Comments by Klaus Regling

on

Dollar Dominance, Euro Aspirations: Recipe for Discord? by Benjamin J. Cohen, University of California

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It is a great pleasure for me to be at this conference and to have the opportunity to be the discussant for two papers on two important subjects.

This is the right moment to think about the global monetary and financial system and its governance, a week after the election of the new US President and a few days before the G-20 will meet at the highest level to begin a series of Summits to prepare changes for the financial system.

I read Prof. Cohen's paper with great interest. The paper contains a solid summary of the available data on the Euro's international use and it is interesting to see how Prof. Cohen puts Economic and Monetary Union (EMU) in Europe into a geo-political context.

But I must say that his paper leaves me puzzled.

I am puzzled because

- Prof. Cohen obviously doesn't like the euro (although I do not expect everybody to like the euro).
- But he seems to be even scared: "the wolf is at the door, ready to wreak systemic havoc" (page 17).
- He seems to be annoyed by "euro enthusiasts" which he quotes frequently.
- Almost every page shows how happy he seems to be that the euro, in his view, has not lived up to expectations.

All this is not a good basis for an impartial assessment of the euro's international role and its future.

I want to use my 10 minutes the following way:
I will recall why the euro was created and what the expectations of the founding fathers really were – and not all of them were euro enthusiasts! And I want to talk about the dynamics in the international monetary system which, in my view, go far beyond the "Europe versus the US" scenario that Prof. Cohen talks about.

But I also need two minutes to note my disagreement with some of Prof. Cohen's well-known views, which he repeats in passing, because they are not the focus of our topic this morning.

Arguments about

- “serious deficiencies inherent in the institutional design of EMU”
- “troubling ambiguities in EMU’s governance structure”

were all put forward before the begin of EMU by those who could not imagine that EMU could ever be created and those who were convinced it would fall apart within a few years.

Prof. Cohen, in another paper, refers mainly to the ECB Council when he talks about governance problems.

I’m puzzled to hear these arguments again today. In the view of many, the ECB has demonstrated convincingly since last year August that it is able to respond to a crisis quickly and convincingly. Its governance structure was obviously not a problem. Many observers have praised the ECB – Prof. Cohen seems to disagree.

And even Finance Ministers and Heads of State and Government were able to agree on a common response to the financial crisis; faster than in the US and more comprehensively. The US is picking up elements from the EU package. It is implemented at the member state-level because national Parliaments have to be involved in some cases. It’s working. But Prof. Cohen complains about the “absence of effective coordination”. I’m puzzled.

Finally, again, he states his believe that EMU has “a strong anti-growth bias built into the bloc’s provisions for monetary and fiscal policy” (page 4). I wonder what kind of evidence he could produce. On a per capita basis, growth in the US and in EMU has been identical since 1999. Differences in headline growth reflect differences in population growth. Policy-making is about raising the standard of living; therefore, growth per capita is the right concept.

Back to the international role of the euro.

It is important to understand the origins of EMU when discussing the international role of the euro in the future.
The process of European economic and political integration is 60 years old and created the single market for goods, services, capital and labour. The euro was the culmination of this process because a truly single market requires one currency. But thinking about a common currency began when the Bretton Woods system collapsed in the early 70s. Europe has a long history of creating systems to protect itself against global currency problems: the “snake” in the 70s, ERM in the 80s, the euro. All these steps were introduced to protect Europe’s internal market.

The protection that the euro provides to its member states has been clearly demonstrated by the current financial crisis. The euro area did not suffer from the kind of internal currency turbulence that occurred in earlier decades whenever there was a problem in the global economy.

That’s also why, as a consequence of this crisis, EU members that are not yet in the euro area are trying to accelerate the process of joining. Even the mood in Denmark is changing and Iceland – perhaps even Switzerland - may want to join the EU only to get the euro. These countries focus on the protection that membership in the euro area offers.

The key point I want to make is that EMU was fundamentally driven by an **internal** wish among European Union Member States to pursue economic and political integration. And to protect the degree of integration reached.

To push the international role of the euro is therefore not a policy objective of the ECB, or the Commission or the Finance Ministers in the Eurogroup.

Prof. Cohen doesn't believe the many statements from the euro area authorities. He writes: "it is difficult to imagine that EMU authorities will refrain entirely from trying to encourage a greater role for the euro" (page 3).

I participated in the first joint euro area mission to China a year ago when President Trichet, PM Juncker and Commissioner Almunia met with the Chinese government and central bank. There were certainly no attempts to push for a stronger global role for the euro.

Given that the euro is very much the outcome of regional, internal integration, we are also not unhappy that the euro is particularly prominent in our European neighbourhood. We like it that way. Prof. Cohen seems to think that that alone makes the euro a second-class currency.

In this context, I also consider Prof. Cohen's doomsday scenario about a leadership struggle between the US and Europe as far-fetched.

I believe in a different scenario for the international monetary system during the next decades.

The trend for the euro to gain in international importance will continue. Foremost in Europe and its neighbourhood. In the short-term also because the US will struggle with some serious economic imbalances that need to adjust; this will lead to a period of slow growth in the US. And the eventual end of the informal Bretton Woods II arrangement in China, the Gulf countries and some others will also reduce the relative importance of the US$ (not because Europe pushes for it but because this arrangement is economically inefficient for these countries).

But the euro will not replace the US$. My expectation is that a third international currency of global importance will emerge over time. Asia will become the economically most important continent during this century according to most forecasts. And one – or two? – Asian currency will join the $ and the euro as part of a multipolar currency system.

The policy architecture that will underpin Asia's role is not yet clear. We will talk about that after the coffee break. The process will not always be smooth. But such a scenario seems more realistic than speculating about leadership fights between Europe and the US.