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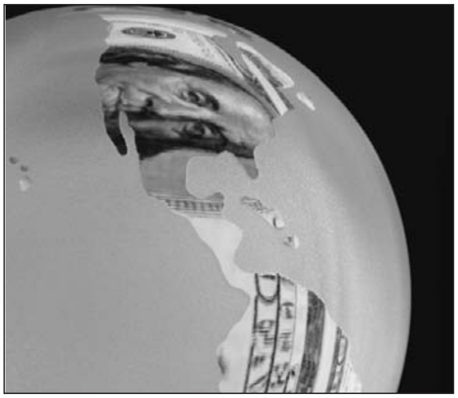

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The Euro - Still "Baffling Pigs" Two Years On

by Paul M. Sauve

January 1, 2002 was a date that the scaremongers and consultants had hyped up just as much as January 1, 2000. Money would run out, computers would crash, banks would collapse and confusion and chaos would reign! This was the date on which euro coins and banknotes became official currency in 12 European countries. Fortunately, the parallels to Y2K hype were in fact completely correct, and on January 1, 2002 nothing too dramatic happened. We are now over two years past the introduction of the euro in hard form and it has become a normal part of everyday life for over 300 million people in 12 countries. A lot of work had to be done and not all went perfectly smoothly at first, but the euro introduction was a success overall, and most doomsayers have moved on to other potential apocalypses. Nonetheless, the euro introduction was an event of epic historical significance, and now, as the European Union (EU) faces expansion from 15 to 25 countries, it is a good time to look at the past and the future of the euro.

A brief primer

On January 1, 1999 the euro became the official electronic currency of 11 EU countries. These countries continued to use their old coins and bills, but now at irrevocably fixed rates of exchange to the euro and thereby to each others' currencies. These 11 countries were joined by Greece midway through 2000 when the latter satisfied the economic requirements of euro participation. These 12 countries made the final leap on January 1, 2002 by withdrawing their old notes and coins and replacing them with shiny and crisp new euros. Table 1 on page 5 gives a complete list of the 12 countries, their old currencies

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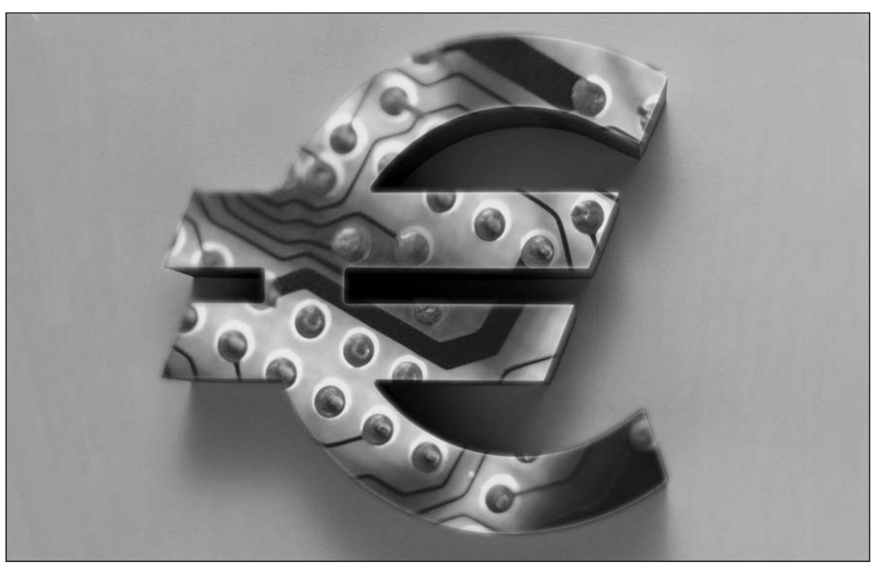
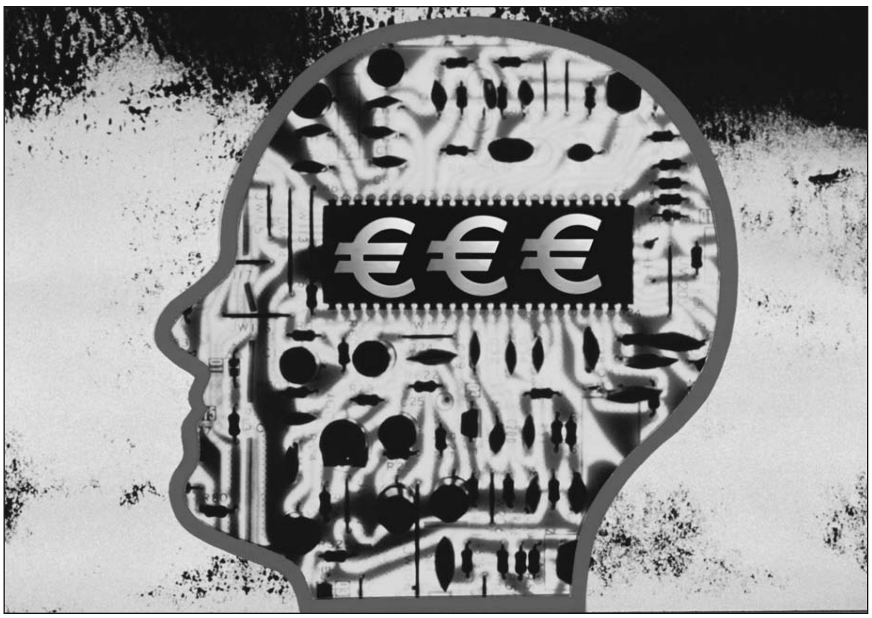


and the fixed rates of exchange to the euro. If you have difficulty remembering the 12 countries (but for some reason have a need to try) the acronym "baffling pigs" (Belgium, Austria, Finland, France, Luxembourg, Ireland, Netherlands, Germany, Portugal, Italy, Greece, Spain), which formed their old currency equivalents when making purchase decisions. This is a testament to the deep-seatedness of the instinctive judgment we make about prices in our daily lives. A Spaniard knows instinctively, for example, that ESP 300 is a reasonable price for a coffee, but EUR 1.81 (or



EUR 2.00 now perhaps) hasn't yet been burned into his subconscious to allow for the same quick value judgment that we all are accustomed to making. One might hypothesize that Europeans who were slow to make this transition actually had a hidden benefit of improving their mental arithmetic through shear repetition of awkward calculations. Who can doubt that Austrians who had to calculate "multiply by 13.8" every time they bought something got better at math? The die-hards are the few, but not unheard of, older French individuals who still value things in "old francs" (replaced in 1959 100:1 with the new franc which has now disappeared into the euro) and are faced with multiplication by 656! Even the Italians have it easier than this, they can multiply by 2000 and not be far off.

Insurance and Pensions

To date the Euro has not had a revolutionary impact on the development of the European life insurance and pensions industry. It clearly caused the insurance companies the pain of having to convert all their policies, accounts and systems to handle the euro as of January 1, 1999, which then operated exclusively in euro as of January 1, 2002. The greater positive impact of the euro in the industry has been in pensions and employee benefits, where multinational schemes can now be established and administered without having to worry about different currencies and changes in exchange rate between those currencies. The euro has therefore facilitated quicker evolution in a direction that was already taking place due to the quest for scale and portability. In individual insurance there are still too many country-specific effects at play for the euro to have had much effect. Each country and its salespeople and consumers still have enough different demands and desires that euro-induced convergence or growth has been scarce. This convergence will eventually take place, but the common currency was merely a necessary condition, and not a sufficient one.

EU Expansion or Euro Expansion

On May 1, 2004 the 10 countries listed in Table 2, page 5, became members of the EU, swelling the ranks of the EU from 15 to 25 countries (and from 11 to 20 official languages!). While these countries are all expected to join the euro at some point, they must first meet financial criteria with respect to price inflation, government debt and deficits and other indications of market integration. These criteria are laid out in the "Maastricht convergence criteria" and essentially require that countries joining the euro have a sufficiently homogeneous economic makeup that they won't upset the stability of the common currency. These convergence criteria are also the rules to which euro member states are required to adhere. The fact that Germany and France have recently repeatedly failed these tests and dodged the intended penalties will make it challenging for the EU Council to hold the 10 new countries to these standards. Regardless of how this delicate situation is sorted out, it is likely to be at least two years before any of the new EU members join the common currency, and it could very well be a lot longer for a few of them. (With only one vowel to work with, there is unfortunately no helpful acronym to help you remember the 10 new EU countries listed in Table 2… at least not in English!)

Three countries who could conceivably join the euro before these 10 are the three abstaining current EU members—Denmark, Sweden and the United Kingdom.

Danes rejected the euro in a referendum in September 2000, by a margin of 53 percent to 47 percent. With a voter turnout of almost 90 percent, this was clearly a very passionate issue. Despite this result, I expect Denmark to join the euro after another referendum likely to take place in 2004 or 2005. The last referendum took place when the euro had lost almost 30 percent of its value versus the U.S. dollar in under two years. Since then, the euro has not only recovered this loss but also gained almost a further 10 percent versus its 1999 launch value. Another sign in favor of Denmark joining is that when the real coins and notes started showing up in and around Denmark in 2002, opinion polls showed a surge in support for Danish participation. Given that Denmark is a full EU member and already pegs its currency to the euro, the final step of joining the common currency is largely symbolic. The emotional reasons to keep the krone will, however, surely make the referendum exciting.

Swedes voted on joining the euro in 2003 when the euro was already riding high against the U.S. dollar and the physical familiarity with the euro was already high. Despite this, they rejected it 57 percent to 43 percent, with an 81 percent voter turnout. The anti-euro movement rode a wave of grassroots opposition to joining, and overcame the well-funded, business-backed pro-euro camp. This isolationist mood will need to subside before Sweden joins the euro, unless they get a brave business-friendly government who is willing to ignore the results of this non-binding referendum.

The United Kingdom has never held a referendum on the euro, but opinion polls have consistently highlighted that a majority of Britons are against euro membership. Prime Minister Tony Blair is in favor of joining the euro but has been fighting not only the negative public sentiment, but also strong opposition from within his party and government. Based on the most recent developments, hope of U.K. euro membership during his present term has pretty much faded away, and 2010 may be the earliest realistic accession date. Shaky economies in the large eurozone countries and their non-adherence to the convergence criteria has hurt the U.K. pro-euro movement and the very active anti-euro movement, therefore appears to be prevailing.

Regardless of how any of these countries decide to proceed, the euro has a strong future in Europe and will keep moving gradually east with EU expansion, and eventually north and west to pick up the stragglers. ☐

Table 1 | Euro Predecessor Currencies

Country	Old Currency	Old Per Euro
Austria	Schilling	13.7603
Belgium	Franc	40.3399
Finland	Markka	5.94573
France	Franc	6.55957
Germany	Mark	1.95583
Greece	Drachma	340.750
Ireland	Punt	0.787564
Italy	Lire	1936.27
Luxembourg	Franc	40.3399
Netherlands	Guilder	2.20371
Portugal	Escudo	200.482
Spain	Peseta	166.386

Table 2 | May 1, 2004 New EU Members

Country	Current Currency	Approx Current Market per Euro
Cyprus	Pound	0.6
Czech Republic	Koruna	33
Estonia	Kroon	16
Hungary	Forint	255
Latvia	Lats	0.7
Lithuania	Litas	3.5
Malta	Lira	3.6
Poland	Zloty	4.8
Slovakia	Koruna	41
Slovenia	Tolar	240

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