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# The Euro in Historical Comparison to the Ruble and the Influence of Overconfidence.

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## Abstract

This paper deals with the structured comparison of the former ruble monetary union with the euro currency area. As a basis, developments in the ruble currency area and in the Eurozone are traced. In a comparison of the central components of the currency areas, similarities, such as the heterogeneity of the states, and differences, for example the role of the central bank and the legal foundations of the currency area, are outlined. Subsequently, the significant historical exit causes of the states from the Soviet Union out of the ruble currency zone are presented. In addition to obvious structural factors, such as the unequal power structure, also practical reasons, such as the insufficient provision of cash for some areas, are considered. Regarding overconfidence, the sub-categories overestimation and overplacement can be detected mainly regarding the behavior of the administration of the former USSR. The third sub-category, overprecision, can primarily be found in the behavior the European Central Bank and their efforts to stabilize the Euro. Based on the findings, the conclusion can be drawn, that there are certain parallels between the two currency areas. However, the available options for action and mechanisms at the political and economic level in the Eurozone today are more wide-ranging than at the beginning of the 1990s in the ruble currency area.

**Keywords** - Euro, Ruble, Financial Crisis, Overconfidence, Behavioral Economics

## 1. Introduction

With his words "Whatever it takes", the President of the European Central Bank, Mario Draghi, allegedly kept the euro currency area from breaking apart on July 26, 2012. His famous sentence was preceded by a multi-year process, which initially started with the US subprime crisis. While public reporting often put Greece first and foremost, it were

also the so-called peripheral states that faltered. As a result, the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) were implemented as instruments to support stumbling states, ultimately saving the Euro as their uniting currency. However, the effect of the words Draghi, which led to a noticeable turnaround, should not be underestimated. For example, regarding the readmission of yields for ten-year government bonds in the Eurozone (European Central Bank, 2015). Behind this development stands the promise of the central bank to supply the market with virtually unlimited liquidity. Critics see in this approach and in the special position of the European Central Bank (ECB) clear parallels to the disintegration process of the ruble currency zone in the early nineties. Critics argue, that both monetary areas lack (lacked) a common economic policy to survive in the long term (Mayer, 2015). In the following, it will be examined which parallels between the ruble currency zone and the euro currency area actually exist and which conclusions can be drawn for the future of the Euro.

In order to enable a structured approach to the two complex currency areas, a brief introduction on the history of the ruble currency zone as well as recent developments in the Eurozone are provided first. Building on this, the comparative study of central features of the two currency areas follows. Here, the complex interdependencies and interactions within the currency areas become clear. The subsequent analysis of the historical reasons for withdrawal from the ruble currency area reveals how complex and sometimes unusual these were. At the same time, fundamental political change in the former Soviet Union always played an important role. In this context, also the potential influence of overconfidence is discussed. The latter especially relates to the historical reasons for the disintegration of the ruble currency area but also applies to certain aspects of the comparison between the two currency zones. The concluding chapter summarizes and qualitatively evaluates the findings and finally concludes whether the decline in the ruble currency zone can be used to draw conclusions for the Eurozone.

Overconfidence is a concept of behavioral economics which consists of the three subcategories overestimation, overprecision and overplacement (Moore and Healy, 2008). Overestimation describes the common observation, that people tend to overestimate their capability and cleverness when comparing themselves to others. Additionally, overplacement refers to the human tendency to generally rank own achievements higher than the successes of others. Moreover, overprecision describes the observation, that people are overly certain regarding own estimations and judgements (Bazerman and Moore, 2012). Overconfidence is considered one of the fundamental concepts in behavioral economics due to its widespread impact on decision making outcomes. Among a variety of effects, overconfidence is held responsible for marked bubbles, entrepreneurial failure, mismanagement and even man-made catastrophes such as war (Bazerman & Moore, 2012). Moreover,

overconfidence serves as a catalyst when it comes to other biases and heuristics people regularly rely on (Plous, 1993).

## **II. The History of the Ruble**

As a result of the Soviet Union's collapse in December 1991, the twelve former republics of the USSR (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, Belarus), as well as the three Baltic states (Estonia, Latvia, Lithuania), which had previously regained their independence, formed the ruble currency zone. As a result, the disintegration process of the currency area, which began as a by-product of the political disintegration, continued in an economic dimension. It should be remembered in the following considerations that there were not just modular changes within a system, but rather a complete system transformation in the whole area (Jacobsen & Sokov, 2004). In a first step, Estonia, Latvia, Lithuania and the Ukraine left the ruble currency zone in 1992, whereupon the pressure on the remaining states steadily increased. The introduction of parallel currencies had become inevitable, partly due to the cash shortage which will be examined in this paper in greater detail (Berthold, Braun & Coban, 2014).

In addition, there was a sharp increase in consumer goods prices and a rapid reduction in real gross domestic product (GDP). In Georgia for example, the real GDP fell by 20.6 percent in 1991 and 44.8 percent in 1992. Another example is Kyrgyzstan, where the real GDP fell by 5.0 percent in 1991 and 19.0 percent in 1992 (European Bank for Reconstruction and Development, 1999). In the following year 1993, the inflation rate in Georgia was 7,487.9 percent and 1,363.0 percent in Kyrgyzstan as also presented in figure 1 (European Bank for Reconstruction and Development, 1999). Russia, Kazakhstan, Uzbekistan, Armenia, Belarus and Tajikistan made attempts to negotiate an orderly transition to a new-type ruble currency zone. However, this ultimately failed due to the almost unfulfillable demands from Moscow. Only Belarus undertook serious steps towards the preservation of the Russian ruble in its own territory from mid-1993 (Berthold, Braun & Coban, 2014). These efforts led to the signing of an intention agreement in April 1994, which was apparently caused by a particular interest from Belarus in securing favorable Russian energy supplies (Institut für Weltwirtschaft Kiel, 1994). However, negotiations on a common currency area with Russia continue to this day. Kyrgyzstan, Georgia, Turkmenistan, Moldova and Azerbaijan did not participate in such negotiations and subsequently withdrew from the currency area (Berthold, Braun & Coban, 2014).

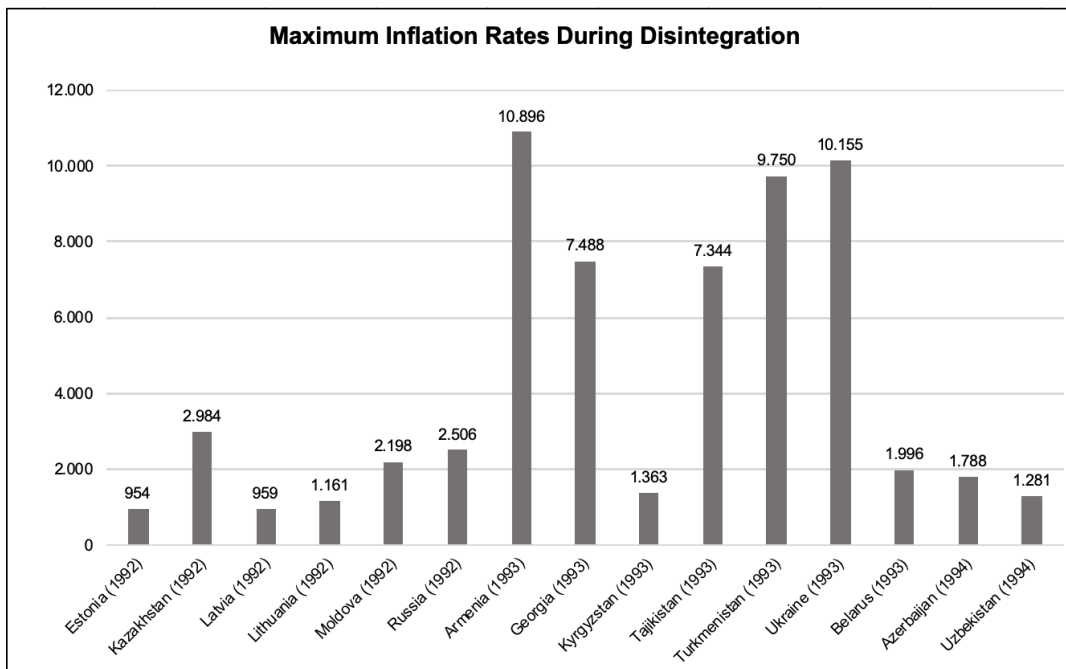


Figure 1 Maximum Inflation Rates. Figure by author, data from European Bank for Reconstruction and Development (1999).

In addition to the failure of negotiations at bilateral levels, agreements on future cooperation at the level of the Commonwealth of Independent States (CIS) could not be reached either. For example, the founding treaties of the CIS contained only non-specific statements on the coordination of economic and monetary policy. Moreover, the agreement of the central bank directors of the CIS on the implementation of an interbank council in May 1992, which was intended to provide solutions to the urgent monetary policy problems, could not prevent further decay of the ruble currency zone (Sieburger, 1993).

### III. Recent Developments in the Euro Area

The crisis in the euro area can be described as the interplay of a banking and a public sector as well as a growth and competitiveness crisis (Shambaugh, 2012). Particularly problematic is the crisis of confidence, created by the combination of different factors, which ultimately raises doubts on the stability of the euro area as a whole (Bofinger et al., 2012). This became particularly clear on the example of Greece. In October 2009, it was announced that the new debt of Greece with 12.5 percent of the GDP actually was significantly higher as it was stated by the previous government (sovereign debt crisis). Yields on Greek government bonds afterwards rose sharply. Critics argue that the euro was initially so popular at the political level, because the financing of government deficits was potentially cheap and almost of unlimited availability.

However, as a result of the crisis, the euro lost its previously assigned function of a currency which allowed reliable cheaper borrowing for all member states (Mayer, 2014). From 2009 onwards, a declining real gross domestic product was observable in Greece. Compared to the previous year, the GDP fell by 4.3 percent in 2009, by 5.5 percent in 2010 and by as much as 9.1 percent in 2011 (growth and competitiveness crisis) (Eurostat, 2015). Consequently, tax revenue also declined, and the already overburdened state budget could only be supported by further loans. The resulting increase in public debt necessitated austerity programs, which additionally weakened the already burdened domestic economy. Unemployment continued to rise, peaking in late summer 2013 at 27.9 percent (Eurostat, 2015a). Within these developments, banks came under increasing pressure due to accumulative risks from their loan portfolios and had partially to be rescued as well (banking crisis).

To counteract the developments in Greece and other countries, far-reaching measures were taken to stabilize the Eurozone. After the first aid program for Greece did not have the desired stabilizing effect on the euro, the euro rescue fund consisting of the European Financial Stability Facility (EFSF), the European Financial Stabilization Mechanism (EFSM) and contributions from the International Monetary Fund, was introduced in 2010 as a supposedly temporary solution (Bundesministerium der Finanzen, 2016). From this program, Greece, Portugal and Ireland were given credit commitments totaling almost EUR 200 billion. The European Stability Mechanism (ESM), with a lending volume of € 500 billion as of autumn 2012, replaced the EFSF and the EFSM as a permanent solution to stabilize the Eurozone. In total, nearly EUR 140 billion of financial aid for Greece, Cyprus and Spain have been provided from this institution by the end of November 2015 (Bundesministerium der Finanzen, 2015). In addition to measures taken by the Eurozone countries, the ECB intervened by continuously reducing the interest rate on main refinancing operations and by buying government bonds. Conclusively, the efforts made an impact, for example on the stabilizing yield of ten-year government bonds and also on the slow decline of record-high unemployment rates in the crisis countries (Handelsblatt GmbH, 2015).

#### **IV. Similarities and Differences**

The degree of parallels between the ruble currency zone and the Eurozone varies depending on the aspect considered. The ruble currency zone emerged as a byproduct to the political disintegration of the USSR. In contrast, the Eurozone is the result of decades of planning and negotiation (European Commission, 2007). Also, due to the determinant characteristics of different political and economic systems, a direct comparison is not always possible. For example, the central bank of the ruble currency zone had clearly different tasks due to its communist character than the ECB today. Also determined by the political system, there was a significant imbalance in the relation of power within the monetary union (Reiter, 2009).

In order to facilitate an orderly comparison of the two currency areas, the first step will be to examine the legal foundations of the Eurozone and the ruble currency zone. Subsequently, the central bank, as the decisive institution of the two currency areas, is compared with their respective systems and their tasks and objectives. Subsequently, the heterogeneity of the states within the currency zones is considered on economic as well as on political level. Finally, each currency area is always exposed to external influences. Depending on the intentions of the respective actor, for example the International Monetary Fund (IMF), the continued existence of a currency area is either supported or questioned.

### **A. Legal Basis of the Currency Area**

In 1970, a commission of experts led by then Luxembourg Prime Minister, Pierre Werner, presented the so-called Werner Plan for the gradual introduction of fixed exchange rates within the member states. A scheme in the sense of this plan was introduced in March 1973 with the so-called snake in the tunnel. A range of exchange rates was introduced between the currencies of the states of Belgium, Italy, Germany, France, Luxembourg and the Netherlands, which fluctuated with a maximum deviation of 2.25 percent (Kleinheyer, 1987). Afterwards, in 1989, the Delors Report, named after the then President of the Commission, proposed a three-staged introduction of an Economic and Monetary Union. In the first stage, starting in the summer of 1990, the free movement of capital between the member states and increased cooperation between the individual central banks were implemented. Likewise, a liberalized use of the European Currency Unit (ECU) was introduced in 1979. In the second stage, from 1994 on, the establishment of the European Monetary Institute (EMI), the prototype of today's ECB with the aim to coordinate the monetary policy of the member states, was implemented. As of January 1<sup>st</sup> 1999, the euro was finally introduced as book money in what were then eleven countries. In order to make this possible, exchange rates were irrevocably fixed, and the competence of a single monetary policy was transferred to the European System of Central Banks (ESCB) consisting of the ECB and the central banks of the member states (European Central Bank, 2011).

In addition to the Delors Report, the European Treaty of Maastricht forms the foundation for the current construction of the Eurozone. The treaty signed by the European Council on February 7<sup>th</sup> 1992 contains far-reaching provisions for the European Economic and Monetary Union. In addition to a timetable, providing the deadline for introducing a single currency by the beginning of 1999, the so-called convergence criteria were established. These cover the four levels: price stability, government finances, participation in the exchange rate mechanism of the European Monetary System and convergence of interest rates (Generalsekretariat des Rates der Europäischen Union, 2015).

Compared to the Eurozone, which formed by decades of negotiations and officially concluded multilateral agreements, contracts and competence provisions, the ruble

currency zone was merely a by-product of the political transformation in the former Soviet Union (Sieburger, 1993). In this context, it seems crucial for the existence of a common currency whether the participating states are generally in a process of integration or disintegration. In the light of recent developments in the euro area, increasing integration may not reflect the reality of daily politics. However, in the medium and long term, the general orientation in Europe focuses on integration. Accordingly, the Treaty of Lisbon plans a progressive integration of the people of Europe and thus also of the Eurozone. This initial situation contrasts with the ruble currency zone, where the Gosbank as an instrument of the Soviet administration dominated the whole economic activity. Regarding overconfidence, this setting can be described as a form of overplacement. After years of dependency on Moscow, there was a tendency towards disintegration in the pursuit of independence by the successor states of the Soviet Union. The design of the legal basis should thus be judged as strongly divergent in the comparison of the two currency areas.

## **B. Role of the Central Bank**

In general, the sole objective of the ECB is to ensure price stability. In addition, the economic policy of the monetary union should be supported. This includes, for example, adequate economic growth, full employment and a competitive social market economy. The additional tasks of the ECB are the determination of an adequate monetary policy for the Eurozone, the management of foreign exchange reserves, the conduct of foreign exchange operations and the promotion of payment systems. Another area of responsibilities includes the supervision of credit institutions in the member states (Article 127 (1) TFEU and Regulation (EU) 1024/2013 of the Council of the European Union).

The European Central Bank's policy of maintaining price stability culminates in what is now known as quantitative easing. A process in which the ECB buys government bonds in large volumes to provide liquidity for the financial market in order to eventually avoid deflation (Welfens, 2015). This happens in the form of so-called outright transactions. In addition to the purchase of covered bonds (Third Covered Bond Purchase Programme - CBPP3) and the purchase of asset-backed securities (Asset-Backed Securities Purchase Programme - ABSPP), the ECB acquires government bonds and bonds issued by European institutions in the Extended Asset Purchase Program (EAPP) and the Public Sector Purchase Program (PSPP). In addition, the Outright Monetary Transactions (OMT) are another ECB instrument not yet used (Deutsche Bundesbank, 2016). Critics see the role of the ECB as Lender of Last Resort (LoLR) confirmed (Winkler, 2014). It also makes clear what far-reaching methods are used in order to ensure the stability of the euro at almost all costs. Nevertheless, the achieving of objectives on behalf the ECB is not a trivial task. Despite all the extensive actions taken in the last month and years, the intended inflation rate of under, but

nearly 2 percent could not be reached precisely and permanent by the ECB. This indicates a form of overconfidence, namely the overprecision on the attainment of the desired inflation rate. The latter appears to be a more intricate task than assumed, which also indicates a form of overestimation regarding the ECB's trust in its own ability to handle the situation. This reasoning is supported by claims of the ECB, that despite the use of advanced monetary policy instruments, the goals are still not completely reached yet. (European Central Bank, 2019).

Compared to the tasks of the ECB, the state bank (Gosbank) clearly had different tasks and goals in the communist system of the Soviet Union. In addition to the cash commission, Gosbank acted as a controlling power for the planning authority. The predominantly state-owned companies were obliged to handle their payment transactions exclusively via Gosbank, which opened up the possibility of full monitoring. In this context, Gosbank as an institution was also entrusted with the calculation and collection of company taxes (Sieburger, 1993). In the meantime, the powers of the Russian state bank apparently also included the sanctioning of non-compliant fulfillment by blocking payments or withdrawing credit lines (Müller & Löffenholtz, 1953). Only through moderate reform efforts in 1987 did the Soviet government begin to implement a two-tier banking system (Muth, 1997). However, even after the founding of special purpose banks for individual economic sectors during the banking reform, Gosbank remained authorized to give instructions to these institutions. An efficient credit allocation therefore was unable to happen (Parzer-Epp, 2002). Because of this structure, it is not surprising that at the time of the break-up of the ruble currency zone, the central bank of the Russian Federation (Bank Rossii), which emerged from Gosbank, was still the main financial institution in the banking sector. A short-term and stringent system change could not be carried out within the central bank organization (Messengießer, 1991). Rather, the central banks of each of the successor states, due to their limited powers, were merely branches of the central bank in Moscow, with all the limitations in power that came with it (Berthold, Braun & Coban, 2014). The situation in the ruble currency zone outlined above was undoubtedly gridlocked and dominated by the past. The latter included the application of old systems as well as the application of old courses of action. In contrast, to the far-reaching instruments and powers of the ECB made an impact while responding to the recent world financial crisis. In addition, there is a detailed legal framework in which the ECB operates, and which deliberately regulates competences, for example in monetary policy, which was absent in the ruble currency zone (Gaitanides, 2005). Regarding overconfidence, a number of possible applications appear to explain certain behavior during the disintegration process. On the part of the Bank Rossii, the willingness to stay in the ruble currency zone for the former Soviet states apparently was overestimated.

### **C. Heterogeneity of the Currency Area States**

The diversity of individual states within a currency area can come with a considerable potential for conflict. Depending on the legal terms of the cooperation, there is a varying degree of incentive for governments to act opportunistically. The latter was particularly true for the ruble currency zone, as its construction at the political level missed critical regulations (Parzer-Epp, 2002). How different the countries of the ruble currency zone were, in terms of their economic performance, can be measured by comparing the so-called net material product in a material product system (MPS). For example, Tajikistan had an MPS of only 1,046.07 rubles per capita in 1990, while in the same period the value in Estonia was 3,454.90 rubles (Muth, 1997). Comparing the GDP in the Eurozone, Luxembourg for example reached USD 119,488.00 in 2014, compared to only USD 21,648.00 in Greece (Statistisches Bundesamt, 2015). Another indication for the heterogeneity of the states of the euro area, albeit varying in intensity, can be deducted from the standard deviation of inflation rates. At a high point in early 2010 for example, inflation rates were nearly three times as far apart as shortly after the introduction of the euro (Berthold, Braun & Coban, 2014).

In addition to the economic factors, the question of heterogeneity also arises at the political level. With regard to the ruble currency zone, the disintegration from the political system of communism has to be considered. Not only sections of economic life, but the entire economic system changed after the political collapse of the Soviet Union. For example, the share of GDP produced by private companies in the Russian Federation in 1991 was only 5.0 percent, compared to 50.0 percent in 1994 (European Bank for Reconstruction and Development, 1999). Similar developments, from planned state-owned enterprises to market participants in a liberalized environment, also arose in other countries of the ruble currency zone (Herr, 1999). However, the previously highly interdependent trade between the former Soviet republics was increasingly hindered by inconsistent political decisions. Foreign trade and in particular customs regulations changed permanently, which made the medium- or long-term planning of a stabilizing economic policy almost impossible. In addition, an increasing number of privately-owned companies met a financial system which was still determined by the planned economy within the framework of the described system change. Thus, after the abolition of state pricing and quantity planning, credit institutions continue to satisfy the funding needs of companies largely blind (Stadelbauer, 1994). In conclusion, both currency zones consist of different countries with varying economic power. However, efforts at the political level, both national and supranational, are different.

### **D. External Influence**

The International Monetary Fund (IMF) had an external influence on the disintegration process of the ruble currency zone. However, apparently the attitude of the IMF changed during the course of the existence of the ruble currency zone. While

still skeptical on the introduction of independent currencies in the former Soviet republics in April 1992, the ruble currency zone of individual states with individual currencies was openly supported later in the same year. The support was fueled by the promise of the IMF to provide loans. Critics complained that the IMF's initial refusal implicitly promoted the economic problems of the individual states which consequently led the uncoordinated disintegration of the ruble currency zone (Muth, 1997). The latter was most likely not intended by the IMF but appeared anyway. However, this behavior potentially was caused by initial overconfidence, in the form of overplacement, which made the IMF propose that individual currencies for the successor states of the USSR were unfavorable.

In addition to the IMF, the increasing influence of external creditors in the former Soviet Union, who had an interest in stable economic and political conditions for reasons of risk, should be noted. After the period from 1940 until 1987, where an official budget deficit was only reported in three years from the Soviet Union, the demand for loans from western banks emerged rapidly in the late eighties (Birman, 1981; Shelton, 1989). From 1987 on, the total external liabilities of the Soviet Union and the successor states increased by almost 120 percent within six years (Elborgh-Woytek, 1998). Apparently, a significant portion of the Soviet Union's budget was paid for by creation of credit. For example, the review of statistical data from 1987 revealed a non-matching revenue position of 146.4 million rubles (Shelton, 1989). The government was well aware that such behavior could not be sustained in the long term and therefore resorted to borrowing abroad. Thus, it is an indirect external influence of the creditors, which became possible only in the course of the political disintegration process and the associated step-by-step opening up of the Soviet Union. A parallel to the Eurozone regarding external influence does not arise in the extend of the ruble currency zone.

## **V. Historical Reasons for Leaving the Ruble Currency Zone**

The historic causes of the ruble currency zone can only be reconstructed by considering the specific historical, political, economic and geographical developments of the former Soviet Union (Berthold, Braun & Coban, 2014). There was a clear desire from the successor states to seize the historic opportunity and to get rid of the economic instructions as well as the political ruling from Moscow. It is almost self-evident that under these conditions a continuing ruble currency zone or at least an orderly leaving process was extremely unlikely. Obviously, this was also recognized by the Russian Federation as the strongest remaining member, which apparently changed its strategy over time. In 1992 and 1993, loans amounting to some 2,200 billion rubles were made available to the former Soviet states in order to maintain trade within the Russia Federation (Korowin, 1994). As early as in the summer of 1993 however, after the introduction of the new Russian Ruble, the central bank of Russia forced a harsher policy and thus urgently exempted the remaining states from the ruble (Korowin,

1994a). The imbalance of power on the political and economic level did not allow them to stay in the ruble currency zone without accepting all the conditions set up by Moscow (International Monetary Fund, 1992). Apparently, this was a key exclusion criterion for the majority of states. In addition, persisting problems, such as the lack of cash supply or the consequences of a monetary policy that did not fit the individual economic needs, became more acute. These factors further accelerated the disintegration of the ruble currency zone.

### **A. Inconsistent Power Relations**

In the power structure of the ruble currency zone, it seems obvious that the Russian Federation, because of its relatively strong economic power, has made central decisions largely autonomous (Kaiser & Maull, 1995). In the consideration of the huge area and the associated economic possibilities of Russia compared to the other states, it soon becomes clear that this was an unequal balance of power. The latter leads to the conjecture, that overplacement was exhibited here. The economic dependency of nearly all states of the ruble currency zone on Russia faded slowly during the disintegration process. However, doubts about the ability of Russia to manage the situation became ever louder (Wagner & van Selm, 1995). There was also a general climate of political suspicion on the side of the successor states towards Moscow. For the national governments in order to preserve their political credibility, leaving the ruble currency zone was basically the only viable option.

In addition to growing interstate friction, there were also divergent ideas in the Russian Federation regarding the new design of an economic policy. This for example became obvious in the constitution that came into force at the end of 1993. The latter contained unmistakable unitary state elements and prohibited the formation of individual (that is to say Moscow-deviating) economic policies (Schneider, 2001; Korowin 1994). From the last two aspects it can be concluded that strong internal as well as external political pressure drove the tendency towards disintegration. In retrospective, a lasting continuation of the ruble currency zone was no longer feasible after 1991, since when the remaining states conducted negotiations only at a bilateral level. In this respect, it was almost impossible to reach a consensus on the continuation of the common currency at the multilateral level (Korowin, 1994). Nevertheless, considering the post-USSR power relations, it appears that Moscow overestimated its bargaining power, which eventually accelerated the whole process of disintegration.

### **B. Lack of Cash Supply**

Within the ruble currency zone, only the central bank of the Russian Federation had the right to issue banknotes. Consequently, the supply of republics with cash from Moscow seemed coupled with the status of political relationship. For example, Turkmenistan, received nearly three times the cash flow which would have been distributed evenly, calibrated by means of the net material product. In contrast, Latvia was almost completely cut off from cash supply (Muth, 1997). However, the individual

central banks of the Soviet Union's successor states, as branches of the central bank in Moscow, were allowed to provide daily due deposits as loans without any restrictions on volumes. In order to finance the considerable deficits, the possibility was actively used. This resulted in increasing inflation rates within the ruble currency zone, for example, in the territory of the Russian Federation of more than 2,500 percent in 1992 (Poser, 1999). The impact on the economic performance of the countries involved was consequently serious. In the years from 1992 to 1994, real GDP fell by an average 11.97 percent per year as also presented more detailed in table 2 (Herr, 2002).

| Grow Rates of the Real GDP |      |       |       |       |       |       |
|----------------------------|------|-------|-------|-------|-------|-------|
|                            | 1989 | 1990  | 1991  | 1992  | 1993  | 1994  |
| Armenia                    | 14,2 | -7,4  | -17,1 | -52,6 | -14,8 | 5,4   |
| Azerbaijan                 | -4,4 | -11,7 | -0,7  | -22,6 | -23,1 | -19,7 |
| Estonia                    | -1,1 | -8,1  | -13,6 | -14,2 | -9,0  | -2,0  |
| Georgia                    | -4,8 | -12,4 | -20,6 | -44,8 | -25,4 | -11,4 |
| Kazakhstan                 | -0,4 | -0,4  | -13,0 | -2,9  | -9,2  | -12,6 |
| Kyrgyzstan                 | 4,0  | 3,0   | -5,0  | -19,0 | -16,0 | -20,0 |
| Latvia                     | 6,8  | 2,9   | -10,4 | -34,9 | -14,9 | 0,6   |
| Lithuania                  | 1,5  | -5,0  | -6,2  | -21,3 | -16,0 | -9,5  |
| Moldova                    | 8,5  | -2,4  | -17,5 | -29,1 | -1,2  | -31,2 |
| Russia                     | -    | -4,0  | -5,0  | -14,5 | -8,7  | -12,7 |
| Tajikistan                 | -2,9 | -1,6  | -7,1  | -29,0 | -11,0 | -18,9 |
| Turkmenistan               | -6,9 | 2,0   | -4,7  | -5,3  | -10,0 | -18,8 |
| Ukraine                    | 4,0  | -3,4  | -11,6 | -13,7 | -14,2 | -23,0 |
| Uzbekistan                 | 3,7  | 1,6   | -0,5  | -11,1 | -2,3  | -4,2  |
| Belarus                    | 8,0  | -3,0  | -1,2  | -9,6  | -7,6  | -12,6 |

Table 1 Grow Rates of the Real GDP. Figure by author, data from European Bank for Reconstruction and Development (1999).

The reason for the rising inflation rates, caused by the bank money creation in the ruble currency zone, can theoretically be described using the so-called tragedy of the commons (Muth, 1997). Due to the unregulated creation of book money, each state could increase its own seigniorage by using this instrument as intensively as possible. However, the costs were ultimately paid by the entire currency area (Wolf, 2013). The basically uncooperative action, which was only intended for a short-term own advantage, seemed inevitable due to the already mentioned lack of trust between the successor states (Wagner & van Selm, 1995). Regarding overconfidence, this behavior seems to be rooted in overplacement of almost all successor states above each other. However, the situation appeared to be too complex and multivariant to just be caused by overplacement. In order to implement a countermeasure in response to skyrocketing inflation rates, conversion factors were introduced with significant discounts on book money from the different states in relation to the ruble value proposed by the Russian Federation. As a result, the problem of undersupply of cash ruble increased even more. The latter was consistently accepted with a parity of 1: 1,

which meant that the cash ruble became all the more in demand, as the book money ruble lost in value (Thanner, 1993).

### **C. Diverging Monetary Policy Goals**

Formally, the Russian Federation alone took decisions on the monetary policy of the ruble currency zone (Heydemann & Vodicka, 2014). However, these decisions were constantly counteracted by the already outlined creation of book money in the individual successor states. The Soviet-established approach of the Gosbank to ensure the redemption of approved loans from its branches initially continued in the ruble zone. As a result, the ruble currency zone's central banks were able to extend the central bank's balance sheet in Moscow continuously. Consequently, it was virtually impossible to fix the monetary policy centrally in Moscow, even if it was done formally (Muth, 1997). Sanctions to combat opportunistic behavior were completely absent in the ruble currency zone (Parzer-Epp, 2002). Concerning overconfidence, Moscow apparently overestimated the obedience of the successor states and did not expect such behavior.

Additionally, the absence of long-term forecasts made it impossible to manage money supply on the basis of inflation rates or money volume in the market. Moreover, the lack of monetary autonomy and the lack of monetary policy instruments as well as the missing corresponding implementation channels on the part of the central bank troubled the effective achievement of monetary policy objectives (Elborgh-Woytek, 1989). Therefore, the implementation of the latter took some time, even after the collapse of the ruble currency zone. Apparently, this delay was also caused by insufficiently qualified staff in the central banks (Prindl, 1992). This circumstance also limited the individual states in developing individual economic strategies after the collapse of the Soviet Union. The latter would have required significantly different monetary policy interventions in the different countries. It was only through the introduction of parallel currencies in the form of coupons that the ruble-exiting states were able to gain access to cash. The implementation of full-fledged national currencies and autonomy over their monetary policy followed subsequently. For example, in Uzbekistan and Kazakhstan a restrictive monetary policy was successively implemented. By contrast, the government of Turkmenistan continued to use monetary policy specifically to finance state-owned enterprises and, in this context, obliged banks to lend it with negative real interest rates (Elborgh-Woytek, 1989).

### **D. Momentum During Disintegration**

As already described, the costs of the opportunistic behavior of individual states were paid by those remaining in the ruble currency zone. In addition to the problem of book money creation, two other system-related triggers were apparently responsible for rising inflation rates. Firstly, the liberalization of the markets and the related liberalization of prices from 1992 onwards revealed that inflation was previously hidden by state pricing of consumer goods (Antczak, 2001). On the other hand, as a

result of the currency changeover from ruble into the respective new national currency, unfavorable exchange rate conditions or exchange rates made it attractive to either buy goods in cash in the countries still remaining in the ruble currency zone or to exchange remaining cash ruble in western currencies. The effects of both actions were almost identical. The amount of ruble in the remaining ruble currency zone continued to rise, thus worsening the inflationary effects of a disproportionate expansion of the money supply (Muth, 1997). It is plausible that states were therefore eager to leave the ruble currency zone as soon as possible.

As the Russian Federation apparently became aware of the impossibility to handle these developments at the end of the ruble currency zone and subsequently undertook various efforts to counteract the continued existence of the currency area. For example, Russia demanded a final conversion of old ruble loans into hard currencies from the last remaining states. The latter would then either have been repaid with interest or redeemed by the transfer of state assets. As a result of these demands, countries such as Kazakhstan, which were oriented towards Russia before in order to not lose access to ruble loans, turned against the ruble currency zone and left (Thanner, 1993). This final act indicates, that the Russian Federation eventually implicitly or explicitly became aware of overconfidence in their former actions and adjusted their strategy accordingly.

## **VI. Conclusion and Outlook**

The causes of disintegration of the ruble currency zone were complex and ranged from structural problems, such as the power structure, to practical problems, such as the poor cash supply. Moreover, different monetary policy objectives were caused by the heterogeneity of the countries in the currency area. Once disintegration has begun, it was difficult to be stopped because of the mutually reinforcing circumstances. With regard to the euro area, a differentiated analysis is needed to be able to answer whether certain exit causes from the ruble currency zone are likely to repeat themselves today. It seems, that the legal structure of the currency area and in particular the role of the central bank is decisive.

A certain imbalance in terms of power relations can also be determined for the Eurozone. For example, Germany has repeatedly dominated important decisions due to its size and economic power. However, there are mechanisms in the euro area that take the principle of "one vote per member country" into account, especially in the case of central monetary policy decisions in the council of the ECB. In addition, the rotational regulation, practiced since the beginning of 2015, ensures the ability to act continuously as the number of member states increases (European Central Bank, 2009). However, this regulation comes with the risk that individual member states feel left out, which in turn could lead to withdrawal considerations (Berthold, Braun & Coban, 2014).

In the context of cash supply in the Eurozone, there was and is a constant discussion on the significantly different TARGET2 balances of individual member states. Through this payment system and policy instrument, an indirect quantitative increase in money stock took place, mainly in the so-called peripheral countries (Sinn & Wollmershäuser, 2011). However, the rather narrow legal context should be noted here. In the ruble currency zone, the uncoordinated book money creation was left as a remnant from Soviet times, whereas TARGET2 is used in the Eurozone due to differentiated agreements.

The independence of the ECB and its competence in determining the monetary policy, goes hand in hand with the restricted room for maneuvers of individual states, for example regarding the management of inflation rates. The governments therefore run the risk of being put under pressure between national requirements and European agreements, as the need for adjustment increases (Berthold, Braun & Coban, 2014). In a pointed scenario, the exchange of governments and possible efforts to leave the currency area are conceivable. An exit dynamic in the way of the ruble currency zone only seems possible if the first examples of the Eurozone's struggling countries show a much more positive development after leaving the Eurozone than before. However, this scenario is considered unlikely, above all due to high conversion costs and the expected above-average capital flight (Blankert & Breitschneider, 2012). Nevertheless, the recent efforts of Great Britain leaving the European Union demonstrate that the costs of leaving are taken into account out of mainly political motives (The Guardian, 2019).

The ruble currency zone opens up questions that are also relevant for the Eurozone. However, the specific historical context must be taken into account. In the disintegration process of the Soviet Union, the continuance of the common currency was excluded almost early on. For the Eurozone, the question arises as to whether the integration path that has been started can be continued or whether the events of recent years have already overburdened confidence in a European future. The configuration of a further integration could possibly range from the introduction of a European fiscal authority up to a full political union (Gabrisch, 2013). However, it remains questionable whether further levels of integration are enforceable in the current political environment. Concerning overconfidence, the ruble currency zone as well as the Eurozone exhibit particular traits. Nevertheless, the measures to react are more advanced in today's Eurozone than they were in the successor states of the USSR.

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