

REFLECTIONS

PERSPECTIVES FOR THE INTERNATIONAL ROLE OF EURO: A COMMENT

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The introduction of the single currency in the Euro Zone is a historical change in the international financial architecture. The increasing significance of the new currency is the result of the 12 EU member's decision to leave the national currency in favor of Euro. The entire GDP of these 12 countries almost equals that of USA and their contribution to world trade is 25% bigger than the USA proportion. On longer term, the newly member states together with Denmark, Sweden and United Kingdom, the 3 older EU members who already have rejected Euro currency, is preparing for fulfilling the Euro Zone convergence criteria and this process will increase the Euros' international significance in future.

The question that arises from this is what would happen if Euro is limited only to EU or if will be a currency more and more used on the international scene.

Carsten Hefeker, Professor of economics at Siegen University and also researcher at the International Economy from Hamburg has elaborated a couple of studies on the Euros' international role. Looking in the past, we could remember the speech of Charles de Gaulle, the French President on the Breton Woods meetings that accentuated the "dollar's extraordinary privilege" that allowed to USA having huge current account deficits covered mainly by currency emission¹. The most part of EU countries accepted the dollar as a most popular currency. In our times, China plays such a role that covers the American deficits by Dollar acceptance in its international reserves. The Chinese official reserves are approximately 989, 9 billion dollars in September 2006. However, the Chinese request for American Dollars is part of China Mercantile Strategy². In the same time the growing Euro reserves represents another Chinese strategy, which is not,

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¹ This is the famous Triffin Dilemma, described in "Gold and the Dollar Crises", published by Yale University Press, in 1960.

² See Dooley (2003).

a negligible fact taking into account the size of Chinese economy. If one day a significant part of China's Dollar reserves would be changed on Euro the international consequences will be huge. However, it is impossible to put in practice immediately this intention.

In addition, Professor Hefeker mentioned the possibility the East Asia to approve a currency basket with a large proportion of Euro. All these strategies are proves that the international architecture is ready to change into a system based on both Dollar and Euro in financial and trade markets.

I will mention some of considerations that might highlight the international role of Euro.

The international role of a currency is a consequence of its utilization in the world trade transactions¹. A currency serves to the following goals:

- Payment tool;
- Transaction tool;
- Saving mean.

That's why a currency it is used for international payment, goods and services denomination in international trade and increasing of reserves on longer time. In consequence, the international role of a currency is increasing in line with its stability. The international investors don't prefer a weaker currency because it brings inflation and cannot fulfill the third criterion, reserve accumulation. A powerful currency is used for international bond issues and also as a second currency in countries with large inflation. The American Dollar still has taken advantage on the fact the USA is the most important commercial and military force from the world. For the last few years, the commercial partners have preferred a certain currency for their transactions and for that, they tried to stabilize the rate of exchange between their own currency and that preferred currency. Take the China example. In the USA's scientific area, it is appreciated that the China's mercantile spirit is on the base of such a long stability of Renmimbi/ Dollar rate of exchange. China's monetary authorities buy dollars avoiding currency appreciation, which implies the increasing of its dollars reserve. Countries use this strategy if they don't want to lose such an important sale market.

There is a physiological factor also. The more people buy the same currency, the more attractive is for others this currency.

The so-called "externalities networking" makes this currency to be preferred in a group of countries. The increasing of these countries produces a bigger international prestige for this currency. The increasing of the states that prefer Euro contributes to an extension of commercial partners that prefer Euro and this creates an intense Dollar competition on the international scene. This effect

¹ See Kindleberger (2005).

explain why the Dollar became the first currency after Breton Woods and why the preference for dollar extended on the almost whole international trading area even in states that were not in the Dollar influence zone. For example, US Dollar is preferred in Argentina's commercial trade because is easier to change the pesos by Dollars and then to allow the imports from Russia than to allow the direct pesos/ Rubles exchanges. There are no so many pesos buyers by selling rubles on the international scene in comparison with those who want to buy pesos by selling dollars or to buy rubles by selling dollars. A thin transaction gives a cheaper price for that currency and also a more volatile rate of exchange.

Otherwise, the preferences changing in the world Financial Markets and Mercantile Exchanges transactions for other currency are more costly because this implies new programmers used by computers and also changes in banking operations. In opinion of Professor Carsten Hefeker this step could be in favor of Euro unless the Dollar utilization would become expansive as a consequence of a to high inflation induced by American Dollar (import of inflation) and/or the other UE partner countries would utilize in their transactions.

The preference for Euro has another reason, namely the replacement of national currencies with Euro in Euro Zone, from January, 1, 1999 when Euro entered in the monetary circuit (first step was the Euro launching on the banking system and only then on the monetary circuit). This changing determined some Western African states to modify the transaction system in Euro, because the main trading partners are the states from Euro zone.

In we are looking back we could observe the same procedure when the Dollar took the first place from Sterling, the most attractive currency in the XIX and the first halve of XX century. Sterling covered approximately 30% from the total international trade exchanges in the XIX century. At that time, UK was an empire and London was the most important financial market from the world. Sterling was a prime currency even after the British Empire dissolution when gradually USA, German and French economies registered substantial economic growth. In the 1920-1930 other currencies such American Dollar and French Franc were preferred in the same time with Sterling. After FED creation (USA Central Bank) the active and efficient Dollar management was possible. Only after the Second War, the international role of Sterling diminished significantly and the American Dollar took its place.

In our days, London remains one of the most important financial markets in the world. The passing from a currency to another is not an instantaneous moment and historical evolution proves this statement.

The increasing of Euro role in the world

There are some factors that determine the increasing role of Euro in the world. The sustainable demand for Euros from the countries that pegged their currencies by Euro plays a key role and that stimulates the increasing Euro utilization in world transactions.

First, the newly EU states affirmed their responsibility to adopt Euro when they fulfill the convergence criteria. Slovenia already passed to Euro at the end of 2006 and the first Slovenian Euro coins entered in circulation since January 1, 2007.

The EU enlargement in next years will stimulate the Euros' increasing role. Both groups of countries are agreeing to adopt Euro by fixing the rate of exchange between their currency and Euro.

However, the most important think is the fact that Russia and China declared the intention to pass to an exchange regime based on a basket where Euro would keep the majority. The main implication of this step would be huge, but we must take into consideration that China has the biggest dollar reserves from the world. This means a more precaution from the Chinese part. My opinion is that gradually Euro becomes the most desire currency in world. Nevertheless, the trend is determined. What we don't know is how long would take to make such a historical transition in Euro favor.

A Dollar/Euro bipolar international system is a good solution for the moment. A rapid conversion of all dollar reserves is not a solution for principal actors from the international financial scene.

The Paper "Enlargement and the International Role of the Euro" published in May 31, 2006, by the analyst Benjamin J. Cohen, has suggested that "Europe's joint currency is fated to remain a distant second to America's greenback long into the foreseeable future because of three structural factors – relatively high transactions costs, due to inefficiencies in Europe's financial markets; a serious anti-growth bias built into the institutions of Economic and Monetary Union (EMU); and, most importantly, ambiguities at the heart of the monetary union's governance structure."

In this paper, Benjamin Cohen extended his earlier analysis, focusing in particular on the impact of enlargement on the governance structure of EMU. "From the start, internationalization of the Euro has been retarded by a lack of clarity about the delegation of monetary authority among governments and EU institutions. The addition of a diverse collection of new members, with significantly different interests and priorities, can only make the challenge of governance worse, exacerbating ambiguity at the expense of transparency and accountability. Enlargement will diminish, not expand, the euros' attractiveness as a rival to the greenback." he added.

References

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