

Let's hear it for the euro

Policymakers are failing to communicate the great benefits of the single currency in these turbulent times, argues Erik Jones



Smart money: eurozone finance ministers like Belgium's Didier Reynders have removed currency volatility from their list of worries. Photograph: European Communities

European institutions are suffering a loss of confidence in the global crisis - and at least part of that is due to misperceptions about the benefits of the euro.

From October/November 2008 to January/February 2009, Eurobarometer pollsters have found that trust in European institutions has fallen across the board. For the first time in its history, more people claim to distrust the European Central Bank (ECB) than to trust it. The situation is particularly grim at the heart of the eurozone – meaning, Germany, France and the Benelux – where the combination of loss of trust and increase of distrust in the ECB has been the greatest (the two things are not equivalent because polling respondents can also say “don't know”). Meanwhile only 39 percent of respondents across Europe believe that the euro has mitigated the bad effects of the crisis while 44 percent believe that it has not. In Italy, Spain and Portugal, a majority of polling respondents believe they would have been better off if they had never adopted the euro in the first place.

Such respondents are sorely mistaken. Life in the financial crisis without the euro would be troubling indeed. Consider the situation with long-term government interest rates (or bond yields). At the moment, the Italian, Spanish and Portuguese governments pay roughly the same over a ten-year period at just over 4.2 percent, while Germany pays just over 3.5 percent. That may seem like a big difference but it is not. During the exchange rate crises of the mid-1990s, the three southern countries paid over 12 percent when Germany was paying just 8 percent. Moreover, long-term interest rates across the four countries converged once their firm intentions to join the euro became clear in early 1998. In turn, that convergence insulated the southern European countries from the after-effects of the Asian and Russian financial crises of 1997-1998.

Of course, monetary union is not the only way to get stable long-term interest rates. Outside the single currency, Britain has had stable long-term borrowing costs as well – with ten-year bond yields only about one percent higher than Italy and Germany at the end of the 1990s and again during much of the past decade, but tracking Germany rather than Italy during the crisis itself. What Britain has not had over the same period is a stable relationship between its currency and the outside world. On the contrary, the pound has whipsawed between the dollar, the euro and the yen, alternatively being strong against one set of currencies and weak against the others or the reverse. The intensity of these fluctuations has peaked during the present crisis as money has flooded out of the pound.

The effect of exchange rate fluctuations has been anything but salutary so far as British manufacturing employment is concerned. Here the contrast with Italy is instructive. In 1998, the UK had 4.5 million manufacturing jobs to Italy's 5.1 million. By 2008, however, British manufacturing had shrunk to just 3.1 million compared to Italy's 5 million. As the *Financial Times* explained in a [May 2007 editorial](#) – written before the onset of the crisis – this exchange rate volatility played an important role in the destruction of Britain's manufacturing base. Moreover, British politicians are not alone in facing the choice between interest rates and exchange rates. The Scandinavians have confronted a similar dilemma as well. In October 2008 they came to different conclusions. The Norwegians and the Swedes decided to allow their currencies to depreciate so that they could try to push down interest rates in response to the global financial crisis. The Danes chose to hold onto their fixed exchange rate with the euro and so found themselves having to raise short-term interest rates instead.

Countries inside the single currency benefit from never having to face this choice. They can have it both ways: stable interest rates and fixed exchange rates. Of course this does not eliminate all of the bad effects of the crisis, but it does reduce unnecessary volatility and so makes things better and not worse. This simple fact needs to be conveyed more clearly in popular discussion of the impact of the euro. It may not restore confidence in European institutions, or in the ECB in particular, but it certainly cannot hurt.

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