The EURO: A Research Brief

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ABSTRACT
The European Union and its pan-European euro currency, introduced with enthusiasm and great promise as an operational example of an optimal currency area, does not appear today to have either the enthusiasm or promise once celebrated in the European Union countries at its launch thirteen years ago. This research examines the beginnings of the euro, its present situation, and reflects on its future. The euro's uncertain future is presented as a question and this manuscript is presented as a research brief rather than a final manuscript. Both the question and the research brief are in recognition of the euro's turbulence and the fluidity spiraling about its situation at this time now. That situation hopefully will clarify in the coming weeks. Below is a research brief summary reflecting the fluidity of the current situation as well as several paragraphs intended for a final manuscript as the euro's situation unfolds.

INTRODUCTION
From a time of enthusiasm and promise on January 1, 1999 when eleven member states of the then fifteen-member European Union - Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Holland, Portugal, and Spain - launched the euro as an optimal currency area (Mundell, 1961; McKinnon, 1963; Reed, 1999: Coy, 2000) to today's dire situation thirteen years later, it has been an interesting journey for the euro. Has the euro's journey now reached a point of the euro zone moving in a downward spiral, a situation illuminated on the front cover of *The Economist* (Economist Article, 2011a) with a euro coin shown as a flaming star hurtling toward its demise? A question, "Is this really the end," accompanies the flaming star. Is it certitude or dubiety for the euro?

The image described above, the latest in a series of euro-related cover pages that *The Economist* magazine has published since May 2010 when it featured the European debt crisis on its cover for the first time, dramatically illustrates the dire condition of the euro, a deteriorating condition being made worse by vacillations of European minister on how to save the euro. *The Economis*t published other euro-related cover pages, with thirteen of the best covers including the flaming star cover available at Euro Cover Pages (2011) at:
http://www.economist.com/blogs/newsbook/2011/11/euro

As *The Economist* (Economist Article, 2011a) notes in the article that carried the flaming star cover page image "the chances of the euro zone being smashed apart have risen alarmingly, thanks to financial panic, a readily weakening economic outlook and pigheaded brinkmanship.
The odds of a safe landing are dwindling fast." Another article in the same issue (Economist Article, 2011b) alarmingly proclaims, "The crisis in the euro area is turning into a panic and dragging the zone into a recession. The risk that the currency disintegrates within weeks is alarmingly high." While these articles suggest a certitude that the euro will disintegrate soon,

there is hope for a better outcome, if for no other reason than "the cost of breaking up the euro is so enormous as to be unimaginable," according to UBS Investment Research (Fidler, 2011).

Will it be certitude or dubiety for the euro? This research brief examines the past, present and possible future of the euro is seeking to answer the question – Is the end of the euro at hand? As this research brief moves toward a final manuscript, a retrospective euro analysis will be presented. Then, the euro's present situation will be examined. Future scenarios for the euro will be elucidated to ascertain its certitude or dubiety. As noted in the Abstract above, please find below in this research brief several paragraphs of an in-progress manuscript and a summary of the fluidity of the current situation.

THE EURO'S BEGINNINGS

On January 1, 1999, eleven member states of the then fifteen-member European Union - Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Holland, Portugal, and Spain - initiated phase one of the euro's launch. Four member states - Denmark, Greece, Sweden, and the United Kingdom - elected not to join the new currency union initially. The countries of Britain, Denmark, and Sweden, the Euroskeptics countries (Stecklow, 1999), did not adopt the new currency. Greece did not qualify under the euro convergence criteria, but subsequently reduced its deficit, public debt, and inflation to enable convergence and entry to the euro.

The euro convergence criteria, established in the Treaty on European Union enacted in Maastricht, The Netherlands in December 1991 (European Parliament, 1998), required the euro-member countries to achieve goals for inflation rates, size of budget deficits, exchange rate fluctuations, and government indebtedness levels as conditional for admittance to the euro: Among the stipulations for euro convergence are:

- Inflation less than 1.5% higher than the average of the rates of the three countries in the euro area with the lowest inflation.
- Long-term interest rates less than 2% above the average of the rates of the three countries in the euro area with the lowest long-term rates.
- A country's exchange rate must have remained within the normal fluctuation margins of the ERM and no devaluation of its currency.
- Budget deficit less than 3% of a country's Gross Domestic Product (GDP).
- Outstanding government debt must be no more than 60% of a country's GDP.
- An independent national central bank.

The Euro Convergence Criteria (2011) are available on the European Central Bank's website at: http://www.ecb.int/ecb/orga/escb/html/convergence-criteria.en.html.

At introduction on January 1, 1999, the euro first was authorized for non-cash transactions in the euro-eleven countries, authorized for equity & debt trading, bank transactions, business-to-business transactions, and for payments by check, credit card and/or bank transfer. After operating as a non-cash currency initially, the euro introduced paper currency and coins into circulation on January 1, 2002. Finally, on July 1, 2002, national currencies were removed from circulation, making the euro the official currency for all transactions in the euro-zone countries.

At the time of its initial launch in 1999, the great promise of the euro currency (Warner, 1999) was that it would transform Europe from "a jigsaw of costly, protected markets into a vigorously competitive economic bloc." It was heralded as a transforming event in the world's financial landscape (Kamm, 1999). Arguably the most significant event in monetary history since the collapse of the Bretton Woods fixed-exchange rate system (Reed, 1999).

EUROPEAN UNION TODAY

Thirteen years after the euro's launch, the European Union today spans twenty-seven countries. Of these 27 countries, the seventeen euro-participating countries and their year of adoption are:

> **1999**: Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland (the initial eleven countries)
> **2001**: Greece
> **2007**: Slovenia
> **2008**: Cyprus, Malta
> **2009**: Slovakia
> **2011**: Estonia

As listed above, seventeen member states of twenty-seven European Union countries now use the euro as their currency (European central Bank, 2011) - Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, The Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland. The other ten countries - Bulgaria, Czech Republic, Denmark, Latvia, Lithuania, Hungary, Poland, Romania, Sweden and the United Kingdom - are EU Member States but do not currently use the single European currency (European Central Bank, 2011). Of these ten countries all but two of the ten countries are committed to adopting the euro sometime in the future. The two countries who have not indicated a commitment are Denmark and the United Kingdom. The question looms whether adoption of the euro by the ten non-euro countries would strengthen the currency and keep it in circulation or will the euro's demise be the next significant event in monetary history.

TRACKING THE EURO'S CURRENT SITUATION

The question whether or not the euro's demise will be the next significant event in monetary history underpins this research. It is a question whose answer is obscured by in-country political posturing throughout Europe and larger global events that a definitive answer is impossible at this time now.

As of this time now (December 10, 2011), the euro's current situation, a situation that arguably is characterized of alarm, confusion, tension and uncertainty, is reflected in headlines such as those listed below:

- *Crisis Ensnares Central Bank in Desperate Bid to Save Euro* (Blackstone and Karnitschnig, 2011)
- *Europe's Crisis: Beyond Finance* (Friedman, 2011)
- *Europe's Economy Weakens, Adding to Fears* (Blackstone, 2011)
- *Banks Prep for Life after Euro* (Enrich, Ball and Alistair MacDonald, 2011)
- *Currency' Allure Dims in Eastern Europe* (Fairclough, 2011)
- *Tensions Ride at EU Summit* (Blackstone, Dalton and Fidler, 2011)

TRACKING THE EURO'S FUTURE

What of the euro's future? The headlines offer some promise, but alarm, confusion, tension and uncertainty remain. Here is a sampling of recent headlines about the euro's future:

- *Can Europe be Saved?* (Krugman, 2011)
- *2021: The New Europe* (Niall Fergusion, 2011)
- *The Euro Deal: No Big Bazooka* (Economist Article, 2011c)
- *German Vision Prevails as Leaders Agree on Fiscal Pact* (Erlanger and Castle, 2011)

AGREEING TO A FISCAL COMPACT

The last headline above, *German Vision Prevails as Leaders Agree on Fiscal Pact*, was "breaking news" appeared as we were about to conclude our preliminary research for this research brief. That headline, in addition to several other articles expressing doubt about the long-term viability of the fiscal pact, convinced us that our research still is very much a work-in-process and argued for submitting this manuscript as a Research Brief rather than a final manuscript. The euro's story is far from complete, many twists and turns are ahead as the euro's drama unfolds.

There appears some promise for success in the drama as Europe's leaders are moving to bring a degree of fiscal control to the European Union. Exactly 20 years to the day after Europe's leaders signed the Maastricht Treaty on December 9, 1991 pledging to unite their monetary policies, create a central bank (now the European Central Bank), and initiate a common currency (the euro), European leaders pledged on December 9, 2011 to unite their nation's fiscally. In uniting fiscally, the leaders agreed to submit their national budgets for review by the European Commission (the EU's executive body). They pledged also to accept limits for budget deficits in their countries, with each country's budget deficit not to exceed 0.5 percent of gross domestic product. Countries not adhering to fiscal responsibility would be subject to an automatic correction mechanism, not presently specified.

So, will the fiscal agreement be a positive twist in the euro's drama? Will this new EU fiscal compact strengthen the euro? As Erlanger and Castle (2011) note, "exactly 20 years to the day after European leaders signed the treaty that led to the creation of the European Union and the euro currency, Chancellor Angela Merkel of Germany persuaded every current member of the union except Britain to endorse a new agreement calling for tighter regional oversight of government spending. The accord, approved at a summit meeting in Brussels early on Friday, would allow the European Court of Justice to strike down a member's laws if they violate fiscal discipline. The agreement was a clear victory for Mrs. Merkel, and it prompted a sharp rally in stock markets in Europe and the United States." So, twenty six of twenty seven EU members, expect for the United Kingdom, pledged to adopt greater fiscal control and submit their budgets to the European Commission for review.

There seems at last to be movement toward a new fiscal compact and greater fiscal control throughout the European Union, arguably needed for some time now, perhaps from the inception of the euro. While promising, the article by Erlanger and Castle (2011) offers the following caution. "But it (the accord) is viewed as unlikely to calm fears that Europe is unwilling to muster the financial firepower to defend the sovereign debts of big member states, including Italy and Spain that have little or no economic growth and have big debt bills coming due soon."

A recent editorial (NYT Editorial, 2011) cautions that the fiscal agreement may not last: "We're losing count of how many European Union summit meetings have ended with historic agreements to contain the euro-zone debt crisis only to see them fall apart as markets judged they were inadequate or irrelevant to the problem of making good on old debts and generating enough growth to pay off future obligations."

EURO'S BENEFITS

The European Union's drama continues. It is not a drama from which to turn away. The European Union and its euro currency are important for global comity and the world's economic future. Several of the microeconomic and macroeconomic benefits of the euro argue compelling for its importance. The microeconomic benefits of the euro include:

- The euro facilitates price transparency across the European markets.

- The euro eliminates waste in currency exchanges.
- The euro facilitates cross-border financial transactions.
- The euro enhances trade and comity among the European nations.
- The euro enables easier travel throughout Europe.

Among significant macroeconomic benefits of the euro are:

- The euro eliminates exchange rate risk in the euro area.
- The euro encourages investment in the euro area.
- The euro encourages and strengthens the development of the single European market.
- The euro promotes the convergence of the national European economies.
- The euro is a tangible symbol of European identity

EURO'S FUTURE

To where is the European Union's drama headed? Is it nearing its final act? What of the euro currency? Will the euro be strengthen and emerge as one of the world's important currencies. Will the euro instill pride and be a tangible symbol of European Unity? Or, will it all come crashing down with first the euro and then the European Union disintegrating? The answers to the questions above obviously are many and have their negative and positive sides.

A negative view is found in the action of some European central banks (Enrich, Ball and MacDonald, 2011) who are considering printing their own national bank notes to be ready if and when there is a euro collapse. It is reported that the Bank of Ireland, as one example, is planning to "secure additional access to printing presses" to be ready in the event of the euro's collapse. Preparing for the possibility of printing national bank notes was not even thinkable until recently. It reflects the dire conditions facing the euro at this time now.

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An optimistic viewpoint is offered by Niall Ferguson (2011) in envisioning a world in 2021 wherein the euro will be used "by more countries than before the crisis" of late 2011. This is an optimistic view of hope for the euro, perhaps touching back to the euro's promise at its launch.

Ferguson opens his vision of a new Europe 2021 with this paragraph: "Welcome to Europe 2021. Ten years have elapsed since the great crisis of 2010-2011, which claimed the scalps of no less than 10 governments, including Spain and France. Some things have stayed the same, but a lot has changed. The euro is still circulating, though bank notes are now seldom seen. Indeed, the ease of electronic payments now makes some people wonder why creating a single European currency ever seemed worth the effort. But Brussels has been abandoned as Europe's political headquarters. Vienna has been a great success."

Ferguson continues his vision of a new Europe: "Life is still far from easy in the peripheral states of the United States of Europe (as Ferguson envisions the euro zone being called in 2021). Unemployment in Greece, Italy, Portugal and Spain has soared to 20%. But the creation of a new system of fiscal federalism in 2012 has ensured a steady stream of funds from the north European core."

CONCLUSION

This research examined the beginnings of the euro, its present situation, and reflected on its future. This research, presented here as a preliminary research brief, will continue to unfold as European leaders more forward to enact a new fiscal compact over the coming month. That fiscal compact, if it is successfully implemented, may become the new system of fiscal federalism envisioned by Ferguson (2011). The outcome will be revealed as the tomorrow's pass forward. Will the tomorrow's beyond bring national banks to print their own national currencies or will Ferguson's vision of a new Europe prevail. Time will bring the answer, provided the euro still has left some time.

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