Euros and sense [1]

Written by **Tim Ambler** [2] | Friday 3 February 2012

In all the panicky talk of haircuts and economic Armageddon, it might be wise to step back and consider the two basic options: Euro or no Euro. The Euro is only a means not an end and preserving it at all costs makes little sense. With hindsight it might just look like an interesting experiment.

German leaders are keen on the Euro, even if their electors are not, because its weakness keeps German exports competitive, it lowers exchange costs and it is a step towards the United States of Europe governed from Berlin. To the extent that the current troubles lead to central, i.e. German, management of national finances throughout the Eurozone, the pain is worth the gain. There was a price for bringing East Germany in from the cold and there is now a price for fiscal union in the Eurozone. But there is a limit to the subsidies German electors will tolerate and Angela Merkel is walking a tightrope.

So the long term Euro retention option boils down to whether Germany is prepared to pay the costs of fiscal union in the Eurozone. The northern fiscally correct countries will play along albeit with some nervousness about the end game. The Mediterranean group will focus on how they can appear to be conforming to the rules whilst actually clearing the till each night. In other words the costs will not stop with the current round of negotiations.

Even Bismarck had to accept that there were limits to German expansion in his day and Germany may now decide the game is not worth the candle in which case the question becomes how to dismantle the Euro with least economic cost.

My friend Richard Warner, a banker from the days when bank bonuses were modest, has figured out that the solution is for the strongest currency to secede first, followed by the next and so on. His reasoning is that if the weakest, say Greece, leaves first, no one will believe the initial Euro:Drachma exchange rate and the drama will continue even though the Greeks can then hoist interest rates. We had a taste of that with the ERM. Double digit interest rates only scared the markets more.

On the other had, if Germany exits first the Euro:Deutschmark exchange rate would be regarded and fairly stable and the two currencies could settle at their own levels allowing the next most stable, the Netherlands perhaps, to exit next.

He has a point, don?t you think?

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