



Wednesday January 7, 1998 Edition

The Euro Will Challenge, But the Dollar Will Reign

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Americans have become pretty accustomed to using their currency almost anywhere in the world. There are more than \$200 billion greenbacks circulating outside the United States.

That convenience could shrink.

A year from now, the European Union (EU) plans to launch the euro - a single European currency for perhaps 11 of the 15 member nations participating at first, the others (Britain, Sweden, Denmark, and Greece) later.

As the euro invades the dollar's turf, more exports will be billed in euros and more bonds denominated in euros.

The implications are huge.

"The dollar will have its first real competitor since it surpassed the pound sterling as the world's dominant currency during the interwar period," writes C. Fred Bergsten, director of the Institute for International Economics in Washington.

In an article in *Foreign Affairs*, Mr. Bergsten ranks creation of the euro as "the most important development in the international monetary system since the adoption of flexible exchange rates in the early 1970s."

And that was a big deal. Today, the cost of a trip to Europe or a Toyota can change in a major way, depending on whether the dollar is strong or weak relative to the German mark, Japanese yen, and so on. The yen, for example, has lost 40 percent of its value in dollars in 2-1/2 years.

Bergsten further sees a major political impact from the euro.

"A bipolar currency regime dominated by Europe and the United States, with Japan as a junior partner, will replace the dollar-denominated system that has prevailed for most of this century," he writes.

Another giant in international economics, Richard Cooper of Harvard University in Cambridge, Mass., disputes Bergsten on a key issue: the speed with which the euro will challenge the dollar's dominance.

Bergsten, though cautious on timing, suggests that between \$500 billion and \$1 trillion in global financial holdings will shift into euros in five to 10 years. That's big money.

The dollar and the euro are likely to wind up with about 40 percent of world finance, with 20

percent each left for the yen, the Swiss franc, and minor currencies, he predicts.

Mr. Cooper, in a lengthy working paper, says major displacement of the dollar will not take place "at least for several decades."

The arguments become somewhat complex. Cooper's view boils down to maintaining that the dollar is just too entrenched in the international system of trade and finance. Inertia will prevent it being replaced soon by a newcomer, the euro. Use of the dollar is just too convenient, familiar, and widespread in the world of finance.

There is, though, no question that the arrival of the new currency will be a notable event to most people on this globe. As the euro invades the turf now held by the dollar, more exports will be billed in euros and more bonds denominated in euros. The US may find demand abroad for its Treasury securities somewhat shrunk, pushing up interest rates at home.

Moreover, most of Europe's famed currencies - for example, the German mark, the French franc, the Italian lira, and probably, eventually, the British pound - will disappear. Europe's plans calls for marks and pfennigs (and other currencies) to be replaced by Euros and cents by Jan. 2, 2002.

In their debate, Bergsten and Cooper toss off fascinating information, most showing the importance of the dollar in world finance and trade. Here's some of it:

- As economic powers, the US and the EU are closely matched. The US provides about 27 percent of global production and 18 percent of world trade. The EU accounts for about 31 percent of world output and 20 percent of world trade.
- About 48 percent of world exports were invoiced in dollars in 1992. That compares with 16 percent in marks and 5 percent in yen.
- More than 43 percent of the \$710 billion equivalent in international bonds issued in 1996 were denominated in dollars. Bonds issued in Ecus (European currency units - a bookkeeping unit valued according to a specified mix of European currencies) accounted for only 1 percent.

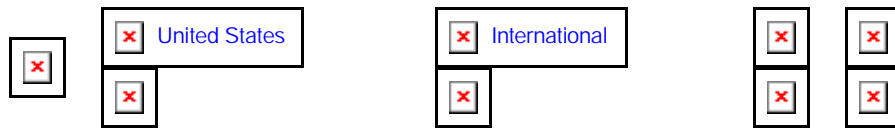
In the \$7 trillion short-term Euro-currency market, based in London, at least 46 percent of all foreign bank deposits were in dollars.

- Central banks or their governments held 64 percent of the \$1.48 trillion in foreign exchange in their official reserves in dollar assets at the end of 1996. Only 14 percent was held in marks, 6 percent in yen, and 3 percent in British pounds.
- There is nothing comparable abroad to the massive US Treasury securities market. It is easy to buy and sell large amounts of these bills, notes, and bonds.

Bergsten and Cooper do agree that if the US fouled up its economic policy, say letting inflation soar, the euro would thrive. But that doesn't seem likely at the moment. So the dollar should remain king of the currencies for a long time.

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