

## The Role of Currency Board Regime during Economic Crisis

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*The preferred exchange rate regime issue, for developing and emerging market economies in particular, has evolved considerably over the past couple of decades. Pegging the exchange rate to a strong anchor currency was popular in the early 1990s – especially for nations in transition from command to market economies. But the 1990s also saw a spate of capital account crisis in emerging market countries, with sharp reversals of capital inflows leading to collapsing currencies and underscoring the fragility of such fixed exchange rate regimes. Surprisingly few exchange rate regimes failed during new millennium to compare with the last decade, though economic and financial crises were not a rare exception. Currency Board regime deserves more attention and praises for its merits with respect to benefit it provides during the turmoil period in particular, even though the regime embraces common features of highly criticized Gold standard.*

*The article examines the roles of Currency Board during financial crises in past and looks at current developments going in the market from the perspective of Currency Board. The first part of the article outlines the theoretical background of Currency Board, and surveys the key advantages and disadvantages of the regime. The second part of the article looks into three historically prominent events of Currency Board regime: speculative attack against Estonian kroner as well as Hong Kong dollar and the failure of Currency Board in Argentina. Besides that, the main reasons and explanations of the events are disclosed and conclusions are drawn about the role and importance of Currency Board regime. Finally, after revealing the story of Iceland failure and comparing its financial state to the Baltic States from the exchange rate regime perspective, it is looked closer at the financial figures of the Baltic States with the purpose to justify the fact that the Baltic States have already passed the worst.*

Keywords: Currency Board, economic crisis, exchange rate regimes, speculative attacks, Baltic States.

### Introduction

**Relevance of the topic.** Currency board is counting its second decade as a successful monetary regime, which lets

quite a few economies through the financial hardships that global economies encountered during the last 20 years, such as European ERM currency crisis in 1992-1993, Asian financial crisis in 1997-1998, Russian financial crisis in 1998 and dot.com bubble burst in 2001. Another global crisis hit the whole world economy in 2007-2010 and by its scale is compared to the Great depression of 1930s. Despite the severe global contraction, liquidity problems and contagion effect around the financial markets, Currency Board countries withstood pressure without any major local currency devaluation.

Conventional wisdom about the Currency Board at the beginning of 1990s was quite optimistic, however became more ambiguous after Argentina abandoned the regime and devalued its local currency. Currency Board was criticized for many shared drawbacks with gold standard. On the other extreme we have Estonia, which introduced Currency Board in 1992, withstood major speculative attack against its currency in 1997-1998 and has been recently admitted to the euro zone “club”, successfully closing the case of Currency Board.

Another parallel was drawn between floating Icelandic exchange rate regime and Currency Board in Baltic States, whereby the sustainability and stability issues were compared between the two. Recent financial crisis left no doubts about the susceptibility and incompatibility of small and open economy and freely floating exchange rate regime. Conversely, Currency Board regime proved its benefit as it offered great stability and credibility restoring mechanism.

**Objective of scientific research** is to analyze the role of Currency Board during the historical financial crises as well as the recent one, and to substantiate its benefits and drawbacks for small and open economies in particular.

**Methods.** For the purpose to analyze the Currency Board role during the previous as well as recent financial turmoil it was referred to the systematic and comparative analysis of scientific literature, analysis of statistical data, methods of logical abstraction and inference generation.

**Scientific Problem.** While there is quite a lot of literature (Ho & Ho, 2009; Aniunas, Nedzveckas & Krusinskas, 2009; Jackson, 2008; Nedzvedskas & Aniunas,

2007; Solheim, 2003; Hanke, 2002; Gulde, Kahkonen, Keller, 2000; Spiegel, 1998; Enoch & Gulde, 1998) examining the Currency Board, comparing it to alternative exchange rate system and analyzing the effect of the regime on the financial system and whole economy, the recent crisis is not yet investigate from the point of exchange rate system. Thus the Currency Board has revived as relatively new topic and needs to be examined in a framework of recent crisis.

Many of the scientific works on Currency Board (Gurtner, 2002; Gulde-Wolf & Willingen, 2009; Keiser, 2008; Thorp, Townsend, Edmonds, 2009; Pilinkus & Boguslauskas, 2009) are usually designated to one particular case, e.g., Argentina's case, Hong Kong Currency Board case, etc. however, there is a lack of more systematic approach towards the theoretical aspects and empirical cases of Currency Board.

Theorization is not a popular tool within the Currency Board. Authors are not trying to find patterns within common exchange rate system, because it is hard to develop a feasible model due to limited history of the Currency Board regime. However, we have briefly described the so called concept of deficit "stabilization mechanism" in the last part of the article.

### **Currency board: theoretical aspects**

As IMF paper published in 2004 puts it, Currency Board is "a monetary regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority to ensure the fulfilment of its legal obligation" (IMF, 2004). This implies that domestic currency will be issued only against foreign exchange and that it remains fully backed by foreign assets (typically more than 100% of monetary base), eliminating traditional Central Bank functions, such as monetary control and lender-of-last-resort, and leaving no scope for discretionary monetary policy.

Above described Currency Board model is called "orthodox Currency Board", which purports to be classical Currency Board regime with its strict practice of predetermined rules - the regime there no exceptions towards aforementioned bullets apply. As IMF (2004) remarks, "some flexibility may still be afforded, depending on how strict the banking rules of the Currency Board arrangements are", which lead us to a "soft" application of Currency Board as in Argentina's case to be described later.

E. Levy-Yeyati and F. Sturzenegger (2003) defines Currency Board as "an exchange rate agreement in which the exchange rate is fixed to an anchor currency and the Central Bank operates with precluded monetary rules". However, these authors restrict any kind of money base expansion until equivalent amount of foreign currency is accumulated. From a practical point of view this means that the Central Bank has no independent monetary policy and that it creates or contracts the money supply only as the result of its interventions in the foreign exchange market. If there is excess demand for domestic currency, capital will flow in (probably in response to an increase in interest rates) and the Central Bank, by acquiring these

flows, will expand the money supply. If there is excess supply of domestic currency, the Central bank will take in this excess supply by giving away international assets, thus contracting the money supply. According to E. Levy-Yeyati and F. Sturzenegger (2003) monetary policy rules are implemented by forcing the Central Bank to have full backing of domestic money base with international reserves, though in some cases Currency Board does not require a one to one backing of the monetary base. However, all authors (Jackson, 2008; Gurtner, 2002; Gulde-Wolf & Willingen, 2009; Sergi, Hsing, 2010; Wang & Lee, 2010; Hsing & Sergi, 2009) unambiguously agree that even not equivalent monetary base backing precludes the conduct on an independent monetary policy or puts it beyond very strict limits. When discussing the choice of exchange rate regime S. Fischer (2001) notices that the choice between hard peg and floating depends in part on the characteristics of the economy, and in part on its inflationary history. The choice of a hard peg makes sense for the countries with long history of monetary instability, and/or for a country closely integrated in both its capital and currency account transactions with another or group of the economies. An exchange rate peg has been successfully used to disinflate from high inflation without cause of crisis, but it also raised many externalities, which is practically inevitable (Sergi, Hsing, 2010; Wang & Lee, 2010; Hsing & Sergi, 2009; Khenzu, 2008; Aizeman & Reuven, 2005).

According to IMF (2008), there are 13 countries with Currency Board in comparison to only 7 in the year of 2003. Six of them correspond to the countries in the Easter Caribbean Currency Union (Antigua & Barbuda, Dominica, Grenada, St. Kitts, & Nevis, St. Lucia and St. Vincent, & the Grenadines), plus 7 other: Bosnia and Herzegovina, Brunei, Darussalam, Bulgaria, Hong Kong SAR, Djibouti, Estonia and Lithuania. Because all these countries are relative small, it places Currency Board in a relative unpopular category amongst exchange rate regimes.

**Advantages of Currency Board.** The main advantage that ascribed to a Currency Board is the credibility gains that it allows, helping deliver lower inflation and better fiscal results (Institute of International Economics, 2004). The argument is plain simple: a Currency Board represents a strong commitment that if broken can have a large and costly effect on expectations. Because politicians fear this loss of credibility, while in place the Currency Board lowers inflation expectations and inflation itself, and should provide the incentives for an improvement in fiscal behavior. Ghosh, Gulde, and Wolf (1998) drawing on a dataset for all IMF countries between 1970 and 1996, found that countries with Currency Boards deliver an inflation rate that was about 4% lower. That is a sizable effect. Moreover, Currency Board exchange regime bolsters the credibility of the monetary authorities who might, otherwise, experience difficulty in maintaining an exchange rate peg. E. Levy-Yeyati and F. Sturzenegger (2001) supported the arguments of negative correlation between fixed exchange rate regime and inflation.

The predictability and rule-based nature of a Currency Board are two of its biggest advantages. Like any fixed exchange-rate system, a Currency Board offers the prospect of a stable exchange rate, which can promote both trade

and investment. Its strict discipline also brings benefits that ordinary exchange-rate pegs lack. Profligate governments, for instance, cannot use the Central Bank’s printing presses to fund large deficits, as “The Economist” magazine (1997) notes.

Fatas and Rose (2001) add that fixed exchange rate regime is associated with stricter fiscal policy because of the credibility role of economic policy. Since many exchange rate devaluations are associated with fiscal deficit and severe problems of credibility for government and Central Banks, tighter fiscal policy becomes a required element in any exchange rate based stabilization.

Lastly, Currency Board may also have an effect on trade as a result of the stability it induces on the exchange rate, an effect similar to the one that has been identified for the countries that adopt a common currency with other countries, e.g. Euro zone. This exercise is specifically undertaken in Frankel and Rose (2002) who find that the effect of a Currency Board is a more than tripling of trade. Thus the trade motive for a Currency Board seems to be important.

**Disadvantages of Currency Board.** Ghosh and Ostry (2009) found three major downsides to more rigid exchange rate. First, such regimes severely constrain the use of the macroeconomic policies, in particular monetary policy, which is handicapped with respect to sub-serve of expansionary fiscal policy during an economic downturn. However, one would argue that stability sometimes might serve as a more solid weapon in the fight with downturn, as opposed to most economic literature. The “impossible trinity” of simultaneously maintaining a pegged exchange rate, open capital account, and an independent monetary policy is well established.

Secondly, Ghosh and Ostry (2009) also found that pegged regimes are associated with greater susceptibility to currency and financial crisis, such as debt crises, a sudden stop in capital flows, or banking crises. The study underlines that crisis contagion is even more likely in developing and emerging countries. This argument again opposes to a counterargument of more stability during turmoil time.

Thirdly, pegged exchange rate regime impedes timely external adjustment and, because the real exchange rate does not adjust, it has a great impact on output and economic activity. To our mind, this is the only sound drawback of the Currency Board, because trade imbalance does more harm than brings benefit, whereas an exchange rate is the most important component of trade equilibrium. Fixed exchange rate regime is tending to misbalance the trade, due to inability of currency to adjust quickly.

There is another sound argument against currency board, which is inability of central bank to act as a last resort lender in order to restore market players’ confidence during the extraordinary financial market environment.

Lastly, it is worth putting a gold standard issue on the table. As N. Lewis (2008) remarks, “a gold standard is essentially a Currency Board linked to gold”. This implies all the drawbacks of gold standard as Milton Friedman spend decades advocating, including inflexibility of an exchange rate to adjust to the economic activity, absence of monetary policy tools, prolonged economic recessions caused by the lack of flexibility and the last but not the least the threat of deflation.

The table below summarizes aforementioned advantages as well as disadvantages of Currency Board regime.

Table 1

**Advantages and Disadvantages of Currency Board Regime**

Advantages	Disadvantages
Helps to deliver lower inflation; inflation is also less volatile than with floating regime: a) Lower money growth rates b) A higher demand for money (confidence effect) at a given money growth rate	Precludes monetary authorities from running an independent monetary policy: a) No money printing option b) “impossible trinity”
Empirical evidence of faster economic growth in comparison to pegged regimes	Limits the ability of Central bank to act as a lender of last resort lender during the downturn
Stronger political commitment to the regime - often reflected in a central bank law or constitutional amendment: a) Deter speculative attacks b) Lower borrowing costs c) Higher credibility	Greater susceptibility to currency and financial crisis, such as: a) Debt crisis b) Stop in capital flow c) Banking crisis
Generates fiscal discipline: a) Prohibits direct money financing of government expenditures (no money printing) b) Restriction on credit expansion c) Better external visibility and high cost of devaluation d) Empirical evidence of smaller fiscal deficits	Exchange rate cannot adjust in response to real shocks; often currency is overvalued or undervalued leading to: a) negative impact on economic activity b) tendency to dis-balance the trade
Effect on trade as a result of the stability; similar effect as for countries that adopt a common currency with other countries	Hindering the possibility of developing a local based financial sector
Stable exchange rate, predictability and disciplined rule-based nature (gold standard) which promotes both trade and investments	Stimulates large currency mismatches in the portfolio structures of government and the private sector

**Historical examples of Currency Board during crisis**

The second part of the article examines three historically important Currency Board events and argues that Currency Board was an optimal exchange rate regime during the downturn period. Firstly, it is expedient to take a close look at how Estonia managed to sustain the “speculative attack” against its currency, later we present the case of speculative attack against Hong Kong dollar, and lastly the reasons of why Argentina abandoned its Currency Board will be examined. Essentially, three historically prominent examples of Currency Boards will be researched: 2 successful and 1 unsuccessful cases.

**Speculative attack against Estonian krooner.** As Grigaliunas and Navickas (2000) concluded, Currency Board regime protects Central Banks from speculative attacks only if banking sector is stable. The other precondition is banks’ confidence in fiscal and Central Bank policy. If there are concerns and doubts that government policy is not directed towards keeping fixed exchange rate regime, the Currency Board is not a “safe harbor” with respect to protecting value of money.

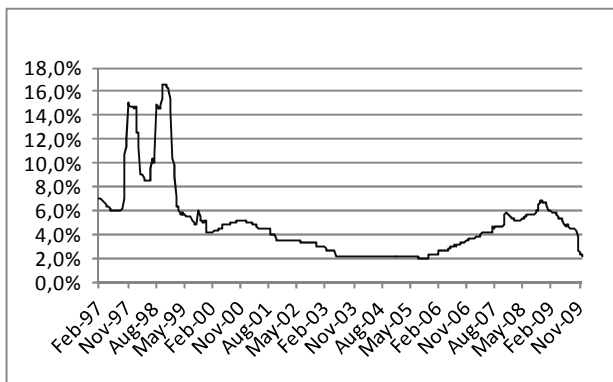
Nevertheless, Estonian reserves stood at a proper level as the attack was established in 1997-1998, fiscal budget was in balance, and bad loan portfolio looked stable. Beside that, the GDP rose at a quick rate signaling a solid fundamental background of Estonia economy. Despite above mentioned facts, speculators saw risk arising from 11% current account deficit, overvalued real exchange rate and worse competitive position in terms of overvalued currency. On the top of that, speculators expected the Russian economic crisis to hit Estonia hardy, and eventually found solid arguments to establish speculative attack. The trigger of speculative attack was pulled by "The Economist" journal, which forecasted the Thailand scenario crisis and suggested Estonia to abandon Currency Board.

The main players of the speculative attack against Estonian kroner were Scandinavian and London banks. London investment banks were selling huge packages of Estonian kroner at the same time entering into forward contracts with Scandinavian banks, while Scandinavian banks started to cover naked positions through Estonian banks. The liquidity dried up in a couple of days, Estonian banks widened forward spreads and within only 4 days speculators surrendered.

There was the second, more organized, speculative attack a few months latter, which took about 6 months for speculators to form their position and eventually fail. This time, speculators used more complicated tools in order not to intimidate Estonian banks and stay in line with liquidity. Ironically, the attack has ended without even a chance of serious damage – as Scandinavian banks acquired major share packages of two biggest banks: Hansapank and Eesti Uhispank. The initial trouble-spot insensibly evaded, and no reasons for speculative attack were longer present.

The graph below (Figure 1) demonstrates the reaction of Tallinn interbank interest rates. Most common 3 month borrowing rates between Tallinn based banks surged to as much as 15% to 17% during the speculative attack.

The speculative attack against Estonia kroner is a good example of benefit achieved through an appropriate monetary policy regime, as such a small economy managed to protect its domestic currency during a series of devaluation cases at that time (Thailand bath, Indonesian rupee, Taiwanese dollar, Russian rouble, etc.).

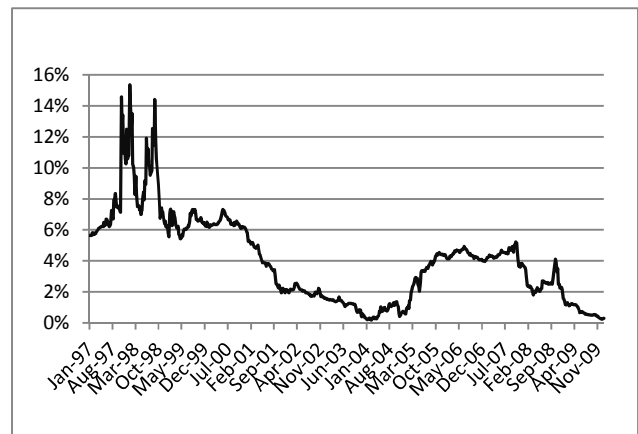


**Figure 1.** Tallinn 3 month interbank interest rates, %

**Currency Board and Hong Kong government collaboration.** The situation appeared to be more complicated in Hong Kong dollar speculative attack as

Hong Kong was one of the world biggest financial and business centers and could not simply allow Currency Board to solve all the issues with respect to attack (the liquidity to dry up and interest rate rise), because it could had affected interest rate-sensitive real estate and financial sectors. Eventually, Hong Kong had to intervene in the market in order to curb speculator's actions.

In October, 1997, a massive speculative attack took place against the Hong Kong dollar (see Figure 2). As Kenneth Kasa (1999) recalls, the interbank interest rates soared into triple digits, and one-month interest rates hit 50%. Although high interest rates successfully repelled this initial attack, it turned out that "Black Thursday" was just the beginning. Major attacks also occurred in January, June, and August of 1998. The prolonged period of high interest rates took a serious toll on Hong Kong's economy, which is heavily dependent on real estate and financial services sectors. Economic output declined by over 5% during 1998.



**Figure 2.** Hong Kong 6 month interbank interest rates, %

Controversial two week government intervention with the aim of punishing currency speculators was criticized for being detrimental to the reputation as one of the world's financial centre. Instead of being a regulator, the government has become "a player, a very key player" as M. Wong and T. Lee (1998) recalls. As we mentioned in the first part, close collaboration between Currency Board and government has to be in place in order to assure a fixed exchange rate regime working. Furthermore, government has to be directed towards keeping fixed exchange rate. This is exactly what happened in Hong Kong in 1998. No matter what critics said, Hong Kong Currency Board soundly contributed to keeping Hong Kong dollar stable.

**The case of Argentina.** Despite a number of successful stories about Currency Board arrangement during economic crisis, unprecedented event happened at the beginning of the 21<sup>st</sup> century as Argentina has been forced to abandon Currency Board regime and devalue its currency. What explanation stands behind this exceptional incident?

The unconventional wisdom about Argentina was that peso had to be devalued because its Currency Board link to the dollar had made it overvalued, making the Argentine economy uncompetitive and stifling economic growth. As Hanke and Schuler (2002) states, Currency Board in

Argentina has never been well understood, either in its strengths or its weaknesses.

Argentina's Central Bank was never subject to any maximum ratio of foreign reserve, as opposed to classic (orthodox) model of Currency Board, where minimum of 100% in reserves has to be maintained. In fact, most of Currency Board regime countries saved additional 5-10% in reserves to guard against losses. Over the year 2001, Argentina's Central Bank had a ratio of foreign reserves to monetary liabilities that varied from a high of 193% on February 23 to a low of 82% at year-end (Hanke and Schuler, 2002). The Central Bank received foreign reserves through the IMF loan on September, but has depleted them by lending to commercial banks and indirectly supporting the market of government bonds, since government bonds were used as collateral for many loans.

The holding of domestic assets and varying of the ratio of foreign reserves to monetary liabilities meant that Central Bank engaged in a discretionary policy of sterilized intervention, which a classical Currency Board does not advocate. The problem with the policy was that it forced a monetary authority to attempt to hit simultaneously two possible incompatible targets – an exchange rate target and money supply target. The convertibility system thus eventually encounter the problem common to all pegged exchange rates: which target to hit when the two come into conflict? Argentina chose the money-supply target, which meant giving up fixed exchange rate regime.

To remember 1991, the year when Currency Board has been approved, Argentina has been suffering triple digit inflation, and couldn't find its way out of the problem. In a matter of approx. 1-1.5 year the inflation as well as the rest of the public finances had been stabilized (see Figure 3). Despite currency crisis contagion in other countries during the period (European Monetary system crisis in 1992-1993, which led to a huge number of speculative attacks against European currencies and failure of Bank of England to protect pound against Soros attack) Argentina withstood the period very well and even managed to bring down its inflation rate from more than 80% in the end of 1991, to just 17.6 by the end of 1992, and to around 7% by the end of 1993 (Bloomberg Market Data, 2010). Currency Board definitely deserves part of the credit for stabilizing inflation. As seen from the graph below, inflation soared as Currency Board has been abandoned and Argentina never managed to bring inflation down to the level of what they had under Currency Board.

Argentina successfully withstood Asian crisis in 1997, Russian crisis in 1998 and dot.com bubble in 2000, but "soft" negligent attitude towards Currency Board, variation of exchange rate management, dubious political actions, prolonged recession and talks about overvalued currency led to regime abandonment. Even though Hanke and Schuler (2002) argue that there were not many signs indicting currency overvaluation, weak government as well as public disputes, were the main factors leading to Currency Board withdrawal and subsequent peso devaluation.

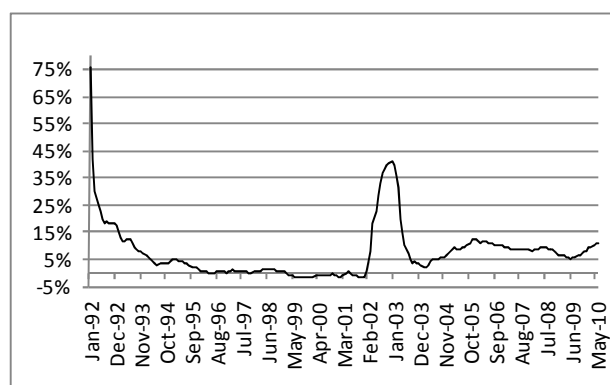


Figure 3. Inflation in Argentina, %

### Currency Board in the current economic crisis

The third part of the article is dedicated to recent financial developments in Iceland and Baltic States. Firstly, we examine the "miracle" of Iceland's economy and investigate the main reasons of what went wrong in previously glorified economy. Secondly, we take a closer look at the Baltic States economies with an attempt to justify the benefit of Currency Board.

**Iceland – from "economic miracle" to reality.** Before the crisis Icelandic people had one of the highest incomes in the world and Icelandic banks and companies were buying up huge swathes of the British High Street (ELTA, 2009). Iceland privatized and deregulated its banking system in 2001, assured strong government support and allowed their banks as well as external debt to grow approx. 10 times the size of their economy (Varblane, 2008). With an economy that become increasingly dependent on financial services, the global financial crisis began to affect Iceland in 2007, despite the fact that Iceland's banks had limited sub-prime mortgage market exposure. As three major banks were nationalized confidence dried up, Central Bank of Iceland was forced to abandon its attempts to peg the Icelandic krona at approx. 130 krona per euro in order to save all foreign reserves they had. The next day the Icelandic krona was trading at approx. 340 per euro following the trading restrictions the day after (see Figure 4). Icelandic krona trading have been suspended a number of times which took different forms and legislations, eventually stabilizing at a level of approx. 180 krona per euro – i.e., 50% lower comparing to the level of pre-crisis period (Bloomberg Market Data, 2010).

Moreover, the financial turmoil led to a huge economic downturn and exacerbated fundamentals: unemployment rose from 1% to approx. 8-9%, inflation – from 5% to 18%, OMX Iceland 15 index fell by more than 90%, banking sector end up frozen with many lawsuits and disputes from other countries.

Was there a single chance for such a small and open economy to avoid immense depreciation and keep its exchange rate stable? The answer is negative, at least not with a floating exchange rate regime. The other question is whether Currency Board regime would have been a viable alternative which could save Iceland from severe depreciation.

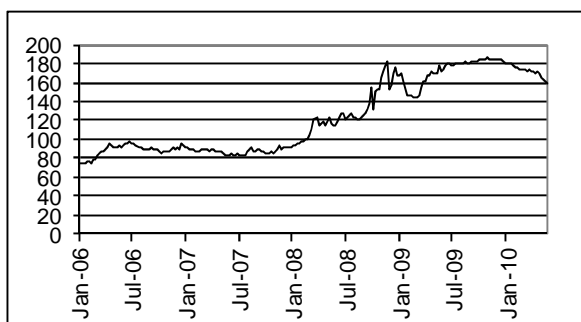


Figure 4. Spot rate of euro and Icelandic krona, EUR/ISK

As Iceland financial sector collapsed there were many concerns about the future of the Baltic States (Melnikas, 2008a). While comparing Iceland and Estonia financials Varblane (2008) underlines 3 core differences between the countries: a) the size and importance of banking sector in the economy, b) the exchange rate system, and c) public debt and stabilization reserves. The author concludes that fighting against devaluation is costly for small Icelandic Central Bank and almost impossible to execute alone. It requires extraordinary measures like the restriction on capital outflow. As Varblane (2008) infers the exchange rate system was an important fact which led to such a different scenarios for two countries: survival of the Baltics and crash of Iceland (Mistzal, 2009; Saboniene, 2009; Gailius, 2009; Ginevicius, 2009; Melninkas, 2008b).

**Baltic States – a good example of Currency Board during the global crisis of 2007-2010?** Despite many speculations and preconceived notion that eventually the Baltic countries will have to abandon their exchange rate regime and devalue national currency due to weak fundamentals such as huge current account deficit, real estate bubble, overvalued currencies etc., the Baltics managed to withstand the darkest period (Belinskaja & Galiniene, 2010; Pilinkus, 2010; Martinkus, Stoskus, Berzinskiene, 2009). Moreover, there are many fundamental signs of stabilizing financials, banking sector and improving trade balance. As from the graph below (Figure 5), 5 year EUR currency denominated credit default swaps (CDS's) are steadily stabilizing at a level of 100 and 200-250 in Estonia and Lithuania, respectively. Decreasing CDS's indicate diminishing risk of government loan default that foreign investors (government bond buyers) conceive. For instance, in the beginning of 2009 Lithuania 5y EUR CDS peaked at approx. 800 bps, meaning that a bond (debt) investor willing to hedge his positions in case of Lithuania default shall be paying as much as 8% of the underlying loan size.

Interestingly, CDS of Lithuania and Estonia were following pretty much the same pattern, and the spread only widened recently, after Estonia was officially invited to join euro zone in 2011.

The fear of devaluation in the face of global crisis let interbank interest rates to 7% and 10% in Estonia and Lithuania, respectively. However, as the risk faded away and interbank interest rates converged to the euro interest rate level. As shown in the graph below (Figure 6) interbank interest rates of most common 6 months term plummeted in 2010, and currently stands at the level of

2005. The spread between VILIBOR and EURIBOR widened to as much as 8% at the peak of turmoil, bottoming out at 1% in the beginning of 2010.

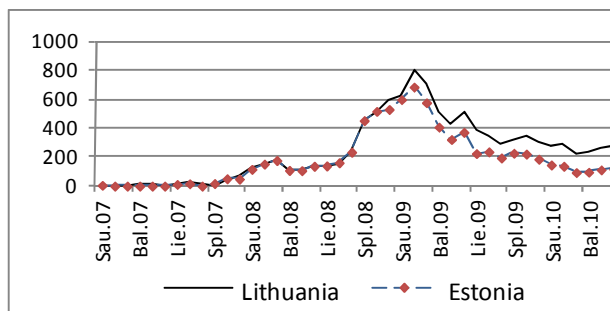


Figure 5. Five year euro currency denominated credit default swaps (CDS) of Lithuania and Estonia

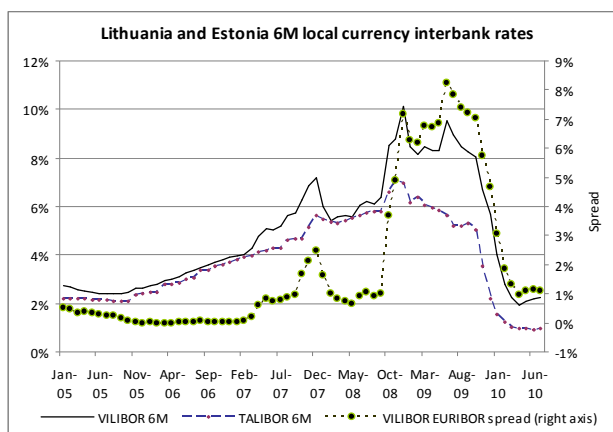


Figure 6. Lithuanian and Estonian 6 month local currency interbank interest rates, %

One of the most important economic activities which demonstrate intensity of pressure on the local currency is current account balance. As current account deficit widens for a prolonged time the pressure on currency increases, signaling the overvalued exchange rate and uncompetitive export goods. From the graph below (Figure 7), Lithuania and Estonia had incurable account deficits for many years, but the account has completely shifted into surplus within less than one year signaling an easing pressure on local currency.

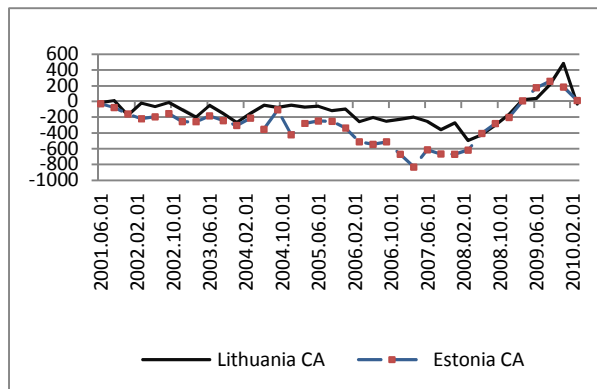


Figure 7. Current account balance of Lithuania and Estonia from 2001 to 2010, EUR mln.

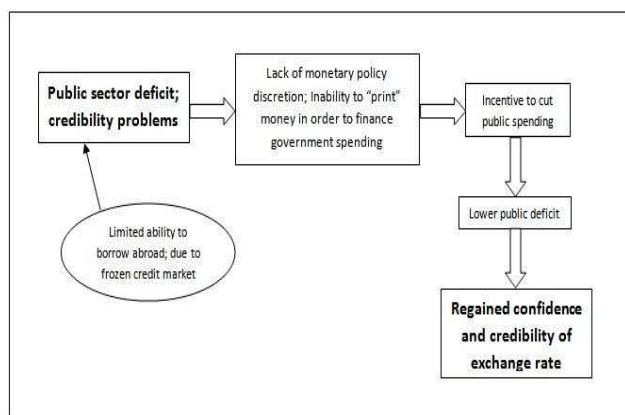
On the other hand, there are plenty of exacerbated economic indicators such as high unemployment rate, huge government deficit (in Lithuania only), unprecedented GDP contraction and falling real estate prices. Current ground of the Baltic States is still fragile and highly dependent on the global situation; however major Scandinavian banks (Nordea Markets, 2009) are seeing first “green shoots”.

Recently, Lithuania managed to borrow quite a substantial amount in international capital markets by issuing international USD and EUR denominated bonds. Both, Estonia and Lithuania, stayed on their own without borrowing from IMF, which would have imposed heavy fiscal restrictions. Lastly, both countries managed to keep their currency stable despite close geographical relations with Latvia, which had the worst situation and was unconventionally put as the trouble-spot in the Baltic region.

While assessing Currency Board effect on Lithuania Alonso-Gamo, Fabrizio, Kramarenko, and Wang (2002) conclude: “The Currency Board served Lithuania well since its inception. It encouraged adjustment in unstable political environment with populist pressure, which, in turn strengthened credibility...>”. IMF conjectures that Lithuania could barely withstand the Russian crisis of 1998-1999 because of its close trade relations under any other exchange rate regime than Currency Board.

When asked about Currency Board advantages to Lithuania during the current crisis, S. Hanke (2009) replied that Currency Board definitely mitigated the pain of the global crisis. He thinks that “things would be worse if Lithuania had any other type of exchange rate regime”. He also blames EU commission and the ECB for prohibiting Lithuania from joining the EMU just because of inflation being hundredth above the requirement.

The concept of self-stabilizer mechanism may serve as a valuable generalization of the discussion. The mechanism discloses that lack of monetary policy discretion and inability to “print” money seeking to finance government spending, as it is required under Currency Board, enables to avoid inflation and regain confidence and credibility of exchange rate. Therefore, the self-stabilizer mechanism clearly reveals benefits of the Currency Board (see Figure 8).



**Figure 8.** The concept of self-stabilizer mechanism

When a small and open economy is experiencing economic downturn and is not able to generate enough income to support its public spending the public sector

deficit emerges. Lithuania suffered an unprecedented economic contraction in 2008-2009 and ended up with 8-10% budgetary hole, huge credibility problem and risk of currency devaluation. Due to Currency Board rigidity Lithuania was not able to use any monetary policy (quantitative easing) and was forced to drastically cut its public spending as it was the only option government had. The austerity measures had to be even stricter, because of liquidity contagion around the international capital markets and consequential inability to borrow abroad. As Lithuanian government was forced to implement severe austerity measures and in fact did it successfully, the confidence and credibility with respect to the currency was regained.

To our mind, Currency Board in Lithuania played an extremely important role in keeping the exchange rate stable during the 2008-2010 global economic downturns. Moreover, the Currency Board was an important trigger which forced Lithuanian government to cut public expenditures hereby working as an automatic stabilizer.

### Conclusions

This article examined the determinants of the sustainability of Currency Boards during the financial and economic turbulence.

Currency Board is a hard peg regime, where Central Bank has no discretionary power to pursue monetary policy and is only eligible for assuring the maintenance of appropriate level of foreign reserve currency. The regime is said to have the following advantages: credibility gains and stability, inflation remedy, trade benefit and public sector stabilizer effect. Currency Board has material drawbacks as well: no discretionary policy option, susceptibility to external crises and impediment of timely currency adjustment of trade imbalances.

Speculative attacks against Estonia and Hong Kong confirms the fact that Currency Board requires strong banking sector and support from government in order to withstand the speculative attack.

The failure of the Argentine Currency Board was largely due to the lack of credibility in keeping the Currency Board functioning, which made the Currency Board highly vulnerable to changes in expectations.

Due to openness and relatively small size of the economy, Iceland suffered a severe devaluation, thus, when comparing Iceland with the Baltic States, the authors suggest that Currency Board regime was an important provision for the success of the Baltics and failure of Iceland during the recent crisis.

Recent financial indicators suggest a significant improvement in the Baltic State’s interbank interest rates, current account balance, risk of currency devaluation and public sector balance. Both Estonia and Lithuania recorded positive GDP growth figures in the 2Q of 2010 and once again strengthened the recovery fact. The Currency Board is credited for its adherence to the overall credibility of economies with respect to keeping exchange rate stable.

The public sector deficit stabilizer effect is a concept, which in case of a big budgetary deficit, disallows discrete monetary policy and forces government to implement austerity measures at the same time restoring confidence within the whole economy.

In conclusion, the role of Currency Board regime is significant particularly in small and open economies as it has been proved in the paper. Economic crises are easier to cope with the Currency Board and such countries successfully fight inflation, achieve faster economic recovery, and maintain greater fiscal and monetary

discipline. Stable exchange rates, disciplined rule-based nature promote both trade and investment. Lithuania is not an exception of this rule and, thanks to the Currency Board regime, it could withstand the Russian crisis of 1998-1999 and the pain of the present global crisis was not as hard as it might be without the Currency Board regime.

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#### **Valiutų valdybos modelio vaidmuo ekonominės krizės sąlygomis**

Santrauka

Paskutiniaisiais dešimtmečiais mokslinėje literatūroje valiutų valdybos modelis vis labiau analizuojamas. Vietinės valiutos kurso susiejimas su stipresne užsienio bazine valiuta buvo labai populiarus 1990 m., pereinant buvusioms komunistinėms šalims iš planinės ekonomikos į rinkos ekonomiką. Valiutų valdybos modelis leido daugumai šalių išvengti skaudesnių ekonominių pasekmių per 1997-1998 m. Azijos ekonominę krizę, per 1998 m. Rusijos finansinę krizę, per dot.com burbului sprogius 2001 m. ir per paskutinę 2007-2010 m. pasaulinę ekonominę krizę, kurios mastai prilyginami 1930

m. „Didžiosios depresijos“ mastams. Valiutų valdybos modeliu buvo suabejota po to, kai Argentina jo atsakė ir buvo priversta devaluoti savo valiutą. Valiutų valdybos modelis buvo kritikuojamas dėl tų pačių trūkumų, kurie atsiranda ekonomikoms funkcionuojant aukso standarto sąlygomis. Kita vertus, kaip vieną iš daugelio sėkmingų valiutų valdybos modelių pavyzdžių galima paminėti Estijos atvejį, kuri 1992 m. įvedė valiutų valdybos modelį, 1997-1998 m. atlaikė spekuliacinius puolimus ir 2011 m. įsivedė eurą.

Šio straipsnio tikslas – išanalizuoti valiutų valdybos modelio vaidmenį skirtingais ekonominio nuosmukio laikotarpiais ir nustatyti šio modelio pranašumus ir trūkumus, remiantis daugiausia mažos atviros rinkos ekonomikos sąlygomis. Tikslui įgyvendinti buvo taikyti sisteminė ir lyginamoji mokslinės literatūros analizė, statistinių duomenų analizė, loginės abstrakcijos ir apibendrinimo metodai. Valiutų valdyba šalies ekonomikoje tampa reikšmingu mokslinės analizės objektu dėl paskutiniojo ekonominio nuosmukio sąlygotų iššūkių. Dauguma mokslininkų, nagrinėdami valiutų valdybos modelį, paprastai gilina tik į vieną atskirą atvejį (pvz., Argentinos ar Honkongo), todėl teoriniuose ir empiriniuose valiutų valdybos modelio tyrimuose pasigendama sisteminio požiūrio.

Tarptautinis valiutos fondas apibrėžia valiutų valdybą kaip „monetarinį režimą, kuris yra aiškiai įteisintas ir ipareigojantis keisti šalies vietinę valiutą į tam tikrą užsienio valiutą fiksuotu kursu, atsižvelgiant į užsienio valiutos kiekį reguliuojančios institucijos apribojimus“ (IMF, 2004). Tai reiškia, jog vietinės valiutos kiekį galima didinti šalyje tik tuo atveju, jei yra papildomi užsienio valiutos rezervai, kas užkerta kelią tradicinėms šalies centrinio banko funkcijoms (pvz., pinigų kiekiu šalyje kontrolei ar centrinio banko kaip paskutinio skolintojo garantui) ir nepalieka vietos diskretinei monetarinei politikai. Kaip teigia E. Levy-Yeyati and F. Sturzenegger (2003), valiutų valdyba yra „susitarimas keisti vietinę valiutą fiksuotu kursu į užsienio valiutą, prie kurios buvo pririšta vietinė valiuta, o šalies centrinis bankas veikia pagal iš anksto apibrėžtas monetarines taisykles“. Žvelgiant iš praktinės pusės, tai reiškia, jog centrinis bankas nevykdo nepriklausomos monetarinės politikos, o pinigų pasiūlos didinimas arba mažinimas yra galimas tik pasiremiant intervencija į užsienio valiutų rinką.

Galima išskirti keletą valiutų valdybos modelio pranašumų. Vienas iš pagrindinių pranašumų yra valdybos modelio sąlygotas pasitikėjimas nacionaline valiuta, o tai skatina infliacijos mažėjimą bei drausmingesnę fiskalinę politiką, t. y. šalies vyriausybės privalo subalansuoti savo biudžetą, jei jos nebegali pasiskolinti piniginių lėšų vidaus ar išorės finansų rinkose. Ghosh, Gulde ir Wolf (1998), nagrinėdami tarptautinio valiutos fondo šalis 1970–1996 m., nustatė, jog valiutų valdybos modelį taikančiose šalyse infliacijos lygis buvo apie 4 % žemesnis.

Valiutų valdybos modelio sąlygota ekonominė disciplina ir nuspėjamumas – dar du šio modelio pranašumai. Kaip ir bet kokia fiksuoto valiutos kurso sistema reiškia, jog bet kada nacionalinę valiutą galima pakeisti tuo pačiu kursu į bazinę valiutą. Kadangi nacionalinė valiuta būna pririšta prie užsienio valiutos, kuria gyventojai pasitiki, tai sukelia gyventojų pasitikėjimą ir nacionalinę valiutą. Be to, esant valiutų valdybai, centrinis bankas neteikia paskutinės vilties paskolų. Dėl to komerciniai bankai tampa atsargesni ir apdaresni.

Būtiną išskirti ir valiutų valdybos modelio trūkumus. Pasak Ghosh ir Ostry (2009), šie trūkumai yra trys. Pirmiausia, toks valiutų režimas smarkiai suvaržo makroekonominės politikos priemones, tačiau labiausiai – šalies banko vykdomą monetarinę politiką. Kitas valiutų valdybos modelio trūkumas yra sietinas su pažeidžiamumu, esant finansiniam nuosmukiui, pavyzdžiui, blogam skolos valdymui, kapitalo srautų sumažėjimui, atėjus bankų krizei. Trečia, valiutų kurso režimas stabdo išorinį susireguliovimą laiku, o tai daro neigiamą įtaką šalyje kuriamam produktui ir vykdomai ekonominei veiklai.

Straipsnyje apžvelgiami istoriniai valiutų valdybos modelio atvejai Estijoje, Honkonge, Argentinoje ir Lietuvoje. Estijos ir Honkongo atvejai atskleidė valiutų valdybos naudą, o Argentinoje teko šio modelio atsisakyti. Kaip teigia Grigaliūnas ir Navickas (2000), valiutų valdybos režimas leidžia apsaugoti šalies centrinį banką nuo spekuliacinių puolimų tik tuo atveju, jeigu šalies bankinė sistema yra stabili. Jeigu šalies vyriausybės politika nėra skirta fiksuoto valiutos kurso režimui palaikyti, tai valiutų valdybos modelis nėra „saugus uostas“, siekiant išvengti šalies valiutos kurso nuvertėjimo.

Estijos kronos spekuliacinį puolimą Skandinavijos ir Londono bankai pradėjo po to, kai tarptautinėje ekonominėje literatūroje Estija buvo sulyginta su Tailandu ir jai buvo pasiūlyta atsisakyti valiutų valdybos modelio. Spekuliaciniai puolimai nesukėlė esminės žalos Estijos finansų sistemai, o skandinaviškas kapitalas netgi įsigijo Estijos dviejų didžiausių bankų kontrolinius akcijų paketus. Estijos pavyzdys aiškiai parodo, kaip valiutų valdybos modelis gali padėti išvengti valiutos kurso nuvertėjimo mažoje atviroje ekonomikoje, nors daugelis valstybių buvo priverstos nuvertinti savo valiutą, pvz., Tailandas batą, Indonezija rupiją, Tainanas dolerį, Rusija rublį ir t. t.

Sudėtingesnis atvejis buvo Honkonge, nes jis laikomas vienu iš stambesnių finansinių ir verslo centrų pasaulyje, todėl nebuvo galima akiai pasitikėti vien valiutų valdybos modelio efektyvumu prieš spekuliacinius puolimus. Honkongo valdžia išikišo į rinką ir suvaržė spekuliuojančių subjektų poveikio ribas. Pagrindiniai spekuliaciniai puolimai vyko 1997 m. spalį, 1998 m. sausį, birželį ir rugpjūtį. Sukilusios palūkanų normos lėmė tai, jog Honkongo ekonomika, kuri smarkiai priklauso nuo nekilnojamojo turto ir finansinių paslaugų sektorių, 1998 m. sulėtėjo 5 %. Dvi savaites trukusi Honkongo vyriausybės intervencija į akcijų rinką, siekiant nubausti valiutų spekuliantus, buvo kritikuojama ir laikoma žalinga šiam pasauliniam finansų centrui. Kad ir kaip būtų, vyriausybės įsikišimas buvo veiksmingas, o valiutų valdybos modelis aiškiai padėjo išsaugoti Honkongo dolerio stabilumą.

XXI a. pradžioje Argentinoje teko atsisakyti valiutų valdybos modelio ir nuvertinti vietinę valiutą. Anot Hanks ir Schuler (2002), valiutų valdyba šioje šalyje iki galo nebuvo niekada suprasta, tiek vertinant jos stipriąsias, tiek silpnąsias puses. Būtiną pažymėti ir tai, jog Argentinos peso kursas buvo pervertintas, susiejant jį su JAV doleriu, todėl Argentinos ekonomika tapo nekonkurencinga ir šios šalies ekonomika nebeaugo. Nors Argentinai pavyko sėkmingai atlaikyti 1997 m. Azijos krizę, 1998 m. Rusijos krizę, 2010 m. dot.com ekonomikos burbulą, tačiau nerūpestingas požiūris į valiutų valdybą, abejotini vietinių politikų sprendimai ir kitos priežastys lėmė tai, jog teko atsisakyti valiutų valdybos modelio.

Žvelgiant į paskutinį pasaulinės ekonomikos sulėtėjimą, išskirtinis Islandijos ir Baltijos valstybių atvejis. Prieš ekonominę krizę Islandijos gyventojai turėjo didžiausias pajamas visame pasaulyje. 2001 m. reorganizavus bankų sistemą, užsienio valstybės skola palaipsniui tapo 10 kartų didesnė nei Islandijos ekonomikos apimtys (Varblane, 2008). Dėl to globalinė finansų krizė 2007 m. palaipsniui pradėjo daryti įtaką ir Islandijai. Kai trys stambiausi Islandijos bankai buvo nacionalizuoti, pasitikėjimas Islandijos bankų sistema išnyko. Be to, nedarbo lygis išaugo nuo 1 % iki 8 – 9 %, infliacija – nuo 5 % iki 18 %, Islandijos akcijų rinkos indeksas nukrito 90 %, šalies bankiniam sektoriui buvo iškelta daugybė bylų, kurias inicijavo subjektai iš užsienio valstybių. Esant tokioms sąlygoms ir turint kintamąją valiutos kursą, nėra jokių galimybių išlaikyti stabilų šalies valiutos kursą. Tačiau būtent valiutų valdybos modelis galėjo padėti Islandijai ir išgelbėti ją nuo kronos nuvertėjimo.

Sugriuvus Islandijos finansų sektoriui, pradėta nuogausti dėl Baltijos valstybių ateities. Tačiau, lyginant Estijos ir Islandijos ekonomikas, galima įžvelgti tris pagrindinius skirtumus: a) bankinio sektoriaus dydis ir vaidmuo šalies ekonomikoje; b) valiutų kurso keitimo sistema; c) valstybės skola ir stabilizavimo fondo rezervai (Varblane, 2008). Šie skirtumai ir valiutų valdybos modelis leido Baltijos šalims išvengti Islandijos scenarijaus. Lietuvos ir Estijos valstybių kredito rizika buvo ilgą laiką panašaus lygio. Tik kai Estija buvo oficialiai pakviesta įsivesti eurą 2011 m., jos kredito rizika išlieka žemesnio lygio, palyginti su Lietuva. Didžiausias skirtumas tarp VILIBOR ir EURIBOR siekė 8 %, tačiau 2010 m. pradžioje šis skirtumas jau tesiekė 1 %. Nors Baltijos šalių ekonomika vis dar išlieka labai trapi ir priklauso nuo pasaulinių tendencijų, tačiau Skandinaviško kapitalo bankai Lietuvoje jau įžvelgia pirmuosius ekonomikos atsigavimo požymius. Lietuva ir Estija sugebėjo išvengti TVF paskolos, kurią paėmus būtų uždėti griežti finansiniai apribojimai valstybei. Abi šalys sugebėjo išlaikyti stabilų valiutos kursą, nors Latvijai tai sekėsi sunkiausiai ir yra finansinių neramumų židinyje Baltijos regione.

Apibendrinant rezultatus galima teigti, jog spekuliaciniai puolimai Estijos ir Honkongo atveju įrodo, jog efektyviam valiutų valdybos modelio veikimui reikalingas stiprus bankinis sektorius ir valstybinės valdžios išikišimas laiku, siekiant išvengti neigiamų spekuliacinių atakų pasekmių. Argentinos nesėkmė iš esmės buvo sąlygota pasitikėjimo valiutų valdybos modeliu stoka bei kitomis vidinėmis šalies aplinkybėmis. Paskutiniai Baltijos valstybių pavyzdžiai įrodo, jog valiutų valdybos modelis yra veiksminga priemonė mažai atvirai ekonomikai, siekiant išlaikyti stabilų vietinės valiutos kursą.

Raktažodžiai: *valiutų valdybos modelis, ekonominė krizė, valiutos kurso režimas, spekuliaciniai puolimai, Baltijos šalys.*

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