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FINANCIALISATION IN THE POST-YUGOSLAV REGION:
MONETARY POLICY, CREDIT MONEY AND DOLLARIZATION

*FINANCIARIZACIÓN EN LA REGIÓN DE POST-YUGOSLAVIA: POLÍTICA
MONETARIA, DINERO CREDITICIO Y DOLARIZACIÓN*

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ABSTRACT

This paper considers long term processes of financialisation in the former and post-Yugoslavia. Regional monetary policy has since the 1980s defended the value of credit money in order to facilitate international capital flows. It is argued that the monetary system of fixed exchange rates, inflation targeting and capital account liberalisation has institutionalised the subordinate financialisation and dollarization of the region. However the origins of dollarization are found in the historic dependency of the productive sector on foreign currency credit imports.

Keywords: Financialisation; Dollarization; Euro; Transition Economies; Southeast Europe.

RESUMEN

Este artículo analiza el proceso de financiarización a largo plazo en la ex- y en la post- Yugoslavia. Desde 1980, la política monetaria regional ha defendido el valor del dinero crediticio de cara a facilitar las entradas de capitales internacionales. Defendemos que el modelo monetario basado en tipos de cambio fijos, metas de inflación y liberalización de la cuenta de capital ha institucionalizado la dolarización y la financiarización subordinadas en esta región. Sin embargo, los orígenes de dicha dolarización se encuentran en la dependencia histórica del sector productivo de créditos para la importación denominados en divisas.

Palabras clave: Financiarización; Dolarización; Euro; Economías en transición; Sudeste europeo.

JEL codes: P2, F31, F33, F36.

1. INTRODUCTION

The aim of this paper is to consider the role of monetary policy in engineering the subordinate financialisation and dollarization of the post-Yugoslav region. In studies of the region, dollarization, or currency substitution, is considered primarily as the result of the historical loss of confidence in the national currency as a store of value due to long periods of macroeconomic instability involving high inflation rates (Becker, 2007, Pepić, *et al.*, 2015). According to the quantity theory of money, inflation derives from the excessive supply of money by governments, for example, in order to cover budget deficits. By contrast, we subscribe to the post-Keynesian view that money is endogenous and demand-determined and thus that the central bank cannot fully control the supply of money. From this perspective, we seek to go beyond recent heterodox accounts that emphasise the perverse consequences of regional monetary policy in creating overvalued currencies that promote financial imports over industrial exports (see e.g. Radošević, 2015). Such accounts make a significant concession to the quantity theory of money by accepting that macroeconomic policy is primarily concerned with price stability rather than supporting the circuit of dollarized credit money. This paper takes inspiration from the late Suzanne de Brunhoff's (1967, 1971, 1981, 1986, 2005) reconstruction of the Marxian theory of commodity money for an age of inconvertible, state-backed credit money. Here international money, central bank money and the deposits of private banks must be linked by monetary policy to one another in terms of money's function of general equivalent so as to enable the mutation from one form of money into another (de Brunhoff, 1971). Drawing on this work, it is argued that the monetary regime of regional financialisation is designed to enable credit money to function as measure of value and means of payment, to preserve finance capital imports from devaluation or default.

However, we reject the tendency to reduce processes of dollarization and financialisation to particular policy regimes. The problem is an ahistorical methodology, proceeding from the idea of a transition to the market commencing *ab initio* in 1989, ignoring "longue durée" regional processes of market and financial integration, and issuing in 'varieties of capitalism' (see Bohle and Greskovits, 2007, Drahokoupil, 2009) or forms of 'dependency' (see Nölke and Vliegenthart, 2009) as potentially varied as there are national units. Instead, we consider contemporary monetary policy in relation to the historical

evolution of capitalism as a monetary economy of production and circulation. Its regional origins are located in the crisis of liquidity of the productive sector and the conversion of fixed assets into credit money and foreign currency flight capital; and its role is to anchor the flux and reflux of flows of dollarized credit money. This historically-informed perspective guides our usage of the potentially vacuous term “financialisation”. The latter usually implies a dichotomous view of the relationship between production and finance, as in the idea of a shift from productive to financial investments, (see e.g., Duménil and Lévy, 2011). In fact, the challenge is to explain transformations in the financing of capital accumulation and how these in turn modify the operation of non-financial firms and the crisis tendencies of capital (Toporowski, 2016). Hence, the term financialisation will refer descriptively to regionally specific forms of financial liberalisation, based on the integration of households (Lapavistas, 2013) and non-financial companies into financial markets, and firmly rooted in the inter-relationship between production and finance.

2. MARX'S ‘MONETARY THEORY OF CREDIT’¹ AND REGIONAL DOLLARIZATION

We begin by drawing out the relevance of Marx's theory of the general equivalent for an age of dematerialised state-backed credit money. For Marx, commodity production poses the problem of the social validation of private labours incorporated in different commodities. Money appears as the commodity that expresses the relative value of all the others, as a general equivalent. It is only as a socially accepted measure of value that money can function as an unit of account and thus as a means of circulation. And it is only with the dangerous leap that is taken during the exchange of the commodity against money that private labour shows its properly social character. However, a capitalist economy is more than just a commodity economy. Money is advanced as money capital for the purchase of labour power to produce commodities for sale at a profit. The money capital that sets in motion the monetary circuit is usually advanced by a holder of money reserves at a rate of interest representing a claim on surplus value, and on this basis a credit system emerges, specialising in the management of money capital, to replace the monetary system as an agent of accumulation (de Brunhoff, 1981).

In Marx, credit is deferred payment within commodity exchange. Thus, the ‘monetary constraint’ or sanction can be provisionally deferred. Credit is a social relation different to the one between buyers and sellers originating in commodity exchange. Here, instead of money effecting direct social validation of private labours, it is a private relation that only becomes indirectly socialised because of the productive activities it serves to finance, otherwise remaining a private convention between bank and borrower (de Brunhoff, 1971). However economic crisis reveals that money is not in its principle identical with credit, is

¹ See, de Brunhoff (1967).

no mere unit of account of prices or debt: credit money no longer appears as a pure unit of account within a closed circuit and promises to pay are replaced by demands for hard cash, for money as a store of value. In the present crisis, quantitative easing is precisely a social validation of devalued credit money via its 'conversion' into, that is articulation with, central bank money.

Thus the normal functioning of the monetary system requires reciprocal convertibility of the different forms of money in usage, including the credit flows (bills, cheques, securities, etc.) between commercial banks, financial markets and enterprises (de Brunhoff, 1971). Credit money can only assume its contemporary function of general equivalent when its convertibility into any commodity corresponds to the convertibility of different sorts of money between each other (de Brunhoff, 1971). Convertibility requires the existence of a central bank as pivot of the credit system (Marx 1991), and specific institutional relationships between central banks and commercial banks that guarantee liquidity in credit crises. The structure of payments is dominated by central bank money (notes and reserve deposits) against which scriptural money (sight deposits in private banks) is issued: credit money thus represents a promise to pay the liabilities of the central bank.

The role of monetary policy is not only to assure the general and unrestrained convertibility of monies within the national economy, but also that of domestic against foreign currencies, for the purposes of international transactions, through different exchange rate regimes; and in the face of international capital movements, which can result in the devaluation of the national currency and alter the conditions of convertibility between equivalents. We will argue that post-Yugoslav monetary policy is geared to the conversion of international credit money into domestic credit money so that it may operate as the measure of value, unit of account and means of payment in dollarized economies. Fixed exchange rates formally preserve the value of international credit money by insulating it from exchange rate risk and transferring currency mismatch to borrowers. Following the quantity theory of money, central banks accumulated foreign currency reserves in order to sterilise excess liquidity caused by foreign currency imports. However, foreign currency purchases merely increase the liquidity of the banking sector, fuelling a carry trade chasing cross-currency yield differentials (Gabor, 2010). In our terms, this financialisation of banking is the outcome of the defence of the exchange rate peg in order to enable foreign currency imports to function as domestic credit money. Before developing these points further we turn to the historical origins of regional financialisation and dollarization in the dependence on capital imports and illiquidity of the socialist firm.

2.1. THE ILLIQUIDITY OF THE SOCIALIST FIRM AND DOLLARIZATION

The Yugoslav system of 'self-management', combining national planning with market decentralization of decision making, was predicated on world mar-

ket integration to import the finance and capital goods necessary for export growth. In the crisis of the 1970s, faced with exclusion from EEC markets, enterprises borrowed heavily in dollars, via the domestic banking system, from the international banks to finance capital goods imports. Between 1973 and 1979 investment spending rose from 32.2% to 37% of total social output (Palairret, 2007). The finance-led investment boom was derailed by the international oil and interest rate shocks of 1978-9. As loans had been contracted at floating rates, interest rates leaped from 5.8% in 1979 to a crippling 15.1% in 1980 on a debt of \$18.5bn (Palairret, 2007). Yugoslavia was thus seized by debt crisis.

The growing monetary (foreign exchange) constraint on the financing of capital investment promoted dollarization, that is, the substitution of the currency in which domestic foreign liabilities are denominated for the local currency, as a store of value, unit of account and means of payment. From 1978, the central bank acquired commercial bank foreign currency deposits in exchange for cheap dinar credits. The transition to foreign currency backed domestic borrowing flowed naturally from the export of labour to Western Europe (to cover the structural trade deficit), whose remittances from 1963 encouraged domestic saving in foreign currencies and provided the basis for foreign currency bank lending to clients to finance imports. The new system enabled the central bank to accumulate foreign currency reserves to settle foreign liabilities without creating new debt. Evolving out of the practice of issuing central bank money against foreign currency deposits, the latter became the dominant component of liquid assets in Yugoslavia and close substitutes for state-backed credit money (Lahiri, 1991).

In line with the 'Washington Consensus', successive IMF structural adjustment programmes (1982-85 and 1989-90) sought to control the money supply by targeting inflation (and later through fixed exchange rates) combined with price and capital account liberalisation. The ambition of monetary policy was to check inflationary pressures; to prevent currency overvaluation from cutting into exports and thus interest payments. However, the combination of monetary restrictions and exclusion from international money markets, together with the transfer of export surpluses abroad in the form of debt service, representing a net outflow of income of \$2.1bn in the period 1982-6 (Dyker, 1990), caused a slump in investment of -37.2% in the years 1979-85 (Lydall, 1989). Lydall (1989) estimates that between 1979 and 1985 total social product actually declined at an annual rate of 0.9%. Overnight the entire productive sector was pushed into illiquidity, and after 1985 into net deficit, reaching a staggering 29% of the value of total social product in 1989 (Palairret, 2001). Enterprises responded by shifting this monetary constraint upon the financing of production. Endogenous demand for credit money was accommodated by the banks, forcing the central bank as lender of last resort to monetise enterprise and bank deficits, and in turn accommodate an inflationary wave of credit creation (Gedeon, 1985-6, Chowdhury, *et al.*, 1990). With further fuel

added by currency devaluation, inflation began to spiral out of control and monetary policy struggled to keep the rate of devaluation ahead of the rate of depreciation: between 1980 and 1988, the dinar lost about 60% of its value per annum, while the rate of inflation rose to more than 75% per annum (Lydall, 1989). Given the failure to make internal adjustments equivalent to growing external liabilities, there was only one remaining alternative; namely seigniorage, or the appropriation of purchasing power by the state due to its power to issue legal tender. This inflation tax replaced foreign finance as the source of enterprise liquidity, representing a significant distribution from households to enterprises in the form of loans at an annual rate of 4.4% of total social product (Lahiri, 1991). It also underwrote currency mismatch, that is mounting losses on the foreign currency deposits of commercial banks following exchange rate devaluation. The practice of issuing central money by acquiring foreign currency deposits meant that depreciation had an amplifier effect on liquidity, further stimulating inflation. Eventually money began to malfunction as a store of value with the onset of hyperinflation of 2719% in 1989.

Chronic inflation accelerated “dollarization”, as expectations of devaluation induced households and businesses to hold increasing proportions of their liquidity in foreign currency deposits, whose dinar value increased with devaluation. But, as we saw above, it was not the cause. Pace Friedman, inflation is not always and everywhere a monetary phenomenon, in the sense of the quantity theory where money stock determines prices. If, as in our case, an endogenous expansion in the quantity of credit money fails to realise a corresponding expansion in commodity production due to supply cuts, and the central bank monetises the resulting losses, then the resulting ‘extra money’ (de Vroey, 1984) is inflationary, central bank money presenting a ‘pseudo-validation’ of supply (de Brunhoff, 1981). The state can only ratify, at variable cost, a creation of money which it does not instigate (de Brunhoff, 1986). Inflation, like dollarization, can only be understood in relation to a monetary economy of production, where the monetary constraint of the social validation of private labours in commodity exchange may be deferred by credit but not superseded. Dollarization tendencies were endogenous to a ‘real economy’ dependent on foreign currency imports where credit money was increasingly issued through the acquisition of foreign currency deposits. But it was monetary policy that in the guise of price stability intensified dollarization: through its inflationary ‘socialisation’ of the monetary constraint in order to continue repayment of the external debt it ended up destroying social trust in domestic money as a store of value.

3. MONETARY POLICY AND REGIONAL FINANCIALISATION IN THE 2000s

The defence of the value of credit money and thus money capital is the corner stone of regional financialisation and involves some combination of central bank independence, inflation targeting, fixed exchange rates and capital

account liberalisation. As we have seen, this package was already institutionalised in Yugoslavia in the 1980s. In this period inflation targeting sought to manage exchange rate devaluation in order to produce a surplus of export earnings, while in the post-Yugoslavia in the 2000s it supervised fixed exchange rates designed to preserve the value of imported credit money and loan capital. This difference was itself the product of the earlier form of inflation targeting, which had deprived the productive sector of import goods and monetised the resulting deficits, before collapsing in a spiral of inflation and currency substitution. The continuity between the two periods was masked by the official ideology of 'the transition' which held that the problem was the 'liquidity hunger' of the socialist firm and the irresponsible propensity of state spending to monetise 'soft budget constraints' (Kornai, 1992).

In fact at stake was a new round of forced opening to foreign capital flows in order to repay inherited enterprise debt. Monetary policy now gave up trying to walk a tightrope between making exports competitive internationally and preserving the value of money as unit of account and means of payment. The value of dollarized credit money would be king and the productive sector would suffer the consequences of expensive credit and overvalued currencies. The monetary system would be geared not to financing productive investment but to attracting flows of money capital to finance private consumption, and to supervising the circuit of credit money. The ambition of fixed exchange rates, the lynchpin of regional financialisation, was to prevent: on the one hand, the depreciation of national currencies so as to avert the revaluation of domestic foreign liabilities; and, on the other, appreciative pressures building up due to large capital inflows. High real interest rates and fixed exchange rates were designed to attract foreign credits, enabling the borrowing needed to pay for imports and cover current account deficits. However, expensive money acted as a disincentive to investment in the real economy, while overvalued currencies made exports uncompetitive.

Under these conditions, in the first phase of privatisation in the 1990s, borrowing against assets and then defaulting on the loans became a way of converting illiquid capital assets into money and money capital (Toporowski, 2012). This was a continuation of the endogenous creation of uncovered and involuntary credit money by enterprises in the 1980s, but under conditions of private appropriation of capital gains. It continued the practice of transferring and socialising the monetary constraint on the accumulation of (money) capital. Since Yugoslav banks were directly controlled by member enterprises, including loss-making firms, the huge losses of the banking system (\$13bn by 1991) were in fact equivalent to the uncovered losses of enterprise bank founders (Uvalić, 1992). In the 1990s, the Croatian banks continued to roll-over non-performing loans of nationalised founder enterprises and create new enterprise deposits through the accumulation of foreign liabilities; while the state continued to socialise enterprise losses by repeatedly bailing out the banking system. In Serbia, the banks rolled over founder member debts while directors siphoned off enterprise assets and laundered them as hard curren-

cy exports via offshore banks, thereby piling up major new uncovered losses (Palairat, 2000). In turn, the accumulated foreign currency liabilities could only be settled through the sale of virtually the entire regional banking system to foreign buyers, through capital account liberalisation and thus the extraversion of the financial system.²

The conversion of company assets into offshore money hoards accelerated in the 2000s. Between 2001 and 2010, an incredible \$84.5 billion in “illicit financial flows” is estimated to have left the region, of which Serbia’s share was \$51 billion (Kar and Freitas, 2012). The stage was set for a new form of financial accumulation. Orchestrated by the foreign banks, it articulated the conversion of fixed assets into money capital with the integration of households into financial markets. In the 2000s mortgage loan growth led to rising asset prices, while access to foreign financial markets enabled domestic companies to turn over loans in financial assets; in turn, the ‘wealth effect’ of rising asset prices spurred the expansion of retail consumer loans and speculative investments. The outcome was a form of Toporowski’s (2000) ‘capital market inflation’, centred on the real estate market. Interest rate differentials set Eurozone money capital flows in motion and completed the credit money circuit as arbitrage profits repatriated by the foreign banks. The economics of Marx’s (1991) “fictitious capital” – that is, the capitalisation of money revenues based on the rate of interest, *titles to future values deriving from the virtual liquidation of the productive sector* – was conditioned by the contradictions of the fixed exchange rate regime, which both drew in interest-bearing capital and acted as a disincentive to investment in the real economy.³ This was an unproductive model of economic growth completely dependent on the external dynamics of international financial flows, collapsing with the great financial crisis. The region is once gripped by debt crisis.⁴

3.1. SUBORDINATE FINANCIALISATION AND WORLD MONEY

In line with the Washington Consensus, regional governments have stockpiled foreign reserves in order to make provisions for exchange rate and interest rate risk, that is reversal of short term capital flows to the banking sector, and to ward off appreciative pressures. Following the quantity theory of money, central banks accumulated foreign currency reserves by sterilising excess liquidity caused by foreign currency imports. In our terms, central banks sought to control the rate

² For example, in Croatia the cost to the state of restructuring the bad debts of the newly privatised banking system amounted to 31% of GDP by 1999 (Živković, 2015).

³ In Serbia industrial production in 2010 was barely 50% of 1990 levels, while in Croatia it was still only slightly above 90%. Croatian exports shrivelled from 40% of GDP in 1987 to 19.5% in 2010 and from 39.2% to 24.7% of GDP in Serbia over the same period (Živković, 2015).

⁴ Regional public debt has increased by a magnitude of two to three times in GDP terms since 2008. As a proportion of GDP, public debt as of end of 2015 is: Croatia, 87.69%; Slovenia, 83.27%; Serbia, 77.43%; Montenegro, 66.41%; Bosnia and Herzegovina, 42.18%; Macedonia, 38.59%; Kosovo 13%.

of conversion of foreign into domestic credit money in order to preserve the value of dollarized credit money. Foreign currency purchases however merely increased the liquidity of the banking sector, fuelling a carry trade targeting cross-currency yield differentials and currency appreciation (Gabor, 2010). Under the fixed exchange regime, the money market operations of central banks are in reality conducted with foreign banks. Due to credit dollarization, interest rate policy is ineffective in managing money market liquidity (Tatomir, 2009), while exchange rate market interventions have a perverse tendency to increase it. Administrative limitations ("financial repression") are of little help since they are subverted by direct cross-border lending by parent banks to corporations. The central bank is reduced to a bag man to the foreign currency carry trade.

The interest of the concept of 'subordinate financialisation' is that it links the resulting outflow of capital to the role of world money, the dollar, in anchoring the international financial flows underpinning financialisation (Lapavitsas, 2013). Reserve accumulation is the hoarding of the dollar as world money to enable participation in world trade (means of payment) or to insure against or facilitate financial flows (store of value and means of payment) (Lapavitsas, 2013). It is the acquisition of promises by the US government to pay an intrinsically valueless dollar for every nominal dollar of its debt. As a form of international seigniorage it represents a (virtually) interest free form of official lending to the US, which enables the US to run a record trade deficit, and finances US capital exports. From another perspective, while they are hoarded in central bank vaults as international reserves, or circulate only within dollarized countries, or within dollar-denominated international markets as international means of payment, dollars are unable to purchase US goods and thus represent imports to the same nominal dollar value into the US (Carchedi, 1991).

3.2. WORLD MONEY AND REGIONAL DOLLARIZATION

These properties of world money are a useful starting point for understanding currency substitution, or 'dollarization'. In what follows we distinguish between unofficial dollarization, where assets are denominated or held in a foreign currency even if that currency is not legal tender; semi-official dollarization, or officially bi-monetary systems, where the foreign currency is accepted as a second legal tender; and official dollarization where the national currency is replaced by a foreign currency. In ex- and post-Yugoslavia all these forms of 'dollarization' have at different times been present, representing forms of dependency on the Dollar, Deutsche Mark, and latterly the Euro as secondary international reserve currencies.

3.2.1. OFFICIAL DOLLARIZATION

Countries like Montenegro and Kosovo that adopt the euro become part of the Eurozone monetary system even though they remain outside both the EU and the Eurozone; they are outer peripheries (Becker, 2007). But, as in

the case of official dollarization in Latin America (e.g. Ecuador and El Salvador), there is by definition no central bank or lender of last resort. The local central bank can neither print euros nor share in euros newly issued by the ECB. The supply of money is solely determined by the balance of payments. The dollarized country must find a way to earn euros either by exporting or borrowing. Hence it does not benefit from either 'national' or 'international' Euro seigniorage in the way members of the Eurozone do. Quite the contrary, it cannot devalue against the Eurozone, and external adjustments have a direct impact on the money supply. Like the countries of the Eurozone periphery, dollarized regional economies must save on labour costs; or export labour to the Eurozone (as Kosovo does in large numbers). The expansion of credit money depends in practice on the lending strategies of foreign-owned banks, on the significant interest rate spread on Eurozone and domestic interest rates. It is particularly ironic then that the aim of currency substitution was to construct independent and sovereign monetary spaces: monetary policy has no meaning here. In fact dollarization is a form of international seigniorage, to the value of the difference between Eurozone interest rates and domestic interest rates; a carry trade in the legal tender that removes exchange-rate risk for the lender and transfers interest rate risk to the borrower.

3.2.2. UNOFFICIAL DOLLARIZATION

In the case of 'unofficial dollarization' the national currency is retained, but household saving and bank lending, and public sector and/or private sector liabilities are in the international reserve currency. Private credits and deposits in the region are Euroised, that is, the majority of loans are denominated in Euros or indexed to the Euro.⁵ The basis of this form of dollarized lending to households and companies is two-fold. Firstly, the historic lack of social trust in national currencies (inflationary expectations) as stores of value, the outcome of the processes outlined in section 2.1 above; that is, foreign banks took advantage of the fact that household savings continued to be in foreign currency to market foreign currency denominated credits.⁶ Secondly, the fact that foreign bank lending did not depend on the collection of deposits, but on external financing, necessitated the transfer of exchange-rate risk through foreign currency lending.⁷

⁵ In 2012, 72% of total loans (including indexed loans) in Croatia and 68% in Serbia were in foreign currencies (Becker and Četković, 2015).

⁶ For domestic borrowers, the attractiveness of high risk foreign currency instruments rested on lower interest rates (than domestic currency loans) and expectations that exchange rates would continue to appreciate, or remain fixed to the Euro. In the crisis, the dramatic appreciation of the Swiss Franc and the depreciation of the Serbian dinar against the Euro, and thus the vertiginous increase in the value of debt in local currencies, have transferred a share of foreign bank losses and risk to respectively, Croatian and Serbian households and businesses.

⁷ In the 2000s, foreign currency credits far outstripped growth in domestic deposits, resulting in a dangerous increase in the regional domestic loan to deposit ratio (Becker and Četković, 2015).

In Serbia, Croatia, Macedonia and Bosnia and Herzegovina, dollarization is orchestrated and promoted by unofficial or official fixed exchange regimes and is also characterised by a complete loss of monetary sovereignty. Monetary policy aims to build up foreign currency reserves to back the peg against the Euro and to prevent inflation from undermining monetary stability. As credit, money assumes two forms: as a unit of accounting for loans and debts denominated in a given accounting currency; and as a means of payment for final settlement (de Brunhoff, 2005). Monetary policy in fact constructs the (fixed exchange-rate) framework in which the international reserve currency, that is state-backed credit money, can function as Marx's general equivalent, enabling the convertibility of national units of account, and more particularly the conversion of different credit monies, and thus of means of 'deferred' payment into means of circulation. For the purpose of the exchange rate anchor is to denominate a debt economy in Euros, to enable the international reserve currency to overcome the risk and uncertainty inherent in the salto mortale from one currency, formed under historically and territorially specific conditions of production and circulation, to another, that is, operate as if the international reserve currency were the general measure of value internal to the domestic market, precisely to become (quasi) world money. It is to enable the international reserve currency to function as means of payment, and thus as loan capital, free from exchange rate risk; to smoothly operate as unit of account and store of value, untroubled by inflationary pressures; and, consequently, to enable credit money to complete its circuit. Finance capital exports from the EU are furnished with a *formally* stable, risk free environment. The currency board system of managing fixed exchange rates – in Bosnia and Herzegovina - based on the full convertibility on demand of the money supply into the referent foreign currency, makes clear what is at stake: the operation of the foreign currency as close substitute for domestic money (state-backed credit money), enabling its conversion as international means of payment into domestic means of payment and circulation, that is, currency substitution. This also indicates the continuing fragmentation of post-Yugoslav monetary spaces, and inability of domestic money to perform key functions of money.

Credit money appears as a closed circuit of financial transactions, as if money were simply a unit of account with a use value. However credit money as deferred means of payment introduces the notion of time, transforming the simultaneous relation of exchange into one between creditor and debtor (de Brunhoff, 2005). Therefore unexpected events (e.g. sudden shifts in exchange and interest rates, in asset prices, or settlement difficulties) may cause it to malfunction as money, as general means of exchange (de Brunhoff, 2005). The relative stability of the value of money over time is the precondition for the completion of the circuit of credit money, and for monetary and financial stability more generally. As such, monetary policy must rule ultra vires any temptation to devalue against the international unit of account: causing the value of foreign assets in domestic currency to depreciate, domestic foreign

liabilities to revalue, and immediately spilling over into a banking crisis. Fixed exchange rates allow the banks to transfer exchange rate risk, by shifting the currency mismatch between liabilities and assets onto the borrower, turning inter-money risk (exchange-rates) into the inter-temporal risk (interest-rates) of default, and enabling credit money to appear precisely as a unit of account within a closed circuit. The system of currency substitution, by formally ruling out devaluation or default, has one overriding aim; that foreign credit money complete its circuit and extinguish itself, that debts are repaid at full value.

3.2.3. DOLLARIZATION, CRISIS DYNAMICS AND LENDER OF LAST RESORT

However in a dollarized credit system credit money no longer represents a promise to pay the liabilities of the central bank. In a financial crisis, as the quality of bank assets deteriorates, credit promises to pay are devalued, a liquidity crisis breaks out, hard cash rules, and banks prefer to hoard money, causing a credit crunch. Credit money rests on the operation of central bank money as the obligatory means of payment backed by state debt. However regional central banks are severely constrained in providing emergency liquidity to banks when the credit system breaks down, because banks need liquidity injections in foreign currency. Since they have in effect ceded control over the management of aggregate credit-flows to the vagaries of international financial flows, extraverted the financial system, they cannot act as the lender of last resort to the banking system. Witness the Vienna Initiative of 2009 between the IFIs, the European Commission and the international banks that parent banks maintain their exposure and recapitalise their subsidiaries in the 'emerging Europe' region. Under the agreement, it is for the home central banks of the parent bank groups to provide emergency foreign currency liquidity to subsidiaries, and thus in the final instance the ECB, to perform the lender of last resort function, while the role of regional governments is to defend the exchange rate peg in order to prevent an uncontrolled devaluation of foreign bank domestic assets and a revaluation of domestic private sector liabilities. Thus far, the Initiative has prevented a systemic regional banking failure, but not negative rates of lending, that is capital outflow to settle liabilities with parent banks and a regional credit crunch. The reversal of capital flows constantly threatens inherently weak regional currencies with devaluation – for example, in the case of Serbia, where the currency has lost 40% of its value since the crisis – and the revaluation of external foreign liabilities. Euroisation thus radically transforms, intensifies and volatilises crisis dynamics, depriving governments of the monetary and fiscal instruments to address macroeconomic imbalances and currency mismatches. As in the Eurozone periphery, since exchange rates cannot adjust, wages and social spending must be internally devalued, causing a collapse in demand and rising external and public euroised debt.⁸ The imperative to preserve the value

⁸ By 2015, Croatian real GDP had contracted for six consecutive years, the second longest recession in the EU after Greece. Since 2008 the region has experienced a double dip recession following directly from that in the Eurozone.

of credit money and thus money capital takes place at the expense of the destruction of commodities (Marx, 1991). No other alternative is possible under the fixed exchange rate system, which is also to say that there is no independent monetary policy. As in the case of official dollarization, the countries of unofficial dollarization, although outside the Eurozone, remain dependent on the dynamics of the Eurozone credit system of which they are also outer peripheries and of the willingness of its central bank(s) to act as lender(s) of last resort.

3.2.4. OFFICIAL DOLLARIZATION IN THE EUROZONE

The final form of post-Yugoslav official dollarization is integration into a monetary union, the Eurozone, with a central bank acting as lender of last resort. The more competitive Slovenian export model, the exception to regional financialisation, was predicated on the rejection of the neo-liberal regime of shock therapy, fixed exchange rates and liberalisation of capital controls. Its failure can be seen in the present debt crisis, which we have previously argued is in reality a crisis of integration into the Eurozone (Živković, 2015). Following monetary integration with the Eurozone, Slovenia was no longer able to devalue its currency to keep its exports competitive against more technologically advanced producers like Germany and so, like the Eurozone periphery, resorted to unsustainable debt-financed growth (Živković, 2015). As in the Eurozone periphery, but also in the post-Yugoslav cases of official and unofficial dollarization, external adjustment through devaluation is ruled out, imposing "internal devaluation". The Slovenian banking crisis has become a sovereign debt crisis because the Eurozone is revealed to be but a fixed exchange rate system, that is, a monetary and not a fiscal union. With the limitations on the ECB to act as a lender of last resort, it has become evident that peripheral debt is in effect denominated in a foreign currency. Slovenia is effectively constrained to implement fiscal policy in a foreign currency, which it must borrow on the terms of international financial markets (Papadimitriou and Randall Wray, 2012). This is an example of what has been called 'original sin', the inability of a country to issue foreign loans in its own currency (Eichengreen, *et al.*, 2007), except that in this case exchange rate risk, external devaluation, is transformed into interest rate risk, internal devaluation. The position of Slovenia resembles that of official dollarization outside the monetary space of the referent currency in that fiscal policy depends on the balance of payments and/or foreign borrowing.

4. CONCLUSION

The political economy of the region has for decades sought to transfer and socialise the monetary constraint on production. In successive phases and forms, credit money has emerged endogenously from the needs of production to defer the monetary validation of private labours: from the creation of demand deposits by banks, via inflationary redistribution from households, to the conversion

of illiquid assets into credit money and flight hoards. However the displacement of sale and purchase has always adapted to the external foreign currency credit constraint on capital accumulation. Displacement has thus meant preserving money as the independent form of value at the expense of both the production of commodities and the domestic currency as store of value. Dollarization, arising out of the crisis of liquidity of the firm, has enabled the restoration of the circuit of credit money, the sine qua non of productive investment and accumulation, but only on the basis of the liquidation of the productive sector, of de-industrialisation. And only in a new form, M-M', on the basis of the illusion of money capital as self-expanding value; in the form of fictitious capital, the source of monetary and financial disturbances. However, recurrent monetary and financial crisis demonstrate that money is not identical with credit, that the monetary constraint cannot be superseded. Monetary policy has been confounded by the problem of articulating world money, central bank money and private bank deposits, and of the validation of a creation of money which it cannot instigate. It has internalised the monetary constraint in the form of a framework that enables the Euro to function as general equivalent, free from exchange rate or interest rate risk. But it has done so only to the extent that it shares the illusion that money is identical to credit, that domestic central bank money is the obligatory means of payment: an illusion dispelled at the first sign of financial disturbance when promises to pay are replaced by demands for hard Euro cash. Nevertheless it will persist in this illusion. For the value of credit money and thus money capital must be preserved against devaluation or default: the valorisation of fictitious capital, or austerity, must take place at the expense of the destruction of commodities and the devaluation of labour-power.

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