Our Currency and Your Problem: Conceptualizing the Euro as a Global Currency

Abstract:
The advent of the euro has sparked an ongoing and vigorous debate about the prospects of the euro to become a (or the) major international currency. This paper assesses the voluminous literature on this issue and argues for a re-conceptualization. Whether it is made explicit or not, the main dependent variable of research on the international role of the euro is monetary power as reflected in comparisons of the euro with the dollar. However, the opaque nature of power, particularly in its monetary form, has led to widespread conceptual confusion. Recent work has shown that monetary power consists above all in the capacity of its holder to preserve autonomy in the pursuit of political and economic preferences. The euro has greatly enhanced the Eurozone’s power in this sense. But the unanswered question is: Power to pursue which preferences? Any debate on whether the euro becomes a rival to the dollar makes sense only after an assessment of the purpose of monetary power. The article suggests a research agenda on this question.

Keywords: autonomy; ECB; Euro; exorbitant privilege; dollar; Eurogroup; Eurozone; monetary power; reserve currency; seigniorage

a) Introduction
Not only since the euro has scratched the $1.60 mark in July 2008, the print media and the internet are buzzing with speculation about a possible replacement of the dollar as dominant international currency. When it became clear that the Maastricht blueprint for a single European currency was likely to become reality, economists and political scientists immediately began to analyse the potential international consequences. High expectations for a potential global role of the euro are understandable since obviously it plays in a different league from the European currencies preceding it, in particular the German mark (DM), the major European candidate for an international role since the 1960s. This is not only due to the size of the Eurozone market (16 countries with a population of 327 million). Even more significant is that the European Union, most members of which will eventually adopt the euro, has made no secret of its ambition to become a global actor, not only a regional one as Germany was and Japan still is. In fact, a vague hope that the euro would redress a global monetary imbalance created by the hegemonic position of the dollar was one of the major arguments driving the debate about European
monetary union since the early 1960s (Zimmermann 2004a). This prospect still exerts a powerful discursive influence on public and official imagination. Any Google search on this issue will easily substantiate that. A globally successful euro also was and is an important factor in legitimizing Europe’s EMU (Economic and Monetary Union), as public pronouncements by representatives of member states and the Commission show. In that sense, the global role of the euro was and is part of the ‘DNA’ of EMU.

The literature on the chances of the Euro to become a truly global currency has by now become very substantial. Many of the more journalistic contributions limit themselves to an enumeration of selected attributes characterizing a global currency and to a discussion of how close the euro is to fulfilling these conditions. These analyses convey only a quite vague idea of the political and economic consequences of a global currency shift. Often, they present a zero-sum notion of supposedly earth-shattering transformations in case the dollar is replaced by the euro. Possession of the leading currency is seen as granting the issuing country an almost unlimited capacity to exert coercive and structural power, an argument repeated in scores of op-ed articles (e.g. Munchau 2008; SPIEGEL 2008). According to this line, dollar hegemony underpins US global hegemony. As the euro rises, the dollar falls, and with it American global influence (Fouskas/Gokay 2005). It is simply assumed that ‘the euro gives European policy makers both global influence and responsibilities which, prior to its introduction, were the preserve of the United States’ (Thom 2000: 179). Such bold statements are rarely repeated by economists who think that markets will decide monetary balances and global currency use in an impartial manner based on efficiency considerations. For them the issue of leading currencies is a fundamentally economic process which reacts to market disequilibria such as persistent US current account deficits. They focus on various economic indicators, and much effort goes into measuring them and forecasting their future direction (ECB 2008; Eijffinger 2003; Galati/Wooldridge 2006; Portes/Rey 1998; Papaioannou/Portes 2008).

Most political scientists dealing with the issue avoid the apocalyptic scenarios conjured up by many pundits (e.g. Fallows 2005). But they see the future of the euro as international currency as an eminently political question, associating it with issues of relative power among states (possibly indicating fundamental historical shifts), with wide-ranging implications for state-market relations, and with far-reaching distributional consequences between and within societies (Kirshner 2003). However, mostly this literature remains at a rather abstract systemic level. Almost nothing has been written on what happens to the Eurozone if, in fact, the euro
becomes a truly global reserve currency. What are the gains and, importantly, what are the drawbacks? Arguably, these unknown implications of the external role of the euro give rise to quite some anxiety among the central bankers in Frankfurt and shape their policy stance. What would the Eurozone do with the power (or burden) bestowed by a global currency? Therein lays the core point this article makes: to determine the (global, regional, domestic and/or local) “purpose” of an international currency is essential for any discussion of its international role and the power which its issuing country – or rather, the citizens of this country - derive from that.

This article proceeds in three steps: 1) I argue that most of the literature on the euro as global currency is (explicitly or implicitly) concerned with issues of the global distribution of political and economic power. I briefly enumerate the various indicators used by this literature, and discuss how they relate to recent definitions of monetary power offered by IPE research. 2) I claim that these definitions of monetary power are incomplete as long as they are not linked to a notion of preferences. That is, even if the euro has increased Europe’s power, in what sense has it done so? What is the actual purpose of this power? Without such an assessment the usual dollar/euro comparison is quite pointless. 3) Finally, I offer a discussion of Eurozone preferences, distinguishing three broad categories, and I present a model for explaining trends in external decision-making. This article therefore combines a theoretical and empirical agenda. I suggest new ways of theorizing the international role of the euro and make a start at the empirical work which is required by such a re-conceptualisation.

b) The Euro and Economic Power
Political science is fundamentally concerned with the question of who gets what, when and how. Power is the core currency in politics to get the things one wants. The discipline is therefore fascinated by questions concerning power. This is also true for the literature on international monetary relations, and specifically on the global roles of the euro and the dollar. It is usually couched in terms of a discussion on whether the euro will one day catch up with the dollar. The ultimate driver of this debate is, as in the popular debate mentioned above, the idea that this issue is fundamental for the distribution of global power. This becomes immediately obvious just by looking at the charged language which is used in this research: ‘competitors’ and ‘bipolar system’ (Bergsten 1997), ‘currency leadership’ and ‘challengers’ (Cohen 2003), ‘monetary power’ (Portes/Rey 1998; McNamara/Meunier 2002) and ‘rivalry’ (Posen 2008; McNamara 2008). Many political scientists, following the footsteps of Susan Strange, assume that the dollar is an indispensable bedrock of American global power (Strange ). Even analyses by
economists are informed by the underlying theme that a potential redistribution of wealth effects caused by currency shifts is closely related to the global balance of power. The fascination derived from the euro-dollar comparison ultimately rests on the idea that the status of global currencies indicates or causes global power shifts. Without this fundamental agenda the question of whether the euro surpasses the dollar would hold little interest for political science. Many analyses exhibit a normative bias for or against the rise of the euro (often hiding a bias for or against the emergence of the EU as superpower and balancer of the US) which shapes predictions in not too subtle ways. These predictions vary enormously. The reason is that, while political science agrees on the political importance of the question, most research is hard pressed to describe precisely how monetary power matters in the euro/dollar relationship, and how it can be made tangible. In fact, it is not easy to substantiate claims of rising or stagnating power, even if historical analogies suggest that dominant currencies underpin (or are maintained by) dominant powers. It is quite paradoxical that, while everybody agrees how much the fact that the dollar is the global currency matters, hardly anybody is able to tell us precisely how it matters. Furthermore, the euro obviously does not lend itself easily to historical comparison. What makes a credible ‘challenger’ or ‘rival’? To answer this question, much of the literature enumerates various indicators for the status of the euro, and extrapolates from those the likelihood of the euro becoming equal to the dollar. I will problematize these indicators in turn.

Economists and political scientists usually start their analyses by noting that a global currency needs some core attributes to obtain and retain this status. The first and foremost necessity is solid confidence by market participants in its value. It has to be supported by an economy which guarantees political stability and low inflation (de Grauwe 2007: 253-4). Second, the currency has to be backed by deep, liquid, and efficient financial markets to guarantee easy access to capital and to allow market participants flexibility in their choice of instruments (Portes/Rey 1998). Third, it must be internationally accepted almost everywhere.⁵ If these conditions are given, the currency might acquire global leadership in the three core functions of international money, according to the standard classification of international currencies: unit of account (transaction currency), medium of exchange (vehicle currency), and store of value (reserve currency). The following table list these functions, distinguishing between private and officials use:

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¹ History suggests a fourth condition: the country issuing the currency should also be the dominant or at least one of the dominant political and military powers of the world.
These factors are quantifiable. Much space has been devoted to their measurement so as to show how far along the way the euro is. Different authors privilege different indicators, often without spelling out why one of these should be privileged.

Generally, indications for a more important global role of the euro are on the rise since a couple of years. The most visible symbol is dollar/euro exchange rate. In recent years it suggested to market participants, whether they are individuals, firms, or states, that holding (and using) euros might be more profitable than holding dollars. A sharply rising euro inevitably led to comments about the demise of the dollar. But currency volatility makes the exchange rate a quite useless indicator for global currency shifts over the long run. The factor which is quoted most often in serious assessments of shifts in global currency usage is share of currencies in total official reserves. According to the IMF, the dollar share shrank from 71.5% in 2001 to 63.9% in 2007. The share of the euro meanwhile rose from 19.2% to 26.5%, though in the past few years this trend has slowed down almost to zero, despite a gigantic growth of global reserves (IMF 2007). Clearly, this is an indication that the dollar still reigns supreme as reserve currency. Yet, some argue that if that trend continues, the euro might overtake the dollar as reserve currency in about 15 years (Chinn/Frankel 2007). This would be quite rapid in terms of monetary history.2 Numerous countries have indicated in recent years that they are contemplating a shift in their reliance on the dollar as dominant reserve asset, among them almost all countries in the top 10

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2 One might argue that much of the rise of the euro is due to the effects of the fall of the dollar, but that presupposes that there is some hypothetical fixed value for a currency. This makes little sense. A major problem of this indicator is, however, that the IMF data on which it is based are very incomplete since many official reserve holders treat the composition of their reserves as confidential.
of global reserve holders (apart from Japan). Private currency holders also seem to place increasing trust in the euro. The amount of euro notes in circulation has exceeded the value of dollar notes since the end of 2006 (Atkins 2006). Debt and equity issue in euro overtook those in dollar since 2005 until the financial crisis hit and the US Treasury swamped the markets with Treasury bonds (Oakley/Tett 2007).

On a basic level, the importance of the indicator of reserve composition lays in the notion of seigniorage. As other nations and their citizens hold the global currency at no interest, they effectively extend a zero-interest loan to the issuing country. However, in terms of global financial power this effect is generally assumed to be relatively small (Kenen 2003: 265). Papaioannou/Portes (2008: 78-9) estimate that in a, very unrealistic, best-case scenario, all seigniorage effects from a shift out of the dollar might amount to about 0.5% of the Eurozone GDP. More realistic figures are in the order of 0.05% GDP (Bini-Smaghi 2009). There are no indications that countries push the international role of their currencies to reap the benefits of seigniorage. More important is probably the psychological aspect of shifts in reserve composition. Changes in such a highly visible area might lead to spillover effects, damaging other potential advantages of global currencies.

Another facet of the seigniorage effect is that the country issuing the dominant currency also benefits from a liquidity premium (Portes/Rey 1998). High demand for the bonds of this country reduces the real yield which has to be paid to investors. The country thus benefits from cheaper borrowing costs. Estimating the corresponding gain is hard. Under a best-case scenario (i.e., investments switch from dollar to euro) the premium might amount to 0.5% of GDP for the Eurozone (Papaioannou/Portes 2008: 22). But these figures are highly speculative.

Another frequently quoted indicator concerns the use of global currencies as transaction or vehicle currencies. The fact that oil is denominated in dollars is often seen as major factor in the dollar’s pre-eminence. Recently, OPEC countries discussed openly an Iranian and Venezuelan initiative to switch from pricing oil in dollars to euro (Blas and Crooks 2007). Most members rejected such a step for political reasons, underlining the political basis of currency issues. As of yet, most international commodities are still invoiced in dollars. The use of the euro as transaction currency is concentrated in the regional proximity of EMU (Papaioannou/Portes 2008: 41-44). The dollar thus remains the world’s leading vehicle currency, being part of 86.3% (out of 200% because two currencies are involved) of global foreign exchange transactions in
2007, whereas the euro share is 37% (BIS 2007). The principal advantage of global vehicle currencies is the lower exchange rate risk for companies located in the core country. Though hard to quantify, this benefit can be considerable, particularly at times of volatile exchange rates. Through currency hedging and out-sourcing, firms can limit these risks.

Related to this is the so-called ‘exorbitant privilege’ of financing deficits with liabilities denominated in the home currency (De Beaufort Wijnholds/McKay 2007: 61). Since – allegedly – de Gaulle or his finance minister Giscard d’Estaing coined the term, this phrase has been used to mean quite a lot of different things. Critics of US global policy use the phrase to allege that the US is able to finance its global strategies with cheap credit without having to fear bankruptcy. Countries like Italy, however, seem to enjoy the same privilege. A more precise and better documented meaning is that the US all through the post-war period was able to borrow short and lend long, continuously earning a higher income on its liabilities abroad than foreigners earned on their generally low-yielding dollar assets. As Gourinchas and Rey (2005) demonstrate, even when US liabilities exceeded its assets by a considerable margin, the US recorded a substantial net income. In case of a dollar devaluation, the US also profited from an exchange rate effect as dollar-holders’ reserves shrank whereas US investments abroad rose in value. There is no corresponding study for the Eurozone. It is, however, not clear whether the ‘exorbitant privilege’ is due to international role of the dollar. It might as well be the case that the American variety of capitalism privileges high-risk short-term strategies whereas most foreign societies are geared towards safe long-term assets.

In a recent paper, Papaioannou and Portes (2007: 16) argued that it is the anchor currency role which in the end determines the other indicators. Currency pegs are a very potent incentive for a country to hold reserves in the currency to which it is pegged. Recent data suggests that the role of the euro as anchor is growing, though still mostly confined to areas in geographic proximity (Galati/Wooldridge 2006: 12). The policies of anchor currencies obviously have a huge impact on countries which peg their currencies to them. However, the impact is less felt by the powerful but rather by the anchored country since it loses autonomy to move according to its own whims (a theme which will be taken up later at greater length). Research by Plümper and Tröger (2006) indicates, for example, that the creation of the euro has already led to a shrinking of the policy autonomy of non-euro European countries, in particular with respect to the setting of interest rates.
In most cases, official pegs are the result of the private dimension of the unit-of-account function, that is, trade and investment relations between anchor and anchored currency. This connection has found its prominent formulation in the claims by economists Dooley, Folkerts-Landau and Garber (2003) that the world is experiencing what they call a Bretton Woods II system. The original Bretton Woods system was stabilized by the willingness of keyfollower countries to hold dollars and finance the American deficits because they had an overriding interest in the competitiveness of their exports (Andrews 2008). This role is now assumed by the big emerging market economies which depend on exports for economic growth. The combination of US deficits and undervalued emerging market currencies creates, according to this argument, a powerful path-dependence. Again, however, it is not clear that this is due to the international role of the dollar.

Research on the quantifiable economic benefits of international currencies across their different functions thus yields two basic conclusions: First, the benefits are unclear and much more research will be necessary, particularly regarding the benefits which the Eurozone already derives from the international role of the euro. In terms of share of GDP and shifts in global power relations, however, these benefits seem not overly significant. Additionally, there is no indication that gains on these effects are important considerations for policy-makers on both sides of the Atlantic. It is difficult to see how countries could manipulate these factors in ways which effectively enhance their power.

Second: many indications point towards a rising role of the euro, but assessments of the importance of different indicators diverge enormously. The majority of analysts remains skeptical that the dollar will soon lose its top position. With reference to the decades it took the dollar to replace the pound, long after Britain had lost most of its political clout, the inertia of changes in the monetary system is often cited as a major reason why the fall of the dollar is not imminent (Eichengreen/Flandreau 2008). The path-dependence of an established currency which market players are used to, creating network externalities and functional synergies, serves as a strong pillar bolstering the dollar (Eichengreen 1998: 484). The Bretton Woods II theory also suggests that fundamental domestic arrangements and preferences condition the emergence and permanence of global currencies: export promotion and protection from currency crises in the case of the Asians, and access to cheap and ample credit in the US case. Apart from the incumbent advantages of the dollar, a number of weaknesses of the euro have been quoted to support a skeptical view regarding its potential. In an influential article, one of
the leading IPE scholars, Benjamin Cohen, offered basically four reasons why the euro will not surpass the dollar in the foreseeable future (2003). First, the efficiency of Europe’s financial markets is still way behind American markets, and the Eurozone has no instrument to rival the convenience of the US Treasury bill (see also Galati/Wooldridge 2006). Second, an alleged anti-growth bias is built into the Eurozone, given the focus on monetary stability. Third, the political structure of monetary decision-making in the Eurozone remains ambiguous. It is still unclear who represents the euro in the international arena: the ECB, the Eurogroup, or ‘Mr. Euro’, Prime Minister Juncker of Luxembourg? Meunier/McNamara (2002) also claim that the Eurozone will continue to punch below its weight in international monetary relations as long as this governance problem is not solved. This is echoed by the European Commission in a recent communication on the first 10 years of the euro (European Commission 2008). Even more serious, and this might be the most fundamental problem of all, is the fact that the euro is not backed by a unified political structure, that is, a sovereign nation state (Cohen 2008a). Doubts about its longevity are bound to linger. This leads directly into the question of the sustainability of the euro. What happens to the Eurozone if countries such as Italy would be forced to leave (Tilford 2006)? While this seems a far-fetched scenario at present, it might become more relevant as international investors weigh the consequences of a long-term shift to the euro. In contrast, nobody seriously speculates about a break-up of the United States. The bottom line of most of the literature is that the euro still has to overcome serious obstacles before it achieves parity with the dollar (Cohen 2008b; Galati/Wooldridge 2006).

Nonetheless, while the dollar is still the world’s leading currency, there is no doubt that the euro is already the world’s second top currency. Europe’s financial markets meanwhile begin to rival the previously unchallenged American markets, according to a recent report on global capital markets which saw the size of European markets at $ 53.2 trillion (Eurozone $37.6 trillion) and the US market size at $ 56.1 trillion (McKinsey 2008). This indicates that the European market has reached a depth which might well sustain a global currency. Even with the UK remaining outside of the eurozone, a pattern of asymmetric bilateralism is the most likely scenario in the next decade (see also: Cohen, in: Helleiner/Kirshner, forthcoming; Eichengreen/Flandreau 2008). With regard to international monetary cooperation, the situation looks structurally similar to the years between the two world wars when the British pound was in decline whereas the dollar was ascendant.
A bilateral monetary system creates interesting questions, once a distributive dimension enters the game and political conflict becomes unavoidable. Adjustment costs have to be born, and their distribution makes the question of monetary power crucial. But, as we have seen in the discussion above, an assessment of the various functions of international currencies is not helpful to deal with this question. Using recent re-definitions of monetary power, the next session will establish more precisely in what sense the rise of the euro has enhanced the power of the Eurozone.

c) Autonomy and the Euro
As we have seen, the nature of monetary power is hard to define. Does it matter if the euro becomes a global currency and the dollar gets a rival? This question ultimately hinges on both the economic and political gains which the Eurozone countries and their citizens derive from that change and, of course, also from the advantages the United States has to forego. Estimates are diverging because there are no uncontested measures of the extent of the benefits (and drawbacks) of global reserve currencies for their issuing countries. While the indicators mentioned above are suggestive, it is by no means clear what the benefits are if the euro catches up as reserve or vehicle currency with the dollar.

Conventional understandings of power attribute to the powerful the capacity to force the less powerful to do what they would not have done without such pressure. Kirshner (1995) has shown how states owning a global currency can, under certain conditions, use it to exert direct pressure on other states through currency manipulation. This is a rather straightforward component of monetary power. Monetary statecraft, however, has significant limits, as Cooper (2006) showed. It is simply to blunt and complicated a weapon to be used effectively. In addition, there are so many spill-over effects that policy-makers will be very cautious to use the international prominence of their currencies in purposeful ways.

So why talk about monetary power at all? The reason is that monetary statecraft encompasses only part of the nature of monetary power. This becomes clear when we ask the question of how certain commonly alleged advantages of global currencies can be sustained. How was the US able to run persistent deficits for an extended period and reap the benefits even without any clearly visible strategy? The answer lays in the notion of autonomy, a theme that has been developed in a path-breaking recent volume on monetary power edited by D. Andrews (2006). It introduced the notion of policy autonomy as the fundamental base of monetary power. On a
systemic level this entails autonomy in policy choices, i.e. the pursuit of fundamental preferences of states, their leaders and their societies without constraints deriving from exchange rate considerations, currency crises, imported inflation, etc. On a subsystemic level, autonomy entails the avoidance of costs for domestic groups and the autonomy to choose economic strategies for state actors. In the volume, B. Cohen defined the essence of monetary power as ‘the relative capacity to avoid the burden of payments adjustment, making others pay instead’ (Cohen 2006: 50). The ultimate measure of monetary power is therefore to be able to pursue one’s goals without regard to the effects on others (‘influence’ ultimately derives from autonomy). Potential adjustment costs will fall on other participants, since opting out of the monetary system is impossible for practically all market participants. The one red thread running through any analysis of US monetary policy since the ascendancy of the dollar is the America’s unwillingness to subject domestic economic strategies to movements on global currency markets, and, more importantly, its capacity to do so. There have been exceptions, notably during the 1960s when, for reasons related to the cohesion of Cold War alliances, the US implemented various restrictions on its international monetary transactions, negotiated deals with allies, and participated in a series of international mechanisms, all designed to bolster the dollar (Zimmermann 2002). The US was also somewhat constrained by the existence of gold as alternative reserve asset. Essentially, however, the US didn’t have to adjust, most notably, of course, to the massive current account deficits of the past decades. Nixon’s Secretary of the Treasury, John Connelly, was certainly not a great economic thinker. But he captured this fundamental truth very well in his famous quip to a group of Europeans: “The dollar is our currency, but your problem”. In words that created a huge buzz in the blogosphere, a high Chinese officials recently pronounced the same froth: “Once you start issuing $1 - $2 trillion (of government bonds)... we know the dollar is going to depreciate, so we hate you guys, but there is nothing much we can do (Sender 2009)

US autonomy for the most part was not based on a conscious strategy, or, in the language of the Andrews volume on ‘influence’ or ‘statecraft’. Despite some conspiracy theories, there are few indications that the US actively tried to promote or preserve the status of the dollar after the 1970s. The most frequently cited episode is described by David Spiro who maintains that US protection of the oil-rich gulf countries such as Saudi Arabia hinges on a quid-pro-quo of these countries to support the dollar and American consumption (Spiro 1999). But that seems to be clearly an exception. It was much more important that other countries had to react to the effects created by various policy choices in the center country, whether that suited their preferences or
not. Europe with its integrating markets, which necessitate a high level of exchange rate stability, suffered particularly from these fluctuations. Acrimonious struggles within the Common Market about adjustment measures and serious losses to European producers because of the exchange rate risk vis-à-vis the dollar zone were the consequence (Zimmermann 2008). Doubtlessly, the introduction of the euro has made the Eurozone much more autonomous in this sense. Exchange rate fluctuations such as the fall of the dollar in the past years would have led to incessant asymmetric adjustment pressure on European currencies in earlier circumstances, whereas in the current situation Europe has suffered remarkably little impact, apart from exports to the dollar area – and this has not yet reached the pain threshold. Isolation from the effects of dollar fluctuations was a major reason for creating EMU. Of course, a monetary union presupposes a loss of autonomy on the domestic level. But, as recent literature has shown, the autonomy of European governments to manage the economy in crucial respects has not necessarily declined as a result of monetary integration (Mosley 2004). In that sense, the Eurozone has acquired the core attribute of monetary power. Just as the US was able to pursue its major objective, that is, to ascertain a continuous inflow of capital without inflation or other adjustment pressures, the Eurozone has been able to pursue its core policy preferences of price stability and reduced exchange rate volatility.

The notion of ‘policy preferences’, however, points to a fundamental point which has been neglected by practically all the literature on the international role of the euro. Whatever structural power an international currency carries with it (such as the American power of cheap credit creation), its assessment depends on the purpose of the powerful, that is, the link between power and preferences. It is to this link, that the analysis now turns.

d) Linking Power and Preferences
Measuring the various indicators, as outlined in paragraph b), or using the notion of autonomy to decide the question of monetary power, essentially amounts to what Baldwin calls a power-as-resources approach in which ‘power resources are treated as if they were power itself’ (Baldwin 2002: 179). Such a ‘power-as-resources’ approach can be very misleading if it is employed in the area of monetary power. This becomes very obvious if one looks at possible drawbacks in the global role of a given currency. More demand for a global currency can drive up the exchange rate, threatening exporters. Incontrollable currency holdings by foreigners can make the control of the money supply difficult, especially in the case of sudden swings in market sentiment. This was one of the major reasons why the German central bank, the Bundesbank,
always looked with uneasiness at any indication of the German DM becoming a major international currency. Its core mandate was to control domestic inflation and huge DM deposits abroad threatened to undermine this mandate. The same is of course true for the Eurozone. It is clear, thus, that predictions about the potential power of a rising euro or a falling dollar are somewhat pointless without reference to preferences. To use Baldwin’s (2002: 186) analogy: if the US plays a game of poker in international monetary policy and the Eurozone a game of bridge the strength of their hands cannot be evaluated through a straight comparison of resources alone. Thus, the question whether a global currency actually conveys tangible advantages to the issuing country (apart from the not unsubstantial but intangible factors of prestige and legitimacy) hinges on whether it actually serves the objectives of this country (and those of its firms and citizens), and whether it enhances this country’s power to pursue these objectives.

Unfortunately, there is not a lot of literature which links the international and domestic purpose of international reserve currencies. One of the difficulties is that this purpose is often not stated openly but rather implicit. An autonomous actor in the sense outlined above does not have to pronounce particular goals in international monetary policy; these are results of policy decisions in often seemingly unrelated fields (policy decisions which are undertaken without having to worry about external consequences). An exception to the lack of solid research on this is the forthcoming path-breaking analysis by Herman Schwartz who investigates the links between developments in the domestic US economy and the global role of the dollar (Schwartz 2009). He shows how foreign lending to the US kept interest rates in the American economy low, feeding a housing boom in a market which permits easy refinancing. This led to a prolonged Keynesian stimulus, pushing American growth rates above those of most OECD countries, and consequentially bolstering the global role of the dollar. This global role in turn gave the US access to abundant and cheap capital, permitting a system of global arbitrage. According to Schwartz, most Eurozone countries do not have the flexible market structures allowing them to profit from cheap credit as a result of the possession of a global currency. In fact, it is very likely that the ECB would regard this as eminent inflationary threat.

At present, the social purpose codified in the Eurozone seems to be price stability (as mandated in the treaties and the ECB statute). The global weight of the euro enables the ECB to pursue this objective with much more ease than the Bundesbank in its heyday, confronted and often overwhelmed as it was with the dreaded ‘imported inflation’ (Emminger 1976). However, while
the ECB might give clear priority to the preference for price stability, it has to compete with a multitude of other actors who might privilege different objectives with respect to monetary policy. Governments want monetary policy to bolster economic growth and geopolitical objectives. Trade-dependent producers have specific preferences regarding exchange rates. Other actors, such as the European Commission or the European Parliament, might want to use the international role of the euro to enhance their hitherto limited influence in EMU decisionmaking more generally. Particularly interesting is the role of the so-called Eurogroup, the 16 finance ministers of the Eurozone (Puettter 2006). Currently, the ECB has a de facto dominant role on the external dimension of the euro; however, as Henning (2007: 336) argues, this can be renegotiated at any time.

Significantly, since its first days, the ECB stuck to the same position in its public statements on the issue: ‘the internationalisation of the euro is not a policy objective of the Eurosystem; it will neither be fostered nor hindered by us. The development of the euro as an international currency will be a market-driven process, a free process, which will take place, without a doubt.’ (Solans 1999). These words have been repeated in the ECB’s reports on the international role of the euro (ECB 2002; ECB 2007: ECB 2008) and in many public speeches (Trichet 2004). They have been often interpreted as a vague ‘we don’t really care’ statement. But in fact, they suggest a set of important positions. First, it is not the primary objective of the ECB to dethrone the dollar. Second, the internationalization of the euro is not supporting its actual primary objective(s); otherwise, the Bank would foster it. Third, the wording suggests it is not undermining these objectives; otherwise the Bank would hinder it. Is this true?

In 2006, the government of Montenegro decided to unilaterally adapt the euro without worrying about whether their economy actually fulfilled the convergence criteria. EU representatives, while not actively trying to discourage Montenegro, clearly expressed their disapproval (IHT 2006). When the Icelandic krona collapsed in the wake of the global financial crisis in 2007/08, Iceland began to contemplate the idea of a euroisation of its economy. Both the ECB and EU institutions reacted very negatively, to the point of threatening sanctions (SZ 2008). In fact, if the ECB had to tighten its policy in response to external influences, this might create enormous strains in some Eurozone countries (Tilford 2006). However, given the economic weight of potential ‘euroizers’, their potential to disrupt the Eurozone is limited, similar to the minuscule impact of dollarizing countries on US monetary policy (Cohen 2002). It is interesting, though, to note that the US has reacted to dollarization with neutrality (Helleiner 2003), while the Eurozone
has been quite explicit in its resistance. The benign neglect to the international role of the euro suggested by the ECB language hides a more complicated picture. It is even harder, of course, to determine the cumulative position of the member states in the Eurogroup. Cohen (2006a: 82), for example, claims that it is certain that Eurozone policymakers will actually promote the internationalization of their currency. However, he provides no evidence for this claim.

The next step in this research therefore has to be an assessment of preferences in the Eurozone. What preferences do Eurozone decision makers privilege when they discuss the international role of the euro? In addition, I will look at the available cases of external actions by the Eurozone, such as negotiations with China about a more flexible currency regime for the renminbi. Space constraints and the fact that this research needs to be complemented by interviews allow only some suggestions. The end result will be a set of objectives on the internationalisation of the euro for different actors. The final step will be to disentangle which of these objectives carry most of weight.

d) Global Monetary Power, Preferences and the Institutional Structure of the Eurozone

On November 27, 2007, a European delegation arrived in Beijing. Its composition was unusual: ECB President Trichet, Luxembourg Prime Minister Juncker aka Mr Euro, and EU Monetary Affairs Commissioner Almunia headed a mission with the purpose of getting China to reverse the appreciation of its currency against the euro. This appreciation had resulted from the peg of the yuan to the dollar and the fall of the dollar against the euro (Kennedy/Yanping 2007). As expected, the group was not noticeably more successful than successive US delegations with similar objectives centered on the dollar-yuan rate, though immediately after the visit the Chinese currency indeed rose temporarily. However, the main significance of the event was that it marked the first time that the Eurozone engaged visibly in monetary statecraft, in this case to reduce the mushrooming trade deficit with China. Research has been openly skeptical whether the eurozone would be able to act in a coherent way if global monetary coordination was to be effected by actual negotiations. Even European industrialists worried publicly about this problem, more specifically about the incapacity of the Eurogroup of Finance Ministers to influence the ECB (Barber 2007). Meunier/McNamara (2002), Henning (2007), and Cohen (2008) pointed to the ambiguous language of the EU treaty regarding the external representation of the currency and to the lack of a unified representation in institutions such as the G 7 and the IMF (see also Mathieu/Oons/Rottier 2005). The Commission itself lamented the same fact (European Commission 2008).
However, the critique of the governance structure of EMU might be exaggerated for two reasons: first, as demonstrated above, monetary power is exerted mainly in a passive manner, by deflecting adjustment costs on the shoulders of others. This pattern is so pervasive that actual international monetary negotiations are a rare occurrence (Andrews 2006). Given the resilience of domestic level preferences and the difficulty of targeted policy change in monetary policy (as opposed to trade), they are also rarely successful. Second, while the external governance structure of the eurozone is in fact fragmented, it is a gross simplification to ascribe a unitary actor model to potential counterparts in the negotiations. Congress usually has preferences which differ from Wall Street, and both do not share the geopolitical considerations which often motivate American presidents. The response to the recent global credit crisis and the China missions have, in any case, not suggested that the Eurozone has insurmountable problems at achieving a common position. This was also the case when the ECB intervened in autumn 2000 to support the external value of the euro (Bini-Smaghi 2007). The simple assertion that the Eurozone is by definition less cohesive needs to be problematized.

How does the institutional system filter Eurozone preferences with respect to the international role of the euro? As in other instances of European integration, the common currency isolates governments of the Eurogroup and the Central Bank from societal pressures, for example the export lobby. Thus, it is possible as a first approximation to concentrate on these two actors. In another paper I have suggested a deductive model to explain states’ preferences in international monetary diplomacy (Zimmermann 2009). The usual conflict between central banks and political authorities (governments) concerns the question whether price stability or economic growth and social stability should be privileged in the pursuit of monetary policy. The international dimension of a currency brings in a third set of objectives: geopolitical motives. As other states are affected by monetary choices, governments have to weigh the political benefits or drawbacks of their monetary actions. I have ranked these three sets of preferences among the two actors as follows:

<table>
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<th>Government</th>
<th>Central bank</th>
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<tr>
<td>1st preference</td>
<td>Socio-economic stability and growth</td>
<td>Anti-inflationary policies</td>
</tr>
<tr>
<td>2nd</td>
<td>Geopolitical objectives</td>
<td>Socio-economic stability and growth</td>
</tr>
</tbody>
</table>
Ideally, governments as well as central banks want to pursue all these objectives and often they manage to do so. However, sometimes the different preferences are in conflict and in that case each actor will privilege the first-ranked preference. Conflicts between central banks and governments arise. In the paper I argue that geopolitical issues often give governments decisive leverage against nominally independent central banks. I have demonstrated this claim using the case of Germany in the 1960s and 1970s, in an institutional set-up quite similar to the Eurozone. Transatlantic cooperation until the end of Bretton Woods and European cooperation since the EMS have often helped the German government to prevail against the Bundesbank. The more international a currency, the larger the possibility that geopolitical factors enter the play. The *de facto* dominance of the ECB on the issue of the global role of the euro can be easily challenged.

<table>
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<th>Preference</th>
<th>Anti-inflationary policies</th>
<th>Geopolitical objectives</th>
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<tr>
<td>3rd preference</td>
<td>Anti-inflationary policies</td>
<td>Geopolitical objectives</td>
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</table>

e) Conclusions
The issue of the external dimension of the euro is among the most debated themes in the public discourse on the euro. However, political science had difficulties to grapple with the issue and to link it to a broader research agenda in IR and IPE. Recent advances in the understanding of monetary power have pushed the debate forward considerably while at the same time opening up new avenues for research. This article has suggested that an assessment of the international role of the euro makes only sense if it is linked to a notion of preferences. As is often the case, at each turn this article opened up more questions than it has been able to answer. Much more work will be necessary to exactly clarify the links between the international role of the euro and its possible effects on domestic economic (and therefore political) conditions and coalitions in the Eurozone. In addition, the process of preference formation in the international monetary policy of the Eurozone is still poorly understood. Both questions are essential parts of any understanding of the Eurozone’s role in global monetary governance, an area which might see intense activity in the near future given global imbalances.
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ii However, the adoption of the Financial Services Action Plan (FSAP) by the EU in March 2000 has been a big step in creating a single financial market. It aims to remove regulatory and market barriers to the cross-border provision of financial services in the EU. There are already some indications that European markets have made substantial progress in catching up with the US.

iii Until 1971, preserving the dollar exchange rate was one of the major objectives of US foreign policy and in the 1960s the dollar was clearly a negotiated currency.

iv Article 138.1 of the Lisbon Treaty stipulates: “In order to secure the euro’s place in the international monetary system, the Council, on a proposal from the Commission, shall adopt a decision establishing common positions on matters of particular interest for economic and monetary union within the competent international financial institutions and conferences. The Council shall act after consulting the European Central Bank.”