in the jargon of the market, "the trend is your friend"; the way to make money is to join, even lead, the herd.

What will count in the end is credibility—a recognition that there is national interest in greater stabilization and a willingness to act. That credibility will require time to attain. I would argue that it is attainable. We have attained it in an area at least as difficult, turning away the inflationary expectations that dominated and constrained monetary policies a couple of decades ago in my country and many others. The Europeans, recognizing the risk of currency instability tearing apart the common market, went a long way toward establishing the necessary credibility within their regional market even before taking the leap into the common currency. The Swiss, among others, have demonstrated that it is feasible even for a small economy.

The kind of approach that I have suggested is much less demanding than the European experience. But if successful, it can be an important way station toward the much more distant vision of a true world currency. In the meantime, I believe that it can be—in fact, it must be within our lifetimes—a critical ingredient in a truly effective global financial system, a system that works to the benefit of all the countries of the world, large and small.

NOTE

This is the speech given by Paul A. Volcker at the University of Delaware on Monday, 30 April 2001. Mr. Volcker was awarded an honorary degree and gave the annual Hutchins Lectures, named in honor of Harry D. Hutchins, who taught economics for 30 years at Delaware and was well-known for his concern for students and his money and banking textbook.
Although the paper's assessment of the EMU as a macroeconomic policy system in the first two years of the single currency highlights a number of shortcomings, the euro so far seems to be more successful than expected. However, further improvements to the system are likely to be required.

In the second paper, "The Markets versus the ECB, and the Euro's Plunge," Jorg Bibow concentrates on the ECB's monetary policy. He argues that factors in addition to the widely-held growth differential between the euro area and U.S. economies have caused the weakness of the euro. The paper examines whether the ECB's monetary policy has played a role in the euro's plunge. It is suggested that the ECB's ongoing communication problem, which causes uncertainty and confusion in the markets, is particularly severe. The special time-inconsistency problem the ECB ran into, with the implication that its aggressive interest-rate tightening weakened rather than strengthened the euro, is viewed as a serious constraint. The analysis presented is in the liquidity preference theoretical tradition, as explicitly stated by the author.

A further ECB-related problem is discussed by Guglielmo Maria Caporale and Andrea Cipollini in their contribution entitled "The Euro and Monetary Policy Transparency." They focus on the lack of transparency of the ECB's monetary policy (especially when compared with other central banks, such as the Bank of England, which has been praised on the transparency issue) as a possible explanation for the weakness of the euro. In order to obtain a time-varying measure of monetary policy uncertainty in both the euro area and the United States (so that comparisons can be made), they estimate a stochastic volatility model using policy-adjusted short-term interest rates. They also analyze directly the impact of higher uncertainty on the euro-dollar exchange rate. The empirical findings are in line with those of other studies, and show that the U.S. Fed is more transparent than the ECB. This results in higher volatility of European interest rates, capital outflows and a weaker euro relative to the U.S. dollar. The early experience of the euro has been accompanied by these occurrences, an observation discussed extensively in the literature.

The lack of transparency and the other problems analysed in the other papers, however, are only a subset of a number of reasons that may explain the failing value of the euro. This is the thrust of the argument of the next paper, "Explaining the Euro's Initial Decline," by Philip Aretesi, Iris Biefang-Franscho Mariscal, Andrew Brown and Malcolm Sawyer, which assesses a number of explanations for the decline in the external value of the euro. In the light of this assessment, they discuss the future prospects of the euro and of more broadly, the eurozone. The authors argue that a combination of eurozone weakness, endogenous to the inception of the euro, and of U.S. strength, most plausibly explains the decline in the value of the euro. Whilst its future value remains uncertain, the future prospects for the eurozone will remain bleak as long as the current institutional arrangements underpinning the euro remain in place.

The next three papers offer a different perspective. The contribution that follows immediately concentrates on the fiscal front, while the remaining two extend the analysis in ways that embrace the more international character of the euro and its implications for the international monetary system.
Philip Arestis, Mosabih Khan and Kal Luitel in their paper entitled “Fiscal Deficits in Monetary Unions: A Comparison of EMU and the United States,” suggest that the stringent deficit criterion followed by the EMU, as embedded in the Maastricht Treaty and in the Stability and Growth Pact, is motivated by the belief that a sustainable fiscal arrangement is an important prerequisite for a viable monetary union. An empirical analysis of the issue of deficit convergence in the euro area is provided, and a comparison and contrast of the eurozone deficit with the U.S. federal deficit is undertaken. On the basis of the results of this empirical investigation, and of the analysis offered in the paper, the authors offer four main conclusions: there is evidence of fiscal convergence in most of the euro area countries; the 3 percent fiscal criterion had been met by all euro area countries immediately before the launch of the euro; the magnitude and variability of fiscal shocks in the whole of the euro area is lower than in the United States; and the euro area is prone to smaller fiscal shocks than the United States.

The objective of the contributions that follows, entitled “The Euro as a Stabilizing and Harmonizing Force in the International Monetary System: Analytical Foundations and Future Prospects,” by Jean-Pierre Allegra and René Sandretto, is to examine closely the hypothesis that the euro may contribute to creating a more pacified international monetary system in the long run. The creation of the euro should lead to radical changes, which are likely to bring about systemic effects in the organization of the international monetary system. This may very well arise as a result of a new situation in the international scene characterized by shared monetary leadership. However, the emergence of a truly bipolar monetary system with the U.S. dollar and the euro as dominant currencies will not be achieved overnight. It will require a long transitional period that is likely to be very turbulent. It is argued that the most appropriate theoretical framework for such an approach is “beggar thy neighbor stability.”

Finally, in an exercise to examine the creation of the euro, its performance, and its relation to the U.S. dollar and the Japanese yen, Dumnick Salvatore in his contribution “The Euro: Expectations and Performance” begins by concentrating on how the euro has performed in the real world since its adoption. Clearly, the expectations prior to its introduction had been euphoric, so much so that some contributors had been predicting that the euro would have seriously challenged the dollar as a world currency. The experience of the euro since 1 January 1999 has been rather less satisfactory than expectations. This is explained by reference to two factors: the expectations were inappropriate, and there is a long-term issue involved which would depend on the evolution of the euro on the international stage and its symbiosis with the other two currencies. The latter would further depend on the process of financial integration in the EMU and developments in the international financial architecture.

The overall conclusion of this symposium is that although the project of a single European currency is not inherently flawed, a great deal of change is necessary, mainly at the institutional level. This is especially true if the euro is to become the engine of economic growth not just in the eurozone but also worldwide, and to contribute to the creation of a more effective international monetary system.

THE EURO: A SUCCESS AGAINST THE ODDS?

Iain Begg
South Bank University

The decline in the external value of the euro, spots between political leaders and central bankers about the stance of policy, and Irish dismay about being criticized by the European Union Council of Ministers for having one of the world’s highest growth rates have all been seized on by critics of Economic and Monetary Union (EMU) of Europe as evidence that the doubts expressed about the single currency are entirely warranted. While there are no signs yet that these disagreements will provoke armed conflict, it is tempting to conclude from the track record of the euro so far that the concerns articulated by the likes of Feldstein [1997] are proving to be well founded.

Yet viewed from the inside, the outlook for the European Union (EU) economy improved once EMU started in 1999. Growth picked up, unemployment fell without appearing to trigger inflation and, despite having been affected by the U.S. slowdown, the EU is suddenly being seen as the global region most likely to sustain the momentum of world economic growth. Whether this is because of, or merely coincident with, the introduction of the euro is a fascinating and intricate question. The aim of this paper is to look behind the headline critique of the euro to explore whether it has, in fact, been more of a success than its early external performance implied. This entails looking not just at the gyrations on the foreign exchange markets, but also at the degree to which the new macroeconomic policy framework in the EU has evolved and whether it can be expected to sustain the improved economic performance.

The next section of the paper looks briefly at some theory and expectations of how EMU would evolve. This is followed by a discussion of the introduction of the euro which, given what could have gone wrong, has been surprisingly smooth. The recent performance of the EU economy is then briefly reviewed and the heavily publicized fall in the value of the euro is then discussed. EMU, however, cannot sensibly be analyzed just by looking at the short-term macroeconomic indicators or the gyrations of the exchange rate. Instead, it is the viability of the policy system that matters, and the remaining sections of the paper focus on these matters.

THEORY AND EXPECTATION

The move to the single currency was extensively discussed in the academic literature prior to the formal introduction of the euro in January 1999. In addition to the more strident "pro" and "anti" contributions, several key themes emerged and it is instructive to review those in assessing what has actually happened since the euro came into being [Eichengreen, 1996]. The probability of asymmetric shocks and the