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The Role of Currency Board Regime during Economic Crisis

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Abstract

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.

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