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New Book by UCSB Political Economist Explores the Euro, the Dollar, and the Future of Global Currency

When the euro was established as Europe's joint money 12 years ago, many predicted it would soon achieve parity with the U.S. dollar –– and possibly surpass it –– as an international currency. In reality, however, the euro has remained firmly entrenched in the dollar's shadow.

In his new book, "The Future of Global Currency –– The Euro Versus the Dollar" (Routledge, 2010), Benjamin J. Cohen, Louis Lancaster Professor of International Political Economy at UC Santa Barbara, examines the core deficiencies in the structure of the euro that make it virtually impossible for it to be anything other than a regional currency –– dominant within Europe, but not elsewhere.

"Ever since money was invented about 2,500 years ago, there has always been a dominant currency that is used internationally," Cohen said. "The central focus of the book is on the competition between the dollar and the euro as today's top international currencies."

According to Cohen, while U.S. external deficits and looming foreign debt indicate the dollar is unlikely to be as powerful as it once was, Europe's money remains unable to mount an effective challenge. "The euro suffers from a number of critical structural deficiencies, including an anti-growth bias that is built into the institutions of the monetary union, and an ambiguous governance structure."

Among the reasons he cited for the euro's inability to pose a serious threat to the dollar is what he called "basic inertia." Once a preference has been established for a particular currency –– in this case, the dollar –– it is difficult to get market actors to shift to another. "Money is a network phenomenon. People accept the dollar –– this green piece of paper with George Washington's face on it –– because there is the general belief that, in turn, others will accept it from them in a network of transactions," he said. "To shift from the dollar to, say, the euro requires people to believe that it will be widely accepted. So that shift depends a lot on what they think other people are doing."

More significantly, Cohen continued, for people to make the shift from one currency to another, they need a material incentive. "One possibility would be lower transaction costs with the euro than with the dollar," he said. "But transaction costs with the dollar are minimal, so there's no way the euro can get a foothold in that regard."

A second possible incentive would be the euro developing financial markets as deep, broad, and resilient as the financial markets for U.S. dollar-denomination assets. "That hasn't happened either, and it isn't likely to," Cohen said. "They're still a very divided group."

That division, in fact, leads to the third reason the euro is unlikely to achieve parity with the dollar. While the dollar is managed by a single government that can make unilateral decisions, the euro is overseen by 17 separate governments. "The Europeans, as has been well demonstrated since the Greek tragedy began in the spring, find it very difficult to get their act together because they don't always agree," Cohen said, referring to Greece's recent economic crisis. "The result is that the governance structure is always going to be deficient, and it can't be overcome as long as they remain politically sovereign states."

Conversely, will the euro ever go the way of, say, the pound sterling? Cohen thinks not, because the European governments have made a deep political commitment to keeping the euro alive. "They'll go to enormous lengths to keep it going," he said. "If the euro zone were to start to break up, the whole European project would be jeopardized. The European Union is too important to them politically to allow that to happen."

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