Introduction

EUROPE'S MONETARY UNION, launched on January 1, 1999, defines a new epoch in monetary history. Various commentators have called the Economic and Monetary Union (EMU) the most important transformation of the international monetary system since the transition to flexible exchange rates in the early 1970s, the Bretton Woods conference of 1944, the replacement of the pound sterling by the dollar as the leading currency in the interwar period, and even the consolidation of the gold standard in the nineteenth century. Whatever the description, monetary union has fundamentally changed the structure of international monetary relations.

The creation of the euro, the new currency of the monetary union, raises a host of questions for the United States, the rest of the world, and the external relations of the European Union (EU). How does the formation of the monetary union affect the interests of the international community? Will international monetary cooperation improve or decline with the consolidation of the euro area? How will the health of transatlantic monetary cooperation affect the global community? Will the monetary union reinforce or hinder the ability of the international community to restore financial stability? How must international institutions adapt to the presence of the monetary union? What will be the external posture of the monetary union? How effectively will the euro compete with the U.S. dollar as an international currency?

This volume concentrates on the ramifications of the euro for transatlantic relations. It asks, fundamentally, whether monetary union will lead to cooperation or rivalry between the United States and Europe. We approach this question by examining the political, economic, and institutional interests of these two principal actors. U.S. concerns are treated by C. Randall Henning in chapter 1 and European concerns by Pier Carlo Padoan in chapter 2.

Henning opens his discussion with a review of selected academic commentary and official U.S. statements about Europe's monetary union. He then analyzes the cross-cutting effects of monetary union on the interests of the United States. He also examines the external monetary policymaking machinery and international representation of the euro area, specifically, in the meetings of finance ministers and central bank governors of the Group of Seven (finance G-7) and the International Monetary Fund (IMF).

Henning is sympathetic to European integration in general, supportive of the monetary union in particular, and persuaded of the importance of international cooperation. But he does not intend to prejudge debate about the future course of the monetary union, its impact on the interests of non-Europeans, or the organization of international cooperation under the euro, and examines alternative views in his portion of the study.

The euro's impact on the interests of the international community, Henning finds, depends on further developments within the European Union. If the European Union provides stability to Central and Eastern Europe, undertakes economic policy reforms, and develops the institutions for external monetary policymaking, then the monetary union will have beneficial effects on the rest of the world, the United States in particular. If the European Union is unable to build upon the monetary union in these ways, the euro's impact outside Europe will not necessarily be favorable.

Since substantial ambiguity remains concerning European mechanisms for external monetary policymaking and representation, Henning contends, the European Union has more work to do in this regard. Clarification and delegation of responsibility for negotiating international monetary agreements with the United States and Japan is particularly important. Countries outside of Europe have an interest, moreover, in further movement within the European Union toward transparent decisionmaking and qualified majority voting. Finally, the United States and Europe should avoid official competition over the international use of their currencies. Liberalization of national capital markets and removal of barriers to investment and financial services within the European Union would be more appropriate and mutually beneficial forms of competition with the United States.

In his analysis, Padoan takes up the question of what role the euro might play as a global currency, a factor crucial to the potential EU-U.S. relationship that Henning has laid out. To answer this question, Padoan examines the factors that might make the euro an attractive currency for investors and economic actors outside the EU area and considers the possible scenarios for euro appreciation or depreciation.

In his appraisal of the euro's potential as a global currency, Padoan begins with the assumption that multiple equilibria in the international financial system are present and anchored in "currency regions" and that there will be a transition phase between a "low" (regional) and a "high" (global) equilibrium. The transition, he notes, will be a function of policy options followed by EMU authorities, particularly EMU's exchange rate policy and its attractiveness for non-EMU countries.

Padoan advocates policies that would focus on long-term stability over an "active" exchange rate policy; such policies would encourage the formation of a currency region that extends beyond the boundaries of the actual currency union. Although the dollar is likely to remain the dominant currency in the short run, Padoan argues that over the long term the euro may well rival the greenback, at which point it will be in the interest of both European and American policymakers to focus on cooperative efforts at stabilizing bilateral rates and ensuring continued economic prosperity.

Padoan discusses not only economic policy options but also the composition of EMU, emphasizing the relationship between the evolution of the exchange rate of the euro and European growth. The net benefit of EMU, he suggests, will increase with the number of members, the size of the EU's gross domestic product (GDP), degree of internal market integration, and monetary and financial convergence. In this regard, he considers several scenarios in which EMU might act as an endogenous currency area for countries that are likely to become part of the euro region, namely, those in Central and Eastern Europe and the Mediterranean. He also discusses the possible impact of instability in the euro-dollar relationship on Latin America.

The euro and dollar are now competing and will continue to compete as international currencies in the marketplace. That competition underscores the need for official cooperation across the Atlantic. Without cooperation between U.S. and European authorities, the risks of monetary and financial instability would be high. With cooperation, the United States and Europe can foster more efficient macroeconomic management and exchange rate stability and improve the functioning of international financial institutions.