



LIVING WITH THE EURO

Part of going to a foreign country is spending time in stores fumbling with change, trying to make sense of the local currency. Arriving in France last August to spend the academic year here, I found that in this respect I fit right in. All my new neighbours fumble with their new currency, the euro, the cash version of which came into existence only last January 1.

Though it's still hard to think of France without the franc, Germany without the Deutschmark and Italy without the lira, that is how Euroland now works. I haven't seen anyone try to make payments with francs. In fact, early on in our visit a friend gave us some francs for our kids to play with: He'd neglected to exchange them so they were now worthless to him.

That the franc is out of sight does not mean it is out of mind, however. It's no longer the "medium of exchange" but to a certain extent it is still the "unit of account." People continue to value things in francs. In most stores the franc price is still written under the euro price. My bank statement quotes both euro and franc values, with the rate of exchange set at the official transition rate of 6.55957 francs per euro, though that's a fictive rate since no one buys or sells francs anymore.

Medium of exchange. Unit of account. Whether the franc is still fulfilling the third of the economist's triad of monetary functions—store of value—is hard to say, though I doubt many people have hundreds of thousands of francs stuffed in their mattress against the day when the euro fails.

The consensus is that just as some Canadians still think in Fahrenheit, some Frenchmen will always think in francs but that in time that generation will die off and the euro will take over, just as

Celsius has done in Canada. On the other hand, it's sometimes argued that the younger generation are having more trouble than the old, since, being products of modern education, they can't handle division by seven. My wife and I sympathize. When—that archetypal French experience!—a wine merchant came to visit, he quoted all his prices in francs. We had an awful time dividing everything by seven, the more so as the sampling progressed. For the time being, the dollar-euro exchange rate is much easier. We're paying essentially C\$1.50 per euro these days, the same as for the US dollar.

The big policy question is whether the euro is working. It depends, of course, on what you mean by *working*.

If *working* means being accepted, then, yes, it is working: It's in widespread use and there really aren't any practical alternatives to it.

If *working* means boosting trade and commerce in Euroland, it's too early to tell: Nine months of trade figures don't lend much insight into anything. On the other hand, a number of surveys show that the euro is eliminating price differences across countries, a clear sign that markets are working more efficiently.

If *working* means creating an integrated capital market in Europe, the euro gives every impression of having done so. One of the new currency's most dramatic effects, even before its cash incarnation, was the convergence of interest rates across Europe. Heading from the mid-90s into the millennium, the graph of national interest rates looks like hair being braided: they're initially all over the map but end up in a tight band.

Finally, if *working* means advancing "the European project," as it's called here, for the moment the euro seems to be de-harmonizing official Europe.

Right now there is a good deal of bickering about the Growth and Stability Pact that established rules about inflation rates and public debts and deficits for euro countries. The idea, championed by Germany, was to prevent profligate borrowers—Italy being the prime suspect—from cheapening the euro's value in world capital markets. Now (wouldn't you know it?) Italy's doing fine but the Germans have bumped up against the 3 percent limit on deficits and are having to find new sources of revenue at a time when their economy is growing slowly, if at all.

France isn't in violation yet but, with growth slowing here as well, will probably hit the limits next budget year. Her official reaction? Not much more than a Gallic shrug, which naturally irritates those many countries that have stuck to the rules.

The president of the European Commission, an Italian, recently characterized the rigidity of the Growth and Stability Pact as "stupid." Though the European Central Bank (ECB) rebuked him sharply, it does seem that, in the classic EU manner, if the rules bind too many countries, the rules will be changed. On the other hand, with the ECB evidently set on keeping the euro credible, excessive borrowing may simply mean a run-up in interest rates.

Given the impressive cost of getting to the euro—several billions of dollars of effort plus a psychological revolution—if it all comes down to dumping the rules or dumping the euro, you know it's the rules that will go.

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