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Overvalued or Undervalued Euroland Entry?

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Abstract

This study addresses the question of the conversion rate upon joining the European Union with respect to the accession countries of Eastern Europe. The article argues in favour of an undervalued exchange rate in order to promote income generation in the new member countries. For this purpose a strategy of managed float is proposed. Countries not having the preconditions to pursue such a strategy should adopt a currency board arrangement.

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This study was carried out in collaboration with ACE-Project Nr. P98-1065-R, ‘Monetary and Exchange Rate Strategies related to the Current European Union's Enlargement Process’.

Parts of this study were written during Hölscher's research stay at the Halle Institute for Economic Research. Stimulating discussions with staff, in particular Hubert Gabrisch, Axel Brüggemann, Bogdan Gorokhovski, Thomas Linne and Johannes Stephan as well as financial support are gratefully acknowledged. The views expressed are those of the authors and do not necessarily reflect those of the National Bank of Poland.

1. The original ERM-II system worked under the conditions of partly symmetrical economies with one dominant player in Frankfurt, whereas now a number of relatively small economies are entering an economic mega-bloc. The original regulations on intervention are seen as in particular need of inflation adjustment and revision.

2. The author's anecdotal evidence points to ski-lifts in Zakopane imported from Austria.

3. This ‘Balassa-Samuelson effect’ features prominently in the transition literature despite the fact that it is a long-run (based on PPP for tradable goods) empirical approach.

4. This is the difference between transition countries and the US, where the Federal Reserve can pursue a policy of income targeting without considering the exchange rate of the US Dollar.

5. ‘The Czech National Bank is today intervening on the foreign exchange market with the aim of weakening the Czech Koruna's exchange rate’, (Czech National Bank, 4 April 2002).

6. The option of devaluation has been ruled out above anyway. This is the reason why the proposed strategy is labelled here as ‘stability oriented undervaluation’.

Additional information

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