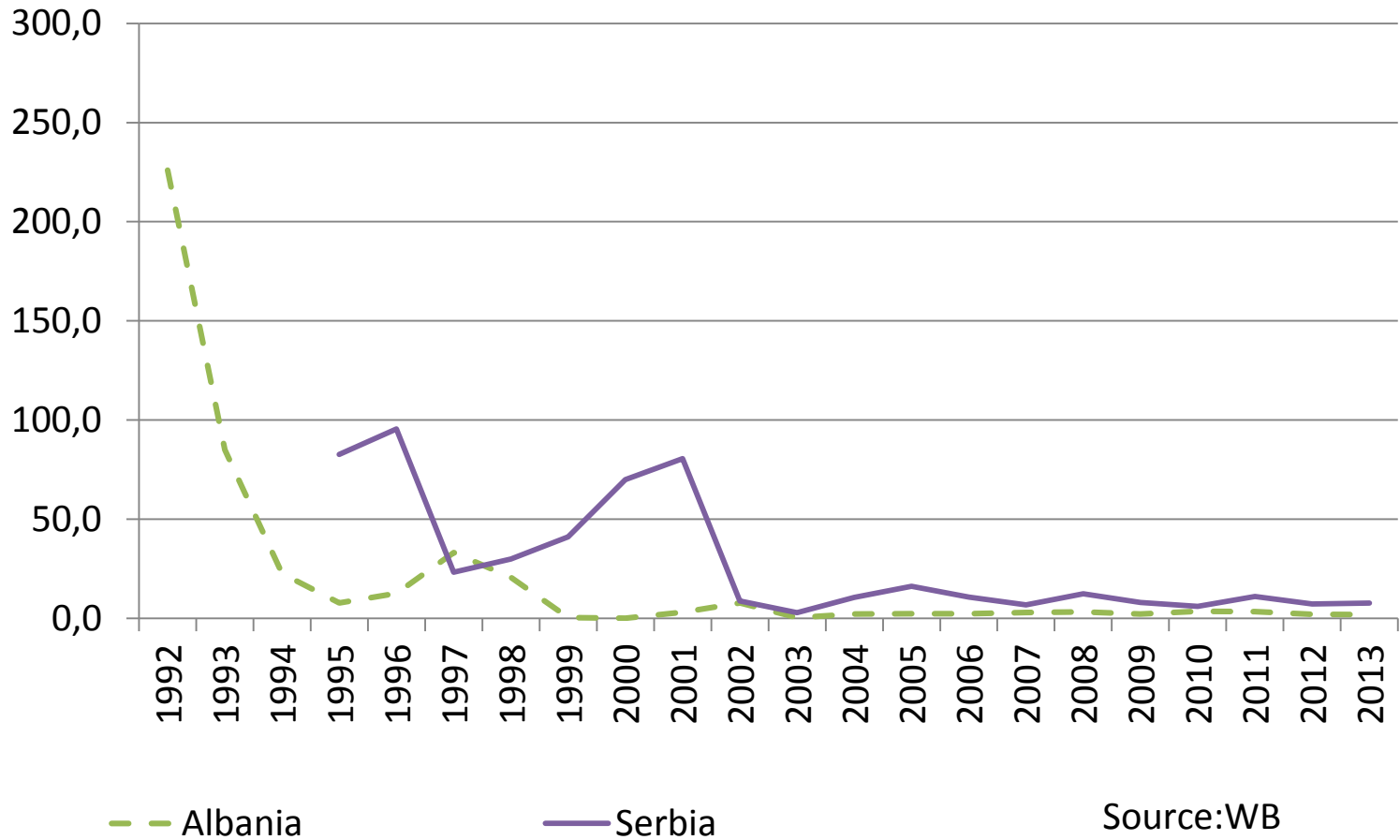


- - Romania

— Bulgaria

Source: WB

Inflation, consumer prices (annual %)



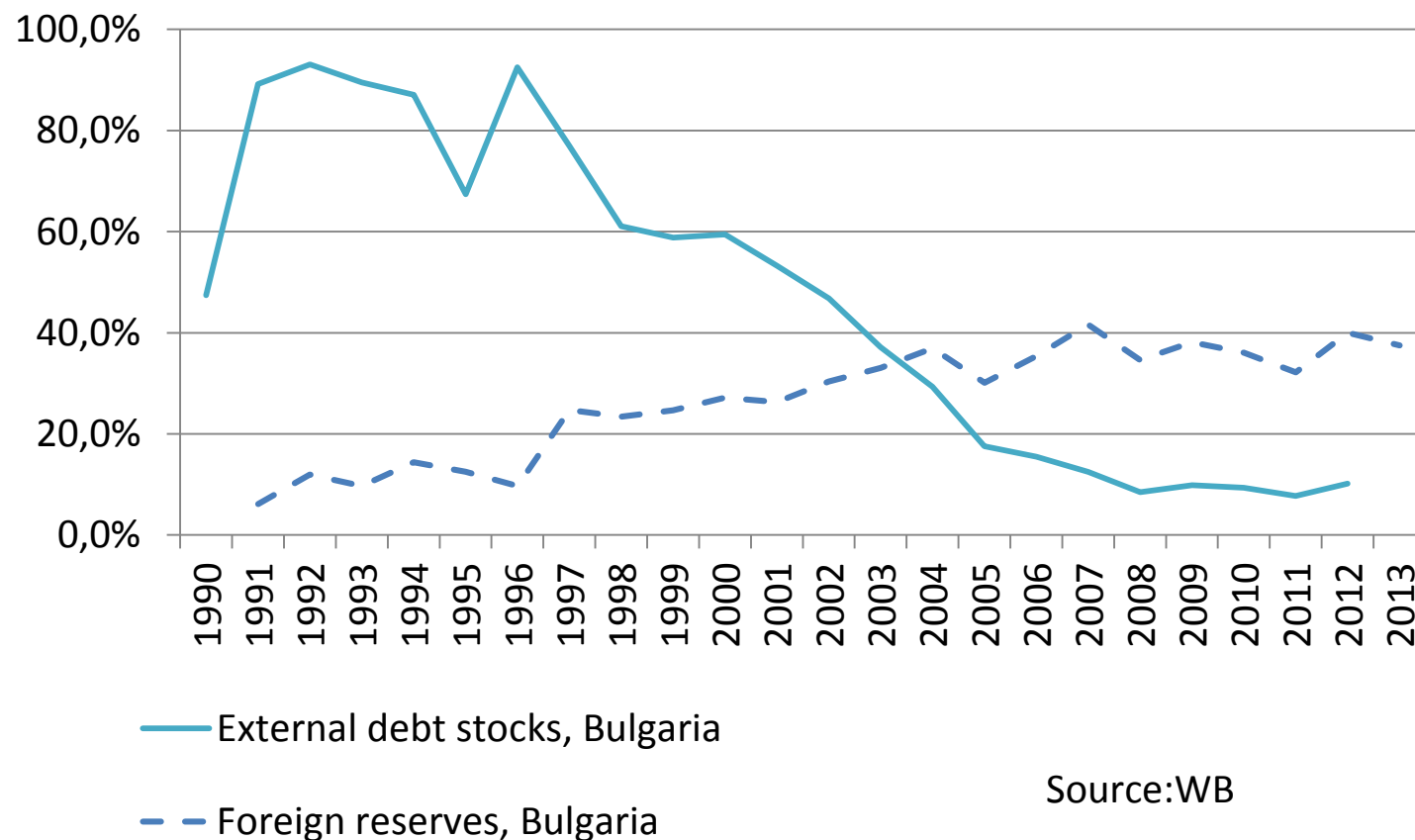
Monetary regime: **Historical parallel**

- **Latin Monetary Union (1865...)**
- **Fixed 1/1 to the franc (bimetallism 15,5:1)**
 - Greece (1867)
 - Romania (1867)
 - Serbia (1868)
 - Bulgaria (1880)
 - Albania (... 1926)

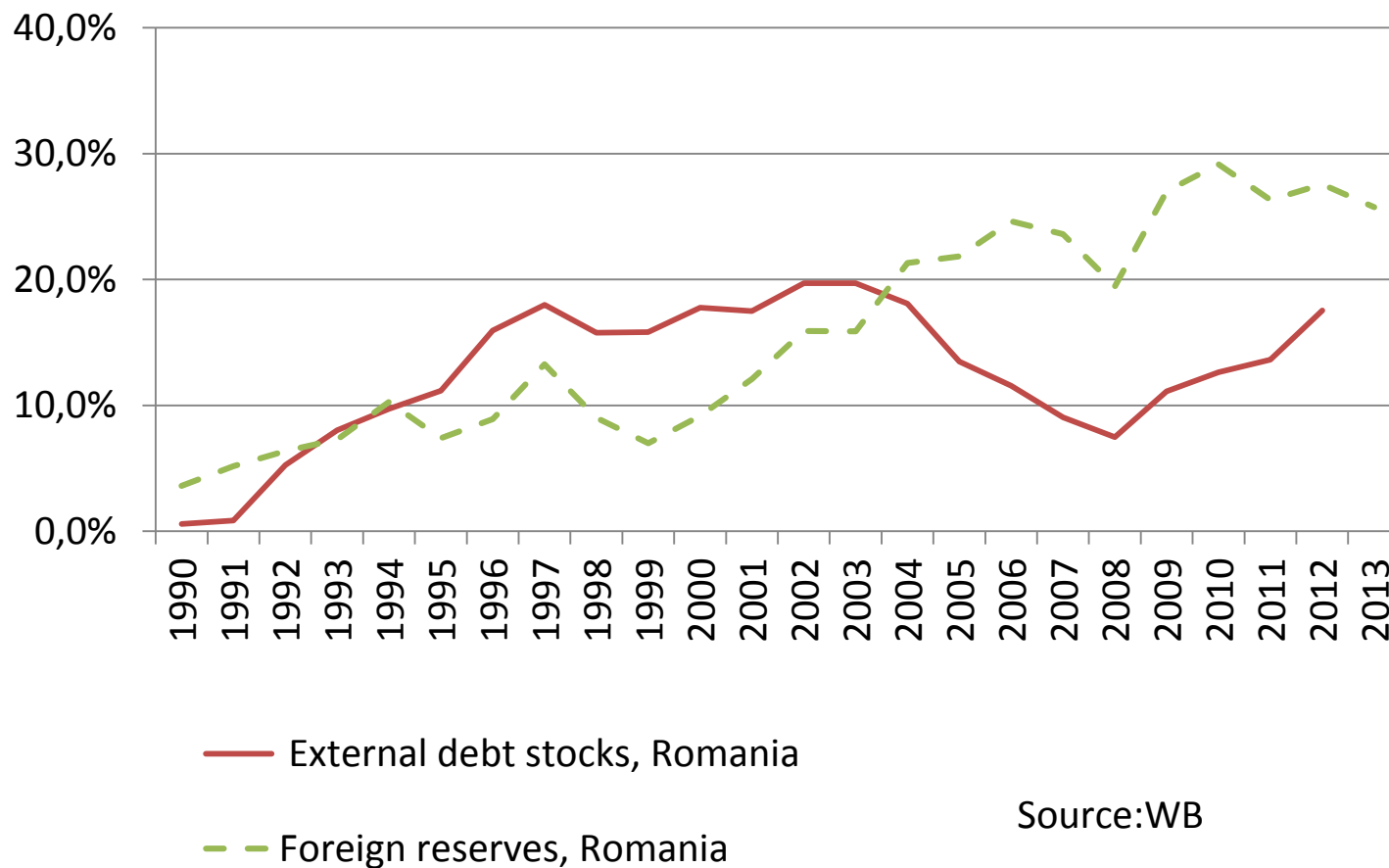
EU accession...

- **First phase: pre-accession (2000 – 2004/2007)**
 - Monetary anchor and EU anchor are **compatible** and reinforce each other
 - Credibility, confidence and discipline work together
- **Second phase: membership (2005/2007 - ...)**
 - Monetary anchor and EU anchor are **conflicting** and create bad dynamics
 - Credibility, confidence, but **discipline is crumbling**
EU funds/EU crisis ...

External debt stocks, public and publicly guaranteed and foreign reserves to GDP (%)



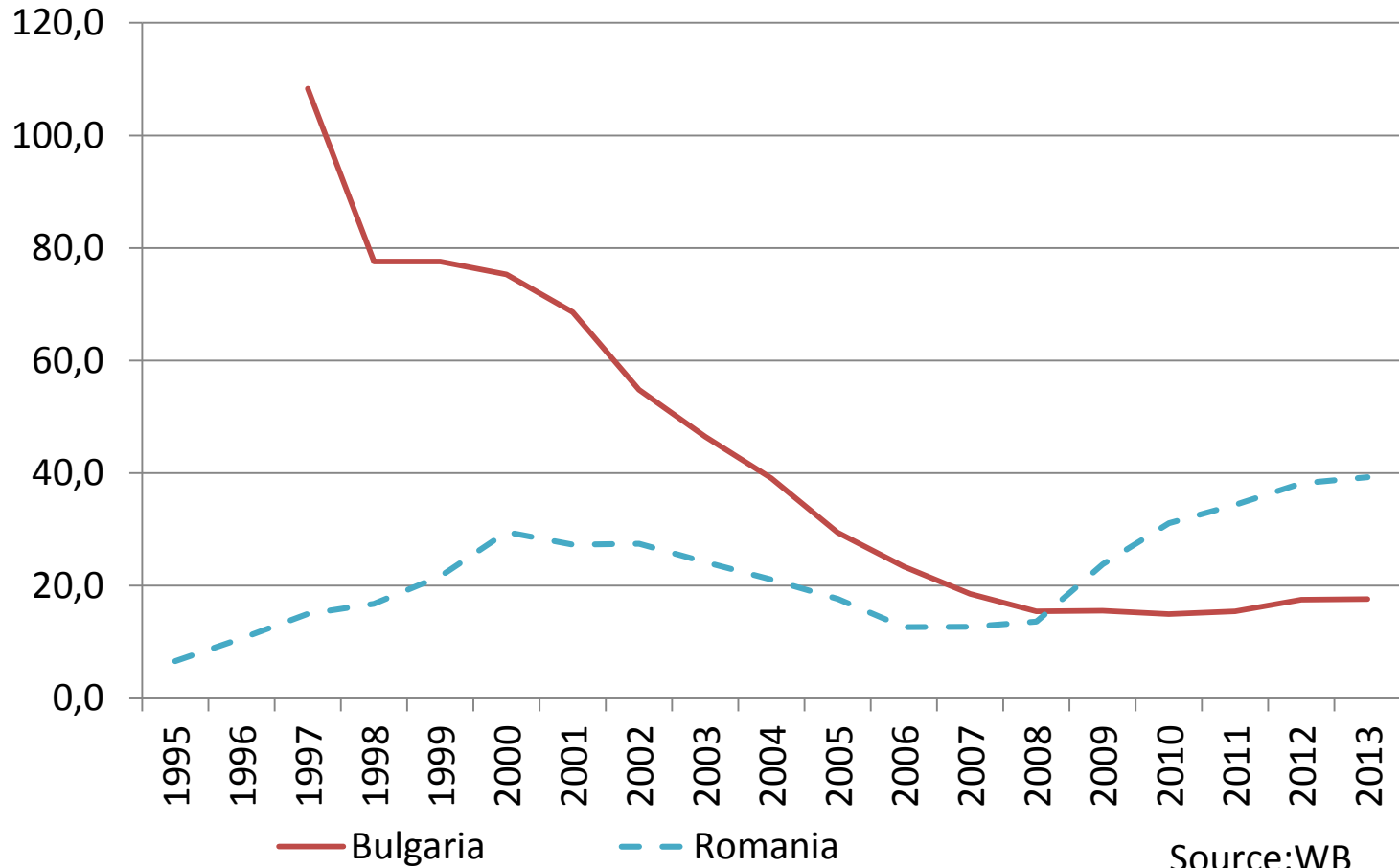
External debt stocks, public and publicly guaranteed and foreign reserves to GDP (%)



Bulgaria/Romania

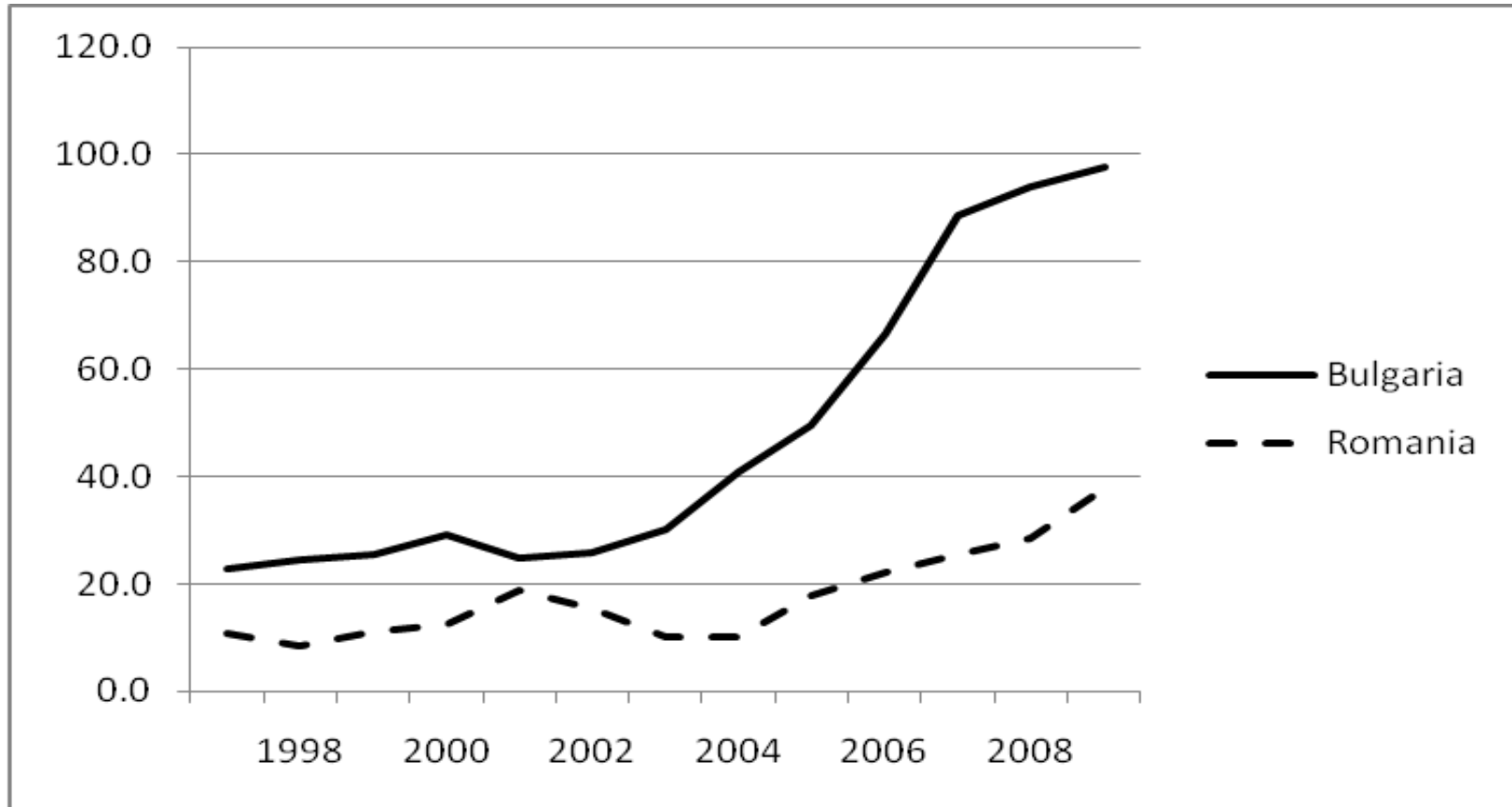
- **Two opposite Monetary Regimes** – two debt profiles – two crisis..
 - **Bulgaria (private sector)/banks** (...Spain, Ireland)
 - **Roumania (public sector)/wages, TVA, IMF** (Portugal, Greece...)

Public debt, % of GDP



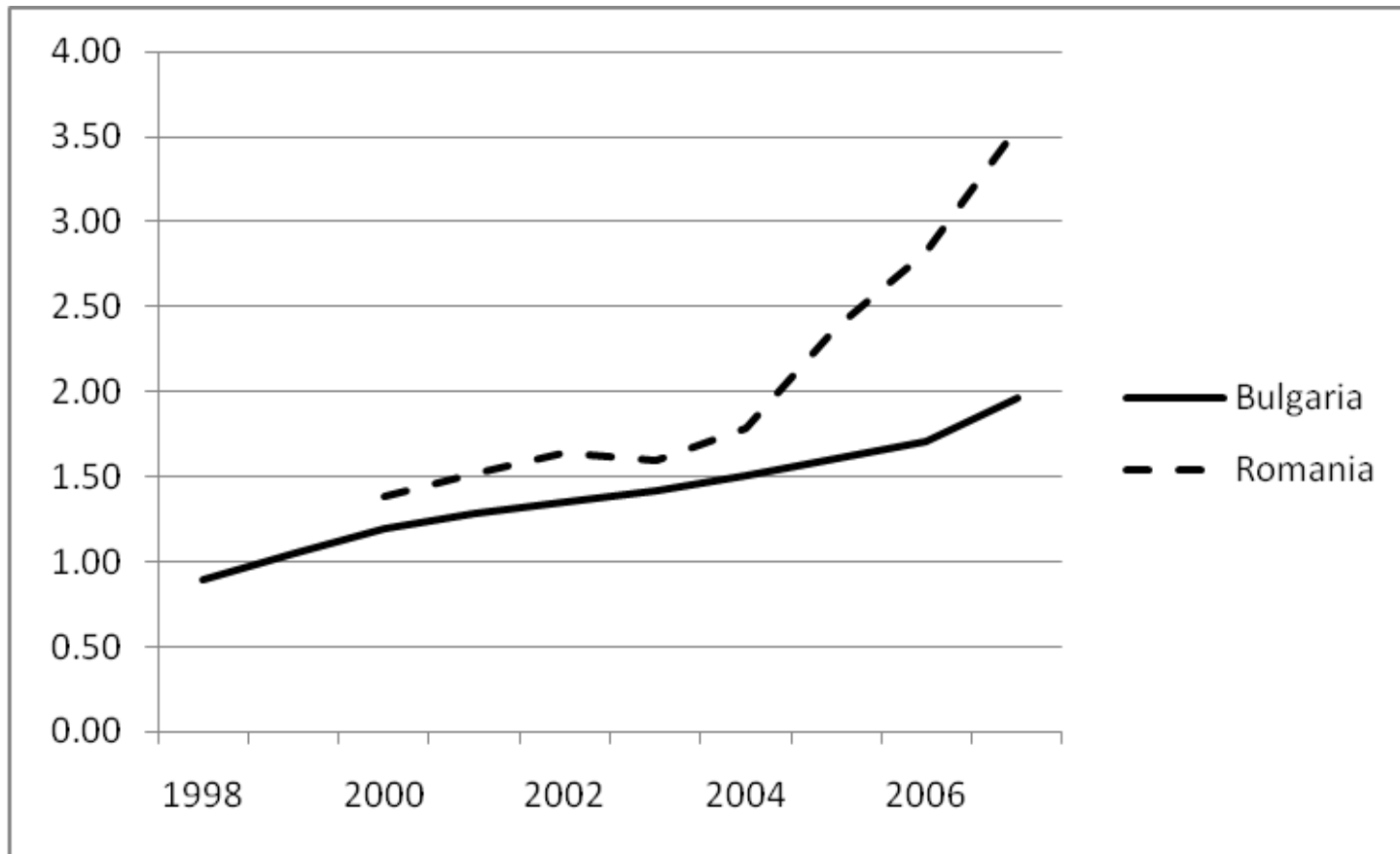
Source:WB

External private debt (% of GDP)



Source: Central Banks of Bulgaria and Romania

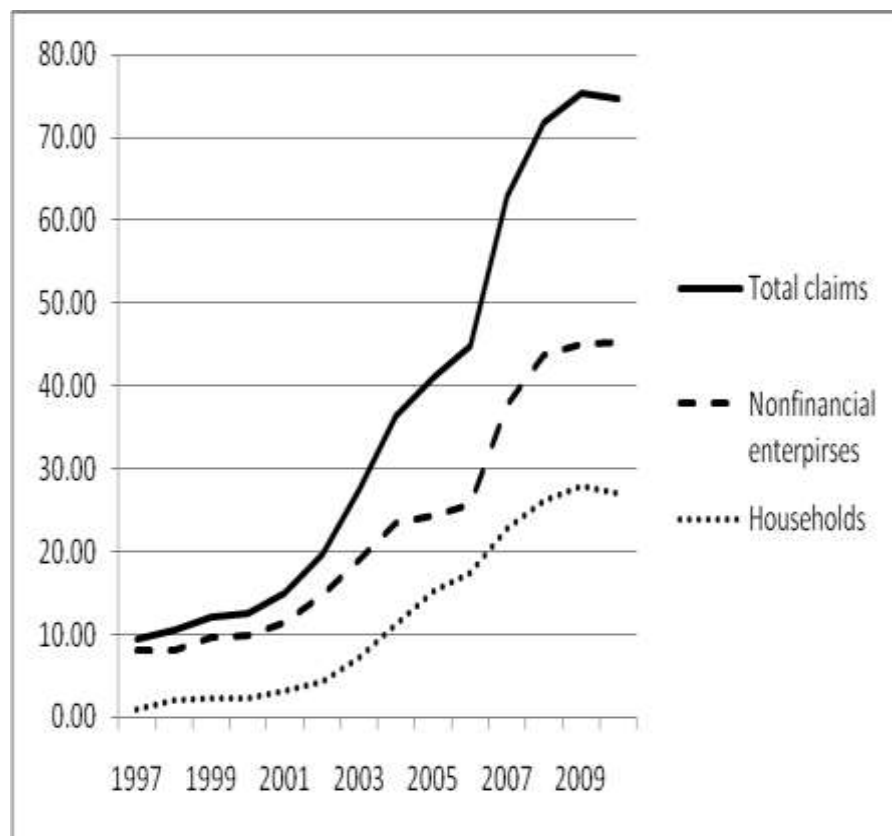
Hourly labor costs (in euros)



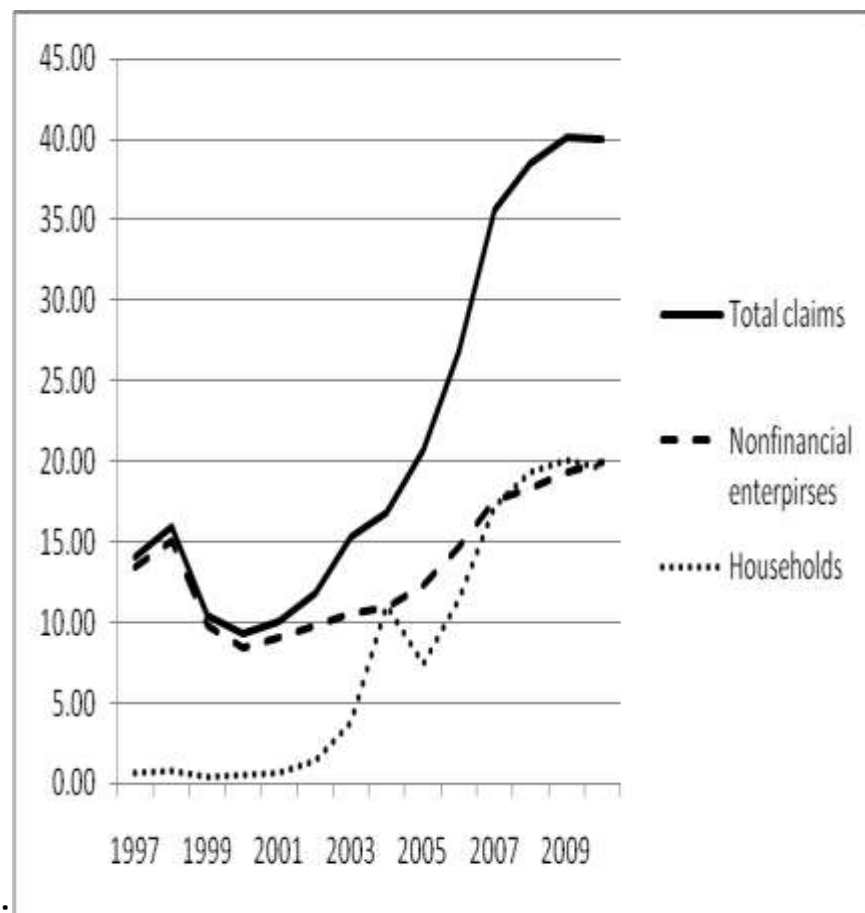
Source: Central Banks of Bulgaria and Romania

Domestic credit to private sector (% of GDP)

Bulgaria

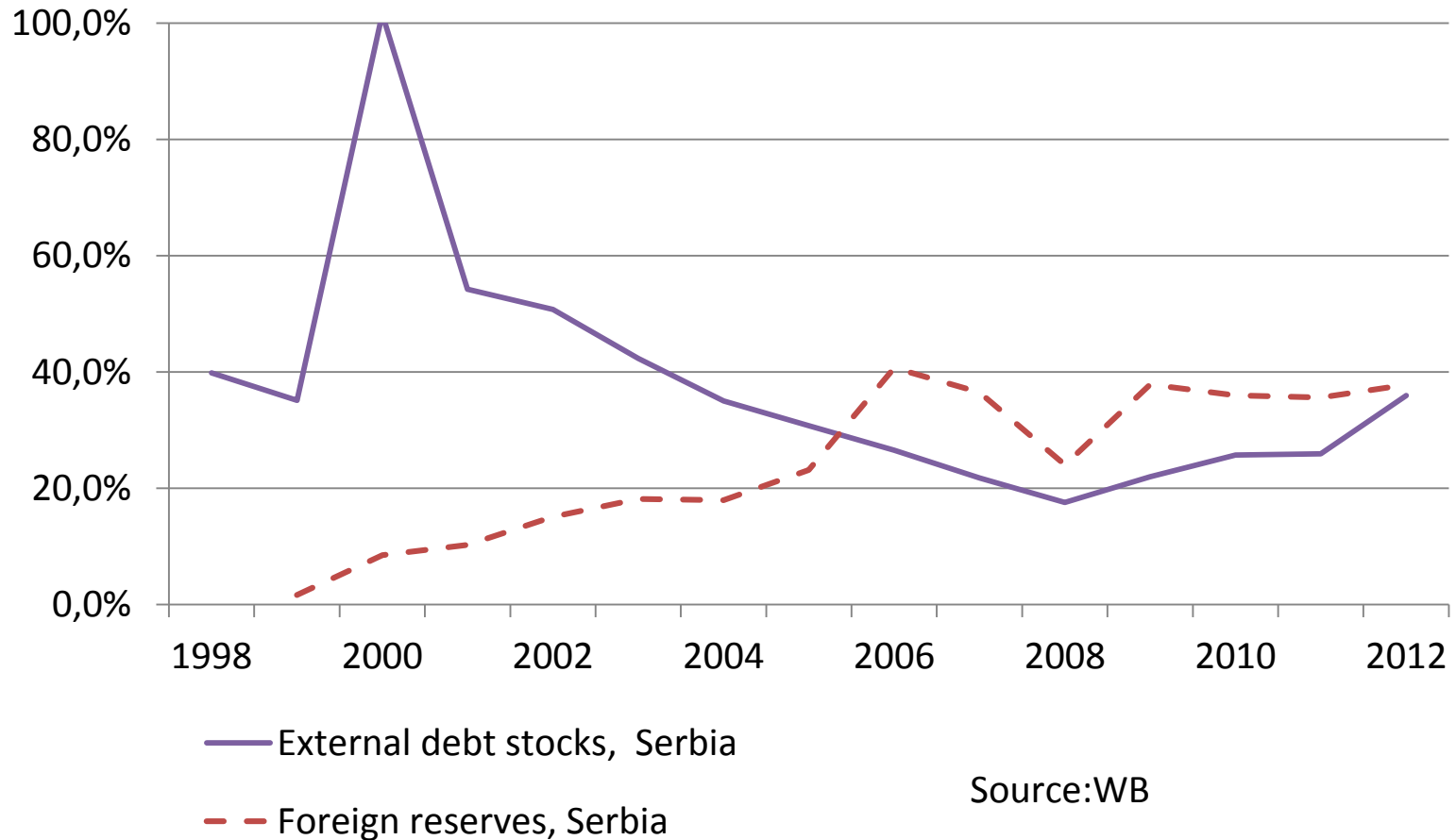


Romania

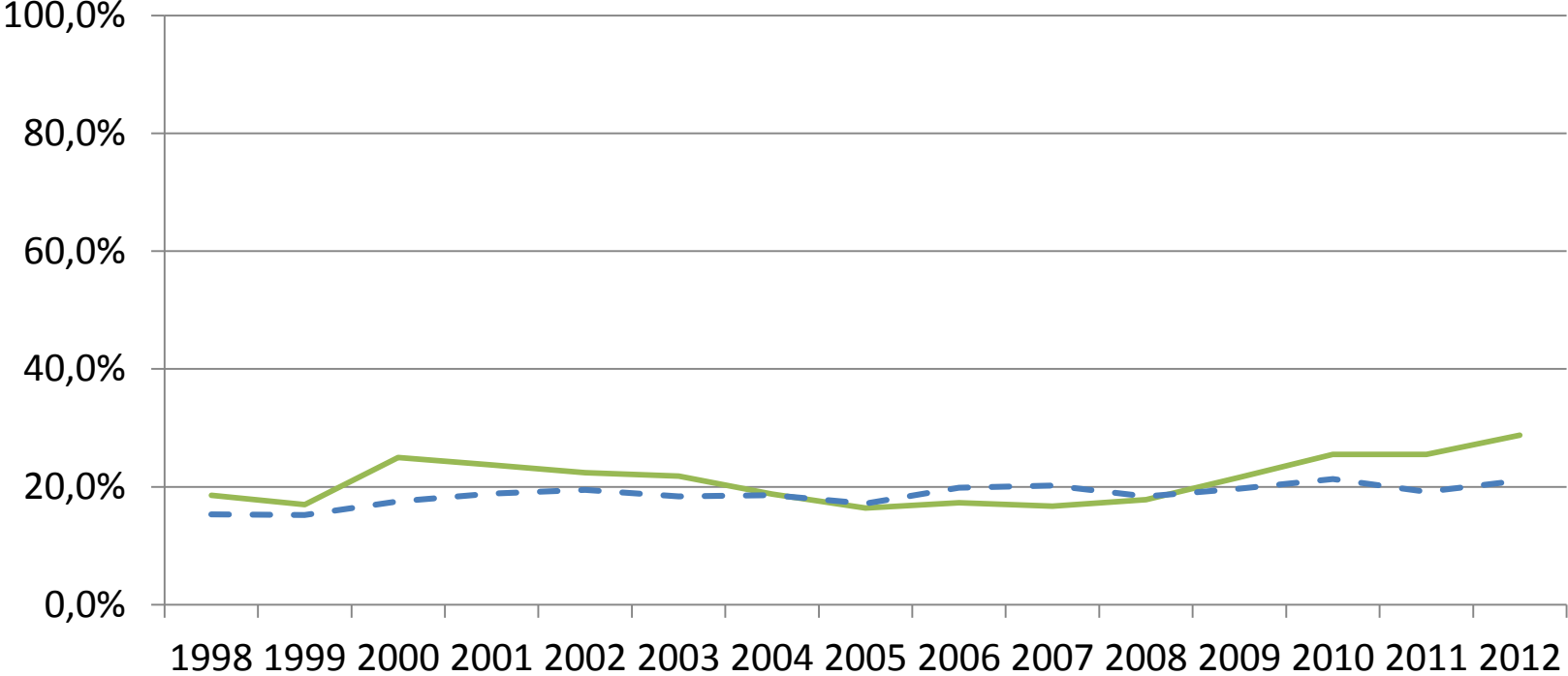


Source: Central Banks of Bulgaria and Romania

External debt stocks, public and publicly guaranteed and foreign reserves to GDP (%)



External debt stocks, public and publicly guaranteed and foreign reserves to GDP (%)



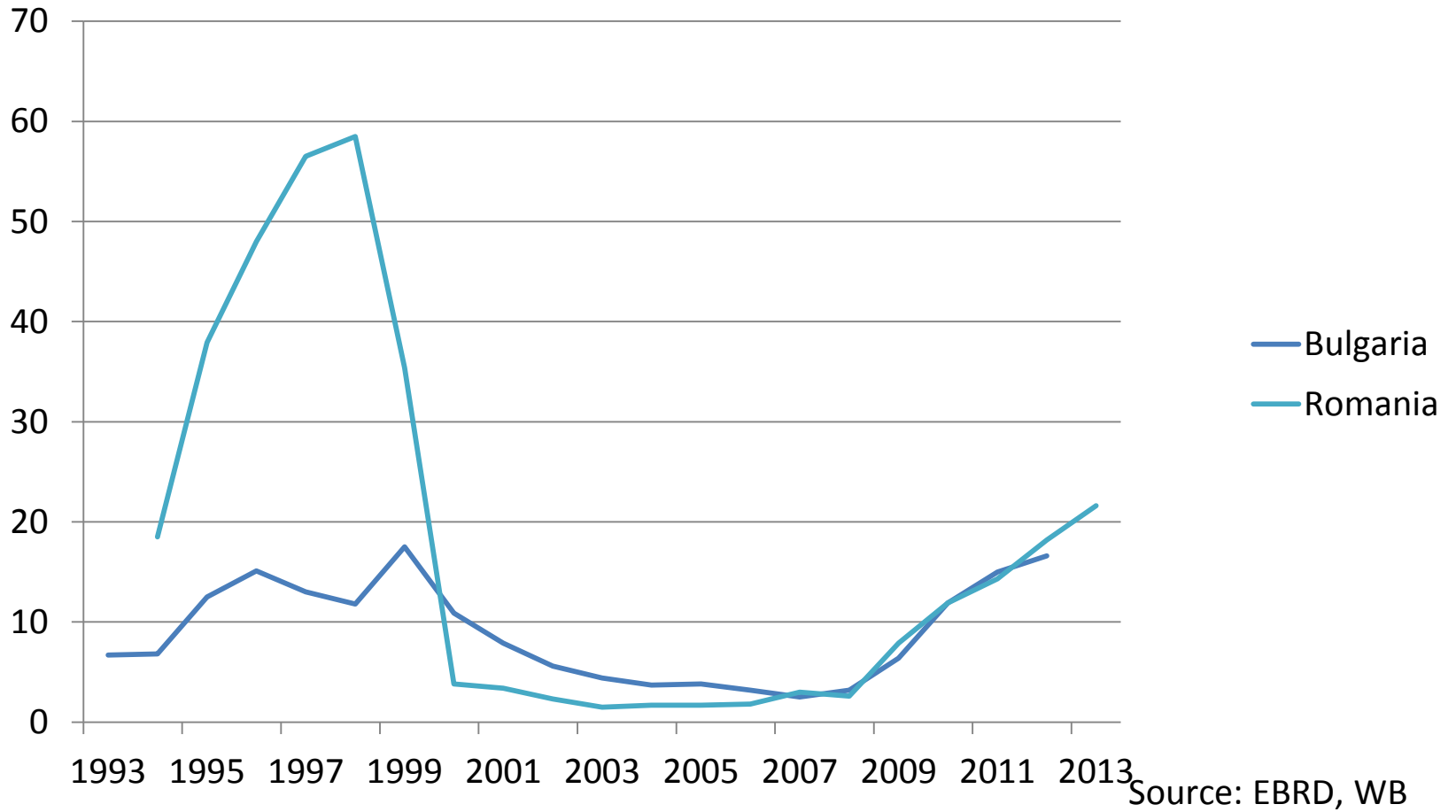
External debt stocks, Albania Foreign reserves, Albania

Source:WB

Bad loans raise ...

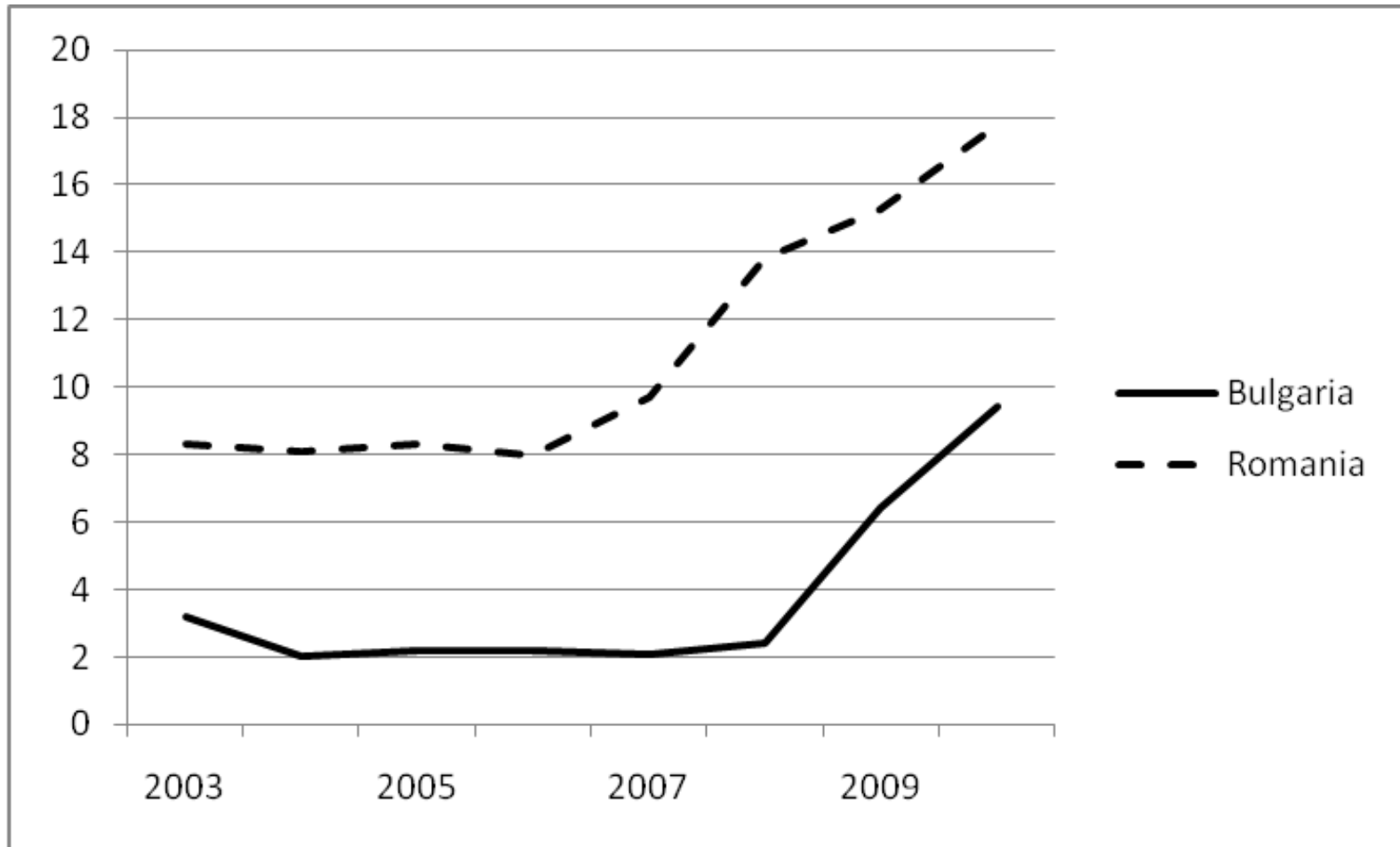
- Common tendency on NPL
 - Bulgaria – 17 %
 - Romania 22 %
 - Albania 25%
 - Bosnia and Herzegovina 16%
 - Serbia 22 %
 - Macedonia 11 %
 - Croatia 15 % (28 % for corporate loans)
 -average 17 %

Non-performing loans (% of total)



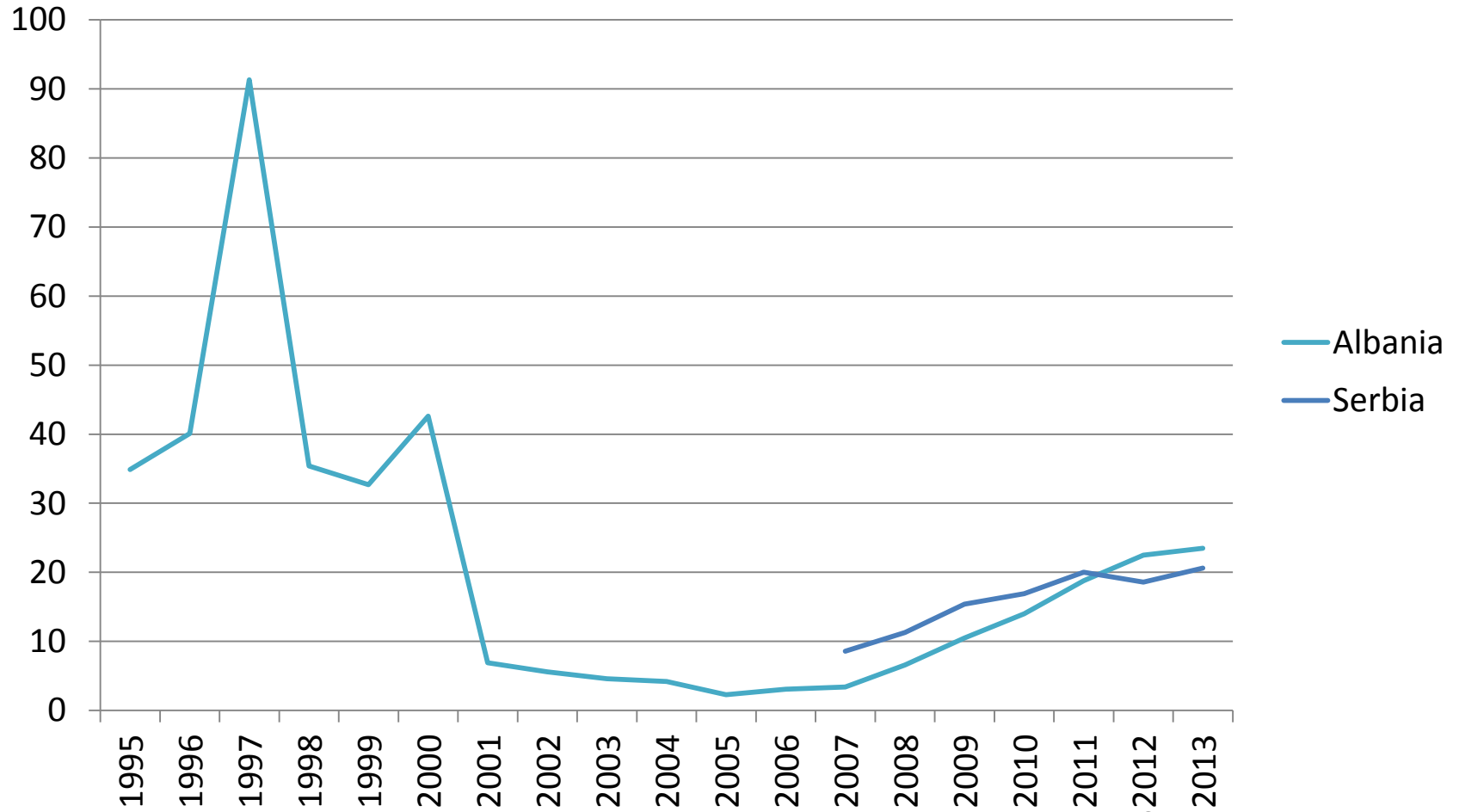
Source: EBRD, WB

Non-performing loans (% of total gross loans)



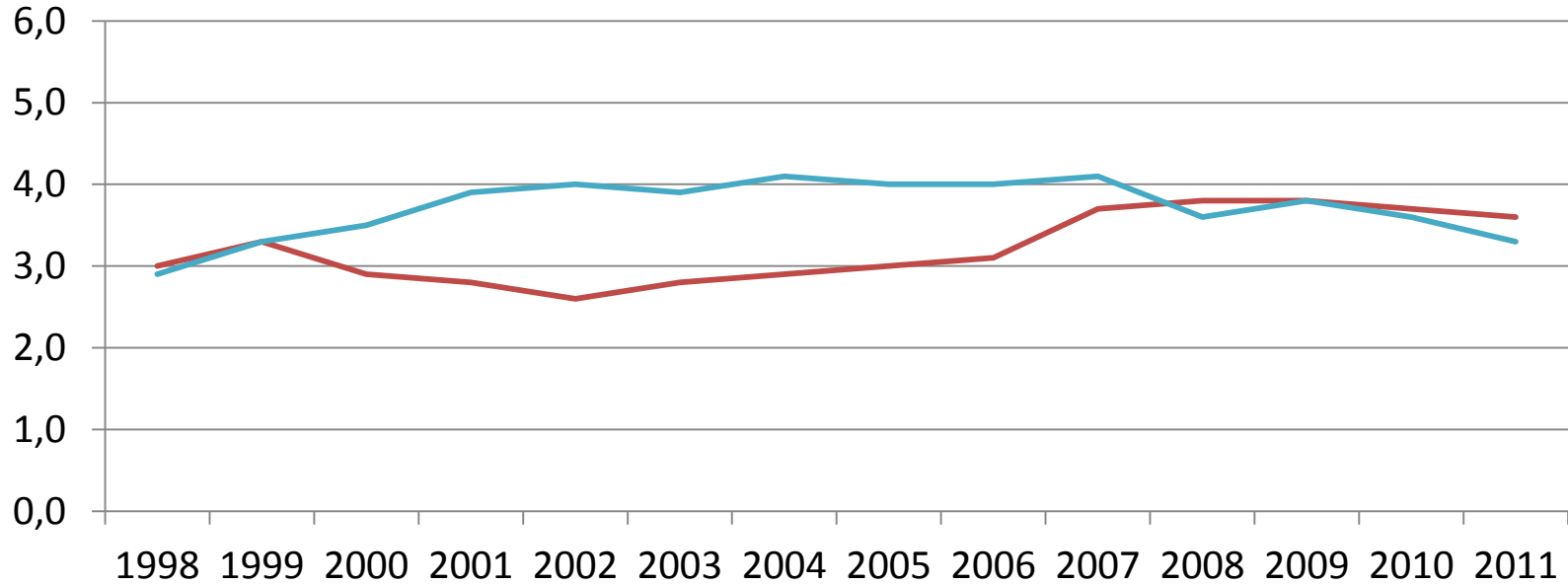
Source: Central Banks of Bulgaria and Romania

Non-performing loans (% of total)



Source: EBRD, WB

Corruption Perceptions Index

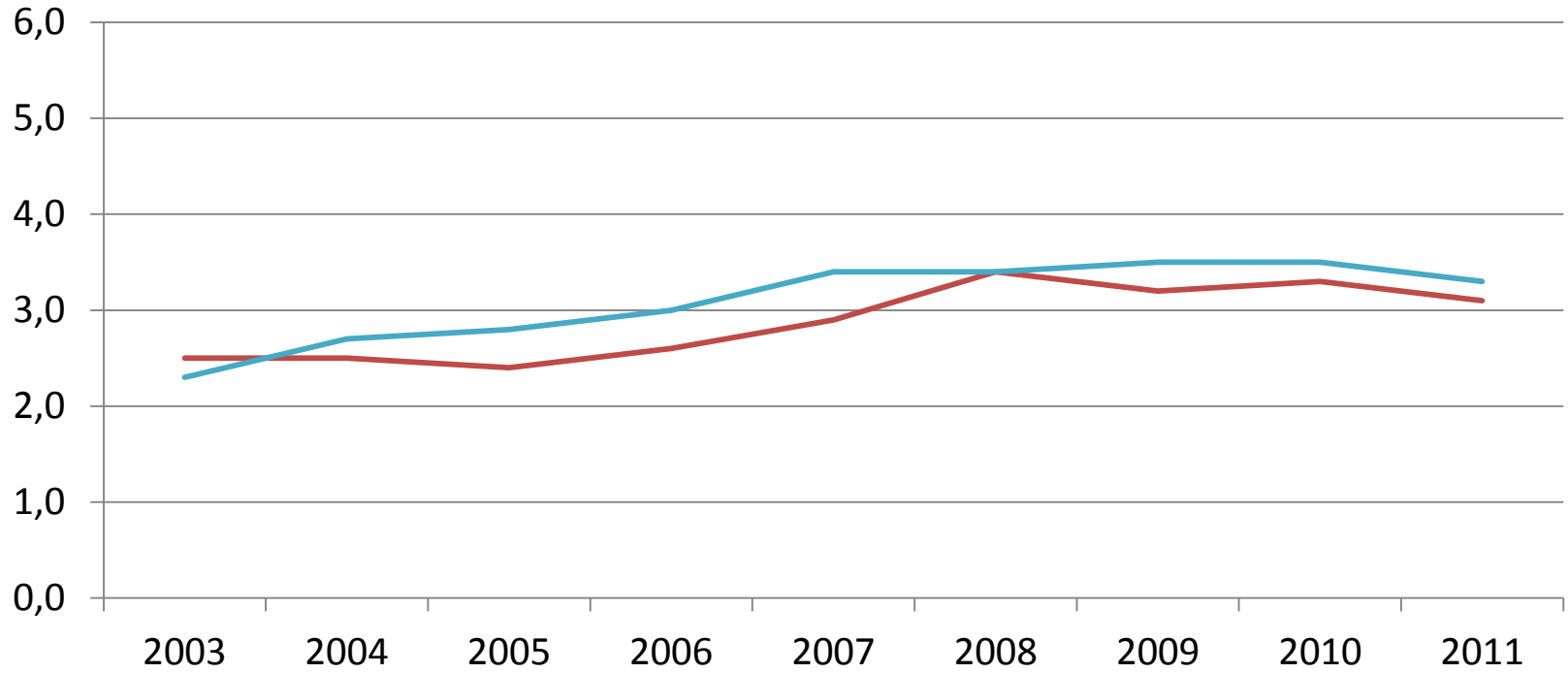


— Romania

— Bulgaria

Source: Transparency International

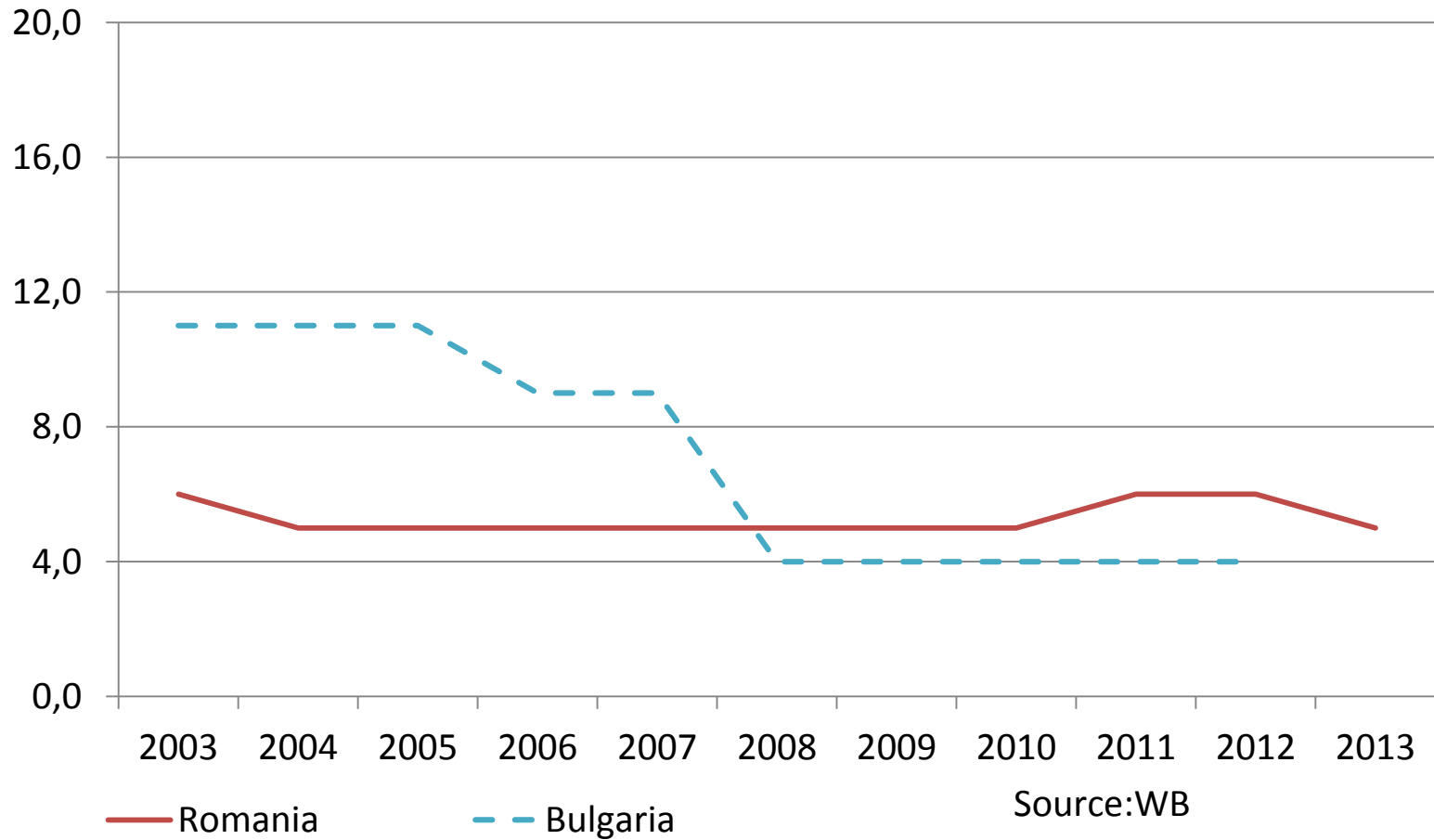
Corruption Perceptions Index



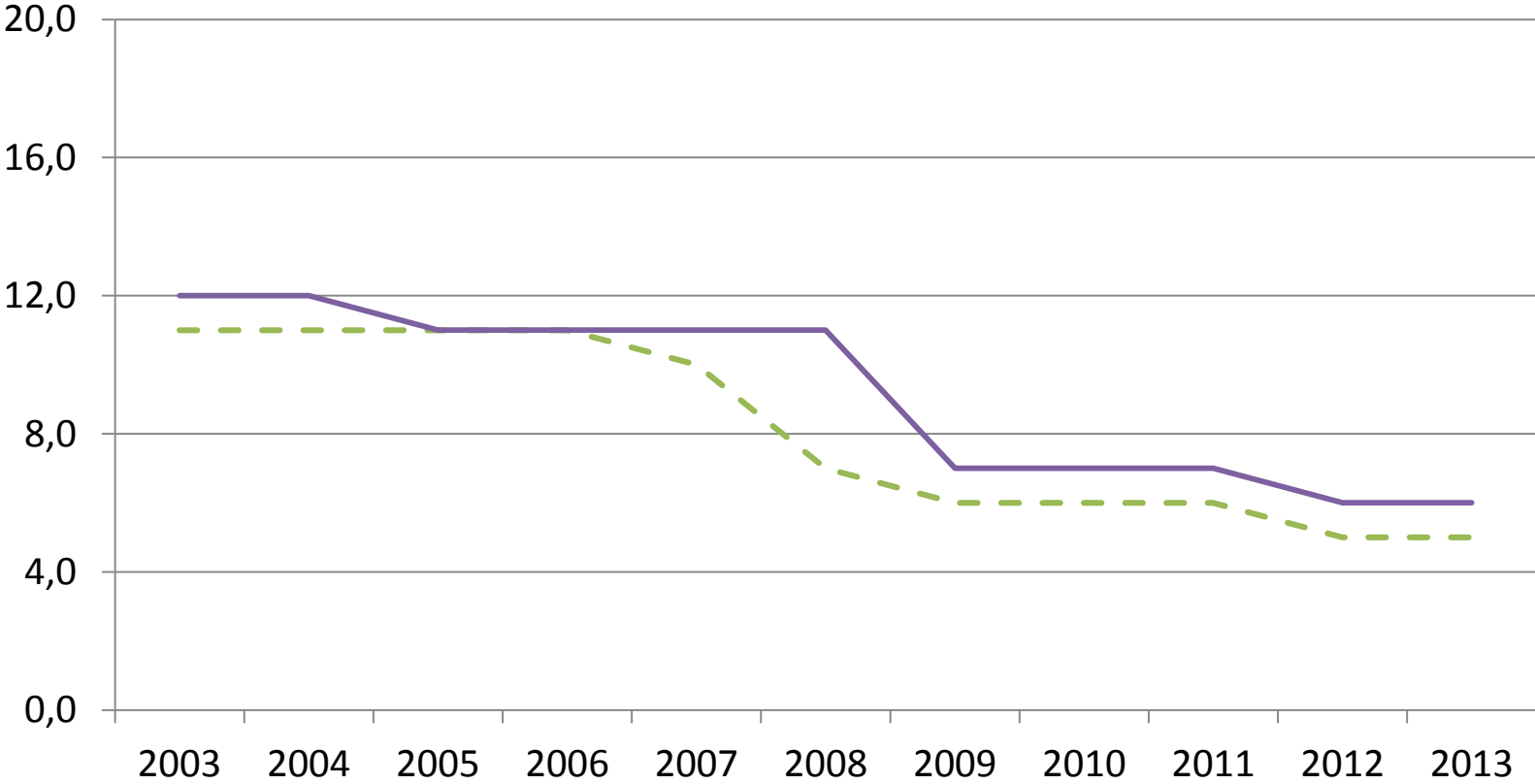
Source: Transparency International

— Albania — Serbia

Start-up procedures to register a business (number)



Start-up procedures to register a business (number)



— Albania

— Serbia

Source:WB

Concluding remarks

- As always at the **Balkans Market is State creature...**
- **Two trends - Captured State/Normal States**, but the dominant is the first ... (interests > ideas)
- **Role of Social anchors**
 - Monetary Regimes/DM/Euro
 - EU accession and membership
- **Currently**
 - No anchor ...
 - What the new anchor could be ?
 - **Nationalism ??**

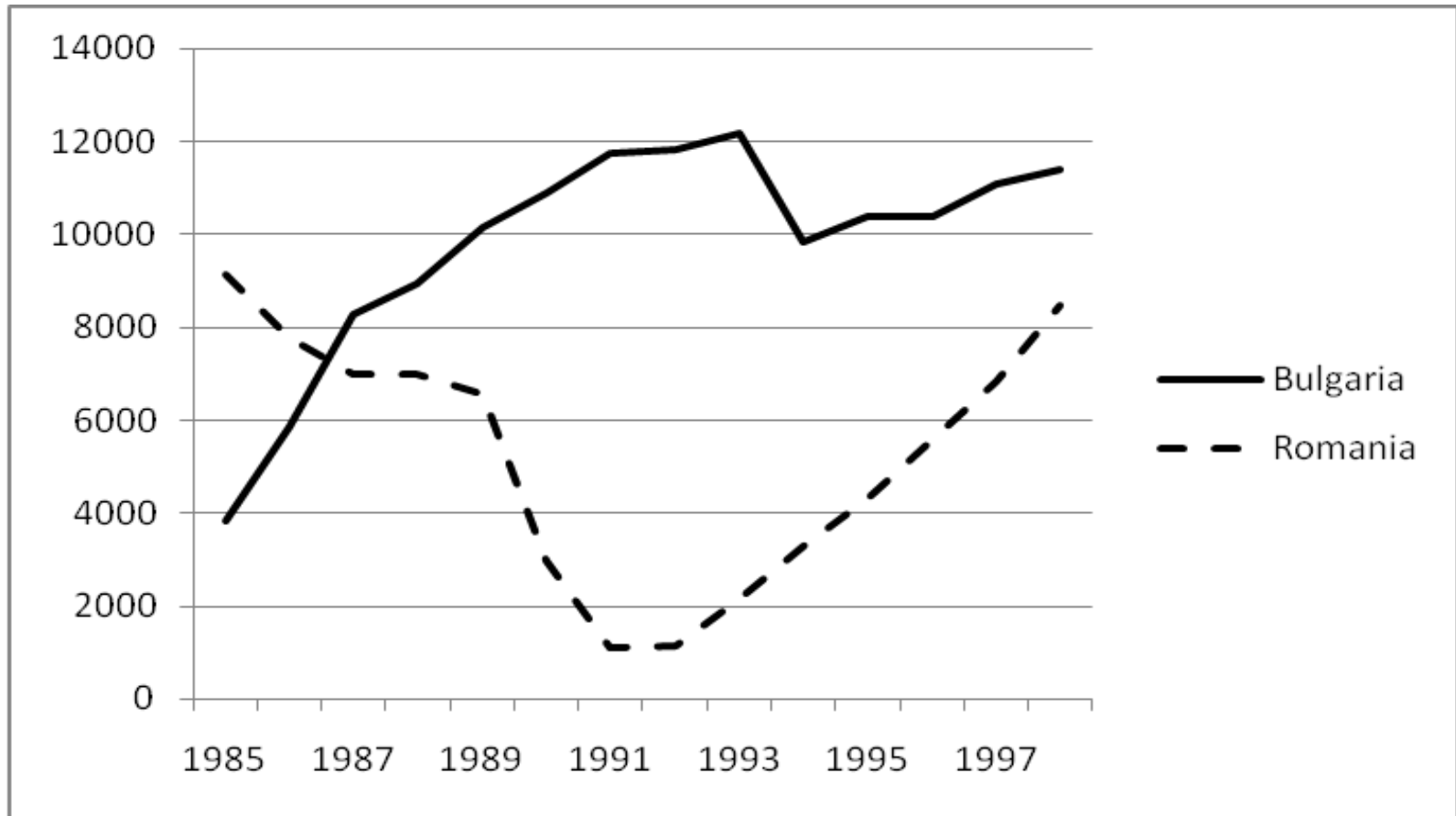
Table 1

Economic indicators for Bulgaria and Romania before the 1996–97 crisis.

	Bulgaria			Romania		
	1985	1990	1995	1985	1990	1995
GDP (in billion constant 2000 US\$)	13.5	14.6	12.8	48.2	44.0	39.5
GDP per capita (constant 2000 US\$)	1512	1671	1519	2120	1896	1742
GDP growth rate (%)	2.68	-9.12	2.86	-0.10	-5.60	7.16
Inflation (%)	0.23	26.18	62.38	0.27	13.60	35.25
Trade (% of GDP)	539	125	84	-	35	43
FDI (% of GDP)	-	0.02	0.69	-	0.00	1.18
Income elasticity of imports ^a						
COMECON	1.94	2.61	-7.86	-10.66	1.00	3.56
Developed countries	3.47	-1.78	-0.19	-	-5.83	5.57

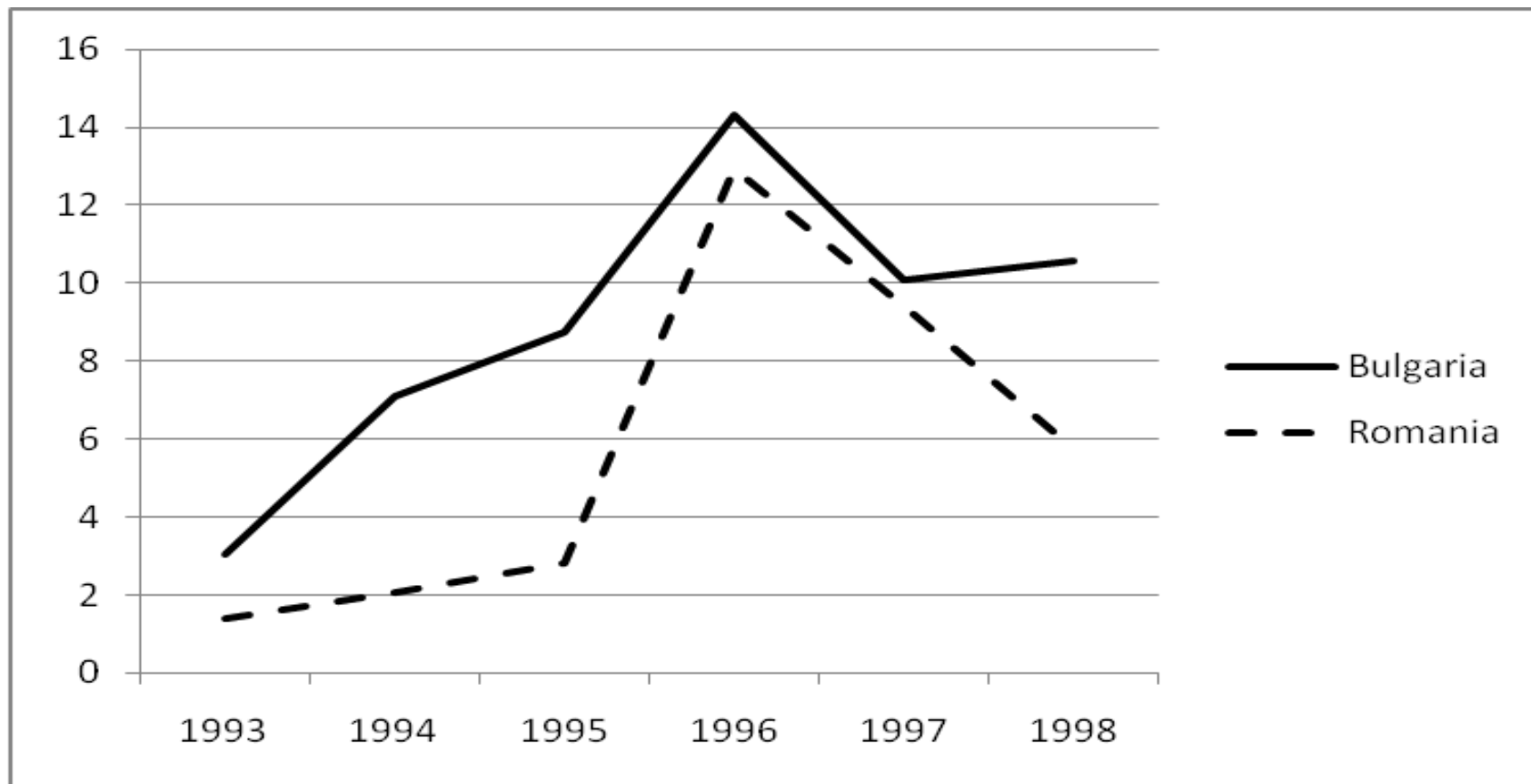
^a As reported in Slim (1997) for the periods 1984–86, 1990–92, and 1993–95, respectively. *Source:* World Development Indicators.

External debt (in millions of current US\$)



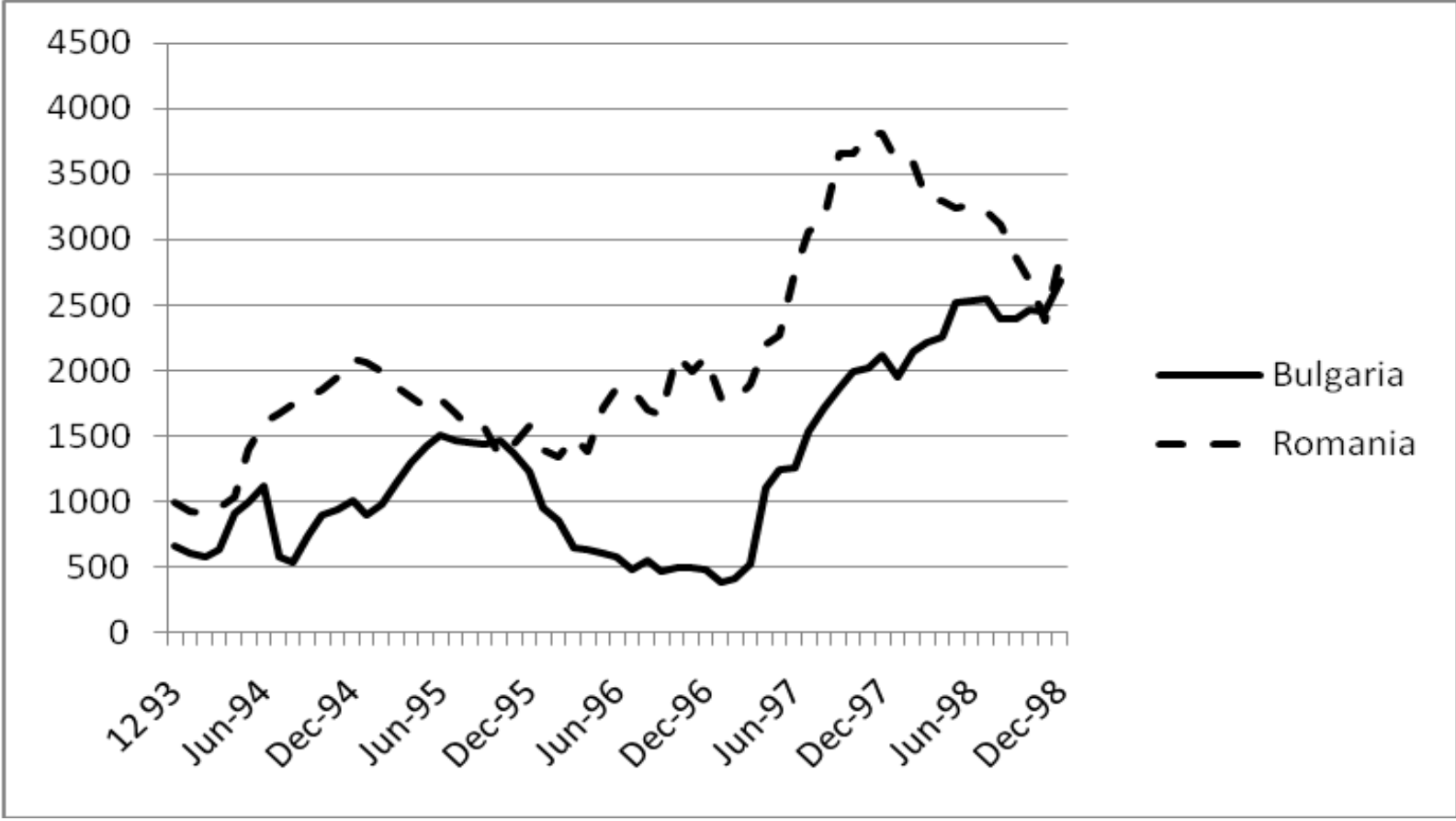
Source: World Development Indicators

Debt service on external debt (in % of GDP)



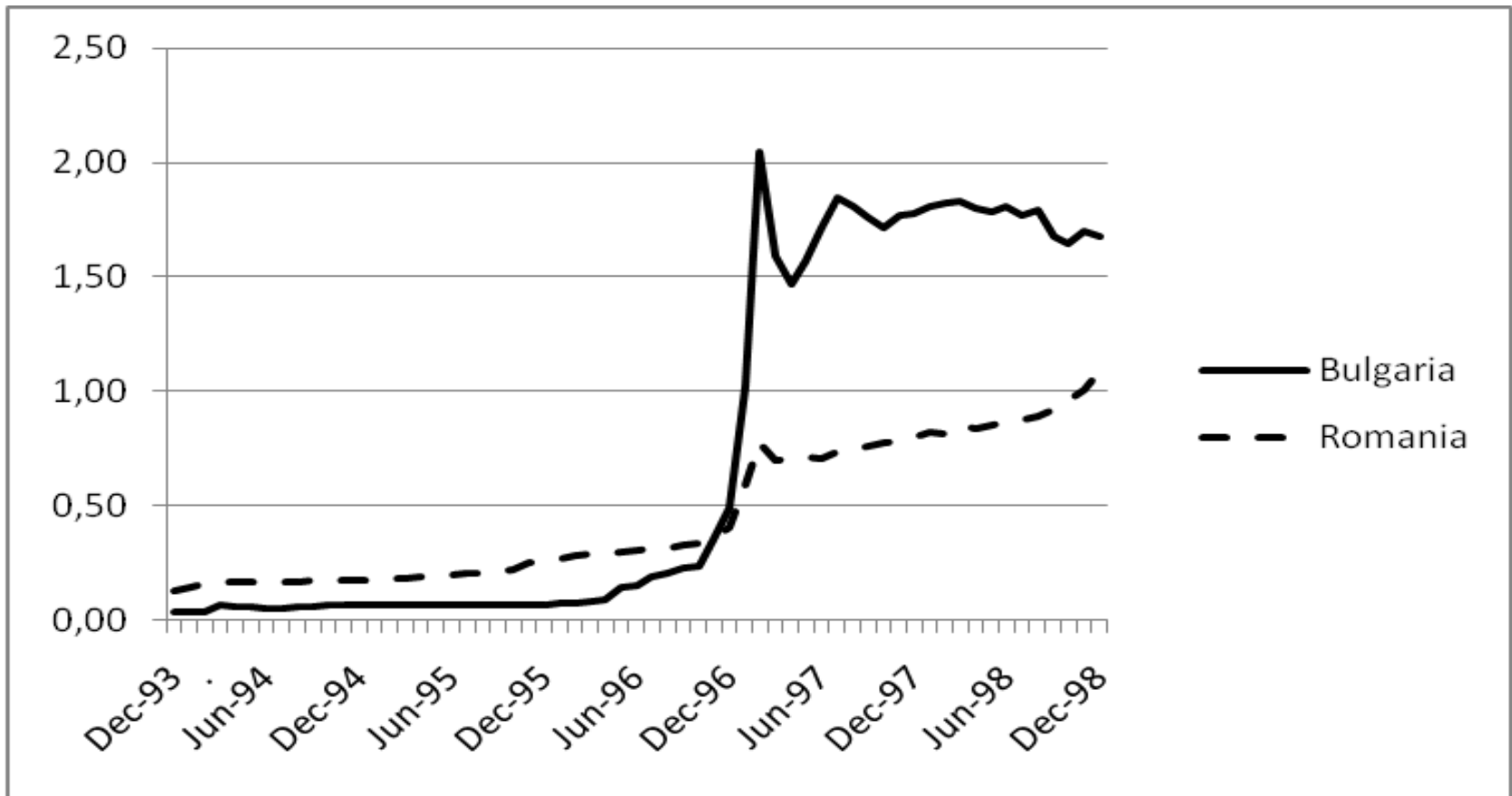
Source: World Development Indicators

Foreign reserves excluding gold (in millions of current US\$)



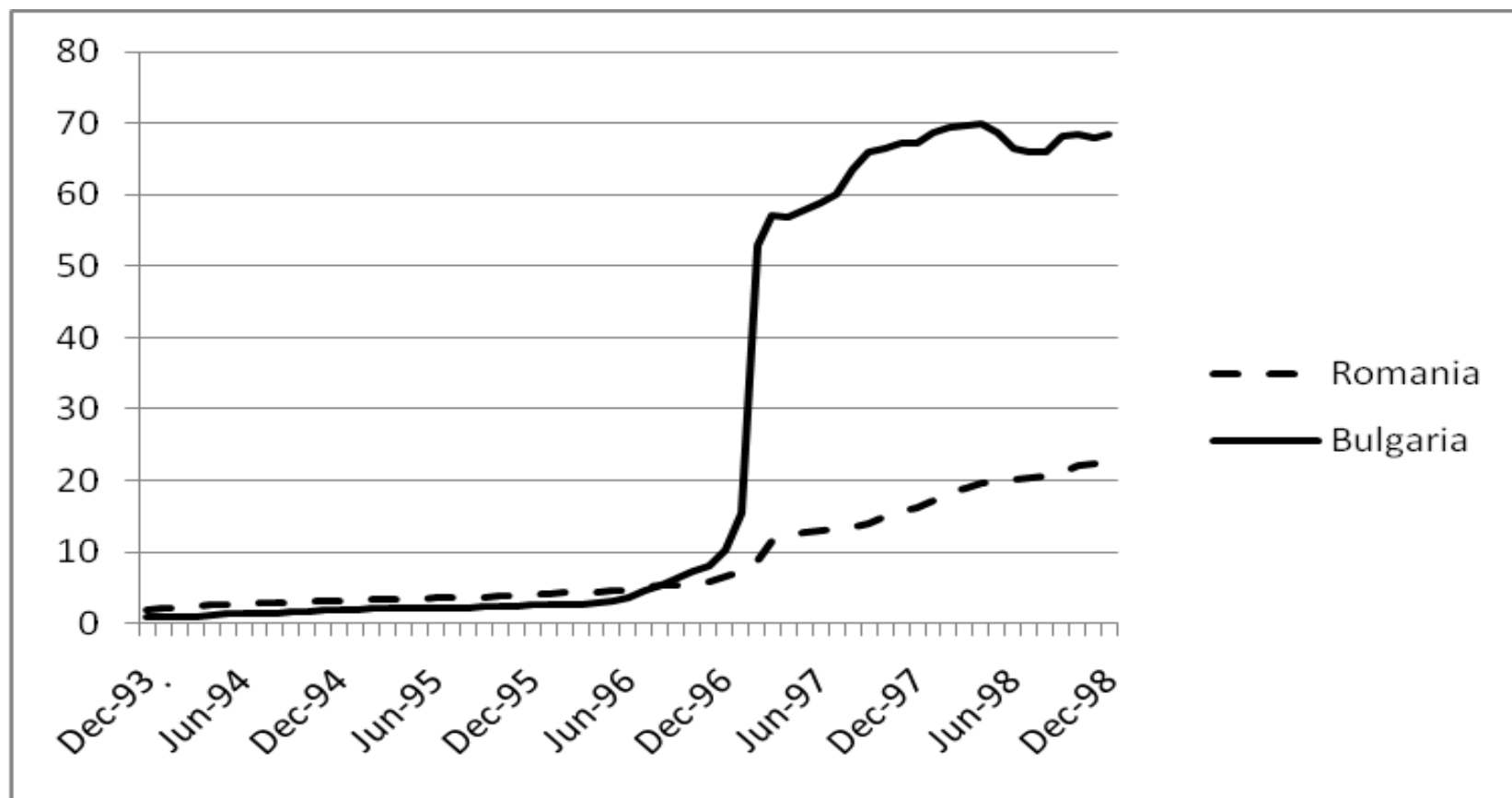
Source: International Financial Statistics

Exchange rate (local currency units per US\$)



Source: International Financial Statistics

Consumer Price Index (2005=100)



Source: International Financial Statistics