Eurozone enlargement in the Balkans

Description

Since the end of communism in the 1990s, the new currencies have had a triple function in the Balkans, particularly in the Yugoslav area. When they were first adopted, the idea was that they should primarily serve an economic function. But their symbolic and political functions must not be overlooked.

After the disintegration of Yugoslavia, adopting new currencies enabled the new governments to pursue an independent monetary policy. In Croatia, for example, the macroeconomic stabilization program known as the "Valentic Plan"(1) was launched in 1993 with a new currency, the kuna. Croatia returned to modest growth of 0.8% the following year, and a balanced budget was restored. Unlike the other states of the former Yugoslavia, Slovenia opted for an economic policy in line with the recommendations of IMAD(2), the Center for Prospective Macroeconomic Analysis, which had recommended a policy of macroeconomic stabilization and a gradualist economic transition model as early as 1991. A new currency, the tolar, was introduced on October 8, 1991.

Introducing new currencies in these newly-created states was seen as conferring additional legitimacy on the elected authorities. The first free elections of 1990 were not held on a federal scale but on different dates in each republic, thus reinforcing the legitimacy of the republican and nationalist elites and the emergence of many ethnic parties. However, the adoption of new currencies also had a symbolic dimension since it was intended to support the national identity of the majority ethnic group in a context of separation and distinction from the other peoples of the former Yugoslavia. It was also intended to underline historical continuity. The kuna was used in the Middle Ages and during the Second World War as part of the independent Croatian state. The kuna's symbolic function is matched by its political role, as it is used in the rhetoric of political parties.

Furthermore, it is necessary to distinguish between the use of the euro as a national currency and formal membership of the eurozone when the country becomes a member of the European Monetary Union. In the Balkans, we need to distinguish between countries that have adopted the euro without being part of the eurozone and without having followed the necessary steps and conditions to adopt the common currency as their national currency (Montenegro and Kosovo) and countries that are formally part of the eurozone and have therefore had to meet the necessary conditions (Slovenia, Croatia).

Montenegro and Kosovo: Euroisation without eurozone membership criteria

The political and historical conditions that led to using the euro as the national currency are specific to these two states. The hyperinflation characteristic of the 1990s in Serbia and Montenegro led the Montenegrin government, on November 2, 1999, to declare the dinar and Deutsche Mark (DM) legal tender in the country. Then, at the beginning of 2001, the Deutschmark became the country's official currency, even though Serbia and Montenegro formed a common state. In 2002, the disappearance of the Deutschmark in connection with Germany's transition to the euro naturally led Montenegro to adopt the new European currency as well.

In Kosovo, until 1999, many transactions were carried out in Deutsche marks, US dollars, or Swiss francs. This was due to a large Kosovo Albanian diaspora in Germany, the USA, and Switzerland. Following the NATO bombardment of Serbia and Montenegro (which ended in June 1999), UNMIK (the United Nations Interim Administration Mission in Kosovo) decided on

September 3, 1999, that the Deutsche Mark would be the main currency. However, the Dinar remained in circulation, mainly in northern Kosovo. As in Montenegro, when the German currency gave way to the euro on January 1, 2002, Kosovo adopted the euro. Recently, at the beginning of 2024, the Albanian authorities in Pristina attempted to ban the use of the dinar in the Serbian parts of northern Kosovo and impose the euro, demonstrating once again the political dimension of monetary policy.

So*, de facto,* Montenegro and Kosovo have "adopted" the euro without meeting the conditions for membership in the eurozone.

Slovenia and Croatia: enlargement of the eurozone

Slovenia was the first Eastern European country to adopt the euro on January 1, 2007. The tolar had a short life of 15 years. In 2006, Slovenia successfully met the conditions set out in the Maastricht criteria for membership of the Monetary Union(3). Since then, the country has enjoyed steady growth and slowly continued its reforms. For example, privatization of the banking sector was not completed until June 2019, 29 years after the start of the transition.

Croatia adopted the euro on January 1, 2023. The benefits of this transition are manifold: firstly, Croatia will be able to take advantage of the economic power of the EU and, in particular, benefit from a high borrowing capacity from the European Central Bank. Secondly, the European currency should provide the country with more excellent protection against inflation and, consequently, greater stability, particularly in times of economic crisis. Finally, adopting the euro should benefit the tourism sector, which is vital to the country's economy. However, fears of a resurgence in inflation have emerged among the population. This was confirmed in 2023, with inflation hovering around 7% in the final quarter, down from the peak at the beginning of the year but higher than in other eurozone countries.

Bosnia-Herzegovina: from Deutsche mark to convertible mark

Due to the hyperinflation affecting the Yugoslav dinar, the Deutsche mark was widely used in Bosnia-Herzegovina. After the Dayton Accords were signed in December 1995 and the international administration of post-war Bosnia-Herzegovina was set up, the country decided to change the name of its currency and introduce a Convertible Mark (KM or *konvertibilna marka*). The first banknotes were printed in 1998. Following Germany's transition to the euro, Bosnia-Herzegovina retained the Convertible Mark as its currency.

Can we speak of a currency board in this specific case? A currency board aims to find a solution to compensate for the loss of credibility of the currency; technically, this board is a monetary authority managing a fixed exchange rate with an international currency (in the case of the Balkan countries, the euro). The currency board(4) in Bosnia-Herzegovina is the result of this situation imposed by the country's international administration.

Serbia and Northern Macedonia: two cases apart?

After the fall of Slobodan Milosevic on October 5, 2000, a group of 17 economists opposed to the former regime addressed the question of Serbia's monetary policy, meeting within the framework of the G17. As elsewhere, priority was then given to macroeconomic stabilization, and reforms, notably privatizations, were carried out rapidly, even though the reform of the financial systems had not yet been completed. Serbia has enjoyed monetary stability and sustained growth for more than a decade. As a result of the war in Ukraine, monetary policy was tightened to ensure continued stability in the face of inflationary risks. The monetary policy pursued with the Serbian dinar for more than ten years enabled the country to weather the crisis of 2008 and the period of the pandemic.

After proclaiming its independence on November 20, 1991, North Macedonia introduced a national currency. The denar was introduced on April 26, 1992. The Macedonian government quickly adopted a monetary policy to combat inflation and ensure stability. As a result, the national currency was pegged to the Deutsche Mark. In May 1993, the new denar was introduced. In 1998, the denar was indexed to the euro.

On the scale of the ex-(or post-)Yugoslav area, Croatia's accession to the euro zone in January 2023 (as well as to the Schengen area on the same day) represents the culmination of an integration process that began three decades ago and now marks new border lines.

Notes:

(1) Nikica Valentic (Prime Minister of Croatia from 1993 to 1995) implemented a macroeconomic stabilization program in 1993.

(2) Institute for macroeconomic analysis and development.

(3) Nebojsa Vukadinovic, “Slovenia”, in *Central and Eastern Europe Scoreboard*, Les études du CERI, 2007.

(4) Sabrina Silajdzic, “The currency board trap: the case of Bosnia and Herzegovina,” *International Journal of Applied Econometrics and Quantitative Studies*, 2005, pp. 47-79.

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Link to the French version of the article

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