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The euro is ten years old!

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Ten years ago, on January 1, 1999, eleven European Union (EU) Member States signed up to a single currency, the euro. Today, the euro area has 16 members, with Slovakia making its entry just as fireworks lit up the European sky announcing the arrival of the New Year (2009). At this time of financial crisis, it is still possible for Europe to take a few moments to celebrate this great success.

The decision to create a single currency in Europe was made in 1993 with the signing of the Maastricht treaty. However, at that time, a number of politicians and analysts did not give the, as yet unnamed single currency, much of a chance of being launched at the end of the 1990s – as was being envisaged at that time. Besides, some may remember the articles in *the Economist* which compared European Monetary Union (EMU) with the emu, an Australian bird a bit like an ostrich and that cannot fly (this being the whole point of the analogy). As the European economy was in recession and the European Monetary System hit a crisis in 1992-1993, the future looked bleak for the EMU.

Fortunately, the European Commission and the European Monetary Institute (the precursor to the European Central Bank) took care of proceedings. Methodically, these two institutions led the way for the legal and political foundations to be laid down in time so as to guide and persuade companies and financial institutions to prepare for the arrival of a common currency. Once these economic actors were convinced of European leaders' true commitment to EMU, interest rates in Europe started to converge with those of Germany. This helped to kick start economic growth and thus facilitated the achievement of the Maastricht convergence criteria.

Ultimately, however, the criteria were applied in a somewhat flexible fashion, particularly with respect to national debt. Due to the cost of integrating East Germany,

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Germany (the very heart of the EMU) hit the debt criterion's ceiling, whereby the ratio of gross government debt to GDP must not exceed 60%. The Netherlands and Ireland, which had disciplined macroeconomic policies, also had public debts that exceeded the Maastricht criterion. It was thus politically difficult to say 'no' to the members in the 'South': Spain, Italy and Portugal.

In spite of a certain degree of asymmetry as far as economic structures between the members of the euro area are concerned, due to the flexibility with which the convergence criteria were applied, the euro has had some positive effects upon the European economies. The single currency provided a strong boost to the growth of intra-European trade. The introduction of the euro also afforded several Member States lower funding costs in international capital markets. Finally, it laid the foundations for the integration of European financial markets, the sector where there has been the most progress as regards economic integration within the EU during the last ten years.

The economic asymmetry between euro-zone Member States has nevertheless affected some of them negatively at certain times over the last decade. As the European Central bank (ECB) sets the key interest rate for the whole of the euro area, some countries experienced interest rates which were too low or too high in light of the performance of their economy. For example, given their very fast growth in the first half of this decade, Ireland and Spain would have benefited from much higher interest rates. Germany, on the other hand, should have had rates lower than those set by the ECB.

This situation is not very different from what we experience here in Canada, where the provinces do not always have exactly the interest rate they need to suit their economic performance. Ideally, for an optimal currency area there must be full mobility of labour so that unemployed workers from one area can move to where there is a shortage of labour – such as during the past few years when workers from the Maritimes went to work in Alberta. The problem is that in Europe, worker mobility is still very limited, not only because of language barriers, but also due to the rigidity of job market regulations. European institutions have been working for years to reduce these barriers, but progress is slow. As always, those who benefit from these restrictions, often supported by trade unions, mobilize themselves politically in opposition to change.

Today, the euro is a strong and stable currency. There are now more euros in circulation throughout the world than there are US dollars. With the current financial crisis and the weakness of the US economy, a number of people anticipate that the euro will, in the next few years, succeed the dollar as the international currency. Countries such as Denmark and Sweden are re-examining their decision to remain outside the euro area. Even Iceland, which is not a member of the EU, is thinking of adopting the euro.

It is true that certain European countries such as Greece, Ireland and Italy are currently experiencing fiscal difficulties, but it is highly unlikely that their situation would lead them to abandon the euro and reintroduce a national currency. Such a move would be catastrophic for these economies.

Obviously, the Stability and Growth Pact, which has already been somewhat eroded, will have to be applied with some flexibility over the next few years, as the current financial crisis is resolved. However, investors now differentiate between the various economies of the euro area, according to the risk associated with the purchase of government bonds from these countries. That was not the case a few years ago, when investors were treating all the members of the EMU equally. Therefore, the pressures exercised by financial markets (i.e. investors), in terms of higher interest rates, will make it more difficult for some Member States to let their fiscal deficits run out of control.

As for the ECB, it has been able to develop a solid reputation for controlling inflation, to the point where it is sometimes accused of being overly concerned with inflation to the detriment of economic growth, even though its main objective is price stability.

All in all, the euro is one of the great successes of European integration. If ever the political and economic conditions allowed for the creation of single currencies in the Americas, in Africa or Asia, it is certain that the European model would be copied. Our friends from the old continent can be proud of what they have achieved and we must greet their success warmly.