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Asia has a model in the euro

By Joergen Oerstroem Moeller.

SINGAPORE - The global currency markets are ruled by turmoil, with the US dollar at an all-time low against the euro and statements from China casting doubts on its willingness to maintain the composition of its currency reserves.

This raises the issue of Asia's capability to ensure currency stability inside Asia and at the same time make it less vulnerable to destabilization from outside. It can be expected to play a significant role when Asian leaders in various groups meet from November 18-22.

A valuable starting point is to digest how the Europeans fared after launching plans for an economic and monetary union 38 years ago and how they actually managed to get from loose plans and sketchy ideas to an established and reputable international currency.

On January 1, 2002, the euro was introduced as the single currency for 12 members of the European Union. It looked like a snap with the fingers, just like that. In reality, it was the result of a long, arduous, hard, difficult and sometimes tumultuous endeavor starting December 1969, almost 33 years before the euro was in the hands of the European citizens. Few people know the tortuous road traveled by the party before arriving at the end.

There was no shortage of good advice to abandon an ambition looked on as ostentatious by the outside world. When sizing it up, academic experts with few exceptions were unanimous in the verdict: not feasible. To make it feasible the academic world prescribed a fundamental change of the European model into a free market model analogous to the US.

An economic and monetary union worked in the US, by implication the economic conditions prevailing there should be copied by the Europeans. Change your societies to make it workable, sounded the verdict and the advice. Otherwise the euro could not be accomplished, and if it did, it would not last, and if it did last, it would soon look like a major and decisive disaster. But the Europeans acted like the bumblebee that according to aerodynamics cannot fly, but unaware of this it just keep flying!

It may be too soon to declare victory. Five years after its introduction we are still in the early days of the euro and much can happen, but it is not too soon to brush aside the skeptics. The euro is here and definitely intends to stay. It has already weathered significant swings in its exchange rate against the US dollar.

Since its inception as a unit of account in year 2000 at a rate of US$117.89 to 100 euro, the exchange rate has fluctuated between a low point of US$82 and a high point of US$145 per 100 euro. Presently it is about the latest figure. This is a swing of approximately 80% against the supposedly strongest currency and the global reserve currency par excellence. The market has not lost confidence and belief in the euro. On the contrary. There is anecdotal evidence of a rising interest in reallocation foreign exchange reserves from US dollar to euro in the portfolio of both official and private funds.

But what about the European economies? Didn't they turn into low growth at the very moment the euro was introduced? The mass media report about low flexibility, low mobility and resistance to changes. The European welfare model is too expensive, keeps people away from work etc. The Euro Zone is in the doldrums, while the free market US economy is thundering ahead. Maybe the verdict that only the US model was compatible with economic and monetary union was right after all?

There is an element of truth in much of the criticism. A comparative analysis published by The Economist shows, however, that the main difference between the European and American economy is not due to the models, but to one and only one factor: higher population growth in the US. Somewhat astonishing figures reveal that:

- From 2001 to 2005 gross domestic product per capita grew at an average of 1.4% in the Euro Zone and 1.5% in the US.
- From 1996 to 2005 employment grew stronger in the Euro Zone than in the US albeit the difference is small. It is equally true if the 10-year period is broken up into two five-year periods.

Nobel laureate Robert Mundell comes to the same basic conclusion - that the main difference between the US and Europe is population growth - in an interview in September 2006 stating, "Some say that Europe has performed badly compared with the US over the past 10 years, but they forget that Europe has zero population growth and that European per capita income isn't much below the US figure."

This is not to say that the European economies are doing phenomenally well, they are not, but they are in much better shape than the popular presentation of sick European economies leads the observer to believe. Add to this the Euro Zone's performance on balance of payments and public budget compared to the almost calamitous imbalances distorting the US economy actually threatening the global economy

Growth prognosis for 2007 and 2008 supports this view. According to the International Monetary Fund, US economic growth is decelerating from around 3.1% in 2005 and 2.9% in 2006 to 1.9% in 2007 and 1.9% in 2008. The Euro Zone is accelerating from 1.5% and 2.8% to 2.5% in 2007 and 2.1% in 2008. One swallow does not a summer make, and the European growth is still below US trend growth, but keeping in mind the points about population growth and imbalances the difference can hardly be said to be significant.

The critics and/or the skeptics point to growing disharmony among the euro members. The new French president calls for less independence for the European Central Bank, Italy is apparently fighting hard to regain competitiveness and Ireland has had to adjust uncomfortably. Such conflicting views should by no means be disregarded. But how easy to forget the running battle in the US about economic policy and the all too obvious difficulty for Japan in finding a suitable balance between fiscal and monetary policy.

The Euro Zone is not the only example, far from it, of an economic area where the central bank is under attack or faces political pressure to adopt a monetary policy preferred by politicians. The mass media report the dilemma the Reserve Bank of Australia faces with regard to its interest rate policy in light of the views of the government and the upcoming election.

Hopefully this suffices to warrant a conclusion that irrespective of all its weaknesses the euro has come to stay, and what we see in Europe of problems are not in any way different from what is seen elsewhere - do not ask more from the Euro Zone than already established national economic and monetary unions deliver.

It is thus legitimate to pose the question of how the Europeans got there. It is interesting not the least because currency cooperation is attracting increased attention in Asia. Very few would dare to take the view that the time has come for an economic and monetary union in Asia, but equally few, hopefully, would discard the view that Asia may gain by exploring how far and how fast cooperation about currency rates can go.

The lessons can be summarized like this.

A firm political will to start and keep going. An economic analysis may tell that the conditions are not at hand, but such an analysis is based on present conditions and currency cooperation is dynamic and changes the circumstances.

It must be realized among political decision-makers that currency cooperation is not emerging by itself calling for a subsequent political framework. It is the other way around. First the political decisions on the basis of political ambitions, then economic advantages may follow. The political leaders must want to do it.

There will be crises, turmoil and upheavals down the road. They may temporarily derail the whole enterprise. It happened for the Europeans in the 1970s and again in 1993 where for a period Europe had to resort to fluctuating exchange rates. When markets had stabilized, the Europeans went back to the drawing table and continued the road towards the goal.

The markets must be convinced that the political will is present. Member states must be willing to pay a price in crisis to maintain the currency cooperation and get the message across. The pound sterling was forced out of the European exchange rate mechanism in 1992 because the market was convinced that the British government would not pay the price to defend the currency rate.

Member states must pursue, broadly speaking analogous economic policies. They do not need to be 100% the same, but the overall design must be congruous. In Europe the German low inflation model labeled stability policy was adopted by France and the other European economies in the beginning of the 1980s.

In the same way member states must have come to the conclusion that exchange rates are not a suitable instrument to redress imbalances on the balance of payments. That happened in Europe in the course of the early 1980s after having been tried repeatedly and unsuccessfully in the 1970s by several member states including France, Belgium and Denmark. The reasoning was quite simple: if exchange rates are not regarded as suitable instruments in economic policy, why keep the option open instead of drawing the logical conclusion to establish an economic and monetary union and reap the benefits hereof.

The members of the Euro Zone have been criticized for not respecting rigorously the criteria in the original treaty about public deficits (3% of Gross Domestic Product) and public debt (60%). But the world does not stand still. There must be flexibility to adapt as circumstances change.

The ground must be prepared meticulously and with a clear eye for what is necessary. The Europeans established a number of common policies like the Common Agricultural Policy, the Common Market and the Common External Trade Policy. Later it was supplemented by the Single Market. Liberalization of capital movements followed. When all these policies were established, the time had come to move towards an economic and monetary union - not before.

Looking at the European economies it strikes the observer that intra trade had grown to more than 2/3 of all external trade and the business cycle among the potential members moves in synchronization.

All in all the conclusion is that the Europeans got the euro by moving steadily, slowly and step by step towards the goal, taking the jump after careful scrutiny of the conditions telling that the time had come.

Whatever course Asia and/or individual Asian countries may choose towards currency cooperation, these valuable lessons are worthwhile to have in mind.

I do not intend to weigh pros and cons for currency rate cooperation in Asia or among the Association of Southeast Asian Nations countries, but offer the following observation: when the Europeans started the voyage in 1969 towards the euro everybody else than those who initiated this step deemed it absolutely impossible. The decision-makers went on to prove that political will and sound economic judgment can turn what looks impossible into a reality. That is perhaps the most important of all the experiences gained.

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