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Introduction

So the last shall be first, and the first last: for many be called, but few chosen.

—Matthew 20:16

In the fall of 2008, Central and Eastern Europe became one of the flashpoints of the global financial crisis. By March 2010, however, the crisis in that region had more or less abated. Public attention moved from Latvia—the country that suffered the greatest pain in the East European crisis—to the PIGS (Portugal, Italy, Greece, and Spain), in particular to Greece. The issue was no longer why Latvia must devalue but what Greece could learn from Latvia. Soon few will remember there was a crisis in Eastern Europe, because nothing is more easily taken for granted than success.

I realized that I had better write a book quickly to bring home the lessons from this episode before it faded from public memory. What lessons can be drawn from the East European financial crisis for Southern Europe and the rest of the European Union? What happened during the East European financial crisis, and how was it resolved so quickly?

For world output, the East European financial crisis was of minimal significance (see box 1.1 and table 1.1 for the countries I focus on). The three main crisis countries, Hungary, Romania, and Latvia, together accounted for only 2 percent of EU GDP, approximately as much as Greece. The greatest concern was the possible impact of this crisis on the European banking system, but it was also a sign of a global financial system out of balance.

Financial warning bells had been ringing since 2006 because of large current account deficits in many of these countries. A rule of thumb is that a current account deficit of more than 4 to 5 percent of GDP is worrisome, and almost all had larger deficits. Latvia and Bulgaria topped the lot with current account deficits in 2007 of 23 and 25 percent of GDP, respectively. As a consequence, some countries had accumulated large foreign debt.

This could not go on, as many, including the International Monetary Fund (IMF), repeatedly stated.[1]

But alternative interpretations dominated. A lot of capital had moved permanently to these countries. An unusually large share of the current account deficits was financed by foreign direct investment, and much of the remaining capital flow consisted of "related" lending similar to foreign direct investment. When a West European bank acquired a subsidiary in the east, its equity capital was recorded as foreign direct investment, but it added even larger loans, which were registered as short-term bank credit. Yet any West European bank would have been reluctant to withdraw such credits, which would have undermined the value of its core investment.

Marek Dabrowski argued that the current account flows within the euro area or to countries with currency boards soon to join the eurozone should not really be seen as current account deficits:

> In a world of free capital movement the geographic origin of capital has lost its importance, and capital invested abroad does not need to return to the country of "residence." There is no "home country bias" in investment decisions any more; the expected rate of return is the key parameter determining these decisions. Some countries may offer a higher rate of return for a long period of time, becoming persistent capital importers, while others may offer a surplus saving on a sustainable basis.[2]

These were rational capital flows to areas offering higher return on investment. Capital was transferred from inefficient, overtaxed, slow-growing, bureaucratized old Europe to efficient, fast-growing new Europe. Central and Eastern Europe was enjoying far higher growth rates than the EU-15, benefiting from catch-up growth in relation to the still-richer, old EU countries. Moreover, they had lower taxes, fewer social transfers, and more flexible labor markets. Modern neoclassical growth theory states that within similar open-market economies, GDP levels converge over time, leading to the obvious conclusion that European economic convergence would be the natural outcome.[3] For two decades economic convergence had been palpable.[4]

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1. Morris Goldstein, "Emerging-Market Financial Crises: Lessons and Prospects" (speech, 2007 Annual Meeting, Institute of International Finance, Washington, October 20, 2007); Susan Schadler, "Are Large External Imbalances in Central Europe Sustainable?" in *Challenges of Globalization: Imbalances and Growth*, eds. Anders Åslund and Marek Dabrowski (Washington: Peterson Institute for International Economics, 2008).

2. Marek Dabrowski, "Rethinking Balance of Payments Constraints in a Globalized World" in *Challenges of Globalization: Imbalances and Growth*, eds. Anders Åslund and Marek Dabrowski (Washington: Peterson Institute for International Economics, 2008), 73.

3. Robert J. Barro and Xavier Sala-i-Martin, *Economic Growth* (Cambridge, MA: MIT Press, 2004).

4. Leszek Balcerowicz and Stanley Fischer, eds., *Living Standards and the Wealth of Nations: Successes and Failures in Real Convergence* (Cambridge, MA: MIT Press, 2006).

Box 1.1 The ten Central and East European countries (CEE-10)

In this book, I focus on the ten new eastern members of the European Union: Estonia, Latvia, Lithuania (the three Baltic countries), Poland, the Czech Republic, Slovakia, Hungary, Slovenia (the five Central European countries), Romania, and Bulgaria (Southeastern Europe).[1] Bulgaria and Romania acceded to the European Union in January 2007. The other eight joined in May 2004. Together, I call them the CEE-10 (Central and East European 10), in contrast to the EU-15, the 15 countries that were members of the European Union before 2004.[2] One reason I limit my analysis to these ten countries is that it is difficult to offer a comprehensive narrative on too many different countries with a variety of problems.

The CEE-10 fall conveniently into three groups of countries with regard to exchange rate policy: Slovenia and Slovakia adopted the euro in 2007 and 2009, respectively; Estonia, Latvia, Lithuania, and Bulgaria have fixed exchange rates based on currency boards; and Poland, the Czech Republic, Hungary, and Romania have floating exchange rates and essentially pursue inflation targeting.

Of these ten CEE countries, three—Hungary, Latvia, and Romania—required International Monetary Fund (IMF) standby programs. Further to the east, Belarus, Ukraine, Moldova, Georgia, and Armenia all needed IMF programs, but each had its own set of problems, rendering generalizations difficult; such a large number of countries would cloud any overview. The same is true of the Balkan countries. Another reason for limiting this study to the CEE-10 is that it focuses on the actions of the European Union and the European Central Bank, which played no significant role outside of the European Union. Yet for the sake of context, I mention key events in the broader region.

1. The other two new EU members from 2004, Cyprus and Malta, fall outside of this study.

2. The EU-15 are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

But by 2008, Central and Eastern Europe was in a state of severe overheating in all regards. Inflation surged everywhere and to double digits in Bulgaria, Estonia, Latvia, and Lithuania. Wages and real estate prices skyrocketed, rendering these countries ever less competitive, which further undermined their current account balance. The country with the greatest overexpansion, Latvia, was feeling a credit crunch already in 2007, as its banks seemed overstretched with excessive lending and the risk of a fall in real estate prices with ensuing credit losses was evident.

The big blow was the Lehman Brothers bankruptcy on September 15, 2008. All of a sudden, world liquidity dried up, and vulnerable Eastern Europe was left with no credit. For half a year until the G-20 meeting in

Table 1.1 Overview of the CEE-10 countries

Country	EU member	EMU status	Exchange rate policy	GDP growth (percent annual rate) 2000–07	2009
Baltics					
Estonia	May 2004	ERM II, 2004	Currency board	7.5	–14.1
Latvia	May 2004	ERM II, 2005	Currency board	8.8	–18.4
Lithuania	May 2004	ERM II, 2004	Currency board	8.2	–15.0
Central Europe					
Poland	May 2004		Floating rate	4.1	1.7
Czech Republic	May 2004		Floating rate	4.5	–4.1
Slovakia	May 2004	Euro, January 2009	Euro	5.7	–4.7
Hungary	May 2004		Floating rate	4.0	–6.3
Slovenia	May 2004	Euro, January 2007	Euro	4.4	–7.8
Southeastern Europe					
Bulgaria	January 2007		Currency board	5.5	–5.1
Romania	January 2007		Floating rate	5.6	–7.2

EMU = Economic and Monetary Union
ERM II = European Exchange Rate Mechanism
CPI = consumer price index
IMF = International Monetary Fund

Sources: Eurostat database, http://epp.eurostat.ec.europa.eu; IMF, *World Economic Outlook,* April 2010, www.imf.org.

London on April 2, 2009, global liquidity remained frozen. Private finance could no longer be obtained at any price. The only financing available for countries in need on the edge of the global financial system was government funding, primarily from the IMF.

What Went Wrong and How It Was Fixed

The East European financial crisis was a standard credit boom-and-bust cycle leading to a current account crisis. Large private capital inflows had mounted to too much private debt. Yet leverage in these countries was limited, that is, their credit and money volumes were moderate in relation to their GDP. Still, the pace of their expansion had been dangerously rapid, and increasingly the capital inflows consisted of short-term bank loans, which were spent on consumption and real estate investment. The causes were a combination of three factors: very loose global monetary conditions; an open, attractive investment environment; and exchange rate policies that allowed the global monetary overflow to boost domestic money supply. This was overheating arising from excessive success. Unlike much of Western Europe and the United States, the Central Europeans had not indulged in subprime mortgage loans or collateral debt

Fiscal balance, 2007 (percent of GDP)	Inflation, 2008 (CPI percent)	Current account deficit, 2007 (percent of GDP)	**IMF program** (type and date)
2.6	10.4	–18.0	
–0.4	15.3	–22.5	Standby, December 2008
–1.0	11.1	–14.6	
–1.9	4.2	–4.0	Flexible credit line, May 2009
–0.6	6.3	–3.1	
–1.9	3.9	–4.8	
–4.9	6.1	–6.4	Standby, October 2008
0.5	5.7	–4.2	
3.5	12.0	–25.4	
–3.1	7.8	–14.4	Standby, March 2009

obligations. Apart from Hungary, none of the Central Europeans suffered from a large fiscal deficit or excessive public debt, and they had no conspicuous systemic flaws.

Exchange rate policy was the dominant policy issue. The ten Central and East European countries (CEE-10) had three different exchange rate regimes. Only two countries, Slovenia and Slovakia, had been allowed by the European Union to adopt the euro in 2007 and 2009, respectively. Four countries had fixed exchange rates based on currency boards—Estonia, Latvia, Lithuania, and Bulgaria. Formally, Latvia did not have a full-fledged currency board, but it operated its financial system as if that were the case. The remaining four countries—Poland, the Czech Republic, Hungary, and Romania—had floating exchange rates and essentially pursued inflation targeting.

The three Baltic countries saw the biggest output plunges of 14 to 18 percent in 2009, and Latvia suffered the deepest financial crisis and needed an IMF program. Countries with the euro or floating exchange rate and decent fiscal policy did well. Poland stood out as the luckiest economy with economic growth in 2009. The Czech Republic, Slovakia, and Slovenia also did reasonably well, while Hungary and Romania required IMF programs, not because of their exchange rate policies but for their comparatively loose fiscal policy.

The four countries that had fixed exchange rates (Bulgaria, Estonia, Latvia, and Lithuania) had no means to sterilize the large capital inflows, as they were caught in the Impossible Trinity: With fixed exchange rates and free capital flows, they could not pursue independent monetary policy. If they had raised their domestic interest rates, they would only have attracted larger capital inflows.[5] They had hardly any bonds. Their only policy tools were fiscal policy and bank regulation, which could and should have been used more, but few did so during the boom. Of the countries with fixed exchange rates, Lithuania and Latvia had almost balanced budgets, while Estonia and Bulgaria displayed steady budget surpluses.

A broad consensus among American economists claimed that all countries with pegged exchange rates would have to devalue, which was their lesson from the East Asian crisis in 1997–98. Also, Russia and Argentina had been forced to devalue. But no single EU country with a fixed exchange rate has devalued, making evident that it was not necessary and perhaps not even desirable. Nor have any of the CEE-10 changed their exchange rate policies. Estonia has been accepted to adopt the euro in January 2011. My personal position throughout—as I elaborate upon below—was that it made no sense for the Baltic countries to devalue.[6]

The severe shock of the international liquidity squeeze from September 2008 caused the floating exchange rates to plummet. In early 2009 worries prevailed that Central and Eastern Europe would suffer a devastating banking crisis, but it never happened. West European banks owned most of the banks in the CEE-10 and the fear was that they would withdraw from the region. In fact, not a single Western bank departed from any country during the crisis. The European Central Bank (ECB) and other central banks in Europe flooded their banks with cheap liquidity, and the European Union stipulated that their banks should not be forced to sell their foreign subsidiaries. The IMF and the European Bank for Reconstruction and Development (EBRD) demanded coordinated commitments from the banks concerned not to cut and run from the east. From April 2009, the credit crunch eased, and the floating exchange rates recovered. In the end, most loans were rolled over and the feared financial withdrawal from Eastern Europe never occurred. Was this a result of intervention by the international financial institutions or a reflection of the banks' self-interest?

In spite of the tremendous economic shocks and prior imbalances, only three countries—Hungary, Latvia, and Romania—required IMF standby programs. Also, the European Commission, the World Bank, and Latvia's neighbors contributed substantially. The IMF acted even faster than usual, providing much more funding, also to finance their budget deficits, and it focused on a more limited set of key conditions than before. The other main international actor was the European Commission, which contributed more than the IMF to the Latvian program. Before the crisis, it

5. Lars Oxelheim, *International Financial Integration* (Heidelberg: Springer Verlag Berlin, 1990).

6. Anders Åslund, "Why Latvia Should Not Devalue," Realtime Economic Issues Watch, Peterson Institute for International Economics, December 9, 2008, www.piie.com.

was not clear how the European Commission and the IMF would interact, but the European Union accepted the IMF lead, offering substantial cofinancing and controlling the IMF programs. The cooperation between the IMF and the European Commission has worked surprisingly well, while the United States and the World Bank took a back seat. The EBRD and the European Investment Bank (EIB) focused on bank restructuring, while the ECB played no apparent role.[7]

The political economy of this adjustment has been quite remarkable. All crisis countries in this region undertook heroic fiscal adjustment programs. They cut public expenditures, public wages, and social transfers, while launching difficult structural reforms in health care and education. Many Western observers claimed that such big expenditure adjustments would be politically and socially impossible. They worried about regime change and collapse of democracy, but democracy persevered, and in fact social unrest and even populism have been minimal. Eight of the CEE-10 have changed government during the crisis, and the main crisis countries—Latvia, Hungary, and Romania—have changed government twice. Remarkably, in every case the new government was more radical in its adjustment policy than its predecessor, with the exception of the new Hungarian government. The center-right has benefited politically. At present, center-right parties rule nine of the CEE-10. Swift and radical problem resolution was evidently the preferred and most successful political approach, and it is the democratic center-right that has been doing so most convincingly.

The origins of the East European financial crisis were not surprising, but its resolution has been all the more so. The crisis countries have undertaken much more radical spending cuts than most economists considered possible. The fixed exchange rates of the currency board countries have not impeded adjustment but facilitated radical adjustment. The political economy of these countries has proven much more fortuitous than generally expected. Is this a peculiarity of these nations, or have their governments found a better solution than other governments? While globalization undoubtedly contributed to the crisis, it has also facilitated speedy crisis resolution.

The financial crisis has increased budget deficits and public debt in all the CEE-10 countries, but they have weathered the crisis better than most of the old members of the eurozone. Of the ten, nine remain below the Maastricht criterion of maximum public debt of 60 percent of GDP, while seven of the eleven original members of the eurozone currently exceed this threshold. By proving that their finances and economic systems are

7. Poland was approved for a flexible credit line from the IMF, since the ECB was not ready to offer Poland a swap credit, but this was a precautionary measure to safeguard sufficient liquidity, not a crisis measure.

comparatively stronger, the CEE-10 countries are giving new impetus to European convergence, even if the crisis has set their output back by a few years. Having gone through the steel bath of this crisis, these 10 eastern EU members will undoubtedly prove more competitive than the old EU members. Ironically, because the European Union treated the East European countries as second-class members, they faced hard budget constraints and pursued much more responsible fiscal policies than the first-class members of the eurozone. Therefore, they are catching up or overtaking the old EU members first in qualitative terms and later in economic welfare. The last shall be the first.

After this financial crisis resolution in the east, it is all the more striking how inadequate the crisis management was within the eurozone when Greece and other eurozone countries entered a severe financial crisis. Since the new EU members are doing qualitatively better than the old ones, this financial crisis is likely to reinforce convergence rather than divergence. The new EU members with currency boards remain determined to adopt the euro as early as they reasonably can, while the financial crisis in the eurozone has aroused new doubts in the countries with floating exchange rates.[8]

Maastricht Criteria and Euro Adoption

The euro was introduced in nonphysical form on January 1, 1999, while the bank notes were launched in January 2002. The original 11 members of the eurozone are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. Greece was admitted in 2001, taking the membership to 12. Slovenia entered in January 2007, Cyprus and Malta in 2008, and Slovakia in January 2009. At the beginning of 2009, out of the 27 EU members 16 belonged to the Economic and Monetary Union (EMU) and used the euro as their common currency. Among the new eastern EU members, the CEE-10, only three, Slovenia, Slovakia, and Estonia, have been admitted to the EMU so far. The other seven are obliged to enter the EMU, but no deadline exists. They have to fulfill five economic convergence criteria and receive political approval by the European Union.

An EU country that wants to adopt the euro must belong to the European Exchange Rate Mechanism (ERM II) for two years and fulfill the Maastricht criteria. These criteria are named after the Dutch town where the Treaty of the European Union was signed on February 7, 1992 by the then 12 members of the then European Community. These criteria remain in the current Lisbon Treaty or the Treaty on the Functioning of the Euro-

8. Increased doubts have been registered in opinion polls in the Czech Republic and Poland, as well as in Sweden and Denmark.

pean Union (TFEU). They are outlined in Article 140 in the TFEU and specified elsewhere:

- Price stability: Average inflation rate one year prior to entry must not exceed the average of the lowest three inflation rates of the EU member countries by more than 1.5 percentage points.
- The public sector deficit should not exceed 3 percent of GDP.
- The public debt should not surpass 60 percent of GDP.
- The normal fluctuation margins (+/–2.25 percent) within ERM II should be observed for at least two years.
- The average long-term nominal interest rate must not be higher than the average of the corresponding rates of the three lowest-inflation countries by more than 2 percentage points.[9]

A country's compliance with the Maastricht criteria is assessed by the European Commission in occasional economic convergence reports, which are decisive for a country's approval for euro adoption. The ECB also participates in this evaluation. However, the actual approval is a political decision, which is taken in several rounds by the council of eurozone finance ministers and all the EU finance ministers (the ECOFIN Council).

An important decision for each EU member outside of the eurozone was when to enter the ERM II. The ERM II rules prescribe a currency band of +/–15 percent around a "stable but adjustable central rate to the euro" or a preannounced, fixed exchange rate to the euro, but new entrants, the ECB, and the European Union (the ERM II committee) can negotiate the exact exchange rate regime. In reality, however, the band is much more narrow and effectively a peg with a narrow band.[10] Estonia and Lithuania entered the ERM II in 2004 and Latvia in 2005. Bulgaria has wanted ERM II membership but has so far not been admitted. The Czech Republic, Hungary, Poland, and Romania have not tried to enter the ERM II as yet.

The three countries, the United Kingdom, Denmark, and Sweden, that joined the European Union before the euro was introduced in 1999 had negotiated an exception and are not obliged to adopt the euro ever. Denmark pegged its exchange rate to the deutsche mark in 1982 and entered the ERM II in 1999. The new members admitted in 2004 and 2007 were not given the option to abstain from the euro.

All EU members, whether members of the EMU or not, are supposed

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9. Article 140, Treaty on the Functioning of the European Union, *Official Journal of the European Union,* Information and Notices C 115, volume 51, May 9, 2008, available at http://eur-lex.europa.eu; Michael Marrese, *The Convergence of CEEMEA Countries as the Global Recession Ends* (New York: JP Morgan, July 29, 2009).

10. Marrese, *The Convergence of CEEMEA Countries*; European Union, "Acceding Countries and ERM-II," EFC/ECFIN/109/03 (Athens, April 5, 2003).

to comply with the fiscal Maastricht criteria, also called the Stability and Growth Pact (SGP), an EU agreement concluded in 1997 to bring fiscal discipline to the future EMU. If a eurozone country does not comply with the Maastricht criteria, the ECOFIN Council can initiate excessive deficit procedures, which can lead to severe penalties. However, because important euro countries violated these rules, excessive deficit procedures were never applied before the crisis.

Parallels to the East Asian Financial Crisis of 1997–98

The most obvious parallel to the East European crisis is the East Asian financial crisis in 1997–98, which hit Thailand, South Korea, Taiwan, Hong Kong, Indonesia, and Malaysia. The new EU members were reminiscent of these East Asian countries, especially South Korea. For years, the world had talked about the East Asian tigers and the East Asian economic miracle. Their open market economies and export orientation with high saving and investment rates had delivered persistent and high growth. Large capital inflows had resulted in excessive investment in real estate in a typical boom and bust cycle.

Finally, in 1997, the bubble burst. The East Asian tigers faced a "sudden stop" as capital inflows seized and were reversed.[11] At the time, that crisis was considered the end of their fortune. Joseph Stiglitz complained about "an unwarrantedly rapid pace toward financial and capital market liberalization" and that some "of the worst aspects of corruption, the so-called crony capitalism, will have to be checked."[12] Paul Krugman claimed that the East Asian growth miracle was caused by too much hard work and too large savings,[13] while others saw nothing but a standard financial crisis based on excessive success resulting in overheating.[14]

Raghuram Rajan has passed a tenable judgment: "The East Asian crisis was...largely a result of corporate overinvestment, in commercial real estate as well as manufacturing."[15] Unlike many previous emerging-market crises, the East Asian crisis did not involve large public deficits

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11. This notion was coined by Rudiger Dornbusch, Ilan Goldfajn, and Rodrigo O. Valdés, "Currency Crises and Collapses," *Brookings Papers on Economic Activity* 26, 2: 219–93; Guillermo A. Calvo, "Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops," *Journal of Applied Economics* 1, no. 1 (1998): 35–54.

12. Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: Norton, 2002), 104, 127.

13. Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (November–December 1994): 62.

14. Charles P. Kindleberger and Robert Aliber, *Manias, Panics, and Crashes*, 5th ed. (Hoboken, NJ: Wiley, 2005), 140–41, 156–58.

15. Raghuram Rajan, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton: Princeton University Press, 2010), 77.

or debts but entirely overheating in the private sector. This was the key parallel to the East European crisis of 2008. Rajan has lucidly explained how the East Asian financial crisis evolved from the perspective of foreign investors:

> Foreign investors who do not understand the murky insider relationships do three things. They minimize risks by offering only short-term loans so that they can pull their money out on short notice. They denominate payments in foreign currency so that their claims cannot be reduced by domestic inflation or a currency devaluation. And they lend through the local banks so that if they pull their money and the banks cannot repay it, the government will be drawn into supporting its banks to avoid widespread economic damage. Thus, foreign investors get an implicit government guarantee. The threat of inflicting collateral damage is what makes arm's-length foreign investors willing to entrust their money to the opaque relationship system.[16]

This picture of the East Asian crisis accurately portrays the East European situation with the main difference being that the West European banks owned most of the local banking system in Eastern Europe and were wedded to stay in these countries. But the three key characteristics—excessive short-term credits, loans in foreign currency, and lending through local banks—held true.

However, after only one year the East Asian financial crisis was over and these countries maintained their virtuous economic policies, which once again delivered stellar growth. As Simon Johnson and James Kwak write: "Even while outside observers are still despairing over corporate governance, macroeconomic management, and crony capitalism, growth picks up again. In 1999, the Korean economy grew by 11.1 percent."[17] Only one country, Indonesia, underwent regime change, with a successful transition to democracy and a more open market economy. Rather than a tragedy, the East Asian crisis was a brief upset that augured even greater success. The Russian financial crisis of 1998 and the Argentine crisis of 2001, by contrast, were profound fiscal crises, but even so the Russian crash initiated ten years of average annual economic growth of 7 percent.

In 2008, there was a broad appreciation of the similarities between the East Asian and East European crises. By and large, this understanding facilitated crisis resolution. Most experts and policymakers understood that this was a financial crisis and not a profound systemic crisis, which limited the demands for structural change. The crisis was seen as a temporary liquidity shortage and not as a solidity crisis, which persuaded international government creditors to provide large loans. Since the East Asians had returned their large loans in full and on time, the international community was prepared to finance substantial budget deficits too.

16. Ibid., 12.

17. Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon, 2010), 51.

A more controversial conclusion from the East Asian drama was that the best way out of a current account crisis to kickstart growth is devaluation. Since none of the East European countries with pegged exchange rates devalued, the exchange rate question is a key issue in the East European crisis resolution.

Structure of the Book

Chapters 2 and 3 provide a narrative of the East European crisis, its causes and eruption as well as resolution. The four ensuing chapters contain analysis of the most important aspects of the crisis. Chapter 4 discusses the prime economic question of the crisis: the exchange rate dilemma. Chapter 5 focuses on the expected banking crisis in Eastern Europe that did not really materialize. Chapter 6 examines the role of international actors, essentially the International Monetary Fund, the European Commission, the European Central Bank, and the United States. Chapter 7 considers why the CEE-10 countries acted so responsibly to resolve the crisis. Chapter 8 deals with implications of the eurozone fiscal crisis for Eastern Europe, and chapter 9 summarizes conclusions from the crisis for Eastern Europe.

In my analysis I focus on countries and institutions as the actors rather than on individuals. In order not to get lost in details, I minimize mentioning politicians and their differences and concentrate on the most controversial issues of principle. The one drawback I faced while writing this book early is that all statistics for 2010 are only forecasts. My primary sources of statistics cited throughout the book are the Eurostat database and the IMF's *World Economic Outlook*, which by and large overlap. Other sources are EBRD and JPMorgan statistics. The IMF website (www.imf.org) contains all official information about IMF agreements and programs.