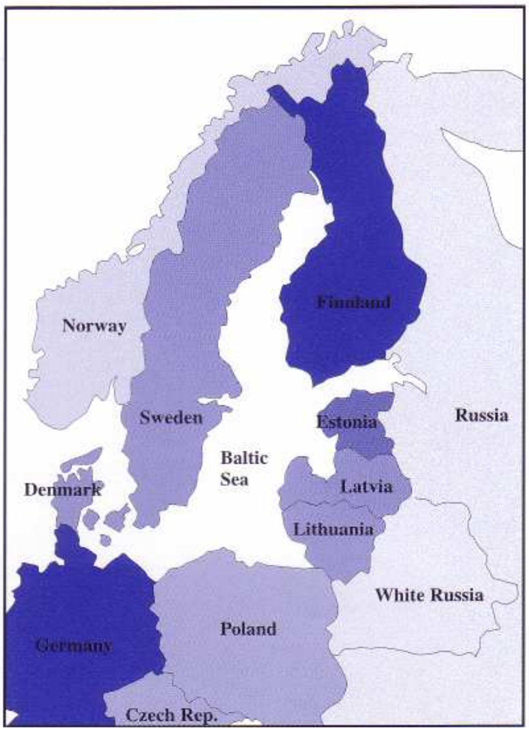
Euro

The Euro - Benefit or Handicap for Baltic Economies ?



With the beginning of the European Economic and Monetary Union (EMU) Baltic economies were faced with a new economic power, which already exist with the European Community, but now face a new dimension. What effects has the introduction of the Euro for the economic relationship of the Baltic region and what does it mean for each single state ?

Euroland - a New Dimension Is Formed Up

Since January 1 st **1999 the Euro** is the common currency of 11 states of the European Communityl; this is the reason why this Euroland can be considered economically as a domestic-market. A comparison with the previous economic world-powers shows that Euroland has formed the leading trading nation of the world. With round about 292 million inhabitants2 the population is twice as big as in Japan and 8 pc bigger than in the USA. Total exports in 1997 amounted to 760 billion ECU3, approximately 20 pc of world expor,ts, while the exports of the USA of 606 billion ECU only amounts to 16 pc and those of Japan to 10 pc. The imports of Euroland of 671 billion ECU are clearly smaller than the exports, hence Euroland made a trading surplus of about 90 billion ECU whereas the USA with round about 792 billion ECU are the Import-World-Champions and therefore have to accept a strong deficit in their Balance of Trade of about 186 billion ECU. In fact, with a view to the Gross National Product (GNP)4 the USA with 7,153 billion ECU are still the biggest economic region of the world, while Euroland only reaching 5,549 billion ECU and Japan only 3,707 billion ECU; but if the GNP of the whole European Community5 is counted, the USA will be displaced to second place.

But not only the Commodity Markets help the Euro to find a strong positon, particulary since there is price stability in all regions with an annual inflation rate of 0.8 to 1.5 pc; also the Capital Markets form a worldwide acceptance of the Euro. Up to now the Deutschmark was the dominant currency in Europe, but on the International Capital Market it only plays a minor role. With the Euro for example a bond market has now arisen which with 80 pc of the US-Bond Market is roughly twice as big as the Japanese Bond Market. Because of its size, depth and width this Capital Market produces new possibilities for international and institutional investors, particulary since the difference in long-term interest rates between the USA and Euroland is only 1/2 nominal pc-point6. Therefore the Euro is, behind the US-Dollar, the second leading currency of the world, whose fundamental data indicates a further consolidation of the stability of the Euro.

Stable Currencies - Basis for Intensive Trading Relationships

But the stability of the Euro, Le. the development of the external value of the currency, has a great influence on the trading relationship of the European Community and therefore also on the states of the Baltic Economic region, whose biggest trading partner is Western Europe. Round about 50 pc of the imports and exports of the three Baltic States Estonia, Latvia and Lithuania were made with increasing tendency within the European Community7, whereas the intra-baltic trade only amounted to 10 pc. Considering that, in the coming two to four years Denmark and Sweden will also join EMU, the Euro dominates in the Baltic Region through which the dependence of the Baltic Region on the development of the external value of the Euro will increase. That means for example, that a stable Euro raises the prices for import goods which endanger the slowly emerging price stability in these countries. This induces potential devaluation of the Baltic currencies and threaten the integration process of the Baltic States. In the short term the Euro therefore constitutes a high political and economic risk because of the high dependence of the Baltic region on the European Community. However a "weak` Euro involves the danger that the exports out of the Baltic region will decrease - and that would weaken on and on the Baltic economies, which have anyhow higher imports than exports. But those theoretical "risks" of the Euro neglect the present integration efforts of the Baltic states and their single exchange-rate arrangements.

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The Euro - Chance for a Rapid Integration

The efforts of the Middle- and Eastern-European nations to join to the European Community are characterized by different intensities. Those of Poland and Estonia are well developed, but there is not yet a real convergence to the European Community. However the link of the Estonian Crown to the Euro as well as the Polish Zloty to a Currency Basket of the USD & Euro will soften the volatility of these currencies against the Euro and therefore contribute to a higher real economic stability. This stability will lead to an increasing trading relationship within the Baltic region and therefore accelerate economic growth and*integration. A similar, but slower development is shown in Latvia, Lithuania and Russia. Latvia and Lithuania for example have already made association agreements with the European Community to accelerate their integration to Western Europe; the Lithuanian currency, the Litas, was already pegged to a currency basket of the USD & the Euro, because barely a half of LithuaniaYs trading relationship was settled within Western Europe. This is the reason why the pegging of the Litas to the Euro shall be intensified. And because of the trading relationship in the mid-term, also Russia could be forced to abandon the link between the Rouble and the US-Dollar in favour of the Euro, as nearly 1/3 of Russias foreign trade is settled with Europe. The increasing trade relationship of the Baltic economies is therefore one reason for a stronger linkage of the single currencies to the Euro. But to sow these exchange-rate agreements on stable real ground, it is imperative to press ahead with other market-conforming reforms. For example, it is necessary to reduce the GovernmentYs influence, to abolish market-entry-barriers, especially for foreigners and to liberalize the capital-, service- and commodity markets. Only the coherence of the Euro and a rapid progress of reforms will have favourable affect on the Baltic region, because with the Euro there is a domestic market of an unexpected dimension for the whole region. The advantages, to profit from the Euro are therefore much bigger than the risks, if there is a link between the currencies and the Euro parallel to an opening of the markets. Also the geographical attachment through the Baltic sea will simplify an intensification of the economic relationship - and also the ethical differences in the Baltic region are much smaller than the discrepancy between North and South Europe. The Euro therefore offers the benefit of accelerating a European integration with economic growth through which the Baltic region could rise in the mid-term to an economic power in North-Eastern Europe.

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