

The geopolitical dimension of the euro

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- Striking contrast between
 - EU as a trading power
 - EU as a monetary power
- EU is trading power but not a monetary power
- I wish to analyze why this is so and what can be done about it.

EU as a trading power

- EU sets rules and standards within the internal EU-market
- These rules are also applied in large parts of the world
- Why?
 - Internal market one of the largest in the world;
 - Full transfer of sovereignty of the power to make trade deals with rest of the world from member-countries to European Commission:
 - as a trading nation the EU speaks with one voice
 - Combination of **size** and **one decision maker** in trade has given the Commission a powerful and credible instrument to pursue the interests of the EU member states
 - This includes the power to retaliate against nations that harm the trade interests of the EU

Example

- Trump administration has started a trade war by bullying the EU
- He has found out that bullying is not enough and that the EU has strong and credible instrument of retaliation
- that will harm the US and Trump politically
- He will probably retreat (as he seems to be doing with China)
- because he cannot win this war against an adversary that is equally strong

EMU and the euro

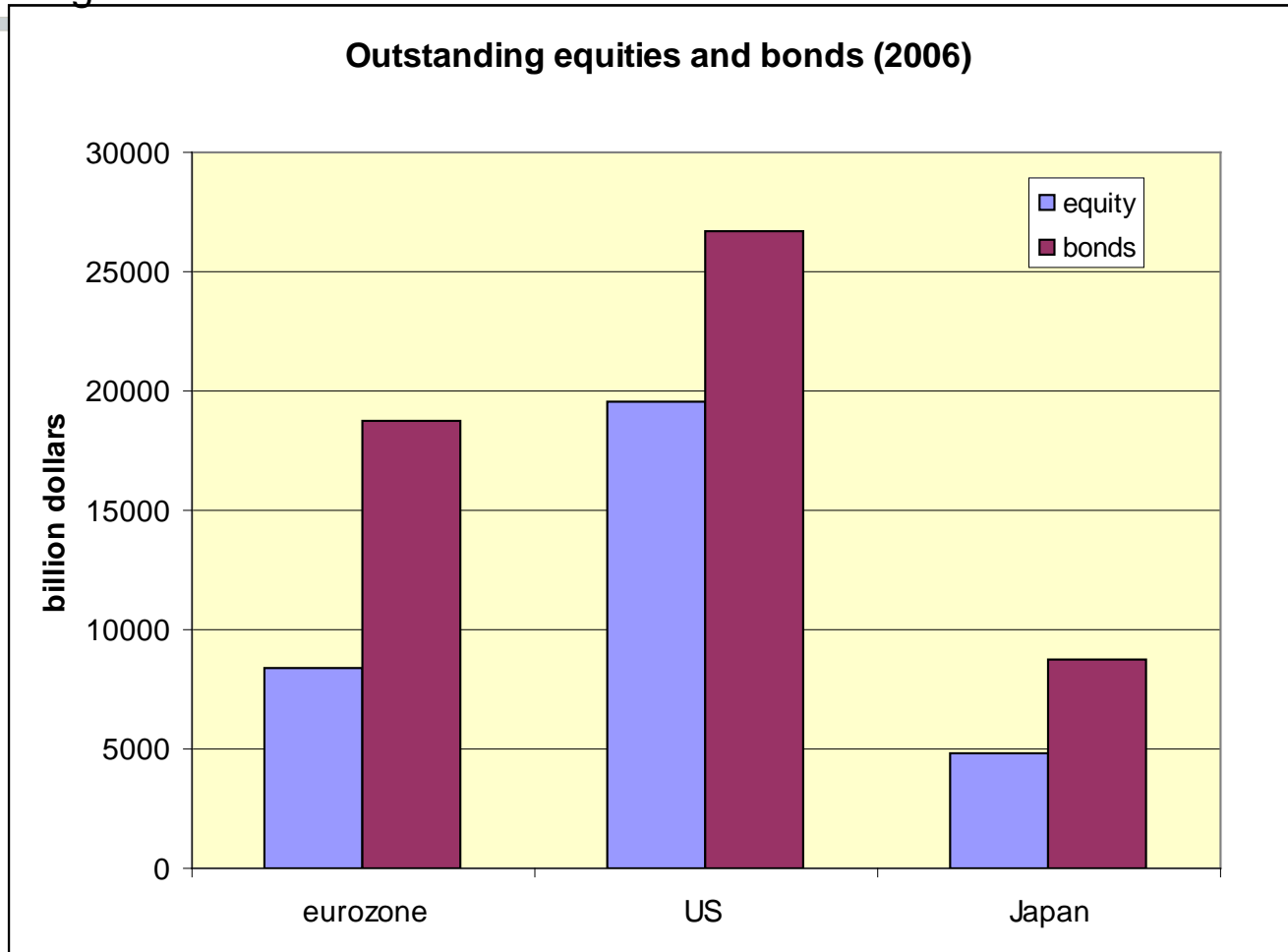
- Can the euro be used as an instrument of European power in the world to achieve political objectives?
- What are the conditions to achieve this?
- Let us distinguish
 - Objective conditions determining capabilities to use power
 - Political conditions that lead to the effective use of that power

Objective conditions

- These relate to size (as trade policy was)
- EU is in the same league of size as far as its GDP is concerned. It is a “real giant” like the US and China
- This is not the case for its financial size which remains relatively small and lacks full integration

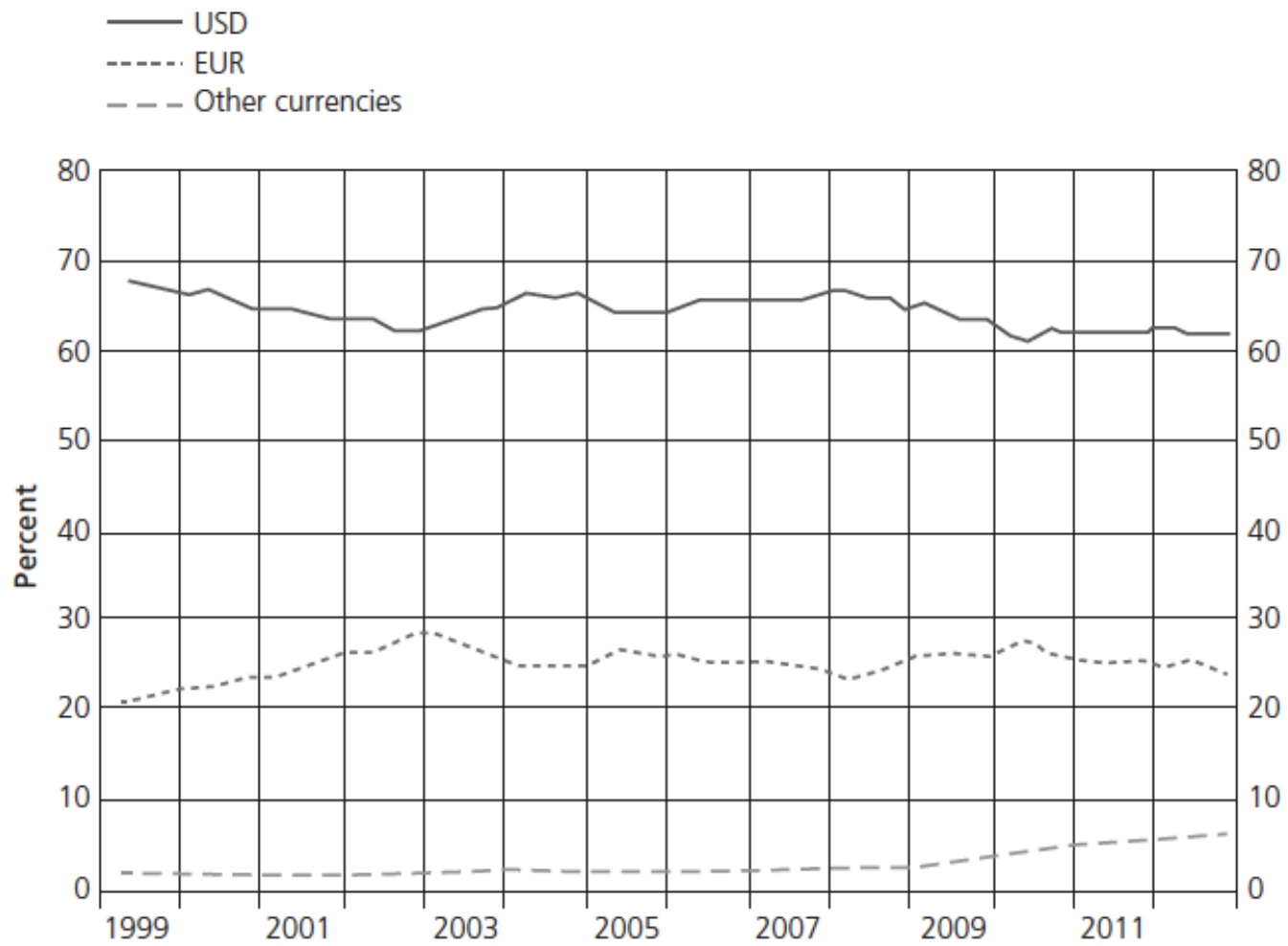
Size of equity and bond markets

Figure 12.5



Source: European Commission, Euro@10, 2008

Figure 12.3 Share of euro in global foreign exchange reserves



Source: European Central Bank, The International Role of the Euro, July 2013.

- Euro is not used as a major medium of exchange outside the Eurozone
- Mainly because there is no euro payment system outside the Eurozone
- And this is due to the fact that the financial area of the Eurozone remains relatively small and heterogeneous
- This contrasts with the dollar
 - Many countries use the dollar when they engage in international trade
 - because there is an efficient and large financial domain
 - that makes a dollar-based worldwide payment system possible

- Thus a number of objective factors are missing to make the euro a world currency comparable with the dollar as a potential stick to be used by Europe,
- the “euro stick” is a small one compared to the “dollar stick” that can be used by America as an instrument of power in the world.
- But even if the objective factors were there to make the euro a potentially big stick, could it be used as an instrument of world power by Europe?

Political conditions

- Even if the Euro was a big stick it could not be used as an instrument of world power
- because of absence of common foreign policy
- Foreign policy remains firmly in the hands of member-states
- There has been little transfer of sovereignty
- Major member states have their own foreign policy objectives

- Euro cannot be used as an instrument to exert power in the rest of the world because there is absence of common objective
- What would we use the euro for on the world scene?
- The French, the Germans, the Italians etc would give different answers to this question.

Contrast with the US

- Two conditions identified earlier (size and political condition) are satisfied in case of US.
- US has a big stick, i.e. currency that can be used to exert pressure
 - Because many countries rely on dollar payment system
 - US has the power to exclude countries from the use of this payment system (example: Iran)
- US has a unified foreign policy based on the existence of one central sovereign with a unique objective

- I conclude from this:
 - Eurozone lacks the financial size that creates capabilities to exert power in the world
 - Eurozone lacks the political unity needed to formulate common foreign policy objectives

What would have to happen to change this?

- Put differently: how to create a world money in the sense of a medium of exchange for the world
- Again the same two factors matter
 - The financial size that creates the capabilities
 - The political unity that allows to pursue common foreign policy objectives

Financial size

- This is the challenge of creating a large financial area in the EMU
- There is no secret what form this must take (as I have argued earlier)
 - Capital markets union
 - Banking union
 - All this is still very much unfinished.
- Also a perception that euro is here to stay. This has been given a serious dent as a result of the sovereign debt crisis
- And continues to hinder the process towards giving more prominence for the euro in world affairs

- Issue that arises here is why the member countries have not been willing to create conditions to achieve a large and unified financial area (banking union and capital market union)
- These would have made it possible to create financial size necessary to create a euro that has geopolitical clout.
- It must be that the benefits of creating a unified financial area were not perceived as strong enough (compared with benefits of common trade policy)

- This is paradoxical as the French in particular have seen the dollar as creating an “exorbitant privilege” for the US dollar
- Why were they not pursuing policies that would create an “exorbitant privilege” for the euro?
- Part of the answer: there is not the same kind of consensus about the welfare gains of financial integration as there exists for trade integration

Political condition

- In order to use the capabilities provided by a large financial area as an instrument of power, the objectives to be pursued should be clear.
- I argued that this is not the case because of a lack of a common foreign policy.
- The latter can only be achieved in context of political union, i.e.
 - EMU-government embedded in a parliamentary system that has to give legitimacy to this government

- I would add to this that the capacity to pursue a common foreign policy is also linked to the capacity to exert military power.
 - Soft power has some importance but also its limits
- Thus for the euro to become an instrument of power, we will have to create a vehicle of EMU-power that is absent today

- In order to achieve all this, massive transfer of sovereignty from nation-states to European level will be necessary.
- The contrast with trade is strong:
- Why did we manage to transfer legitimacy to the European Commission to pursue a common trade agenda?

- I think this was because of
 - A strong perception that this would create large welfare gains
 - A perception that transfer of sovereignty was of a technical nature: it was seen as a contract with the European Commission that ultimately could also be revoked
- Contrast of sovereignty in the fields of foreign policy and military affairs: this touches upon the existence of the nation-state itself
- It also has a permanent feature: a complete abandonment of national sovereignty

Conclusion

- It will take a long time for the euro to become an instrument of European power on the world scene.
- But nothing is impossible
- as Jean-Claude Trichet reminded us: it took the US 200 years to achieve its unity which made it possible to exert monetary (and other) power in the world