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NEWS RELEASE

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THE EURO AT TEN: THE NEXT GLOBAL CURRENCY?

WASHINGTON—Ten years after its establishment, the euro has been very successful as a stabilizing force for the European economy. Its very existence has helped euro area member economies weather the current global financial and economic crisis, without disruptive competitive devaluations or capital flight. Before the crisis, the euro provided a boost to financial integration and a reduction in member countries' interest rates, though admittedly no revolutionary improvement in members' economic growth. Skeptics and critics who had argued that the euro would not be a viable currency have been proven wrong.

Yet, the euro's status in international monetary affairs continues to be limited. It has emerged as the second international currency and has gained influence in areas contiguous to the borders of the euro area but it is not en route to replace or even rival the dollar in its global role. Among the factors working against a broader international role for the euro are continued fragmentation of policymaking in the financial area, relative lack of financial depth in Europe as compared to US markets (despite the huge progress on European bond market integration), poor long-term growth prospects despite the euro area's current economic size, lack of coordination on policy areas beyond monetary policy narrowly defined, fragmented international representation, and geopolitical limitations on its attractiveness. It is revealing that even in the midst of the worst financial crisis in 70 years, one widely and somewhat justifiably believed to have begun in the US economy and resulting from US policy mistakes, the flight to safety of world savings was to the US treasuries, and not noticeably to the euro.

These are some of the central conclusions from *The Euro at Ten: The Next Global Currency?* a timely new book published by the Peterson Institute for International Economics and Bruegel, a European think tank devoted to international economics. The book, edited by Adam S. Posen, deputy director of the Peterson Institute, and Jean Pisani-Ferry, director of Bruegel, draws from essays, papers, and speeches contributed by top academics and senior officials from both sides of the Atlantic to a high-level conference held last October at the Institute, sponsored by the European Commission.

While other regions around the world are increasingly considering alternatives to the dollar, or at least to sole reliance on it, only Eastern Europe and parts of the Mediterranean are developing deep euro ties and reliance, the book finds.

Regions such as East Asia, the Gulf states, and Latin America are looking to regional monetary integration or basket arrangements (with the euro as only one among a few nondollar currencies). Barring even greater US economic policy mistakes, euro usage will continue to increase slowly in trade invoicing, financial investment, and reserve holdings, commensurate with deepening real economic ties to Europe—but nothing to rival the dollar. Over time, this trend, too, is likely to diminish as the size of the euro area economy shrinks relative to the rest of the world (especially if eastern enlargement of the area is not supported, let alone if the lack of crisis response hinders growth in Eastern Europe), according to *The Euro at Ten*.

The financial crisis and its impact on the euro area and neighboring countries—including EU members and major trading partners—bring home three fundamental limitations of the euro area, says *The Euro at Ten*, despite its success in easier times to date.

- First, persistent obstacles to European financial integration continue to limit the attractiveness of the euro. A primary driver of foreign capital inflows to the United States has been the development of its financial markets, the book finds. Despite the progress of financial integration over the last decade, European financial markets remain fragmented in some important areas. Most critically, banking and financial supervision remains a national responsibility, and there is no integrated market for government bonds.
- Second, euro area governance is based on rules and procedures that are not well equipped for crisis management or for coherent representation at a global level. Feeble and divergent national reactions initially to the banking crisis eventually triggered a common response in October 2008, but that welcome response was the result of ad hoc cooperation rather than of institutionalized coordination. This was in sharp contrast to the European Central Bank's decisive actions in 2007 and 2008 on the monetary aspects of crisis response.
- Third, in crisis times the euro area has not behaved as the regional anchor it should be. The euro area should have been more proactive to support largely euroized and eventual euro member countries in its neighborhood. Ironically, while most EU members outside the euro area have found the goal of euro adoption more attractive in light of the crisis, they have simultaneously been disappointed by the euro area leadership's short-sighted response, making euro entry more distant.

Monetary competition between the dollar and euro is not a worthwhile goal for its own sake, for either the European Union or the United States, the book finds. The primary privilege for reserve currency countries of being able to issue debt in one's own currency is already available to euro area members, and their increased ability to do so has not impaired the US government's debt issuance in dollars.

Yet, the limited role of the euro as a global currency, let alone its inability to achieve bipolarity with the dollar, raises two important concerns, according to the book. First, it brings out the market verdict on the fundamental economic and governance problems underlying the euro area economy. Second, it leaves a leadership gap in international monetary affairs, especially when the dollar and US economic primacy are in question. That leadership gap can itself imperil

global financial stability—especially in a time of global economic contraction. The reemergence of a global discussion on international monetary arrangements calls for more initiative on the part of the euro area. For these reasons, the book concludes that it is critical that the euro area member governments and institutions move beyond the area’s internal economic success to address the weaknesses keeping it from becoming the next global currency.

To address the shortcomings of euro area cooperation and crisis response, *The Euro at Ten*’s editors argue for a practical agenda that would also enhance the euro’s status as a global currency:

- First, they recommend a long-term consolidation of decision-making in financial matters in the euro area, with greater accountability and flexibility. This decision-making would apply not only to the representation of the euro area at international financial institutions like the International Monetary Fund but also to supervisory and regulatory entities monitoring the health of major financial institutions and the financial system in each euro area member country.
- Second, European policymakers should also move more quickly to define common responses to the current crisis. This applies to banking regulation and supervisions (for example, deposit guarantees and limits on new lending, so as not to further destabilize Eastern European economies) and also to other potential forms of crises affecting countries within the euro area or in its neighborhood.
- Third, the European System of Central Banks, which comprises the European Central Bank and other central banks in the European Union, must provide more aggressive support of the informally euroized and near-euro EU member states, particularly those that have faced difficulties in the current crisis. Among the forms of assistance that should be part of the rescue approach are euro-denominated swap lines and acceptance of noneuro assets for repurchase agreements (or repos), and provision of additional credits to troubled countries.

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Adam S. Posen is deputy director of the Peterson Institute for International Economics, where he has been a senior fellow since 1997. A widely cited expert on monetary policy, he has been a visiting scholar at central banks worldwide, including on multiple occasions at the Federal Reserve Board, the European Central Bank, and the Deutsche Bundesbank. In 2006

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