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Europeans Learning to Love the Super-Euro

NEWS ANALYSIS, PAOLO PONTONIERE,
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Editor's Note: The weak dollar and strong euro has hit European manufacturers hard. But PNS contributor Paolo Pontoniere says that, increasingly, European economists and politicians are seeing the benefits of the super-euro.

The aftershocks of the dollar's fall are still felt far and wide by Europeans. Yet, slowly but surely, the continent is beginning to appreciate the newfound power of a strong euro.

In factory boardrooms, European entrepreneurs still seek strategies to offset the increased cost of exporting their wares to the United States and Asia. But on the street and in the halls of government, optimism is growing. Many of the old continent's analysts are peering around the edge of the tempest and seeing clearer skies.

Europeans who travel abroad, for example, are feeling the same sense of power and abundance that American travelers knew before the advent of the recession and the Bush administration's hands-off monetary policy. International airfares and hotels and meals outside the EU have become extremely cheap for Europeans. Foreign imports are cheaper by the day, American products of course, but especially Chinese and other East Asian products. Even the punishing cost of commodities like oil, since those trades are named in dollars, has been in part offset by the gain that the euro has made on the U.S. dollar.

In fact, a strong euro even allows European exporters to absorb some of the increased cost of doing business with the United States.

"Italian staple products and fashion nowadays have to be subsidized by our exporters to remain competitive on the American market," say Vittorio Palladino, commercial attache to the Italian Consulate General in San Francisco. But Palladino points out that European exporters have kept prices steady for U.S. consumers, and they can do that, he says, because a strong euro enables them to absorb the losses generated by the poor exchange rate with the United States.

European trade with the United States accounts for one-fifth of the old continent's exports. With China, the EU registers a trade deficit of about 50 billion euros. But with the United States it still registers a trade surplus. In fact, the United States still imports more from Europe than it exports, accumulating -- according to EU official sources -- a deficit of about 80 billion euros a year, about \$107 billion. As imports from Europe keep growing, that deficit is bound to increase.

"If I were an American industrialist I would be worried about the strength of the euro right now, because U.S. and EU economies are highly interdependent," says Guido Fontanelli, economy editor for Panorama, one of Italy's leading newsweeklies. "More than a quarter of world transactions are made by firms that have investments on either side of the pond. The transatlantic relationship is still the nexus of the global economy, since the U.S. and the EU are the largest trade and investment partners for many of the world's countries."

Even with securities, Europe is poised to reap the benefits of a strong currency.

"As the dollar falters it is unavoidable that foreign investors will start to look at Europe's securities and its currency as refuge investments," says Jeffrey Frankel, professor of economics at the Kennedy School of Government and a former Clinton administration advisor. "The greater rate of return of European investments is compounded also by Europe's higher interest rates. As long as the Euro stands strong, the European Central Bank (ECB) doesn't have any incentive to reduce those rates."

In fact, the ECB recently signaled its intention to raise interest rates, and noted in the same announcement that currently, one-fifth of world's monetary reserves are named in euros.

The rise of the euro may also empower Europe's political leaders to deal with the continent's labor market rigidity, which has hampered Europe's growth.

To offset export losses, says Gary Becker, Nobel laureate for the economy in 1992, Europeans will have to increase productivity and reduce labor costs. "They'll have to follow the American lesson of the 1980s, when Japan was flooding the U.S. with cheap electronics and automotive products," Becker says. "The U.S. didn't turn to protectionism, but instead increased productivity, the mobility of its work force and invested heavily in research and development and thus found again its economic edge."

Europe may be ready to follow suit. In Italy, air-transportation unions -- the most powerful in Europe -- recently agreed to layoffs and pay cuts in order to help Alitalia, Italy's flagship airline, get out of bankruptcy.

According to Fontanelli, Europe's real conundrum is with Asiatic countries and countries whose currencies have been pegged to the dollar. Fontanelli believes that the dollar's present level is tantamount to reducing China's costs of exporting to Europe by a further 30 percent, since the value of China's currency is pegged to that of the dollar.

But with last July's inclusion of nine former Iron Curtain countries into the EU, Europeans have discovered their own domestic China -- that is, an area to which they can safely offshore production, gaining both low production costs and high-quality products.

"Eastern Europe is becoming Europe's NAFTA", says Michele Libraro, CEO of Global StartUps, a Silicon Valley venture capital firm devoted to promoting European start-ups in the United States. "Poland, the Czech Republic, Hungary and the Baltic countries are attracting a great deal of West European investments and production. Those countries have a very good industrial base. For the first time in centuries, Europe could have a closed-circuit economy where everything is produced and consumed internally.

"Regardless," Libraro says, "Eastern Europe's production keeps European products competitive internationally, notwithstanding China and the rise the euro."

Pontoniere is the San Francisco-based correspondent of Focus, Italy's leading monthly magazine.

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