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The Experience of Exchange Rate Regimes in Southeastern Europe in a Historical and Comparative Perspective

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Editorial

The choice of a country's exchange rate regime is one of the most important decisions with respect to the macroeconomic policy framework. As history shows, the exchange rate regime can, at times, contribute to bringing about incisive and significant changes in the course of macroeconomic developments. Nurturing sound and sustainable growth as well as managing a monetary crisis can be intimately linked to the choice and management of an exchange rate regime. Moreover, regional and global economic integration is closely connected to exchange rate developments and their influence on macroeconomic variables and policies.

Since the start of economic transformation in Southeastern Europe (SEE) almost two decades ago, exchange rate regime issues have often been at the center of the economic policy debate. This is true of the regime choice at the start of transition, but equally so, of the evolution of the exchange rate regimes in the course of transformation, sometimes also in crisis situations. In the debate, it has increasingly been felt that there is a need for more research about the history of exchange rate regimes in SEE also with a view to informing actual decision-making processes today.

This idea of shedding more light on the exchange rate regime experience in Southeastern Europe in the 19th and 20th centuries was taken up by the South-Eastern European Monetary History Network (SEEMHN) in its 2nd Conference in Vienna at the premises of the Oesterreichische Nationalbank on April 13, 2007. The conference was dedicated to "The Experience of Exchange Rate Regimes in Southeastern Europe from a Historical and a Comparative Perspective."

The SEEMHN, a community of financial historians, economists and statisticians, was established in April 2006 at the initiative of the Bulgarian National Bank (BNB) and the Bank of Greece, with the main objective of spreading knowledge about SEE economic history as an integral part of the European experience. The network focuses particularly on financial, monetary and banking history and brings together economists and historians. Additionally, the SEEMHN Data Collection Task Force aims at establishing a historical data base with 19th and 20th century financial and monetary data. The BNB had hosted the 1st SEEMHN Workshop/Conference on "Monetary and Financial Polices in South-East Europe. Historical and Comparative Perspective" in Sofia from April 13 to 14, 2006.

For the Oesterreichische Nationalbank, the 2007 SEEMHN conference in Vienna complemented a series of conferences and workshops with a focus on SEE that the OeNB had organized in the past, e.g. the 2004 Conference on European Economic Integration and workshops bringing together the chief economists of SEE central banks in 2005 and 2006 in Vienna.

This volume presents the keynote lectures and papers of the 2nd SEEMHN conference, which was attended by representatives of the Albanian, Austrian, Bulgarian, German, Greek, Romanian, Serbian, and Turkish central banks, as well as participants from a number of European universities and research centers.

In his welcome contribution, *Peter Mooslechner (Oesterreichische Nationalbank)* underlined the undiminished importance for economic policy attached to choosing exchange rate regimes. This issue is particularly relevant for small open economies such as (almost all) SEE economies. Despite the fact that in Europe the overall perception of monetary policy has shifted to the notion of monetary union, it is still necessary to review and reflect on different approaches, which is reinforced by recent economic experience in several respects.

He pointed out that the worldwide surge of capital flows in the last two decades appears to have favored a tendency of exchange rate regimes moving either toward either a hard peg or toward a free float; intermediate regimes turned out to be difficult to sustain. Looking at SEE as well as the entire Central, Eastern and Southeastern European (CESEE) region, the larger countries seem to have more frequently opted for free or managed floats, whereas the majority of countries (including, especially, the smallest/smaller ones) retained pegs to the euro. Regardless of their present regimes, according to the Treaty, all current and future EU Member States will need to participate in the Exchange Rate Mechanism II (ERM II) before eventually joining the euro area. Such an explicit commitment had to be compatible with other elements of the overall policy framework, in particular with monetary, fiscal and structural policies.

Luca Einaudi (Italian Prime Minister's Office) argued in his keynote lecture on the monetary separation of Southeastern Europe in the 19th and the early 20th centuries that although the efforts of Balkan states to break away from the former Ottoman Empire and the Austro-Hungarian Empire and to introduce sovereign currencies were successful, the desire to rapidly modernize and catch up with the most advanced European nations unfortunately could not offset bleak economic and financial realities.

Matthias Morys (University of Oxford) stated in his paper that under the classical gold standard from the 1870s to 1914 there might have been more room for economic policy maneuver (also for peripheral economies) than scientists had previously thought. *Kalina Dimitrova and Nikolay Nenovsky (*both from the *Balgarska Narodna Banka)* and *Giovanni Pavanelli (University of Torino)* described the history and perspectives of exchange rate control in Italy and Bulgaria in the 1930s. While officially aiming at monetary stability and enhanced credibility in a very difficult external environment, these policies are found to have been bogged down in unethical practices and political favoritism. *Erik Buyst*

(Katholieke Universiteit Leuven) and *Ivo Maes (National Bank of Belgium)* dedicate their paper to the role of central bank as a lender of last resort in 19th century Belgium. While they find that the Belgian central bank had rendered the Belgian financial system more crisis resistant, especially by restricting banking sector leverage, they conclude that the National Bank of Belgium had not really functioned as a lender of last resort, as most rescue operations had taken place upon the explicit request of the finance minister. In their paper, *Martin Pontzen* and *Franziska Schobert* (both from the Deutsche Bundesbank) discussed episodes of German monetary history and drew lessons for transition economies. The authors found interesting parallels between post-Second World War German bank restructuring and banking reforms in transition countries during the 1990s, and between monetary aspects of West Germany's catching-up process during the Bretton Woods era and of the catching-up processes of many emerging markets today.

In his keynote lecture, *Peter Bernholz (University of Basel*) focused on general patterns in the monetary history of Balkan countries in the 20th century. He distinguishes four episodes of hyperinflation that struck the region since 1945, namely in Greece in the aftermath of the Second World War, in Yugoslavia between 1989 and 1990, in Serbia and Montenegro between 1992 and 1994, and in Bulgaria in 1997. These episodes share a number of qualitative characteristics that have been confirmed in other cases: At the beginning of the hyperinflation episodes, the real stock of money increases at a faster rate than the price level and the exchange rate. Later, the dynamics reverse, leading to undervaluation, which is only overcome once monetary stabilization has been effected.

In their study, *Kalina Dimitrova (Balgarska Narodna Banka)*, *Martin Ivanov (Bulgarian Academy of Sciences)* and *Ralitsa Simeonova-Ganeva (St. Kliment Ohridski University, Sofia)* analyzed the impact of the effective exchange rates in Bulgaria in the period 1897–1939. They find that real effective exchange rate movements had statistically significant effects on Bulgarian exports only during the period of relatively free international trade, namely when the classical gold standard was in force (1896–1913). *Biljana Stojanović (Megatrend University, Belgrade)* discussed the exchange rate regimes of the dinar in the years 1945–1990 and assessed their appropriateness and efficiency. Given that in former socialist Yugoslavia ideological and legal frameworks were conducive to persistent monetary expansion, the weakening of the Yugoslav currency was inevitable, whatever the officially applied exchange rate regime. *Elisabeta Blejan,* whose paper was prepared under the coordination of *Professor Stoenescu*, and the co-authors *Brîndusa Costache* and *Adriana Iarovici (all Banca Națională a României)* described the foreign exchange regime in Romania between 1929 and 1939. Whereas the country had introduced exchange controls, the large number of foreign exchange and trade regulations and their frequent modifications as well as the multiple exchange rates for the same currency resulted in distorted exchange relations between the leu and foreign currencies. *Yury Goland (Russian Academy of Sciences)*, in turn, discussed the exchange rate in the period of New Economic Policy (NEP; 1921–1928) in Soviet Russia, from which he draws some lessons for present-day Russia: Competitiveness should be improved by cutting production and distribution costs, and real exchange rate depreciation should be achieved by decreasing inflation rather than through nominal devaluation.

Yüksel Görmez and *Gökhan Yilmaz (Türkiye Cumhuriyet Merkez Bankası)* elaborated on the evolution of exchange rate regime choice in Turkey. Turkey appears to have tried various kinds of exchange rate regimes, ranging from strictly fixed to free-float regimes. In the past – contrary to the current situation – an experimental regime choice was common practice against the background of structural imbalances, ever increasing dollarization and the lack of fiscal discipline coupled with central bank financing of public deficits through short-term advances. In their study, *Ljiljana Đurđević* and *Milan Šojić (both Narodna banka Srbije)* focused on the exchange rate of the dinar in the Kingdom of Serbia in the period 1882–1914. The country had committed itself to bimetallism, and the dinar remained a relatively stable currency in spite of a number of economic challenges that had emerged during this period. *Dragana Gnjatović (Megatrend University, Belgrade)* analyzed the foreign exchange policy in the Kingdom of Yugoslavia during and after the Great Depression. The author outlined the short period during which the gold exchange standard was in place, explained the reasons for a sudden decrease in the state's foreign exchange earnings during the Great Depression and reviewed the successful dinar stabilization achieved thereafter.

Finally, moving further up to the present, *Stephan Barisitz (Oesterreichische Nationalbank)* shed some light on paths of monetary transition and modernization: He provided an analytical survey of exchange rate regimes and monetary policy in Southeastern Europe including Turkey from the 1990s to 2006. Barisitz concluded that a wide variety of monetary strategies had been put in place and had been practiced quite successfully across the region.

This volume also contains an annex of historical data pertaining to exchange rates, discount rates, reserves and banknotes in circulation in Albania, Austria-Hungary, Bulgaria, Greece, Romania and Serbia in the period 1867–1914. For each country, aggregate data displays are preceded by explanatory remarks. (In the case of Albania, only explanatory remarks are available.) For Albania, the latter were written by *Elsida Orhan* and *Kelmend Rexha (Banka e Shqipërisë);* for Bulgaria, the authors are *Kalina Dimitrova* and *Martin Ivanov*, for Serbia *Milan Šojić*, *Ljiljana Đurđević, Sanja Borković* and *Olivera Jovanović (Narodna banka Srbije)*, for Austria *Thomas Scheiber (Oesterreichische Nationalbank),* for Romania *Professor Stoenescu*, *Elisabeta Blejan*, *Brîndușa Costache* and *Adriana Iarovici*, for Greece *Sophia Lazaretou (Bank of Greece)*. We would like to thank all colleagues, especially *Matthias Morys (University of Oxford)*, who coordinated and managed this exercise, for the valuable contributions to the first stage of the SEEMHN Data Collection Task Force endeavor.

The SEEMHN will continue to take up research issues from a historical angle that provides insights also for the analysis of present economic and financial developments and for today's policymaking in these areas. It was agreed already, that the 3rd SEEMHN meeting will be hosted by the Bank of Greece on March 14, 2008, in Athens. The topic of the conference will be "Banking and Finance in South Eastern Europe: Lessons of Historical Experience".

Last but not least, special thanks go to all those who helped to organize the whole event as well as to the members of the organizing committee and the scientific committee of the conference and, in the end, to those who have worked on the publication of this conference volume. Only their enthusiasm and efficiency has made the conference and the book possible.

Peter Mooslechner
Oesterreichische Nationalbank
Chair of the Organizing Committee and the Scientific Committee of the Conference