

Chapter 1

Now We Are Ten

On January 13, 2009, Jean-Claude Trichet, president of the European Central bank, traveled to the Strasbourg to give a lecture celebrating the tenth anniversary of the euro. It was a pleasant, downbeat occasion. Over much of its short existence, Europe's single currency had been a bitterly contested, viciously fought-over creation. Over prolonged European summits it had been argued over savagely by a whole generation of political leaders. Careers had been made and broken. Referenda had been played out across Europe, and, as the votes were counted, the fate of the project regularly hung in the balance. As preparations were made for its introduction, the global financial markets poured endless buckets of scorn on its prospects for success. As the notes and coins were introduced from Bavaria to Lombardy, from Catalonia to Provence, shopkeepers turned up their noses at this strange, foreign money, a garishly colored imposter creeping into their tills. And as it made its debut on the markets, it was treated much as the new fat boy might be at a rough school: an object to be kicked around and bullied, mainly for the amusement of the bigger and nastier children.

And yet, even at the tender age of 10, it appeared to be approaching a kind of calm, middle-aged serenity. If it was possible for a currency to pull on a cozy pair of slippers, make a cup of hot chocolate, pull itself up by the fire, and start reading the gardening supplement in the newspaper, then that is what the euro would be doing. And that mood was

very much reflected in the tone of Trichet's speech to the European Parliament that afternoon.

"For decades, the single European currency was merely an idea shared by a few people. Many others said that it could not be done, or that it was bound to fail," said Trichet.

Today, the single currency is a reality for 329 million citizens. The creation of the euro will one day be seen as a decisive step on the long path toward an "ever closer union" among the people of Europe.

Since the introduction of the euro, fellow Europeans have enjoyed a level of price stability which previously had been achieved in only a few of the euro area countries. This price stability is a direct benefit to all citizens. It protects incomes and savings, and it helps to bring down borrowing costs, thus promoting investment, job creation and prosperity over the medium and long term. The single currency has been a factor of dynamism for the European economy. It has enhanced price transparency, increased trade, and promoted economic and financial integration within the euro area and with the rest of the world.¹

Indeed so. Trichet is in many ways the perfect Mr. Euro. A smooth, articulate French intellectual, he speaks with the calm authority of a fiercely intelligent technocrat. You could interrogate the man for weeks and not force him into a single error, slip, or gaffe. Over a career spent pushing for the closer integration of the European nations, he sometimes appears to have transformed himself into a living embodiment of the ideals he strives to articulate: a kind of Franco-German unity turned, with surprising success, into flesh and bone. Like all French political and intellectual leaders, his speeches and press conferences are often elaborately erudite, laden with cultural, historical, and literary references. In the manner that only French officials can achieve, he is never afraid to make the connections between poetry and central banking (Goethe and Dante turn out to be among the influences on the European Central Bank's decisions on interest rates, in case you were wondering). But he has also assumed a Teutonic rectitude

and sternness. He is never shy about imposing a very German view of financial conservatism on Europe. He discusses thrift and balanced budgets as matters of morality as well as economics and bookkeeping, in a way that plays better in Bavaria or Saxony than it does anywhere else in Europe. He is well aware that money is as much a matter of national identity as a medium of exchange, and perhaps more so. The euro could have no better champion.

In his lecture, he pointed to three key achievements of the first decade since the euro was introduced, first as a financial currency in 1999 and then in the form of physical notes and coin in January 2002.

First, it had overcome the credit crunch. Plenty of people had been warning that the euro didn't have the strength to survive any kind of significant shock to the global economy. And yet only a few months earlier, following the collapse of the American investment bank Lehman Brothers, the financial system had gone into meltdown. Banks had been going bust all around the world. In the case of Iceland, a whole country had gone pop. Trade had collapsed at a faster rate than at any time since the Great Depression of the 1930s. The great container ships that sailed from Shanghai to Rotterdam laden with the mass-produced consumer goods that were the physical manifestation of globalization were suddenly tethered empty to the docks. And yet, even though the ships were empty, the euro had sailed through the crisis unscathed. Whatever the problems weighing down on the global economy—and there were plenty of them, no question about that—no one was suggesting that the euro was one of them.

Next, the economic union that had been the primary goal of the euro had been summoned brilliantly to life. Price stability had been achieved, and the economies of Europe had been drawn closer together. Raw materials harvested in Sicily could be sent to the Rhineland to be manufactured, then trucked to Burgenland in Austria or to the Algarve in Portugal, for sale, and the goods could be paid for, accounted for, and taxed all in the same, uniform unit of money. The result was a Europe that was far more dynamic, more prosperous, more open, and more innovative, Trichet argued.

Finally, it was getting bigger all the time. Whereas its critics claimed the euro would quickly collapse, and while the British, the Swedes, and the Danes snootily declined to take part at the beginning of the

grand experiment, fearing it was doomed to inevitable failure, instead this was turning into a club that everyone wanted to join. When the euro was launched a decade ago, Trichet reminded his audience sharply, it had 11 members. As of the first of January 2009, it was the common currency of 16 nations. If the natural impulse of any organism is to survive, replicate itself, and enlarge its territory, then the euro was by that measure a triumphant success.

“Ladies and gentlemen, during its first years of existence, the euro had to face major trials: the establishment of a sound and credible central bank and the creation of a stable new currency inspiring confidence,” he concluded with a flourish. “These challenges were overcome successfully and the euro is today firmly established. Hence, this is certainly a time for celebration.”²

On January 8, Trichet was singing from a similar hymn sheet, this time at a ceremony to mark the arrival of Slovakia in the euro-zone. In Bratislava, the Slovakian capital, on January 8, the European Central Bank welcomed the second of the former Soviet bloc countries into the club of nations that shared the single currency. It was, once again, a remarkable testament to the power of the euro. Two decades earlier, Slovakia had been part of a communist empire that stretched from the borders of Austria and Germany all the way to Vladivostok in the Far East. Now it was able to share its currency with the rest of Western Europe. “Robert Schuman stated in his founding declaration that Europe will be made through concrete achievements which create tangible solidarity among its people. European monetary union is a concrete achievement, and the euro is a tangible sign of solidarity among its people,”³ said Trichet in his remarks welcoming Slovakia into monetary union.

It was, in truth, a historic achievement, and one built against the odds. As it celebrated its tenth birthday, the euro could be celebrated not just with rhetoric, but with, just as Schuman demanded it should be, tangible, demonstrable achievements.

“It is absolutely conceivable that the euro will replace the dollar as [the] reserve currency, or will be traded as an equally important reserve currency,”⁴ former chairman of the Federal Reserve, Alan Greenspan, told the German magazine *Stern* in 2007. According to a study by Harvard University’s Jeffrey Frankel and Menzie Chinn of the

University of Wisconsin for the U.S. National Bureau of Economic Research, the euro could surpass the dollar as the world's most important currency by 2022. They looked at the way the dollar gradually replaced the British pound in the years before World War I and found that something very similar was happening right now. The United States was declining in global importance, it was running an evermore reckless fiscal policy, and it was failing to hold the line against inflation. For all those reasons, the rest of the world would gradually despair of holding dollars and start looking for a safer alternative.

As the years rolled by, and as the euro established itself more firmly in the minds of investors, that view was gaining steadily in credibility. OPEC, the powerful cartel of oil producers, started to make noises about pricing oil in euros rather than dollars. The Chinese, who use the vast trade surpluses run up by the country's exporters to accumulate massive foreign exchange reserves, started to talk by the middle of 2009 about holding more of their assets in euros rather than dollars. The Russians, whose oil reserves meant they were steadily building up financial reserves in the same way the Chinese were, shifted some of their holdings out of the dollar and into the euro. Whichever way you looked at it, the European currency was gaining ground over the American one.

Nor was that a mere matter of continental machismo (although there would be plenty of politicians, particularly in Paris, who would regard every inch of territory the euro gained on the dollar as another step forward for the forces of civilization against the forces of barbarism). There are huge economic advantages to having the world's reserve currency. Right now, everyone has to hold dollars because that is the money used for world trade. Every time people buy some of those dollars, they are, in effect, making an interest-free loan to the United States. Moreover, the government of the world's reserve currency has huge financial firepower. A U.S. Treasury bill is the benchmark safe asset for the financial markets. When there is a crisis, everyone buys T-bills: It is the acme of safety. That makes it very easy and very cheap for the U.S. government to issue lots and lots of debt that, in effect, the rest of the world has little choice but to buy. Reserve currency status acts as a kind of tax the United States is allowed to impose on the rest of the world. But if the euro could oust it from that

position, then some of those benefits would accrue naturally to Europe and its citizens, rather than to the United States. It would be Frankfurt that would tax the rest of the world, not Washington. Europeans would become richer, and Americans poorer, and, best of all, they wouldn't even have to do any more work. It was a prize well worth striving for.

The growing importance of the euro in the capital markets, however, was only one component of the single currency's success. In plenty of other ways, the euro was doing well enough to make its founders proud of their creation. Inflation was low and steady right across the vast continental economy the euro now covered. Government bond markets functioned smoothly: Portugal could borrow money just as easily and almost as cheaply as the Netherlands or Germany, despite the fact those countries had vastly better credit records. The capital markets functioned more smoothly. There were signs that trade was increasing between countries as companies no longer had to factor in the risk of the currency markets moving against them when they made goods in Eindhoven and sold them in Turin. What had started out as a great and risky experiment, and one that plenty of people had predicted would collapse when it faced its first real test, was turning into a huge success. By 2009, the euro was becoming boring, normal, a part of everyday life. It was part of the atmosphere, like the oxygen we breathe. It was *just there*. That was everything its founders could have hoped for.

But, in truth, the tenth birthday party was premature in its toasts of success. That speech in Strasbourg was to be the last chance Trichet would have to celebrate very much. Even as the words were delivered, a crisis was brewing that would, in the year that followed, threaten to blow the single currency to pieces.

It would be a crisis that would expose the flaws built into the very foundations of the euro itself.



A continental currency, with a dual metallic and fiduciary base, resting on all Europe as its capital, and driven by the activity of 200 million men: this one currency would replace and bring down all the absurd varieties of money that exist today, with their effigies of princes, those symbols of misery.⁵

The notion of a single European currency, like all bad ideas, has been around for a very long time. That sentence was written by the great French writer, Victor Hugo, author of *The Hunchback of Notre Dame* and *Les Misérables*, among many other works, in *Actes et Paroles*, which was published in February 1855.

Nor, as it happens, was Hugo the first person to think of it. The patchwork of currencies across Europe, each with its own rules and territories, has long been a puzzle to reforming, liberal minds. Napoleon Bonaparte had proposed a single currency for the whole of Europe, under French leadership, naturally enough. John Stuart Mill, the great philosopher of Victorian improvement, advocated a single European currency as part of the inevitable march toward a single global money. Winston Churchill, far more of a believer in melding European nations together than later leaders of the British Conservative Party, endorsed a single currency as part of his wider vision, put forward in a famous speech in 1946, of a “United States of Europe” to be built out of the rubble and ruins of World War II.

A single currency had long been a dream of politicians, and indeed of some economists. It had even been tried a couple of times already. The Latin Monetary Union was created 1865, and comprised France, Italy, Belgium, Switzerland, and, rather surprisingly, Greece as well. Based on both silver and gold, it made each member’s currency legal tender within every other state. The idea, much like the euro, was to promote trade among the members, while also serving as a stepping stone to a full monetary union. The central bank of the states in the union was meant to coordinate monetary policy among them. It lasted until 1927, but was running out of steam long before that, as the will to coordinate policy between the members lost momentum. It collapsed when both France and Italy, under huge pressure to reinflate their domestic economies, started issuing paper money that was backed by neither silver nor gold.

Another attempt was made with the Scandinavian monetary union, which linked the currencies of Denmark, Sweden, and Norway. It lasted from 1873 to 1920, and for a period involved intense cooperation among the central banks of the three different nations. And, of course, on a global scale the gold standard, which held sway right through the Industrial Revolution and lingered on in a diluted form

until Richard Nixon took the dollar off gold in 1971, was a form of single currency. Every paper currency based on gold was convertible into every other one, depending on the price of the precious metal. So they were, in effect, all the same money, and it certainly wasn't possible for central banks just to print more currency whenever they happened to feel it might be necessary.

But it was only during the 1970s and 1980s that the idea of a single currency for the European Union started taking real, tangible shape. And it is worth pausing to review how it came about for the simple reason that it is the debates and arguments that led up to the creation of the euro, and the compromises between different visions, that in the decade to come will inevitably lead to its unraveling.

In the 1970s, French President Valéry Giscard d'Estaing and his German counterpart Helmut Schmidt faced the inflationary turbulence of that decade with a determination to create a closer union between France and Germany. With the gold standard finally abandoned, and with all the world's major currencies floating against one another, exchange rates were moving violently against one another. Both leaders were well aware that this was crucifying their manufacturers. When German companies exported to France, they had no way of knowing what they would end up being paid, or whether they would make a profit, and vice versa. It was causing chaos. And there wasn't much point in taking down trade barriers between the countries of the European Union if they were still reluctant to trade with one another because of turmoil in the foreign exchange markets. The response of both men was the *Snake*, and it was to prove a formative event in the creation of the euro.

Created by the members of what was then still known as the European Economic Community (the more grandly titled European Union was not to be established until much later), it was in some respects a mini-version of the Bretton Woods system of managed exchanged rates that had lasted from the end of World War II until Nixon's decision to take the dollar off the gold standard in 1971. Under Bretton Woods, most of the world's major currencies were pegged to the dollar, and the dollar itself was pegged to gold. Devaluations were periodically allowed as a way of coping with economic shocks, but, by and large, currency rates remained stable against one another over long

periods of time. Under the Snake, the European countries attempted to replicate that system for one another. Although the currencies floated against one another on the foreign exchange markets, each member agreed to limit, by market intervention if necessary, the fluctuations of its exchange rate against other members' currencies. The maximum permitted divergence between the strongest and the weakest currencies was 2.25 percent. The agreement meant that the French government, for example, would ensure that the value of the French franc would experience only very limited fluctuation against the Italian lira or the Dutch guilder, but that there was no commitment to limit or smooth out fluctuations against the U.S. dollar, the Japanese yen, or any other currencies that were outside the agreement. The idea was that while there might be frantic volatility against other major currencies, the European currencies would never move very much against each other. That would encourage trade among the members of the EU. And it would also mean that the different European currencies that belonged to the Snake would start to behave as a single block. If the deutschmark started to move up against the dollar, then so would the pound and the franc and the lira, because all the different currencies were in effect linked to one another. It was the euro in the making.

The trouble was, it didn't work very well. Britain and Ireland tried it for a month, and then, with the typical hesitancy of the Anglo-Saxons over any European project, gave up and withdrew. The French found it too hard to stay the course, and so did the Italians. Only the Germans, with typical determination, remained members all the way through to the end of the system, which lasted until 1979. Countries stayed in when it was easy to maintain membership, but generally opted out as soon as the exchange rate mandated by the system became difficult to defend. It wasn't, as it turned out, much of a protection against anything, because everyone always abandoned it as soon as the going got difficult.

The flaw in the system was simple. It was set up to fight the currency markets. The only way, for example, that the franc–deutschmark rate could be defended was if the Bank of France intervened to buy francs as soon as currency traders started selling them. But that quickly became ruinously expensive (to the central bank, that is; it was

fabulously profitable for foreign exchange traders). The central bank was always going to lose money on the trade. By 1979, the system had become a joke: It was merely a way of transferring wealth from taxpayers to bankers. There was no point in carrying on with it.

With the collapse of the Snake, a fresh generation of European political leaders had another go at stabilizing exchange rates within the European Union. This time it was called the European Monetary System. Launched soon after the Snake collapsed, the EMS was a more serious and hardheaded approach to the issue. It created a new currency unit called the ECU (standing, not very imaginatively, for the European Currency Unit). The ECU was a basket of each member's currencies, weighted in terms of the respective size of their economies. Each member of the system undertook to manage the value of its currency against the value of the ECU. It worked in much the same way as the Snake in that it stabilized exchange rates between the member states of the EU, while allowing them to fluctuate against the rest of the world's currencies. It was, however, easier to defend. The standard maximum exchange-rate fluctuation permitted for each EMS currency was 2.25 percent. However, there were wider bands for weaker members, such as Italy from 1979 onward, Spain from 1989 onward, and the UK from 1990 onward. The system was also subject to frequent realignments of the grid, which had a tendency to make a mockery of the whole structure of the EMS. The trouble was there wasn't a huge amount of stability in the system when any one country might suddenly need to revalue the rate at which its currency was traded against the notional ECU. Rather like the Snake, it worked only when times were good. But, of course, when times were good, you didn't really need it. What you wanted was a system that could stand up to storms and shocks in the global economy, and the European Monetary System certainly wasn't that.

The system blew apart after the British joined. In 1992, with a deep recession in the UK, currency traders were selling the pound. The Bank of England was finding it impossible to defend the rate against the ECU (and in effect against the German deutschmark) mandated by the system. The German central bank, the Bundesbank, showed no inclination to help out by intervening in the markets on behalf of the pound, or by adjusting its own interest rates to bring

them more into line with British ones. After a desperate battle with the markets, which cost the Bank of England billions of pounds in foreign exchange reserves, the British were ignominiously forced out of the system. Soon afterward, the trading bands for the EMS were widened to 15 percent. It was, in effect, dead. If currencies can fluctuate by 15 percent against one another, they are not fixed in any meaningful sense of the word.

The Snake and the EMS were both quite rightly regarded as failures. They had foundered on two main rocks. Any attempt to fight the foreign exchange markets was always doomed to ultimate failure. And any attempt to tie together very different economies was always going to produce strains and tensions that would in the end tear the system apart: It was the attempt to bind the very different British economy into the EMS that was to prove its downfall. But, as we have already noted, you can't keep a bad idea down. While some people might have concluded that any attempt to manage exchange rates between the members of the European Union was doomed to failure, the EU's political and bureaucratic elite drew precisely the reverse lesson. Their verdict was that the next time around they would try even harder, creating a single currency that was completely impregnable to attack by the currency markets, and that would bind the economies of its members together so tightly that they would in effect congeal into one harmonious economic whole, much as the economy of the United States did under its own single, continental currency, the dollar.

And so the idea of the euro was born.



On the banks of the river Meuse, which runs through France, Belgium, and the Netherlands before emptying out in the North Sea, the town of Maastricht is a historic tourist destination in the Dutch province on Limberg. It is famous both for its university and for its elegant stone streets. But these days it is probably better known as the city in which the euro was born.

On February 7, 1992, the leaders of the European Community gathered to sign what became known as Maastricht Treaty. Under the leadership of the energetic Frenchman Jacques Delors, the Treaty was the most decisive step yet taken toward a single government for

the whole of Europe. The Treaty established the European Union as a political as well as an economic union. And it committed the members to full monetary union. It laid down the criteria for membership, the essential rules that would govern the single currency, and a timetable for their introduction. There were still plenty of hurdles, but after the signing of the Maastricht Treaty the die was cast. Europe was committed to merging its old currencies, and there was no turning back.

When the treaty was signed, there were 12 members of the newly restyled European Union. British Prime Minister John Major, mindful of the fiercely anti-European mood of the Conservative Party back in the UK, had negotiated an opt-out for the British: They could join if they wanted to, but were under no obligation to do so. The Danes, who also tend to be suspicious of centralizing schemes cooked up in Paris and Brussels, hitched a ride with the British, and secured an opt-out of their own. But once the Treaty was ratified, the rest of the EU's members were formally committed to merging their old national currencies into one new one. The timing could be negotiated. So could the details of the new money. The ultimate goal could not.

But what kind of single currency? Nobody had ever attempted a project of this scale or ambition before. True, there had been earlier attempts at monetary unions in Europe, as we saw earlier in this chapter. The United States created a single currency with the dollar, a currency that replaced the old state-issued money that existed prior to the Declaration of Independence. Some would argue, with much merit, that it was only with the establishment of the Federal Reserve in 1913 that the United States moved to creating a genuine single currency for the entire country. Yet those were experiments of a completely different order. The European currency mergers of the nineteenth century were small, practical, local affairs. And anyway, with a foundation in gold and silver, they were already part of a global monetary system. The United States was a single country when it created its currency. It may have been a federal republic with a weak central government. But it would be absurd to imagine that Massachusetts and Texas, for all their obvious differences, were not recognizably part of the same country, in a way that France and Portugal, or the Netherlands and Spain, were simply not. In truth, this was the first serious attempt to create a single currency for a diverse

continent. The scale of the ambition was breathtaking. So, too, were the challenges the new currency would soon face.

“There is no example in history of a lasting monetary union that was not linked to one state,” argued Otmar Issing, chief economist of the German Bundesbank back when the euro was first being put together in 1991.⁶

Issing was absolutely right. Economists have been studying currencies since the dismal science was first invented. One feature they shared in common was absolutely clear. They were always and everywhere linked to a strong and unified central government: one that could raise taxes, distribute wealth between regions, borrow money on the global capital markets, and authorize a central bank to issue paper money. They weren’t based on loose, optimistic confederations, with no significant revenue-raising powers, no ability to move funds around the region, and, when you looked at it closely, no genuinely popular mandate. Of course, that wasn’t to say it wasn’t possible. It was just that it hadn’t been tried before.

As the euro was created, there were two views on whether it needed to be backed by an effective central government in Brussels. One said that the central authority would come in time. Indeed, the euro would be an instrument that would summon a single European super-state into being. Ever since the French politician Jean Monnet had founded the European Iron & Steel Community, the forerunner of today’s European Union, in 1951, the federalist dream of uniting Europe had progressed by stealth. No one had ever said their goal was creating a strong, centralized government in Brussels: They pushed some other agenda, which ended up creating a stronger European government, as if it was a by-product of something completely different. The euro very much fitted into that pattern. It could be sold as a simple technocratic adjustment, a minor economic reform to make life easier for the accounting departments of companies that exported stuff around Europe and to save tourists the bother of swapping currencies if they had to change trains in Brussels. Once it was created, it would become gradually clearer and clearer that, to make it work, you needed common tax policies as well, and then common spending plans on top of that, until pretty soon you ended up with something that looked identical to a central government in Brussels. And by then it

would be too late to do anything about it: The consequences of trying to unravel the single currency, once established, would be too horrific for anyone to contemplate.

The euro would have nudged Europe toward a fully centralized super-state.

An alternative view was that a currency could float above national governments. The Nobel prize-winning economist, Robert Mundell, is sometimes known as “the father of the euro,” and with good reason. Mundell pioneered the concept of what became known in economics as an *optimal currency area*: that is, a geographic region where economic efficiency was optimized by sharing a single currency. Sometimes that would happen to be a single country, but quite often it wouldn't be. So, for example, it is easy to imagine that the Netherlands and Belgium could form a natural currency union, so similar are the two economies, while Italy, with its vast differences between the wealthy, industrialized north, and the rural, poverty-stricken south, probably wouldn't. The concept was a powerful impetus behind the creation of the euro. If you could demonstrate that Europe was an optimal currency area, then you wouldn't need a strong central government to try and iron out the differences between regions. The euro would function perfectly well as the currency for all of them without one.

But it depended on what kind of euro you had: a strong or a weak one? And what kinds of rules would govern it? Those were issues that would be fought out in the years to come as the ground rules for the new currency were established. And they were battles that, as we shall see later, were to determine in due course whether the single currency would last for generations as its founders hoped and dreamed it would. Or whether it would buckle and then break when the first financial storms started to blow up around it.



On the surface, there was a smooth timetable laid out for the progress toward the euro. In stage one, the candidate members were to set strict targets for borrowing, inflation, and growth. The architects were well aware that you couldn't suddenly merge very different economies. And you couldn't even merge quite similar ones if they happened to be at

different stages of the economic cycle. Once countries shared a single currency, that meant they also shared a single central bank and the same interest rate. If one economy was contracting and another was suffering from rising inflation, then it would be impossible for a single central bank to mitigate one while controlling the other. You had to get all the economies moving in sync, and then hold them there, to have any realistic prospect of making the euro work.

Stage two was the detailed planning for the new currency. The central bank had to be created, staffed, and policies and objectives set for it. Even a name for the new currency had to be chosen. There were plenty of suggestions. To the Italians, the term *florin* seemed a natural choice, harking back to the coins that circulated in medieval Florence. The Greeks argued that the word *drachma* had the virtue of unmatched longevity, if not stability. To the French, *ecu* seemed the most obvious name: An *ecu* was not just the European Currency Unit, the immediate forerunner of what became the euro; it was also a thirteenth-century French coin. There was even a suggestion that each country keep the name of its own currency, but prefix it with the word *euro*, so that the “euromark” would circulate in Germany, and the “eurofranc” in France, and so on. Among German bankers, there was a joke that any currency that ended with a vowel was always a disaster: the *lira*, the *drachma*, the *peseta*, or the *escudo*, for example. Proper currencies ended with a consonant: the pound, the dollar, the yen, or, since you happen to mention it, the mark. On that logic, they favored the “euromark” as the name for the new money.

That, however, like every name that included part of the old currencies, or was rooted in one particular language, seemed to miss out on the spirit of the new money. It wouldn't have severed the link, psychologically at least, between the old national currencies and the new European one, which would inevitably make it far too easy to go back to the old ones if that was what people wanted to do one day. And that was not what the founders intended at all. The euro was designed to be irreversible, and everything about it had to suggest solidity and permanence. In the end, in 1995, it was decided to go for the simple word *euro*. It was the first four letters of the continent's name. And it was the one word every European could pronounce easily enough, if not always in the same way.

But it was not matters such as the name that really counted, nor whether you put Beethoven or Picasso on the banknotes. Those were all relatively trivial issues. What really counted was the plumbing: the way the central bank would work, and the way it would govern the huge new economic empire that it would take charge of. Behind the scenes, a fierce battle was being fought for the type of euro that would be created. A hard, stern, anti-inflationary currency, modeled on the German *deutschmark*, and with a central bank built in the image of the old Bundesbank? Or a soft, political bank, much closer to the old Bank of France, firmly under the control of the politicians? That was the crucial choice that had to be made.

One victory was won over the location of the ECB. Frankfurt won out over Paris and Brussels, and indeed, rather implausibly, London. According to a theory fashionable in the late 1990s, the location of the central bank played a crucial role in determining which cities emerged as important financial centers. It was never a very compelling explanation. After all, the Federal Reserve was based in Washington, but the American banks were 200 miles away in New York. Even so, it stoked the argument, with the British and the French insisting they needed the ECB headquarters in their capital to preserve the status of their financial center. The British had no plans to join the euro, so their new Prime Minister at the time, Tony Blair, never had much of a claim. Brussels already had more than enough European Union buildings to be getting on with. Paris was a more serious contender. It had the backing of the French, and they always win more battles in the European Union than they lose. But in the end, Frankfurt was the more important financial center. And only basing the new central bank there would convince the global money markets, the audience that really counted, that the ECB meant serious business.

There were other battles to be fought as well. The French wanted one of their own men, Bank of France Governor Jean-Claude Trichet, to be the first president of the new European Central Bank. The Germans were proposing Dutch banker Wim Duisenberg. In EU political dogfights, the Dutch tend to be used as proxy Germans, allowed to take up senior roles when the Germans feel bashful about grabbing them for themselves.

But, in reality, the issues of the headquarters and the presidency were just metaphors for a much larger and far more important battle. The key fault-line was emerging, as might be suspected, between France and Germany. The Germans wanted a strictly disciplined currency. They wanted the central bank to be completely independent of any form of political interference. They wanted hard, inflexible limits on how much debt any member of the single currency could run up. And they wanted there to be no bailouts between member states.

The French wanted something different. They didn't express it as a "weak currency." That wouldn't have sounded quite right. But they did express it as putting the central bank under firm political control. They demanded an "economic government" for Europe to be built into the creation of the euro. At a summit to discuss progress toward monetary union in 1996, then-French Prime Minister Alain Juppe hammered home the historical differences between the French and German approaches to economic management. "We don't want a technocratic, automatic system that will be exclusively under the control of the European Central Bank," he told the *Frankfurter Allgemeine Zeitung* in December 1996. During that month, Juppe and French President Jacques Chirac called for an EMU Advisory Council to be created alongside the ECB, with the power to advise on interest rates. That proposal was fought off by German Finance Minister Theo Waigel.

In fact, that only set up a more heated argument, this time over the Growth and Stability Pact, an agreement on economic management that each member of the new currency was to be made to adhere to. The proposal was very clear. The Germans wanted each euro member state to be limited to running a budget deficit of just 3 percent of GDP. The monetary logic was impeccable. A country with its own currency and its own central bank can, if it wants to, run just about any kind of budget deficit it happens to feel like. If it finds it can't borrow the money it needs to fund itself, then it can just order the central bank to print some more. This is not the completely cost-free exercise it might appear at first glance. Print too much money, and you will create hyperinflation and your currency will collapse in value. That is what happened in Germany in the 1920s. It is what has happened in countries such as Zimbabwe in the past few years. But it is still an important freedom. Within those constraints there is flexibility and room to

maneuver. Countries with their own currencies can when necessary run far larger deficits and get away with it than countries with currencies that are pegged to some other monetary unit, or, indeed, that share their currencies with other nations.

The Bundesbank could see very clearly that once inside the euro, it couldn't work like that. The national central banks would continue to exist. There would still be a Bank of France, of Italy, of Spain, and of course a Bundesbank. But they would be pale shadows of their former pomp and splendor. Crucially, they would have no ability to issue currency. That would be the sole preserve of the European Central Bank in Frankfurt.

So what would happen if one member ran up big debts? Say it went on a wild borrowing spree, running up bills it could never meet, until ultimately it lost the confidence of the bond markets and could no longer pay its bills? The ECB couldn't be expected to print more and more euros to help it out. That would risk creating inflation, and if there was one thing the Germans were determined upon it was that the euro should be as stable and secure as the deutschmark it replaced. But neither could the other member states be expected to bail out that country, with soft loans extended to cover up its deficit. That, too, would never work. It would be grossly unfair if the states that were managing their finances responsibly were forced to subsidize the states that had been spending profligately. There would be no incentive for anyone to keep their national books in order. The situation would quickly descend into chaos, with every member living way beyond its means, then expecting its neighbors to bail it out or the ECB to print the money to finance its extravagance.

The situation was unthinkable. There needed to be strict rules to prevent it. And the answer was the Growth and Stability Pact. The 3 percent limit on budget deficits would stop national governments from running up excessive debts.

The trouble was, not everyone in Europe saw it the same way the Germans did. At a summit meeting held in the Irish capital Dublin on December 13 and 14, 1996, there was a furious battle between Germany's finance minister, Waigel, and his French counterpart, Jean Arthuis. "The French and Germans had almost come to blows on the subject of the Stability Pact," reported the authoritative German newspaper, *Die Welt*, in its report of the behind-the-scenes machinations. "The bone of

contention in the closing phase of the negotiations was above all Germany's request that the budgetary discipline demanded of euro-zone members be shored up by precise quantitative criteria. Most other countries were reluctant to agree to an automatic mechanism of this kind."

They certainly were reluctant. The German proposal seemed to many of the other members as if it was imposing too strict a limit on their independence of action. Governments would no longer be free to set their own fiscal policy: There would be a set of rules, enforced in Brussels, that would decide how much they could and could not spend. It was a huge compromise in national sovereignty, and one that many countries, the French in particular, didn't feel they had signed up for when they embarked on the euro project. Against that, the Germans argued that all they were giving up was the right to destroy the currency union through financial profligacy. It was of no more significance than the right most of us give up to carry submachine guns through the street: There may be some notional loss of freedom involved, but it is very clearly in the greater good.

In the end, Luxembourg Prime Minister Jean-Claude Juncker hammered together a compromise. Member states would stick to the Stability Pact, but they could invoke "a severe recession" as an excuse to run a larger deficit. How severe? A drop of 0.75 percent in GDP, which in the view of many economists would not really be a severe recession at all, but more a normal cyclical dip of the kind a healthy economy can expect to experience every few years. The European Commission would automatically launch an inquiry against a country that breached the Pact, except in cases where output fell by more than 2 percent a year, in which case the country could do pretty much whatever it wanted. And the French succeeded in getting the word *Growth* inserted in addition to what the Germans wanted to be called just the *Stability Pact*: They insisted that the euro had to be a currency that promoted economic expansion, and were already fearful that the entire project was being hijacked by a fiercely anti-inflationary Bundesbank. But, crucially, the German demand for stiff, automatic penalties for any country that broke the 3 percent deficit ceiling was dropped. The worst you would face was an inquiry from the European Commission. "As so often happens, there were only winners in the end," said *Die Welt*, delivering its verdict on the summit.

French President Jacques Chirac congratulated the German Finance Minister on his success in the negotiations and Theo Waigel too was manifestly pleased with the outcome. As the Dublin Euro-summit came to an end, the conference participants were only too happy to exchange compliments, in the warm glow of the press.⁷

But that rosy view of the outcome wasn't one that would survive in Germany for much longer. The country had bought into the single currency, in part as a quid pro quo for the rest of Europe accepting the reunification of Germany without any protest. While the euro looked like swapping a lot of weak Mediterranean currencies for a recreated deutschmark, Germans could live with that. But they had already had to water down the Stability Pact as well as fight off an effort by the French to install one of their own officials in the ECB presidency. And as the run-up to the launch continued, it became clear that fudges and compromises would have to be made all over Europe if the target date for the introduction of the euro was ever to be met.

The hard, inflexible euro turned out to be remarkable malleable. Italy announced a special "Europe tax" in its 1997 budget to allow it to just about squeeze into the Maastricht convergence criteria. France switched some pension assets from the state-owned France Telecom to get its public debt figures into better shape. Nor was there much sign of rigor in economic management. One of the most obvious consequences of the launch of the euro was that the market was about to get a lot tougher. Countries weren't going to be able to devalue their way out of trouble the way they had in the past. They would have to compete with the ruthlessly efficient Germans on quality and productivity. Their workers would have to hold down wages to make sure they remained competitive with their neighbors. And yet, what did the French do? The new Socialist government of Lionel Jospin introduced the 35-hour week, one of the most destructive economic policies of recent decades, and precisely the wrong preparation for the rigors that lay ahead in a monetary union with Germany.

As the legislation establishing the European Central Bank was written, there were some victories for the old Bundesbank. Monetary instruments and monetary control techniques were all closely modeled

on the old German central bank, rather than any of its rivals around Europe. It was set an inflation target of below 2 percent per year over the medium term, about the same as the old Bundesbank target rate. It was declared illegal for any of the national governments to seek to influence ECB policy, an even stricter definition of independence than the old German central bank had enjoyed.

But they were drowned out by two important concessions. The European Union had not built in any significant penalties for breaching the deficit rules. And in the run-up to the launch of the euro, it had allowed government to blatantly fudge and fiddle with the convergence criteria.

Both were to prove very costly in the medium term, and, as events far away were to demonstrate a decade later, probably even fatal.



The great day dawned with a certain amount of nervousness. In the run-up to the launch of the physical euro, on January 1, 2002, the European Union, the European Central Bank, and the governments of the 11 countries that would make up the initial members of the currency union had been running campaigns to reassure their people that everything would go smoothly. The euro had already been up and running for two years, of course, but that was purely as a financial currency. Some digits in a banking computer system were a very different proposition from hundreds of millions of notes and coins filling tills and wallets right across the continent. And there was no way yet of knowing how that would play out.

The marketing campaigns varied from country to country. The Bank of Ireland sent out a free pocket calculator, with a special button for converting Irish pounds into euros, to all of the country's 1.4 million households. The Finnish central bank ran television ads featuring a friendly truck driver explaining how much easier it would be for him to crisscross the continent without having to change currencies constantly. In Belgium, the ads showed a small girl with her piggy bank. "Don't worry, little pig," she said, patting the little porcelain figure with her hand. "I will have to get all the francs out of you on January first to trade in for euros. But it won't hurt."⁸ The ECB ran its own advertising campaign, in addition to each national one, evoking shared elements of

European heritage: from lederhosen-clad campers along alpine lakes to smiling couples at outdoor cafes looking out over the Mediterranean, all with the tagline underneath: “The Euro, Our Money” (or *Der Euro*, *Unser Geld*, *El Euro*, *Nuestra Moneda*, and so on).

The logistical challenges were formidable. Because the ECB was worried about the risk of counterfeiting, it didn’t want to hand out any notes or coins in advance of the official handover. So instead 14 billion euro notes had to be printed and stored in readiness for the big day. Virtually every delivery truck in Europe—and thousands of military vehicles as well—were used to make sure that if you used an ATM anywhere in the euro-zone a minute after midnight on the opening day of 2002, you’d be given euros instead of francs, lira, or deutschmarks.

And yet, for all the anxiety, and for all the chewed fingernails, after the fireworks had been released it all went perfectly smoothly. There was a two-month transition period during which both the new notes and the currencies they replaced would carry on being legal tender. But it didn’t even take that long. At the end of the first week, the new currency had settled down, and most people appeared to accept it. The strikes threatened by bankers in France and Italy to protest at all the work had fizzled out. By the end of the first month, most of the old paper currencies had been handed back into the banks, from where they were either burned for fuel or else mulched down into agricultural compost. It was a slightly sad end for all those deutschmarks, francs, and lira, but at least it was environmentally friendly. And it would stop anyone from thinking you could get them out again, as they might if they were stored in a vault somewhere.

“The process of monetary union goes hand in hand, must go hand in hand, with political integration and ultimately political union,” said the ECB’s first president, Wim Duisenberg, in the European Parliament in the month before euro notes and coins were introduced. “EMU is, and was always meant to be a stepping stone on the way to a united Europe.”⁹

Indeed it was. And at that moment it seemed to be going perfectly according to plan.



To mark the tenth anniversary of its founding, the European Union published a report on the currency’s first 10 years. “EMU is a resounding success,” it concluded, somewhat boastfully.

Ten years into its existence, it has ensured macroeconomic stability, spurred the economic integration of Europe—not least through its successive enlargements—increased its resilience to adverse shocks, and become a regional and global pole of stability. Now more than ever, the single currency and the policy framework that underpins it are proving to be a major asset.¹⁰

It was hardly an unbiased, or indeed an objective assessment. There were, of course, successes to be pointed to. The euro was a far larger currency than it had been when it was started: Greece had joined, so had Slovenia, Malta, and Cyprus. Inflation had been low and stable across the euro-zone: Inflation averaged just over 2 percent in the first decade of the euro, falling from 3 percent in the 1990s and a range of 8 to 10 percent in the 1970s and 1980s. There was more trade across Europe's old borders: Cross-border trade now accounted for a third of euro-zone GDP, compared with a quarter when the single currency was launched (although how much of that was due to the single currency itself and how much was due to the onward march of globalization was not really clear).

Financial markets were more integrated, companies could raise capital from anywhere in the continent, and the strength and stability of the euro allowed the economy to withstand whatever storms were blowing through the financial markets. "Today once again, the euro area appears protected from the worst of the present global financial turbulence," the report argued.

Meanwhile, the nations of the euro-zone were drawing closer together. "The environment of macroeconomic stability and low interest rates coupled with the support of the cohesion policy and its structural and cohesion Funds have created the conditions for accelerated catching up; the positive effects of sound economic policies have been reinforced by the development and integration of national financial markets with the rest of the euro area," it stated.¹¹

Overall, it reported, 16 million jobs had been created in the euro-zone since the single currency was launched. Unemployment had fallen to 7 percent, the lowest rate in 15 years. Jobs were being created at a faster rate than in other mature economies such as the United States. The euro was taking a bigger share of the global money markets, establishing itself as the world's second most important currency

after the dollar, and increasingly as the U.S. currency's challenger. Although growth had not been fantastic, and productivity hadn't really advanced, there was plenty to boast about.

Most important, however, was not the economics. It was the politics of the euro that really counted. "Although its objectives and achievements are predominantly economic, EMU has never been solely an economic project," the report concluded. "From the outset EMU was conceived as a crucial step in the process of EU integration."¹²

That was certainly the way the European elite saw it. The creation of the single currency was the most significant step forward in creating a single European state since the founding of the European Union itself. It was both an important symbol in itself of the transformation of what used to be a set of distinct nations into a single political and economic space, as well as a spur to further integration. Everyone was well aware that making the euro work would require more integration. But a huge amount had been achieved, and so long as the euro could establish itself, and so long as the single currency was seen as irreversible, then those questions could be answered later.

And yet, perhaps there had been too much fudging of the hard questions. "Independence of the central bank is a means to an end, to win Germany's approval for monetary union, but it is not the end of the story," said Michel Rocard, the former French prime minister, in 2007. "We will not be able to escape a situation taking place where the government will have to give orders to the central bank."¹³

That was certainly going to be true one day. The Germans appeared to have won many of the battles over the euro. They had fought for it to be a hard currency, modeled on the deutschmark. But they hadn't won every battle. The euro that was created had been compromised.

Fatally so? The answer to that question was taking shape many hundreds of miles to the south—in Athens.