

Josef Christl
Executive Director
Oesterreichische Nationalbank

Dollarization and Euroization – Some Introductory Remarks

Vienna, November 29, 2004

Ladies and Gentlemen,

As the Chair of today's second session with the eye-catching title "A Foreign Currency for my Country? The Case of Dollarization and Euroization" let me set the scene with some introductory reflections on the euro. As a Eurosystem central banker, I am proud to say that we have established a truly credible and attractive European currency within a short period of time. Moreover, it is a fact that the euro has since come to play a significant role also in Central and Eastern European countries. You may remember that before the cash changeover of national currencies to the euro there was an intense debate about whether the euro would be able to take over the role of the Deutsche mark in Central and Eastern Europe, and whether the euro would be able to attain the kind of reputation that the Deutsche mark – and the Austrian schilling – enjoyed.

Today, substantial amounts of currencies are circulating outside the countries in which they were originally issued. In most cases, however, little is known about the exact whereabouts, the extent of currency substitution and the motives behind the decision to hold a foreign currency rather than the domestic one. Yet it is important, for various reasons, to learn more about the extent a foreign currency is used abroad. Here I would like to touch two issues. First, large amounts of circulating foreign currency can add uncertainty to the results of monetary policy. Increases or decreases of domestic money demand might be wrongly appraised if foreign currency demand is incorrectly estimated. Second, knowledge of the volume of currency circulating abroad can be revealing for domestic and foreign fiscal policy. In both cases, the size of unofficial dollarization or euroization might be related to the size of the foreign currency black market, reflecting a certain degree of tax evasion.

In 1997 the Oesterreichische Nationalbank started to commission representative semi-annual surveys in our neighbouring regions – specifically in Croatia, the Czech Republic, Hungary, Slovakia and Slovenia – to learn more about the amounts of foreign currency held by the population. Looking back, we are now able to analyse how the behaviour of Central and Eastern European countries has changed over time. What can we learn from these surveys? The latest public opinion poll was conducted in the second half of 2003 and shows for example that in the two preceding years the percentage of private persons holding euro has increased in all countries. This share grew most strongly in the Czech Republic, from 13% to 25%, and in Slovakia, from 20% to 27%. Slovenia is the country with the highest share; in this country, 44% of all respondents held euro assets.

Furthermore, the results illustrate that currency holdings are typically not motivated by domestic transactions – with one exception, namely Croatia, where 12% of the respondents said that domestic transactions were their main motive for holding euro. Czechs, Slovaks and Hungarians tend to use euro holdings predominately for transaction purposes abroad – such as for holidays or for cross-border shopping. By contrast, in Croatia and Slovenia euro holdings are mainly motivated by the euro's store-of-value-function. These differences are also reflected in the amounts of euro people in Central and Eastern Europe hold. According to our latest survey, the median amount of euro held is EUR 300 in Slovenia and EUR 130 in Croatia. In the Czech Republic, Hungary and Slovakia, median euro holdings were found to range just between EUR 80 and EUR 116.

The surveys also showed that in May 2001, that was before the cash changeover, the majority of people holding Deutsche mark or Austrian schillings were still unsure about their plans for conversion. Of those who had made up their minds, 58% planned to exchange their mark or schilling holdings into euro whereas 42% wanted to convert them into "other currencies." The moderate perception of the euro before its introduction can certainly largely be attributed to uncertainties relating to the changeover. People were unsure about the exchange rate, they did not know who would be in charge of the exchange and they feared that they would have to pay considerable commissions. Many people were also uncertain whether the new single European currency would be as hard and stable as the D-Mark, or the Austrian Schilling, had been. According to the 2002 survey, which reflects actual exchanges after the introduction of the euro, 71% of all respondents in the end exchanged their Deutsche mark holdings for euro and 21% for local currencies. A much smaller fraction – just 4% – was exchanged for US dollars.

Now, what do people in Central and Eastern European countries think about the stability of the euro these days? The euro has excellent "approval ratings" in this area. About 90% of all respondents think that the euro is currently rather or very stable, and that it will remain stable or rather stable in the next two years. The results clearly show that the euro has successfully taken over the predominant role that the D-Mark and the Austrian

schilling used to play in these countries. So I think one can say that the euro has become a currency in which people in the region really have a lot of trust.

Ladies and Gentlemen,

The topic of this year's Conference on European Economic Integration is "South Eastern EUROPEAN Challenges and Prospects". Of the countries to which I have specifically referred so far, only a single one – namely Croatia – is located in South Eastern Europe. What role does the euro play in other countries in the region? The single European currency is very important for the economies and economic policies in South Eastern Europe: Most countries have geared their monetary policy to an external anchor, which is – without any exception – the euro. Two non-sovereign territories, these are Kosovo and Montenegro, have unilaterally adopted the euro. It is evident that in these cases euroization took place in exceptional historical situations, which were the aftermath of the Kosovo war, as well as the conflict with the Milosevic regime and its inflationary policies. Even though these territories have still a long way to go until they may enter the European Union, it needs to be acknowledged that formal or de facto euroization is considered to be inconsistent with the Maastricht Treaty. M. Trichet was very clear on that.

Euroization can have some advantages but – as we know – it is also associated with high risks. We will hear more on these issues in the following presentations. At any rate, a high degree of a foreign currency as a means of exchange is certainly an indicator that the domestic monetary system inspires little confidence. Countries in South Eastern Europe could benefit from the lessons learnt from some of the new Member States. Overall, the countries need to develop a strong commitment to the reforms required to achieve economic and social convergence towards EU levels. I hope very much that our Conference will add to our understanding of this part of Europe: the challenges and prospects it faces.

The second half of the first day of our conference is devoted to questions related to monetary and exchange rate policies. In the first part, which we cover with this session, we deal explicitly with dollarization and euroization; in the second part of this afternoon we are going to focus more broadly on challenges of monetary and exchange rate policies.

Ladies and Gentlemen,

Let me now move on to introduce the speakers for session 2.

- First of all, I am honored to welcome Professor Eduardo Levy-Yeyati. Professor Levy-Yeyati worked as the Chief Economist at the Central Bank of Argentina and is now Professor at the Universidad Torcuato Di Tella in Buenos Aires. He has published numerous articles in the most renowned economic journals such as in American Economic Review, European Economic Review or Economic Letters.

As an expert in the field of dollarization, who has also published a book on these issues, Professor Levy-Yeyati has been asked to give us an academic-oriented presentation on the case of dollarization.

- I am also very happy to have Deputy Governor Boris Vujcic of the Croatian National Bank on our panel. Mr Vujcic will share with us his views on the interrelation between a highly euroized economy and its incentives for adopting the euro.
- Finally, it is a privilege to announce my esteemed colleague, Mr. Adalbert Winkler, Deputy Head of the EU Neighboring Regions Division, at the European Central Bank as a speaker in this session. We have asked Mr. Winkler to complement the academic presentation of our first speaker with a geographic focus on the region of South Eastern Europe and a more practical focus on the experiences of euroization in the various countries.

Thank you!