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REVIEW ARTICLE

THE WAR OF CURRENCIES IN A GLOBALIZED ECONOMY

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ABSTRACT

The dollar and euro reflect at best their countries destinies and they are the rulers of the world. With a difference of about 200 years with each other these two coins are the focal point of the finance and by their performance depend the economic performance of the major part of the world. The fact that European nations created a union between them is always considered as a rivalry against the United States, and once that EU emitted the common European currency, it was described as a challenge to the dollar. The beginnings of the euro haven't been so good given that has there was a depreciation of its currency against the U.S. From this fact the whole world had the impression that the EU wouldn't last for a long time, but with the passing of years it was showed that this assumption was fair enough since the euro continues to be valued higher than the dollar. The purpose of this topic is to demonstrate the advantages and disadvantages of each of the currencies in the global economy. Also, a comparative analysis is made between the two currencies to see which of them is likely to rule the world in the future.

INTRODUCTION

1. Euro and dollar – The stories of creating a currency

1.1 Euro

The desire to create a common European currency has been existed since the 60s when the EEC (European Economic Community) thought as necessary the existence of a tool that would enable the coordination of economic and monetary policy and the free movement of capital in the European Union area. But the idea of a common European currency was born virtually only on 1 January 1999. During the period 1969-1999 were realized many steps that made possible the harmonization of monetary policy from the fixation of the exchange rate, to the creation of the European System of Central Banks and the European Central Bank. All these steps preceded the establishment of the euro, which virtually was created in 1999, but the currency was issued three years later, i.e. in 2002. The acceptance of the Euro was rejected by the United Kingdom and Denmark (although this latter pursues a policy of fixed exchange rates of the euro with Danish Krone). The creation of a single currency formalized the monetary union thus approaching more and more the idea of full union. From 1999 until the end of 2001 Euro zone countries continued to use their currencies until these latter were eventually removed from circulation by issuing euro. The name EURO was set to the currency in 1995, replacing hence the name ECU (European Currency Unit), which was used until then for the European unit of calculation. The design of banknotes and coins was introduced over two years and their printing began in 1999, so it took a three years period to prepare them. On January 1, 2002 were printed 7.4 million banknotes and 38.2 million coins that would be used by consumers and businesses while to the wholesalers and to the retailers these coins were distributed on December 1, 2001 in order to not create confusion. There are 7 denominations of the euro banknotes n and their symbolism is shrewd. In each of the notes appear the European architectural styles of different historical periods, where with the increase of the value of the currency the architectural style becomes more modern. Each of these architectures is presented through the doors and windows on one side, while on the other side appear bridges. The firsts represent the willingness of European countries for cooperation and openness with each other, while the bridges represent the communication of the European countries with each other and with the world. Identical signs for every banknote are the EU flag, the initials of the European Central Bank in five official languages of the EU, European map, the 12 stars of the European Union representing the 12 states when it was created and the name Euro in Greek and Latin.

1.2 The dollar

The history of the dollar in North America has its origins in 1690, before the birth of the state, when the territory was still under the domination of the colonies. The initiator was the Colony of the Bay Massachusetts which used securities exchange to finance military spending. This example was followed very quickly by the other colonies. In 1775 when the colonies were preparing to go to war with the British Army, the

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Continental Congress introduced the continental currency. However the duration of this coin wasn't long due to the lack of funding and the easiness of counterfeiting. The dollar was elected to become the monetary unit for the United States in 1785. The Coinage Act of 1792 helped to build an organized monetary system which issued gold coins, silver and copper while in 1861 as a financial aid to the civil war were put into circulation banknotes.

In 1913 through the Federal Reserve Act was created a single and organized central bank which will be taking into consideration the changing financial needs of the country. In its beginnings the American banknotes has been black, but given that the photographic technology of that time couldn't print the black color it was chosen the green color, which represents stability. After World War II, the dollar was the only major currency through which can freely be developed the international exchange. The dollar's role was formalized under the Bretton Woods monetary agreement of 1944. The other Nations set official exchange rate against the dollar.

2.The advantages and disadvantages of euro and of dollar

2.1 The advantages and disadvantages of Euro

Given that the history of the euro is much more recent than that of the dollar, the advantages and disadvantages of the euro will be seen from the perspective of creating a new currency, the existence of which must convince Euro zone members to justify their choice.

2.1.1 The advantages of the euro

- The elimination of transaction costs - Through a common currency can be made business without having to worrying about the transaction costs. Euro zone countries have benefited from it, while the United Kingdom loses million pounds a year to buy and to sell Euros. Also benefiting from this advantage are the tourists belonging to the Euro zone which now can eliminate exchange costs.
- Transparency of pricing - often firms and various European consumers want to compare prices of goods and services in different countries. In the case of non-existence of a common currency the process is difficult, but for the Euro zone countries it is easier due to the use of the same coin.
- Eliminating the uncertainty of exchange rate fluctuations - Many firms are concerned when investing in foreign countries as a result of the uncertainty caused by exchange rate fluctuations. Investments will increase within the euro area as a result of using a universal currency and uncertainty will disappear gradually.
- A single market has the necessity of using a single currency - trade will be developed more efficiently and effectively if within the European market will be used the euro.
- Rivalry with the "Two greats" - two of the strongest currencies in the world are the Yen and the Dollar respectively belonging to the two most powerful economies, the Japanese and the US. The euro enables EU countries to trade only within their area without having to perform commercial transactions with Japan and the US. Consequently the Euro turns a very strong currency against those of others, which has already happened.
- Prevention of War - European Monetary Union is in essence a political project where its main aim is to prevent war. It is known that countries that effectively trade with each other don't go to war. Given that after the introduction of the euro the trade between EU countries is strengthened and developed, then peace and prosperity is more likely to flourish.
- Inflation - During the first half of 80s countries such as Italy and France had many problems with high inflation rates. These countries were forced to follow such policies to achieve inflation rates close to those of Germany, because otherwise the franc and the lira will be abrogated so much that will adversely affect the fixed exchange rate that was located in Europe. Many other countries were forced to follow the norms set by Germany which had good results in terms of inflation because the German Central Bank (Bundesbank) was independent of the German government. On the other hand the central banks of Britain and France were controlled by the respective governments and during electoral periods there was a pressure on central banks to reduce the interest rates. This monetary policy in the short run lead to an economic boom, but then it was accompanied by a sharp increase in the price level. By placing the euro as a unique coin the problem of government pressure can be avoided. So EMU could affect a stable price level and furthermore lower rate of inflation.

2.1.2 The disadvantages of the euro

- The instability of the system - During 80s United Kingdom refused to join the ERM (exchange rate mechanism) based on the justification that it would be impossible to keep fixed exchange rates as long as the pound depended on the price of oil and Britain's inflation was higher than that of Germany. At the moment that the United Kingdom decided to join the countries that had made an arrangement related to the fixed exchange rates, the system had three years that hadn't have fluctuations giving the impression that it was a fairly stable system. But in September 1992, when Italy and Britain decided to get out of this agreement, it was ascertain that the system wasn't really as stable as expected.
- Overestimation of the benefits from trade – The reduction of the transaction costs according to some experts is overrated. In fact the gains of switching system, from the one with fixed exchange rates to the usage of a single currency, haven't been as great as expected.
- Loss of sovereignty - in the case of the creation of the monetary union the governments that accept this union lose their control over the respective Central Banks. From a political point of view of the independency of Central Bank is undemocratic because people choose their representatives who have the duty to control the monetary policy of the bank. The power of those states that have adopted the euro has moved to Brussels and they have become powerless regarding monetary policy.
- Different states, different economies - all EU countries are at different stages of the economic cycle. So interest rates will be determined in dependence on the economic stage of

the state. A central bank alone cannot determine the level of inflation for each of the member States.

- Diversity in culture - The dollar has functioned as a single currency in the United States because United States of America has the same language, almost the same culture and a flexible labor market. But the creation of a monetary union in the European countries that have different languages, different cultures and consequently a fixed workforce presents many difficulties.
- Interdependence - As result of the existence of a common euro zone, countries are obliged to cooperate with each other in order to achieve common objectives set by the monetary policy of the European Union. In this case the economic problems of a state could affect the rest of the member countries.

2.2 The advantages and disadvantages of the dollar

Given that in recent years the dollar has lost its value that, as a result of the creation of the euro and lately as a result of the crisis, in this paper it will be seen what are the benefits and costs of weakening the dollar.

2.2.1 The advantages of weakening the dollar

- In times of crisis a weak currency is the solution - eakening the dollar helps the US economy because the foreign trade is promoted by keeping stable the local consumption. In this way the trade deficit will decrease because exports will increase over imports.
- Increases competitive advantages - a weak dollar can be translated into a competitive advantage for the US because American goods will be required over the world as a result of their cheaper prices compared to the world prices.
- The production is stimulates and the unemployment is reduces - If exports grow then companies will begin to produce more and thereby the employment will increase.
- Encourages FDI – The depreciation of the dollar has led many global companies to invest in the US, mainly through mergers and unions. This has largely happened as a result of the fact that investment costs have declined sharply since the dollar has become cheaper in the market.
- The positive impact on tourism - A weaker dollar means that tourists will spend less of their national currencies to buy a dollar. So they will tend to visit more the United States of America because it will cost less. This is translated into more revenue for the US budget.

2.2.2 The disadvantages of weakening the dollar

- Increases of the prices of imports and the reduction of consumption - Americans should pay more dollars to buy a commodity that is not manufactured in the USA. So many customers have to cut their spending on consumption. This means that many manufacturers in order to keep their profits stable will increase the prices.
- The price of petroleum - this latter move inversely to the dollar trend, so a weaker dollar will bring higher prices of petroleum.
- Reduction of wages - as result of the increases of import prices many employees will ask for wage increases in order to meet consumer spending. But this won't be possible for most of the producers because their income, mainly as a result of the rising of petroleum prices will not be so high.
- The impact on business - Those businesses affected mostly by the decline of the dollar, are the travel agencies and businesses that use foreign products in the production of their goods.
- Inflation - the weakening of the dollar make more expensive the imported goods by reducing consumer spending and forcing firms to increase their prices. So it is a vicious circle that leads inevitably to inflation.

3.International coin and the power of money (dollar and euro)

The financial crisis, which had its beginnings in August 2007, caused by underestimation of mortgages in the United States has affected the monetary space around the globe. As a result, the American model of innovation that has served as a financial lever has taken a serious blow. Indeed, the growing pressure of deregulation and financial guaranty markets seems to have reached its limits. Policymakers around the world have realized the dangers of this situation and have called for the creation of a new financial structure, which should be better regulated, more supervised and coordinated through a system as the most vulnerable "visible hand ". Forum G20 major economies, has already replaced the previous grouping of economic powers known as the G7 or G8 forum, a forum in which are made discussions and the coordination of global macroeconomic policy. The financial crisis has primarily affected the consolidated financial economies as the United States and the European Union, member of the BRIC countries (Brazil, Russia, India and China), countries that have gained prominence in discussions on the reconfiguration of the international financial system. When the United States were affected by the crisis, they stressed that the EU will suffer more serious consequences and emerging markets will suffer from fever crisis.

In this situation, the European Union Euros through its shield confronted the crisis better than in previous crises cases. BRIC member countries apparently have managed to withstand the crisis with little recession as Brazil's case, case with slowdown of economic growth like China case. The United States gradually lose their reputation as the global center of economic development. As a result of the effects of this crisis developed economies such as the BRIC countries are raising questions about whether: American dollar should continue to be the main currency in the international monetary system. Never before the leading elites in developing countries, haven't discussed so openly against the dominance of "green currency" in the international financial system. Surprisingly also China's top leaders have voiced their criticism even though China is the largest owner of American debt roughly 2.5 trillion dollars in foreign currency.

The consequences of these developments have made the world leaders to look for other alternatives versus the dollar standard. So far the only international alternate is the common currency of the European Union, euro. European Monetary Union (EMU), which recently celebrated the 10th anniversary of its establishment, generally seen in emerging markets as a success story by academics and other market participants. Despite the problems caused by the Greek debt crisis and the instability in some countries like Spain, Portugal, Iceland, the achievements of the euro should not be underestimated. The fear of transition of currency management from the nations to a common currency managed from the European Central Bank passed without problems. The integration of trade and financial markets has not been with desired rates but has continued. Even in the days before the crisis inflation targets, creating new jobs and economic growth have been better in the euro zone than in the United States. As a result of these achievements, the euro has been consolidated as the second currency used in the world and is seen as a strong competitor for the dollar. Even during the peak of the crisis, the euro has dominated the exchange rate against the dollar where one euro was exchanged about $ 1.3. However the effect of currency goes beyond the numbers in absolute value.

Historically, the currency used abroad functioned as an extension of sovereignty prestige, reputation and influence. That represents the international money power. However there are a number of questions about the common European currency related with the implementation of the model as international currency in the absence of a sovereign state after or perception of EMU by leaders of other markets, particularly the BRICs. Also question about the multipolar system of the euro as an alternative to a unipolar system of the dollar has been arise. Money are not seen by market forces only as a neutral instrument to accomplish its three main roles of money as unit of account, medium of exchange and store of value. It is also understood as a political tool for achieving the objectives of sovereignty. Also can be used to force other countries to do things that otherwise wouldn't do. In this view, money is power in itself. If it usage and its influence goes beyond this, then it becomes an international force.

3.1 The determination of international currency

How a currency does become international currency? In economic literature, is widely accepted that there are five factors that determines it.

- The size of the economy
- A developed financial system
- Trust in currency values
- Political stability
- Network externalities

In a more simplified way these factors can be summarized in three factors:

- Self-esteem;
- Liquidity;
- Network transactions.

Policies may indirectly affect economic determinants through some aspects. Confidence in the currency may be supported by economic factors, as well as "other factors provided by the international power of the state" or "a conservative monetary policy, which is closely linked to institutions and domestic politics". The first is embodied by the military power of the United States, while the second by the anti-inflationary unique stance of the European Central Bank.

3.1.1 Dollar as negotiation currency

Recent studies clearly show that such economies as Brazil and China have increased their dissatisfaction over the performance of the American dollar as the currency in which the global economy depends. Economic leaders in China and Brazil in recent years have openly expressed their discontent for the dollar. The first public critic came from for Prime Minister of China Wen Jiabao in the Chinese National Congress in 2009, in which he said he was concerned about Chinese investments in dollars. Some weeks later the Chinese National Bank governor, Zhou Xiaochuan, published an article on reforms monetary system requires by raising more questions about the dollar and presenting the ideas on the use of the SDR, which is used by the IMF as new currency for stocks. Since then many senior Chinese officials have made calls for the completion of the dominant era of the dollar as the main currency in exchanges. Many economic experts agree that the best way for global finance is that of a single international currency.

The main question that arises in this case is what should it be and what should be done if the system does not function normally? The problem with the current regime is its instability. It is very easy to choose a connection with a currency that is stable, but when the financial system starts to stumble, then the place that has chosen it start to be rocked too. That is the reason why the countries try to avoid it. There are two main reasons why China is reacting in this way against the dollar. The first is its close relationship with the dollar. The second is related with the volatility of the exchange rate by which has been suffering in recent years. Being the most developed economy in the world, the model of floating exchange rates gives to the USA the opportunity to use the monetary policies in the national interest by ignoring the responsibilities that it has as the international monetary power, and without considering the interests of economies that may be affected by the undertaking of these policies. The so-called "Triffin Dilemma", which means "laying the currency in local markets", is the biggest concern of global markets. The massive injection of currency by Federal Reserve can cause inflation in other world markets and would lead to underestimation of the dollar. By considering this fact, international cooperation is needed, which essentially means negotiating the status of the dollar as the international currency. Concerns about the dollar dysfunction go beyond the use of currency because it will also affect the economic growth model which in recent decades has been led by the United States. Already economic model based on innovation and free competition is in question.

3.1.2 The impact of the Euro

As a result of growing discontent against the dollar and the United States, global developed markets are studying the possibility of implementing another currency in global trade relations and as the main candidate is seen Euro . The question that arises in this case is if the Euro can function as stable currency in global trade. European Union currency, the euro, in recent years has shown that it is a stronger currency that the American dollar and the European Central Bank is known for aggressive interventions about price stability. Based on the above, a priori one might think that the euro has the potential to be the future major currencies in trade exchanges. Euro zone countries together with other EU members have stronger economies than the United States. Its financial system hasn't the size of the Wall Street, but in recent years financial integration has shown consistency. The political stability of member countries of the EU is guaranteed by liberal and democratic systems with their strong institutions and with their separation of powers and the political will to work together. Finally external network is a powerful factor, as the EU is the area with the greater market and financial development in the world. Despite the strengths mentioned above, the euro still isn't seen as a replacement (nearly in time) of the green currency. Emerging economies like the BRICs cite some euro weakness as the lack of financial instruments in Euros and the fragmentation of the debt on the markets of the old continent. The BRICs countries evaluate the possibility of buying bonds in Germany, Italy, Spain, in the same currency, which is seen as something positive, but these are small markets to consider. Insufficient liquidity is another concern.

If it is assumed that the Chinese economy will decide to invest in significant amounts in euro bonds, the European financial system could be ruined. Currency value will decrease more and prices will suffer significant increase. Euro is still a small player to be international currency, or we can say that China is a very strong player in the international financial arena (it is the largest holder of dollar reserves in the world 3.2 trillion dollars in 2011). If it was going to transfer this amount in euro that means that the American dollar would decline and the euro would have levels of instability for European exports, which would lead to a financial struggle. Chinese economy can't diversify its stock in other currencies although it is desired by them. The Chinese government has been trapped by the dollar, even though they want to leave the dollar and are trying to find new ways to do so, the euro cannot be viewed as a final solution. Euro could reach its target only when it will reach the agreement on political integration. The second main problem is that the Euro zone has a central bank, but a large number of Ministries of Finance, which means that there is no fiscal union system. As a result it is difficult for EMU to compete with dollar, which has a currency, a central bank, a government and a treasury system. Euro zone crisis in cases of Greece, Spain, Portugal and Iceland showed signs of lack of coordination of the joint to withstand the crisis, which led to the collapse of the euro and has led many foreign investors to shift investments towards green currency area. To face the crisis in the Euro zone needs to strengthen more the relations between the EU countries and this situation is seen as a good opportunity for her political integration which is the only way to be. For the European Union, EMU has proved to be a great achievement and currently is seen as the best model for achieving monetary integration in different regions of the globe.

Conclusion

There are two hypotheses on the dominance of the euro in the economic literature; the Euro-optimistic hypotheses and the euro-skeptic hypotheses, where as the main arguments are presented the market size, the sophistication of the financial system, the confidence in the currency and the foreign relations network. The dollar dominates about two-thirds of global economic activity, and the euro less than one third of. The data show that the euro cannot be done international currency without achieving economic - political cooperation, which hasn't yet been reached by EMU. Europe is politically divided, which makes it a difficult competition with the American dollar. However the euro has reached its goal to protect its member countries by the dominance of the dollar, which has contributed to the weakening of the latter. Despite the collapse of the power of the dollar in recent years, it continues to dominate as the main currency exchange of the markets in the world.

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