POLICY PAPER
22 AUGUST 2019
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BERLIN
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ECONOMIC SOVEREIGNTY AND THE INTERNATIONAL ROLE OF THE EURO

ROADBLOCKS AND CHALLENGES

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Executive Summary[1]

Relative to the economic weight of the euro area, the euro underperforms as a global currency, coming in a distant but solid second place to the US dollar. In the current global context, where traditional alliances and the rules-based economic order itself are increasingly under strain, improving the international standing of the euro has become not only a question of economic benefit, but also of bolstering European economic sovereignty. A stronger global euro can act as a counterweight to the 'weaponisation' of economic clout (e.g. through sanctions) by other major powers, increase EU autonomy and resilience, and provide a source of stability and diversification for its trading partners.

Although a greater international role for the euro has never been more worth striving for, there are major roadblocks that stand in the way: the existing dollar inertia in international trade and finance, the shortage of euro area safe assets, a lack of deep and liquid euro capital markets, and lingering euro area breakup risk. There are also operational challenges that would arise with a more global euro, namely the challenge of a stronger euro for export-oriented growth models, an increased strain on the supply of safe assets, and new institutional demands that would fall on the European Central Bank (ECB).

This paper draws the following main conclusions:

- Given the strength of the current dollar inertia, a market-led initiative is unlikely to be sufficient to drive greater use of the euro abroad. Greater international use of the euro requires active supporting policies at the European level, including the establishment of euro benchmarks in critical markets, improvements in the eurozone architecture, and geopolitical outreach.

- Strengthening the stability, resilience and credibility of the euro area is an essential prerequisite to improving the international standing of the euro. The most essential measures are increasing the supply of euro safe assets (ideally with a common safe asset), making concrete progress on the Capital Markets Union, and reducing breakup risk by demonstrating a credible political commitment to the common currency and dealing with remaining sources of systemic risk.

- The ECB will need to be prepared to embrace the 'exorbitant duty' of issuing a global currency, i.e. by providing euro liquidity to third countries and taking into account both the larger impact of its actions on foreign markets as well as the larger impact of foreign markets on the euro area.

1. The impetus for this policy brief came out of an expert workshop held on 22 March 2019, co-organised by the Policy Planning Unit of the Federal Foreign Office of Germany and the Jacques Delors Institute Berlin. The argumentation reflects the opinion of the author and not the position of the Federal Foreign Office nor of any individual participant.

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1 . INTRODUCTION

Safeguarding Europe's economic sovereignty is an issue of increasing concern in the current global climate, in which traditional alliances and the rules-based international order itself are increasingly under strain. The issue sits at the intersection of foreign policy and economic policy, and is likely to take on more prominence in the coming years as other major powers, namely the US and China, show a growing willingness to use their economic leverage strategically to support foreign policy goals.[2]

> "THE INTERNATIONAL ROLE OF THE EURO IS A CORNERSTONE OF THE ECONOMIC SOVEREIGNTY DEBATE

The international role of the euro – where it stands and where it should stand – is a cornerstone of the economic sovereignty debate.[3] From the complaints by former French Finance Minister Valéry Giscard d'Estaing about the 'exorbitant privilege' of the US dollar in the 1960s to the criticism of the outsized role still played by the dollar in Europe by Jean-Claude Juncker in his 2018 State of the Union address, the link between currency and the economic sovereignty of Europe – especially vis-à-vis its largest competitor, the United States – has long been a preoccupation of European policymakers.

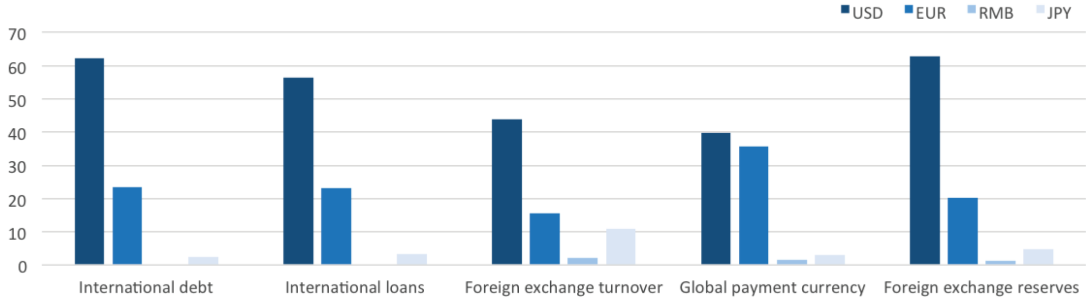
This policy brief provides a brief overview of the euro's current international standing and sets out the foreign and economic policy rationale for improving the international role of the euro, emphasising the value of a more global euro as a counterweight to the economic leverage of other major powers. It then discusses the major roadblocks to improving the euro's global status and the operational challenges that doing so could pose for the euro area. It concludes with brief policy recommendations.

2 . THE CURRENT GLOBAL STATUS OF THE EURO

The US dollar remains uncontested as the world's foremost global currency. However, the euro lies far ahead of any other third currency in the international monetary system, securing its place as the second-most important currency worldwide (Figure 1). While the gap between the US dollar and the euro shares in global payments is relatively narrow, the euro is a more distant second to the dollar on other global currency metrics. In terms of its use as a vehicle currency for foreign exchange, for example, the Bank for International Settlements (BIS) reports that 85–90% of global foreign exchange transactions since 1998 have involved the dollar, compared to 31–39% that have involved the euro.[4]

2. Jean Pisani-Ferry and Guntram Wolff, The Threats to the European Union's Economic Sovereignty: Memo to the High Representative of the Union for Foreign Affairs and Security Policy, Bruegel (July 2019).
3. See e.g. the emphasis on economic sovereignty in European Commission, Communication from the Commission: Towards a stronger international role of the euro (December 2018), COM(2018) 796 final.
4. Bank for International Settlements, Triennial Survey of foreign exchange and OTC derivatives trading (last updated 3 May 2018), foreign exchange turnover by currency.

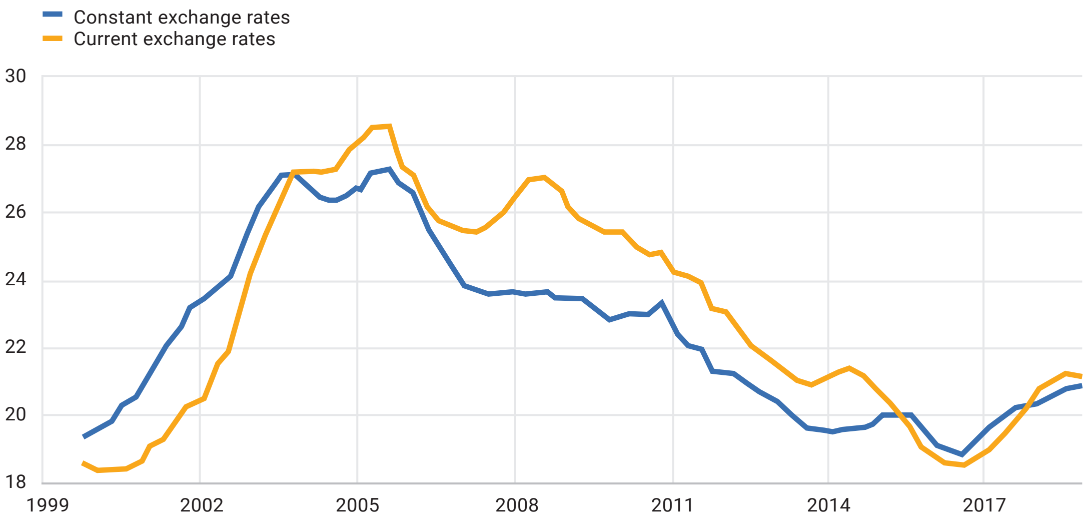
FIGURE 1 ▪ Use of global currencies in the international monetary system
In percentages, data as of 2017Q4



Source: European Central Bank (2018).

The euro has more or less inherited the international role that was played by its legacy currencies, notably the Deutsche Mark and the French franc. Since the mid-2000s, however, and particularly in the period since the euro area sovereign debt crisis, international use of the euro has declined and has not yet recovered. A European Central Bank (ECB) index constructed from a pool of common international currency metrics indicates that on average, international use of the euro in 2016 and 2017 dropped below the levels observed at the introduction of the currency in 1999, although it has started to recover slightly within the last year (Figure 2).

FIGURE 2 ▪ Index of the euro's international role
In percentages, four-quarter moving averages, 2018Q4



Source: European Central Bank (2019), based on data from BIS, IMF, CLS, and Ilzetzki, Reinhart & Rogoff (2017). Notes: Simple arithmetic mean of the shares of the euro at constant exchange rates in stocks of international bonds, cross-border loans, cross-border deposits, foreign exchange settlements, global foreign exchange reserves and exchange rate regimes.

Of particular concern to the European Commission is the limited use of the euro as a settlement or invoicing currency in certain strategic sectors, notably energy, transport (aircraft), and commodities despite the EU's considerable market power. Although the EU is the largest importer of energy in the world, more than 80% of its energy imports are paid for in US dollars, even though these originate primarily from Russia, the Middle East and Africa. In the aircraft manufacturing sector, nearly all invoicing, even within the euro area, is denominated in USD. The majority of raw materials and food commodities are also traded internationally in USD.[5]

> "THE EURO UNDER-PERFORMS AS A GLOBAL CURRENCY

Relative to the economic size of the euro area, and considering the status of the EU as the world's largest trading bloc and consumer market, the euro underperforms as a global currency. Both external and internal factors play a role in the current international status of the euro and its downward trend in recent years. On the external side, the current dollar equilibrium in the international monetary system is deep and self-reinforcing. However, the euro is not just competing against the dollar: in the period since the global financial crisis, the euro has also lost ground to other currencies, such as the Canadian and Australian dollars, as reserve managers seek to further diversify their portfolios.

On the internal side, the euro area sovereign debt crisis has affected the perception of stability and level of safety of euro-denominated assets. The crisis also demonstrated the ECB's reluctance to provide emergency liquidity support to central banks in countries that make substantial use of the euro as a parallel currency for lending and deposits (e.g. as was the case with Hungary and Poland during the global financial crisis in 2008-09), which may make investors and central bankers outside the euro area more wary of relying on the euro. Financial fragmentation within the euro area, as well as the limited and declining supply of euro- versus dollar-denominated safe assets, have also further constrained the development of deep, liquid and integrated markets for euro assets. Finally, low interest rates on many euro assets in recent years may have made euro-denominated securities less attractive to global investors.

3 . THE CASE FOR A GREATER INTERNATIONAL ROLE OF THE EURO

Whereas the euro is currently underperforming as a global currency relative to the economic weight of the euro area, a strengthened global role for the euro has potential benefits for both economic policy and foreign policy.

From an economic policy perspective, there are several potential benefits arising from a greater international role of the euro. The classical benefit is the 'exorbitant privilege' noted by Giscard d'Estaing, i.e. the ability of the issuer of a global currency to issue its debt at lower interest rates due to the perceived safety, stability and liquidity that flow almost axiomatically from its status as the issuer of a global currency. The European Central Bank (ECB) recently estimated the existing exorbitant privilege of the euro area at a magnitude of about 110 basis points, compared to 160 basis points for the United States.[6] An earlier American study fo-

5. European Commission, Communication from the Commission: Towards a stronger international role of the euro (December 2018), COM(2018) 796 final, p. 12.
6. European Central Bank, The international role of the euro (June 2019), special feature B.

cusing on the period 1926 to 2008 estimated the exorbitant privilege for US Treasury bonds at about 73 basis points, saving the US government approximately 0.25% of GDP per year (equivalent to about USD 51 billion in 2018) in interest costs on its public debt.[7]

> A STRONGER INTERNATIONAL EURO [...] CAN ACT AS A SOURCE OF DIVERSIFICATION AND STABILITY

A greater international role of the euro also has the potential to benefit European businesses through lowering the cost of trade. Greater use and acceptance of the euro abroad can reduce or eliminate the exchange rate risk and transaction costs of currency exchange for European firms, as well as increase the autonomy of European firms vis-à-vis the policies of other major economic powers (as in e.g. the case of unilateral US sanctions). It also allows for more stable and reliable access to financing for European firms. However, the potential economic benefits are not only limited to firms based in Europe. A stronger international euro provides a global alternative to the US dollar, which can act as a source of diversification and stability for the EU's other trading partners and improve the resilience of the international financial system as a whole.

In the foreign policy domain, the concept of a common European currency has historically been bound up with the idea of European economic sovereignty, especially vis-à-vis the United States.[8] This link still persists today: In his last State of the Union speech, Jean-Claude Juncker criticised the continued use of the dollar in intra-EU transactions and called for the euro to become 'the face and the instrument of a new, more sovereign Europe.'[9] A stronger international euro has also worked its way into recent proposals aimed at safeguarding European economic sovereignty in the face of economic leverage wielded strategically by the US and China.[10]

Indeed, one of the most important benefits of a strong international euro is as a counterweight to coercive economic leverage exercised by other global powers. In the current international climate, this goal takes on a high strategic importance. Under the Trump administration, the United States has shown an increasing willingness to 'weaponise' its economic clout in order to further its trade and foreign policy goals, and the global dominance of the US dollar is a key element of this clout. Given that a large share of global transactions involve the dollar and are therefore likely to pass through the US financial system at some stage, the US exercises an outsized amount of power in imposing and enforcing economic sanctions, which it does not hesitate to use to its advantage.

> EUROPEAN FIRMS SIMPLY DEPEND TOO MUCH ON DOLLAR TRANSACTIONS TO RISK CONFRONTATION WITH THE UNITED STATES

The American decision in 2018 to pull out of the Iran nuclear deal and unilaterally re-impose sanctions on Iran against the protest of its European allies is perhaps the best recent example of the power of the dollar and its continued hold on Europe.[11] Despite the fact that the EU had previously negotiated an exception to secondary US sanctions, and despite EU attempts to create a special purpose vehicle (INSTEX) to bypass American financial infrastructure and facilitate direct payments with Iran, most European banks and companies have pre-emptively complied with US sanctions. European firms simply depend too much on dollar transactions to risk confrontation with the United States, and do not have faith in EU governments to be able to shield them from the consequences.[12]

7. Arvind Krishnamurthy and Annette Vissing-Jorgensen, The Aggregate Demand for Treasury Debt, Journal of Political Economy (2012), 120(2):233–67.
8. Jean Pisani-Ferry, The Euro Crisis and its Aftermath, Oxford University Press (2014), Chapter 19.
9. Jean-Claude Juncker, State of the Union 2018: The Hour of European Sovereignty (2018).
10. Mark Leonard, Jean Pisani-Ferry, Elina Ribakova, Jeremy Shapiro and Guntram Wolf, Redefining Europe's economic sovereignty, Bruegel (June 2019).
11. See e.g. Keith Johnson, Europe's Dream: Escaping the Dictatorship of the Dollar, Foreign Policy (14 June 2019).
12. Mark Leonard, Jean Pisani-Ferry, Elina Ribakova, Jeremy Shapiro and Guntram Wolff, Redefining Europe's economic sovereignty, Bruegel (June 2019).

Strengthening the international role of the euro is therefore seen by policymakers as one way to combat the effects of unilateral sanctions and other trade tensions – not just for Europe itself, but also for its trading partners. In its latest report on the international role of the euro, even the ECB acknowledged that unilateral sanctions and international trade tensions appear to have contributed towards recent increases in international use of the euro.[13] Over the longer term, the emergence of alternative financial infrastructure and financial nodes based around the euro could truly challenge dollar dominance and reduce US economic leverage in a more broad sense.[14]

Nevertheless, currency dominance is only one possible source of economic leverage, and the effect of shifting towards a greater use of the euro should not be overstated. The dominant role played by US financial institutions in the global financial system, as well as the location of key elements of the international financial infrastructure in the United States, also contribute to the economic leverage at the disposal of the US government. Other factors also play an important role in generating economic leverage and are not unique to the United States: the ubiquity of its firms in global supply chains, the global reach of its companies and investors, and the sheer scale and importance of its domestic market are all characteristics that likewise apply to China and other economic powers (albeit on a smaller scale).

While the same set of characteristics similarly provide the EU with economic leverage of its own, the struggle of EU policymakers to respond to the unilateral American sanctions on Iran highlights the continued vulnerability of the EU to the strategic wielding of economic clout by other global powers. Although improving the international role of the euro is therefore likely to improve the EU's resilience to some degree, as far as foreign policy goals are concerned, it would need to be accompanied by other measures aimed at bolstering European economic sovereignty, including a more active presence in global affairs as well as progress on common defence and security.[15]

4 . ROADBLOCKS AND CHALLENGES TO A GREATER GLOBAL ROLE FOR THE EURO

Achieving a greater global role for the euro is easier said than done. Several roadblocks currently stand in the way of the euro reaching a global status that could rival the US dollar. In addition to the roadblocks encountered along the way, there are also a number of challenges that would arise from achieving a greater global role for the euro that need to be considered and pre-emptively addressed. The following section explores some of these major roadblocks and challenges.

13. European Central Bank, The international role of the euro (June 2019).
14. Peter Harrell and Elizabeth Rosenberg, Economic Dominance, Financial Technology, and the Future of US Economic Coercion, Center for a New American Security (April 2019).
15. For example, see proposals made by Nicole Koenig, From Meseberg to Sibiu: Four Paths to European Weltpolitikfähigkeit, Jacques Delors Institute Berlin Policy Paper (November 2018).

4.1 Roadblocks

Roadblocks are initial obstacles that would need to be overcome in order to achieve a greater international role for the euro. Four of the largest roadblocks are discussed here: dollar inertia, fragmented capital markets, the shortage of euro safe assets, and breakup risk.

1. Dollar inertia

As noted above, the existing international equilibrium at the US dollar is deep. In a series of stakeholder consultations carried out among European businesses earlier this year by the European Commission, 'tradition, inertia and ease of use' was one of the most frequently cited obstacles that business stakeholders saw as prevented the euro from playing a greater role in their respective markets.[16] This inertia is self-reinforcing through strong network and liquidity effects. In particular, the dominance of the US dollar in energy and raw materials markets (especially in crude oil) has an influence on currency choice up through the entire supply chain, encouraging firms in sectors heavily dependent on these products to finance, insure, and invoice in dollars in order to minimise exchange rate risk. The lack of euro-denominated benchmark prices in these markets was also cited as a factor contributing to the dominant use of USD for key derivative products (e.g. of crude oil). Additionally, some companies are headquartered in jurisdictions where legal or accounting rules require denomination in US dollars. In short, dollar dominance in several key markets is well-established and difficult to dislodge.

2. Fragmented capital markets

> "DEEP, LIQUID AND INTEGRATED CAPITAL MARKETS ARE A PREREQUISITE FOR FORMING A GLOBAL CURRENCY

Deep, liquid and integrated capital markets are a prerequisite for forming a global currency. In an increasingly globalised financial system, integrated capital markets increase the attractiveness of a currency for international actors by lowering transaction costs, providing more opportunities for investment, and improving 'safety' through higher liquidity and reduced rollover risk.[17] Deep and liquid capital markets in the EU would also provide new and more diverse sources of financing for European businesses as well as improve risk-sharing among private market actors. Ultimately, deeper and more liquid capital markets in the EU are expected to increase global demand for the euro and contribute to overall economic resilience in the euro area.

Nevertheless, capital markets in the euro area remain highly fragmented along national lines due to a multitude of legal, regulatory, infrastructure and other barriers, and are far less integrated and deep than capital markets in the United States. Progress on the Capital Markets Union (CMU) has been far slower than progress on the Banking Union, in part because the way forward on CMU is less concrete and less straightforward. Whereas the Banking Union could be conceptualised in three relatively simple pillars – uniform supervision (SSM), uniform resolution (SRM), and the as-yet incomplete uniform deposit insurance (EDIS) – there is no comparable simplification or roadmap available for CMU. The action taken on CMU so far has focused on the piecemeal dismantling of technical and regulatory barriers accompanied by slow movement towards common supervision. Despite widespread but vague calls in recent years in support of 'completing the CMU', the process of getting to that point remains just as complex and fragmented as the national capital markets themselves.

16. European Commission, Strengthening the International Role of the Euro – Results of the Consultations, Staff Working Document, SWD(2019) 600 final.
17. Benoît Cœuré, The euro's global role in a changing world: a monetary policy perspective, speech at the Council on Foreign Relations, New York, 15 February 2019.

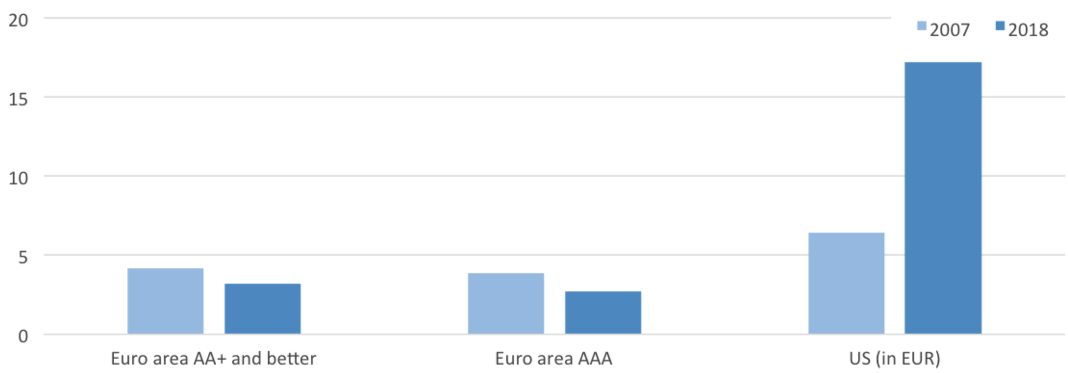
3. Shortage of euro safe assets

Since the euro crisis, the euro area has experienced a persistent shortage of public safe assets. This is evidenced in part by high investor demand and record low and even negative yields on sovereign bonds issued by the 'safest' countries, most notably Germany. Safe assets act as a reliable store of value and means of exchange, and as such serve a number of critical functions in financial systems. Institutional investors (such as pension funds) seek them out as safe investments; banks need to hold them to meet regulatory requirements; central banks and private financial institutions alike use them as sources of high-quality collateral for borrowing and lending. In other words, they are essential instruments for the smooth functioning of markets in any given currency. Safe assets are particularly relevant in the context of a global currency, where they are in high demand not just domestically but globally as a safe store of value and as vital tools in any financial system that makes use of that currency. A shortage in safe assets has therefore been compared to a contraction in the money supply,[18] with a similarly dampening effect on markets in that currency. Like the dollar inertia problem, having a shortage of euro-denominated safe assets also acts as a constraint on currency choice up through the rest of the economic value chain.

"THE SUPPLY OF EURO SAFE ASSETS IS SMALL AND HAS DECREASED SINCE THE EURO CRISIS

While there is currently a large global supply of dollar safe assets, with more than USD 20 trillion in outstanding US debt securities, the supply of euro safe assets is small and has decreased since the euro crisis on the scale of about EUR 1 trillion, or roughly one quarter over the total outstanding sovereign debt from highly-rated euro area governments in 2007 (Figure 3).

FIGURE 3 ■ Outstanding general government debt at market value in 2007 vs 2018 for the US and for euro area economies rated at least AA+
In EUR trillions



Source: Own compilation based on Bank for International Settlements, 'Total credit to the government sector at market value (core debt)' (extracted 3 July 2019). Euro area AAA includes Germany, the Netherlands, and Luxembourg in 2018, plus Finland, Austria, France, Spain and Ireland in 2007. Euro area AA+ and better includes the AAA-rated countries in each respective year plus Finland and Austria in 2018 and Belgium in 2007. Sovereign credit ratings in 2007 and 2018 are based on Standard & Poor's assessments on January 1 of each respective year.

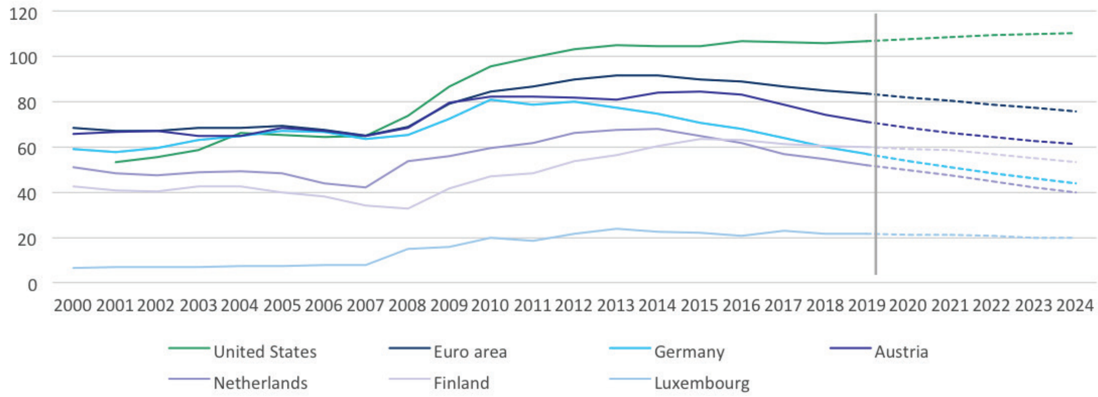
The decline in euro area safe assets is partially due to downgrades in the credit ratings of certain euro area governments following the crisis, and partially due to conservative fiscal policy and debt reduction among the euro area's 'safest' governments. Germany, for example, whose government debt is the euro area's de facto primary safe asset, currently has a debt to GDP

18. Benoît Cœuré, Sovereign debt in the euro area – too safe or too risky?, keynote address at Harvard University, 3 November 2016.

ratio of 57%, which is projected to decrease to 44% over the next five years.[19] The debt to GDP ratios of the Netherlands, Luxembourg, Austria, and Finland, the only other euro area countries with sovereign debt ratings of AA+ or higher, are all projected to decrease between 6 to 13 percentage points (2 for Luxembourg) over the next five years (Figure 4), further restricting the supply of public euro-denominated safe assets.[20]

FIGURE 4 ▪ Debt to GDP ratios of the United States vs euro area economies rated at least AA+

In percent of GDP



Source: Own compilation based on IMF DataMapper, 'General government gross debt' (extracted 1 July 2019).

4. Breakup risk

> THE INTERNATIONAL STANDING OF THE EURO WILL REMAIN CONSTRAINED BY UNCERTAINTY REGARDING THE EURO AREA'S POLITICAL AND FINANCIAL STABILITY

The euro area sovereign debt crisis left a lasting impression on investor perception of the euro area. It exposed structural weaknesses in the Economic and Monetary Union (EMU) architecture that allowed internal imbalances to accumulate unchecked, as well as deficiencies in crisis preparedness and response. To the extent that international actors still question the political determination of EU leaders to hold the common currency area together, and therefore view the euro area as fragile, at risk of breaking up, or simply at risk of another systemic financial crisis, the international standing of the euro will remain constrained by uncertainty regarding the euro area's political and financial stability. Although steps have been taken since the crisis to deepen EMU, unsustainable debt loads and high non-performing loan ratios persist in some Member States (e.g. in Greece, Italy and Portugal), and public disputes with certain Member States (e.g. Italy) demonstrate that the euro area still lacks an effective way of dealing with 'uncooperative' governments that actively disregard common rules.

There remains a widespread perception among policymakers that 'more' needs to be done in order to reduce systemic risk, increase resilience, and improve the credibility of the euro area. Nevertheless, policymakers in the euro area appear unable to break the current impasse between those who argue that stricter compliance with existing fiscal rules and stronger measures to combat moral hazard are sufficient (generally Germany and the 'northern' Member States), and those who argue for further risk-sharing and deeper integration within the EMU (generally France and the 'southern' Member States). Despite prominent proposals to balance

19. Adam Tooze and Christian Odendahl, Can the euro rival the dollar?, Centre for European Reform (December 2018), based on IMF data on general government gross debt.
20. International Monetary Fund, General government gross debt, dataset accessed 1 July 2019.

these two perspectives,[21] there has been little progress in any policy direction, with continued uncertainty on future outlook.

4.2 Challenges

Overcoming the main roadblocks – dollar inertia, fragmented capital markets, a shortage of safe assets, and breakup risk – is only the first part of the process to establish a greater international role of the euro. Although a greater international role of the euro is desirable for both its economic policy and foreign policy benefits, as discussed above, it would also bring with it a number of operational challenges for the euro area that will need to be addressed. Three key challenges are considered here: challenges to export-oriented growth models, further strain on the supply of safe assets, and new demands on the ECB.

1. Challenge to export-oriented growth models

Encouraging greater international use of the euro will increase global demand for euros. All else equal, a sustained increase in the global demand for euros will increase the value of the currency. A stronger euro would pose a challenge for export-oriented economies, particularly Germany, as European exports would become relatively more expensive compared to the rest of the world. As a counterpoint, however, European consumers and importers would benefit from cheaper foreign products as well as greater purchasing power when travelling or investing abroad.[22] Nevertheless, a stronger euro in the current economic climate could place Europe at a competitive disadvantage with respect to its largest economic competitors. The United States seems poised to abandon its long-time 'strong dollar' policy,[23] and although the IMF no longer considers the Chinese Renminbi to be undervalued, there is no doubt that Chinese policy had kept the Renminbi below market value in the recent past.[24] An appreciation of the euro in this context would therefore need to be considered carefully in light of other strategic objectives.

2. Further strain on the supply of safe assets

> EUROPE WILL HAVE TO BE PREPARED TO SUPPLY THE WORLD WITH A EURO-DENOMINATED SAFE ASSET

The limited supply of safe assets in the euro area not only stands in the way of strengthening the international standing of the euro, but also poses a continuous problem that is likely to worsen as the euro takes on a larger global role. Increasing global use of the euro will result in a growing global demand for euro-denominated safe assets and worsen the existing shortage. In the same way that the United States currently supplies the world's de facto global safe asset, Europe will similarly have to be prepared to supply the world with high enough volumes of a euro-denominated safe asset to the extent that it wants to encourage greater global use of the euro. However, unlike the United States, the euro area simply does not offer enough safe assets to meet the kind of world demand that comes with being a leading global currency. Whereas in 2018, the US government had about USD 20.3 trillion (approx. EUR 17.2 trillion) in outstanding debt securities at market value, the corresponding figure for the euro area coun-

21. E.g. the so-called '7+7 paper' by Agnès Bénassy-Quéré, Markus Brunnermeier, Henrik Enderlein, Emmanuel Farhi, Marcel Fratzscher, Clemens Fuest, Pierre-Olivier Gourinchas, Philippe Martin, Jean Pisani-Ferry, Hélène Rey, Isabel Schnabel, Nicolas Véron, Beatrice Weder di Mauro, and Jeromin Zettelmeyer, Reconciling risk sharing with market discipline: A constructive approach to euro area reform, Centre for Economic Policy Research (2018).
22. See e.g. Federal Reserve Bank of Chicago, Strong Dollar, Weak Dollar: Foreign Exchange Markets and the US Economy (1998).
23. Gavyn Davies, President Trump abandons the strong dollar policy, Financial Times (15 April 2017).
24. International Monetary Fund, Press Release: IMF Staff Completes the 2015 Article IV Consultation Mission to China (26 May 2015).

tries rated AA+ or better stands at only EUR 3.2 trillion – less than one fifth of the US volume.[25] In this state of affairs, an increase in the international role of the euro will place further strain on the limited supply of safe assets and drive euro area interest rates even lower, especially in the 'safer' countries.

3. New demands on the ECB

Issuing a global currency and global safe asset carries an 'exorbitant privilege', but it also comes with an 'exorbitant duty'. One of the defining features of a global currency and a safe asset is that both increase in value during periods of financial instability due to the 'flight to safety' mechanism, as investors pull their capital from riskier assets and seek to store it in a 'safe haven' (i.e. in safe assets). Since capital is flowing into countries that issue safe assets at the same time that capital is flowing out of countries that do not, the issuers of safe assets come under pressure to provide additional liquidity (generally in the form of currency swap lines) to countries under stress.

The US Federal Reserve has historically embraced this 'exorbitant duty' and shown that it is prepared to act as a provider of dollar liquidity to the world, having intervened for example to provide temporary liquidity to emerging economies with substantial dollar markets in Asia and Latin America during the global financial crisis. In contrast, the ECB was far more reserved in terms of the scale, timeline, and conditions of the currency swaps that it offered to EU but non-euro countries (i.e. Poland and Hungary) which were struggling with euro liquidity issues during the financial crisis.[26]

> "A GREATER GLOBAL ROLE FOR THE EURO WILL ONLY INCREASE PRESSURE ON THE ECB TO ACT AS AN EMERGENCY LIQUIDITY PROVIDER

A greater global role for the euro will only increase pressure on the ECB to act as an emergency liquidity provider in times of financial stress. Any change in the ECB's officially neutral stance towards international use of the euro would therefore have to be accompanied by the willingness to act as a provider of euro liquidity for non-euro area countries. Like the Fed, the ECB would also find itself needing to take into account the effect of its monetary policy on international financial markets, such as the potential effect of euro exchange rate fluctuations on global demand, and, conversely, the larger influence that the actions of third countries would have on euro interest and exchange rates. In short, greater international use of the euro would imply greater responsibilities for the ECB on both the European and global scale.

5. CONCLUSIONS AND RECOMMENDATIONS

The road to a more global euro is a difficult one, and this paper has laid out only some of the major roadblocks and challenges ahead. Nevertheless, a stronger international role for the euro has never been more worth striving for. We live in an era of growing global uncertainty in which traditional alliances and the rules-based economic order are increasingly coming into question. The US and China have both shown a willingness to use their economic clout to further their foreign policy goals, making it more important than ever that the EU be in a position to assert and protect its economic sovereignty. A stronger international role for the euro contributes to this goal with benefits for both foreign and economic policy.

25. Bank for International Settlements, Total credit to the government sector at market value (core debt), dataset accessed 1 July 2019.
26. Francesco Papadia, Central bank cooperation during the Great Recession, Bruegel (2013); and Shahin Vallée, Behind closed doors at the ECB, Financial Times (30 March 2010).

The following points can be drawn as key conclusions and recommendations.

- Dollar inertia is a significant obstacle and should not be underestimated. Given the pervasiveness of the US dollar at multiple levels of the value chain, and especially at its base, it is unlikely that a purely market-led initiative will challenge dollar dominance. Strengthening the international role of the euro will require active supporting policies at the European level, such as establishing euro benchmarks for crude oil and raw materials, improving basic euro financial infrastructure, and geopolitical outreach / economic diplomacy to encourage international use of the euro.

- Strengthening the stability, resilience and credibility of the euro area is an essential prerequisite to improving the international standing of the euro, and it is essential to find a way past the current policy impasse. The roadblock discussion singles out the three elements most relevant for boosting the international role of the euro: safe assets, Capital Markets Union, and reducing breakup risk.

    - Addressing the safe asset question is unavoidable. In the long term, Germany cannot sustainably supply all of Europe – let alone the world – with safe assets. The euro area needs to increase its supply of safe assets. Ideally, it should introduce a common safe asset in order to facilitate risk-sharing, increase the volume of highly-rated euro government debt, dilute the link between sovereigns and domestic banks, and avoid destabilising capital flows from one Member State to another in periods of stress.

    - Furthering the Capital Markets Union is on the surface an uncontroversial proposal – but this is largely due to the fact that there is no shared, simple conception of what CMU 'is' and what it should include. The way forward on CMU manages to be both too vague and too technical. It is not enough for policymakers to support the hollow 'label' of CMU. The EU needs to adopt a clearer overarching vision for CMU, and make significant, concrete steps forward on major initiatives such as strengthening the common supervision of securities markets and harmonising key framework conditions in areas such as insolvency and investment taxation.

    - The euro area needs to dispel investor fears of breakup risk and show that it will continue to do 'whatever it takes' to preserve the common currency. This involves both political and technical elements. On one hand, the euro area needs to demonstrate its political commitment to the currency area by showing that it is willing and able to pursue ambitious reforms, e.g. in CMU and completing the Banking Union, and by showing that it can credibly deal with non-cooperative members. On the other hand, the euro area needs to reduce systemic risk that continues to threaten the cohesion of the currency area – for example, by establishing an effective budgetary instrument for the euro area and a strategy for sovereign debt restructuring.

- A greater international role for the euro requires a more proactive approach by the ECB. This means not just abandoning its neutral stance towards the use of the euro by third countries, but also embracing the 'exorbitant duty' of issuing a global currency. The ECB will need to take on expanded responsibilities similar to the Fed, i.e. showing a greater willingness to provide euro liquidity to third countries and taking into account both the larger impact of its actions on foreign markets as well as the larger impact of foreign markets on the euro area.

Improving the global standing of the euro will not be a silver bullet solution ensuring European economic sovereignty now and forever. It is, however, an essential building block of a broader foreign and economic strategy aimed at bolstering European sovereignty in uncertain times. Despite the roadblocks and challenges along the way, a global euro is a strategic goal worth striving towards.

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