Ten years later, the euro stands strong
Carter Dougherty and Mark Landler

A child in Brussels displaying a giant model of a euro coin. (Francois Lenoir/Reuters).

The president of the European Central Bank, Jean-Claude Trichet, still marvels at the feat.

Paris, Lisbon, Madrid, Rome and Berlin - each, at some point, the political and economic capital of an empire, containing the power of New York and Washington combined - each surrendered a piece of sovereignty to a common currency, a foreign coin of the realm.

"When you have to cope with the history enshrined in those capitals," Trichet said in an interview in the Eurotower, the European Central Bank's headquarters, in Frankfurt, "you are necessarily working on an original."

That original, the euro, is the currency of 15 countries and 320 million people today. Trichet and top European leaders, including Chancellor Angela Merkel of Germany, will gather Monday in Frankfurt's elegant Old Opera to celebrate the accomplishment.

The euro is as gilt-edged an investment as can be found in the current tumultuous global economy. And it is, in the view of Trichet and many others, its stability that is the ECB's greatest single accomplishment.

Now, 10 years after its birth, the central bank - more successful than its architects imagined, more powerful than its detractors feared - faces what could be its greatest challenge since the invention of the euro: How will it make monetary policy for a patchwork of countries as some in southern Europe become mired in a global slowdown while Germany, the largest euro-area economy, thrives but is stalked by inflation?

Ten years on, the ECB's accomplishments are clear.

It has fulfilled its primary mandate: keeping inflation in check. Over the last 10 years, prices rose an average of 2.1 percent a year, even with the recent spike in food and energy prices. No politician has made a serious effort to undermine the bank's independence. And despite the discomfort of a single monetary policy, no country has seriously mulled an exit.

Privately, European central bankers chuckle over the prediction by the American economist Martin Feldstein, in 1997, that divisions created by the euro might lead to war between nations using the currency.

"It has been a remarkable success," said Philip Lane, an economist and director of the Institute for International Integration Studies at Trinity College in Dublin. "It is hard to overstate that."

For European businesses, the euro became a reality on Jan. 1, 1998. For European consumers, the euro arrived on Jan. 1, 2002, when euro-denominated bills and coins became legal tender.

But for the architects of the euro, June 1, 1998, marks the date when years of dreaming, pondering and haggling bore fruit in the form of the ECB itself, based in Germany's financial capital.

The ECB embodies a dream even the founders of what is today the European Union never permitted themselves. When the original treaty calling for "ever-closer union" was signed in Rome in 1957, global currencies were tied to the dollar, which was linked to gold. Dreams of a common European money, harking back to the days of the Roman Empire's silver denarius, seemed unnecessary.

The successful introduction of the euro, a monumental logistical and technical task in its own right, gave way to a string of all-too-national frustrations for Trichet and his colleagues.

Even before the ECB's inception, European central bankers had been clamoring for new thinking in national capitals. The ECB would set a single benchmark interest rate and the euro would have a single exchange rate, so national leaders would never again be able to devalue their currency to remain competitive.

So, the central bankers prescribed looser labor laws about hiring and firing, fewer regulations on things like retail services, and greater willingness among Europeans to move around to new jobs. In essence, they asked that Europe look more like the United States, the other big expanse of real estate with a successful stable currency.

They were disappointed.

"We always knew that a one-size-fits-all would cause problems," said André Szász, a former Dutch central banker and negotiator of the Maastricht Treaty, which in 1993 laid the founding rules of monetary union. "What we hoped for was flexible nonmonetary policies," he said - work and labor rules, for example.

"With benefit of hindsight, this was not a realistic expectation," he acknowledged.

That may be because the central bankers who wrote the treaty had more economic than political acumen. They assumed, wrongly, that the loss of monetary independence would force European leaders to rework the policies they could still make.

"There was this belief in Germany and other countries that if you set up a hard monetary commitment to price stability, you would scare unions and politicians into reforms," said Adam Posen, deputy director of the Peterson Institute for International Economics in Washington. Instead, the "behavioral influence" of the common currency has been limited, he said.

The result of this miscalculation has been a wild divergence in economic performance that has much to do with those dashed expectations for reform.

Germany, the largest economy in Europe, spent much of the ECB's first 10 years in a slump, while traditional laggards like Spain, Italy and Greece charged ahead. Now that equation has neatly reversed itself, with the southern nations sliding into distress as Germany, made more resilient and flexible by years of painful structural changes, has reclaimed its role as Europe's economic locomotive.

The ECB provided Europe with easy credit for most of the last decade, in deference to Germany's stagnation and modest inflation. That policy was well received across Europe because cheap cash fed a housing boom and obviated the need to follow the German example of unpopular reforms.

Because Germany has revived, now the ECB has to tighten access to money, a much less popular decision, but one much more in line with what the framers of monetary union expected would be the hard part: administering unpleasant medicine to the rest of Europe. That has stoked fears that the scapegoating of the euro, by politicians and ordinary Europeans, has yet to really get under way.

But some observers see strength in diversity, over the long run. "I like these disparities, because it distributes the risks," said Daniel Gros, director of the Center for European Policy Studies in Brussels. "If you had one gigantic Spain" - where a huge property bubble is bursting - "we would be in one gigantic mess."

The ECB's monetary policy, however, can look a bit ill-fitting at times, especially now as prices of food and energy increase. The ECB could end up raising interest rates, a policy most suited to a thriving Germany, even as weakening growth diminishes the risks of inflation elsewhere in the euro zone. Indeed, tighter monetary policy in the midst of contracting economies in many countries could make any downturn worse, potentially bringing Europe's restive citizens into the streets, and leading their governments to look for scapegoats.

"The old temptation of the governments to find a culprit for their problems has come back," said Alexandre Lamfalussy, the last president of the European Monetary Institute, the forerunner of the ECB.

Trichet's standard answer to this quandary is that the ECB makes policy based on data from the euro area as a whole. The ECB does not try to synchronize Germany and Spain any more than the Federal Reserve tries to get New York and California on the same economic cycle.

Trichet says that closing fissures in the euro zone demands structural changes that could stimulate growth and lower inflation. And those tasks have far more to do with the once imperial capitals - Paris, Lisbon, Madrid, Rome and Berlin - than the central bank in Frankfurt.

"It is in this domain that the courage of leaders is most needed," Trichet said, "whether you have a single currency or not."

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