BY STEPHAN-GÖTZ RICHTER

Many European economists are adamantly warning against a weak euro, even though currency movements of the magnitude of the euro's recent fall – roughly 15 percent against the dollar – are quite common. Moreover, from a purely economic perspective, the euro's decline is more than understandable: Short-term interest rates are higher in the United States, acting as a magnet for idle corporate cash for payrolls, inventory and the like.

To quite a few Europeans, though, the euro represents something besides a currency. They view it as the means by which Europe can wrest its rightful position as co-leader of the global economy. And thus, to them, the euro's decline so soon after its creation amounts to failure.

But seen in proper context, the euro's weakness is an opportunity. Europe needs a weak euro to foster industrial restructuring, and the unified currency could promote this process with less muss and fuss. Imagine, by contrast, the hoopla and backbiting we would have seen by now had a whole range of European currencies moved lower – probably to uneven levels and at uncertain rates.

STEPHAN-GÖTZ RICHTER is the president of TransAtlantic Futures, a Washington-based economic intelligence group.

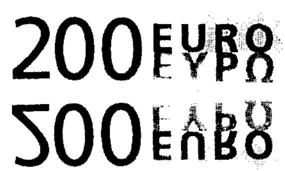
RON CHAPPLE/FPG INTERNATIONAL (2)

HOW TO PROMOTE RESTRUCTURING

From the perspective of the United States, it is vital to understand how the euro's decline is a key to a European economic renaissance. Europe faces a difficult task in the next few years, restructuring businesses so they can attain the productivity of American competitors. Fortunately, the Europeans have a model for this process – namely what happened in the United States about 15 years ago.

Back then, American businesses underwent a restructuring similar to what Europe needs today. And by the late 1980's they had a powerful, if impersonal, ally in their efforts to become more competitive: the weak dollar. Between early 1985 and late 1989 the dollar's exchange rate against major currencies fell by about one-half. Despite the relatively small

weight of trade in the United States economy – coincidentally, about the same as the weight of overseas trade in today's Euroland – the dollar's depreciation provided the extra kick in demand needed to keep the United States economy growing. Jack Welch, chairman of the General Electric Company, made no bones about cause and effect. "We're pounding ourselves on the chest in America over how wonderfully we've done," he explained. "But we got a huge help from the currency."



The traditional European economic argument against current depreciation is linked to concerns about inflation. Depreciation makes imports more expensive and increases demand (foreign and domestic) for domestically made goods – and is thus doubly inflationary. Moreover, in the past Germans especially wanted a strong currency to stop inflation at the border.

But in today's low inflation (some would say deflationary) environment, such concerns are overblown. And compared to the advantages of allowing the euro to weaken, the inflation argument should carry little weight. Consider that exports accounted for about 13 percent of Euroland GDP in 1997. A 5 percent increase in exports – a reasonable assumption given even a modest euro depreciation – would thus raise Euroland's GDP by 0.6 percentage points, a substantial portion of one year's growth. Depreciation would have an even larger impact since it would make European manufacturers more competitive domestically as well. Americans used similar gains to ease the dislocation associated with restructuring in the late 1980's, and with little impact on prices.

THE POLITICS OF MONEY AND RESTRUCTURING

The nexus between economics and politics in Europe has moved a long way over the past year. The defeat of old-style Euro-socialism, embodied in the resignation of Oskar Lafontaine in Germany, opens a window of opportunity for the forces of reform. Now is the best time to enhance and direct the restructuring of European business. And the European Central Bank is the institution that could pull it off.

At its birth, the E.C.B. found itself facing a dilemma. As every green-eyeshade type knows, financial markets' conviction that the central bank will support the value of the currency is the key to central banking success. By the same token, however, the European economy was badly in need of a dose of easy credit to take it out of the doldrums.

The E.C.B. faces another credibility issue, however – one which has broader implications for Euroland. Should the role of the central bank be narrowly defined as an agent of monetary policy, or should it take broader responsibility for the heath of the European economy? As the German Bundesbank has shown in the past, a central bank can lead the way in developing a society's economic strategy.

The Bundesbank's reputation was made not only by maintaining a strict monetary policy, but by serving as a stabilizing influence on economic policy even as the politicians dithered. If the E.C.B. is to be more than a minor institution – if it is to become for Europe what the Bundesbank has been for Germany – then it will need to take an active role in meeting Europe's prime challenge: the restructuring of its corporate sector.

The potential political fallout is enormous. Workers are about to discover that, despite decades of loyalty to employers, their services are no longer valued. Communities will discover there is no such thing as a good "corporate citizen" – that business is in the business of making money, period. And just as happened in the United States, workers, communities (and in Europe, whole countries) affected by restructuring will no doubt try to slow it down or lead it down inefficient paths.

AN INDUSTRIAL-MONETARY PACT

In the United States, the dollar's fall undermined these forces of resistance. Simply put, layoffs and corporate changes are much easier to accept when new opportunities abound. There is a catch, however: If European governments use a weak euro to protect inefficient companies from foreign competition, it would be worse than useless. What Euroland thus needs is a kind of industrial-monetary pact, one combining currency depreciation with structural reform.

As European businesses pursue the process of rationalizing their operations, the E.C.B. and the national governments could put in place the policies to minimize the suffering. The E.C.B.'s role, then, would be to maintain relatively easy credit, and thus allow the euro to weaken. The weak currency would help to keep the economy buoyant, reducing the pain for individuals and communities. This would, in turn, help to insulate the restructuring from political interference.

For their part, European governments – especially Germany, France and Italy – would adopt the legal, regulatory and labor-market reforms to facilitate the restructuring. By creating this implicit "conditionality" in its monetary policy, much the way the I.M.F. conditions loans on structural changes, the E.C.B. could smooth the way to American-style competition.

An industrial-monetary pact would also help the E.C.B. to accomplish the single most important task it faces in its formative years. To become an effective institution, the E.C.B. must carve out its own expertise and power, separate from those of the national central banks. Otherwise, the E.C.B. will remain vulnerable to the kind of confusion that reigned when national central bank heads – notably Hans Tietmeyer – have insisted on maintaining strong, independent voices that undermine the E.C.B.'s message. An E.C.B. initiative on an issue of great importance would be the ideal way to establish it as the continent's premier economic policy-making body.

Constructing such a pact would obviously require political effort, but the potential payoff is worth it. A monetary-industrial deal would satisfy both those Europeans who want to see the continent recognized as an economic powerhouse and those who want a weak currency to stoke demand. Easy money types calling for a weaker euro would get it, but only under conditions insuring that the depreciation translated into permanent structural improvement.

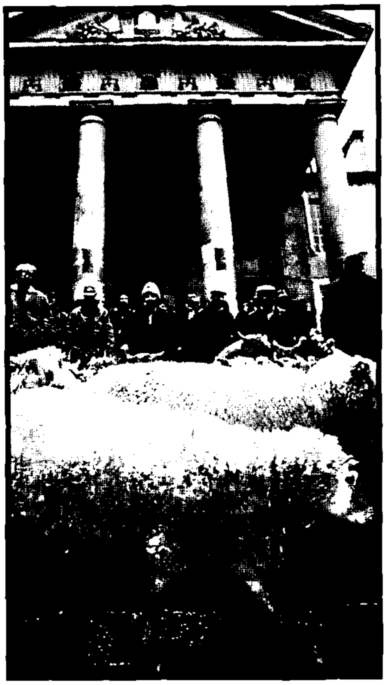
THE ROLE OF THE UNITED STATES

The exchange rate issue requires leadership, and not only from the E.C.B. Making room for European restructuring requires foresight on the part of the United States. Indeed, it would be a test of whether America is fit to play leader in the world economy – a test that requires the country to rise above its inclination to see itself as the victim of ungrateful foreigners. Leadership demands not merely the passive example of its economic structure, but the active acceptance of the responsibility that comes with being the trailblazer.

Dollar appreciation is consistent with two points that American leaders – notably Treasury Secretary Larry Summers – have articulated with regard to Europe. First, they strongly advocate that Europeans reduce their emphasis on macroeconomic management and pay more attention to the restructuring of inefficient, overregulated markets. Second, they realize that businesses compete, not economies – that the U. S. has much to gain and little to lose from a more productive European economy.

The restructuring horse is truly out of the European barn, and will not be put back. Global capital markets are forcing European companies to rationalize or risk being crushed. The threat is not just from more efficient foreign producers, but also from global investors who seek other, more profitable places to put their money.

The big headline mergers – along with less obvious changes in financial and managerial behavior – are bringing corporate Europe into a new era. And the fallout is beginning to show up on the political radar. Overcoming resistance is a matter for the Europeans themselves. As noted earlier, however, a weaker euro would help grease the wheels, and it is here that Summers could make a difference.



THOMAS HALEY/SIPA PRESS

A cheaper euro means happier farmers.

For, by virtue of his management powers over the dollar, the Treasury Secretary can help insure that it is directed along the path the United States chose in the 1980's.

Summers' second point – that competition between economies is a mirage – underscores a vital educational mission. Many Americans view the global economy as a zero-sum game in which the United States loses when foreign economies grow. For his part, Summers has clearly stated that "to the extent that Europe is more prosperous and confident, it will be a better partner for us." But it is important not just for him to understand, but also to lead the United States to the same understanding. Summers should be unequivocal in asserting that the result of a weak euro (in tandem with a determined effort to restructure) will be a stronger European economy. And that both continents will benefit.

Europe's moves in this direction amount to the sincerest form of flattery. Europeans, who have long criticized the uncontrolled capitalism of the United States, have discovered it is precisely this lack of control that encourages risk-taking and economic growth. Corporate Europe is committed to the new order. But others will certainly become unhappy, as the implications become widely understood. Everything possible must be done to help the wide European polity learn to live with, and even love, American-style capitalism.

Returning by popular demand,* we once again offer capsule reviews of selected published articles and unpublished working papers relevant to economic policy. By the way, suggestions for research to include in future columns are always welcome.

CAR WARS

Back in 1973, General Motors was king and the occasional Honda subcompact seen puttering down the highway was driven by a hippie or a college professor. A quarter century later, Japanese cars have become the common-sense vehicles of choice, praised or damned as instruments of Detroit's fall from grace.

But what really explains the dramatic shift in market share? Conventional wisdom says the Japanese offered the right models at the right time – small, fuel-efficient vehicles for an oil-scarce world – and then won brand loyalty with exceptional reliability. Brad Barber and Masako Darrough of the University of California-Davis, along with Reid Click of George Washington University, offer a more textured analysis.

Oil price changes did make a difference, they confirm, but explain only 6 percent of the month-to-month changes in market share. Likewise, exchange rates and the business cycle mattered. But such macroeconomic effects explain less than 20 percent of variations in sales. It seems that the Japanese sold product the old-fashioned way, making the cars people wanted at prices they were willing to pay.

By the same token, Detroit's comeback can largely be explained by producing sport utility vehicles early and often. All told, this is a reassuring lesson in market economics. [*"The Impact of Shocks to Exchange Rates and Oil Prices on U.S. Sales of American and Japanese Automakers." Japan and the World Economy. Volume 11, 1999. For access, e-mail the authors: rclick@gwis2.circ.gwu. edu.*]

**Thank you, Rodney Popular of Managua, Nicaragua*

WHAT IS TO BE DONE?

Six times in the 1990's, reminds Martin Mayer of The Brookings Institution, crises have shaken the world's financial structure. And each time the response of policy makers has been to go looking for "a new financial architecture."

Mayer, an expert in banking who has always come at the issues from the perspective of a practical man, is deeply skeptical that the ritual is useful. "Our discussions of financial matters have moved too far from the realities of getting and spending in real economies," he writes in a working paper for the Jerome Levy Economics Institute. "Once perceived as parasitical but inescapable in a world where only partial information exists,