From the Virtual to the Tangible Euro

Ten years after the conclusion of the Maastricht Treaty, and three years after the entering into force of European Economic and Monetary Union (EMU), the euro is about to enter a new stage: with the issuance of 17 billion notes and 56 billion coins the virtual euro will become visible, tangible and hence "real". This transition has, firstly, a logistic dimension. The notes and coins must be distributed safely from the national central banks to the financial institutions and further on to retail stores, restaurants, post offices, public transport, petrol stations, theatres and cinemas, and finally to the consumer. In reverse, the national monies, now obsolete, must find their way back to the storehouses of the central banks to be annulled and recycled. At the same time price tags have to be rewritten (and prices adjusted), vending machines and cash registers adapted, and sales personnel trained. These mainly technical tasks are well under way.

A greater challenge is the second dimension of the transition process: the change in public consciousness with reference to Europe. This is an effect most of the founders of EMU had in mind: the single money stands for a single and united Europe, and European notes and coins should help create and deepen a sense of common identity among European citizens. Indeed, money is more than a technical means of facilitating economic transactions. For many peoples it is a symbol of national unity alongside the national anthem and the flag, and for the post-war Germans one might even say that the deutschmark has been the only meaningful such symbol. The role of a (tangible) common currency in creating a European identity should therefore not be underestimated. Yet, the euro will only be able to deliver if a high positive value is attached to the new money. To that end it must not stand alone but be supported by credible common policies (not only in the economic domain) and by good economic performance. Europe needs more than symbols to become a reality.

The tangible euro should also help to highlight the changed roles and responsibilities of the nation states and their economic policymakers (including trade unions and employers' associations) under a joint monetary regime. This is a third dimension of the transition process. The European notes and coins will make manifest what has been a reality for the past three years: monetary and exchange-rate policy is no longer a national domain but that of the European Central Bank (ECB) which, by definition, is bound to take a European perspective of its task. Asymmetric national economic shocks and troubles, whether they relate to high inflation or low growth, must be addressed with national policy instruments, i.e. fiscal, wages, social and regulatory policies. This puts a higher burden of responsibility on national policymakers: European monetary policy cannot, in general, be held responsible for poor national economic performance. The Irish and the Dutch have to find national solutions to their inflation problems and the Germans must finally face the sad truth that their economy has been at the bottom of the European growth league since the mid-1990s.

At the start of the tangible euro, how has the virtual euro performed so far? In a difficult economic environment shaped by the aftermath of the Asian and Russian crises, the temporary tripling of the oil price, the slowdown of the US and world economies, and the terrorist attacks, the European Central Bank (ECB) has been able to gradually build up reputation. True, the Bank has been heavily criticised for occasionally ill-explained, sudden policy shifts, for its "obscure" two-pillars strategy (with regular overshooting of the reference value for M3), and for its alleged lack of transparency. It has also been subject to criticism by some national policymakers for paying too little attention to the risks of deflation (in early 1999) or an impending economic slowdown (in autumn 2000). Looking back over the past three years one must conclude, however, that the Bank's strategy was on the whole appropriate to the situation. The ECB can now count on a growing understanding that its policy assignment is different from the Fed's, and that the Fed, in spite of its activist policy, has not been too successful in averting a recession.

As far as the ECB's primary task, price-level stabilisation, is concerned, at first sight it appears that the Bank has missed its own mark. Inflation doubled from 1.1% in 1999 to 2.3% in 2000 and accelerated further to 2.7% this year (culminating at 3.4% in May). It should be noted, though, that the ECB never claimed to be able to achieve its ambitious goal of less than 2% at every instance of time and under all circumstances. Indeed the acceleration of inflation was mainly due to external and/or non-monetary shocks over which the ECB has no direct control. Any short-term attempt to prevent their feeding into the general price level would have entailed major macroeconomic costs. What the ECB did with some success was to prevent those shocks from generating second-round (wage) effects feeding into medium-term inflation expectations. Consequently, long-term interest rates have remained at historical lows. By 2002, inflation is forecast to fall again to 1.8%.

Contrary to earlier expectations the economy of Euroland, in spite of its (statistically) reduced export dependency, remains heavily dependent on the business situation in the rest of the world and especially in the USA. While EMU has cushioned the economic impact of external shocks, it has not achieved the degree of "insulation" or "self-sufficiency" anticipated earlier. It appears that among the transmission channels are not only actual trade flows but to a large extent business expectations as reflected, *inter alia,* in stock prices. On the whole, therefore, the US economy continues to serve as the trend-setter for the international business climate.

On the external front, the euro has been unable to meet the high initial expectations. Its exchange rate against the dollar declined by 30% between the start of EMU and the autumn of 2000. In the first year the ECB paid little attention to the exchange rate, maintaining (correctly) that it was explicitly bound to care for a stable price level rather than for a stable external value. "Benign neglect" was given up when the euro, on 27 January 2000, plunged under the "magical" parity (EUR1 = USD1). Yet, the downward trend was only stopped when the ECB as of 22 September 2000 engaged in a series of exchange-market interventions. Since then, the euro has fluctuated around a level of $0.90 without, however, being able to recover ground permanently. Various "theories" have been offered to explain that weakness, from the poor growth performance of the euro area to cash transfers into dollar notes in anticipation of the termination of the deutschmark. As a consequence of its external weakness, the euro has so far been unable to challenge the dollar's position as the leading international currency.

As expected, the euro has served as a catalyst in the creation of a European financial market. Yet its effect has been limited so far. It has been felt mainly on the wholesale markets, and especially the money markets, whereas the retail markets continue to remain fragmented by different national regulations and high transition costs. A notable development is the rapid growth in the issuance volume of corporate bonds. Another observation refers to the shift in perspective and benchmarking from national to European and sectoral standards. Most importantly, the single currency has directed attention to the many regulatory obstacles standing in the way of a truly integrated European financial market.

On the whole, the tangible euro starts from a solid foundation. Transition from virtual to "real" money will certainly help to raise the visibility and acceptance of the single European currency both within Europe and abroad. It may even have some catalytic effects. Yet, in order to deliver it will continue to need the support of a credible and successful European policy.

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