



The international role of the euro

In a series of three articles in the *Banque de France Bulletin*, the international role of the euro is examined in terms of its history, its costs and benefits and, in this introductory article, the current health crisis. The efforts carried out to deal with the pandemic are largely founded on a dollar-based international financial system and test the economic stability and credibility of US financial leadership. Twenty years after the creation of the euro – a stateless currency in a world made up of states – the position of the single currency in the world, which was initially called into question, and now encouraged, is still undefined.

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Deputy Governor of the Banque de France

JEL codes
E61, F15, F32,
F36, F4, G15

2nd
ranking of the euro among
international currencies

20%
share of the euro in international
foreign exchange reserves

60%
share of euro area exports
to third countries invoiced in euro

Composite index of the international role of the euro

(constant Q4 2019 and current exchange rates, four-quarter moving average; in %)



Source: ECB, *The International Role of the Euro* (2020).



Since the start of the coronavirus epidemic, the European debate has focused on the question of the degree of solidarity that is desirable within the euro area. The series of articles looks instead at the external aspect of the single currency, i.e. the international role of the euro, its representation, and the way in which it is used outside the euro area as a means of payment, a savings instrument and a reserve currency.

Before going into detail, we would like to provide an overview and put into perspective some of the choices made when the euro was created. The current crisis is so violent that it would be premature to draw definitive conclusions, but it could well contribute to accentuating developments that were already perceptible.

Three articles on the euro

In addition to this paper, two other articles discuss the different facets of the international role of the euro.

The first looks at the developments in the international monetary system over the long term, with a broad horizon: how did the dollar manage to supplant the pound sterling in the 20th century? How did the collapse of the Bretton Woods fixed exchange rate system contribute to the lasting dominance of the dollar, without the euro, the yen or the renminbi playing an equivalent role? When the euro was created, European political leaders, such as the European Central Bank, decided neither to encourage nor to discourage the use of the euro as an international currency. Is this cautious, more or less explicit, choice to stick to a policy of neutrality still relevant today?

The second article examines the advantages and disadvantages of a wider international role for the euro. What are the consequences of the dollar's dominance for financial stability and for trade? How can the euro's position as a reserve currency for central banks, as a means of payment and finally as a pull factor for capital flows be strengthened? Dependency on the dollar is not without consequences not only for trade but also for national sovereignty, as shown by the unilateral sanctions decided by the Trump administration against Iran. But the status of the dollar as a reserve currency, and even more so as a currency in which the debts of third-party countries are denominated, also creates obligations.

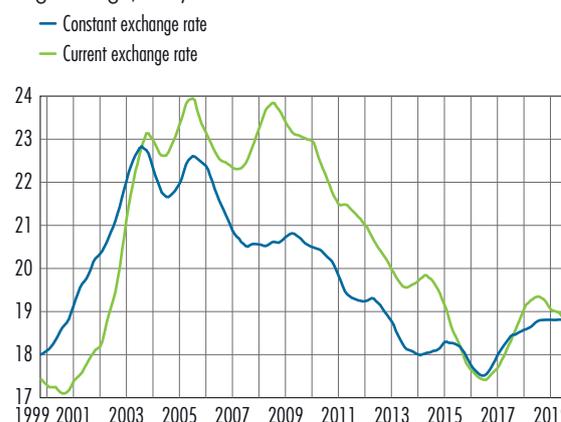
1 Where do we stand?

The international weight of the euro

After twenty years, the euro is the **world's second most important currency**, far behind the US dollar but ahead of all other world currencies. While the euro area accounts for around 11% of the world economy, the share of the euro amounts to around 20%, irrespective of the indicator chosen: 20% of global foreign exchange reserves, 22% of the international stock of debt securities, 15% of cross-border loans and 18% of deposits (see Charts 1 and 2). In addition, half of imports into the euro area and 60% of exports outside the euro area are invoiced in euro (ECB, 2020).

C1 Composite index of the international role of the euro

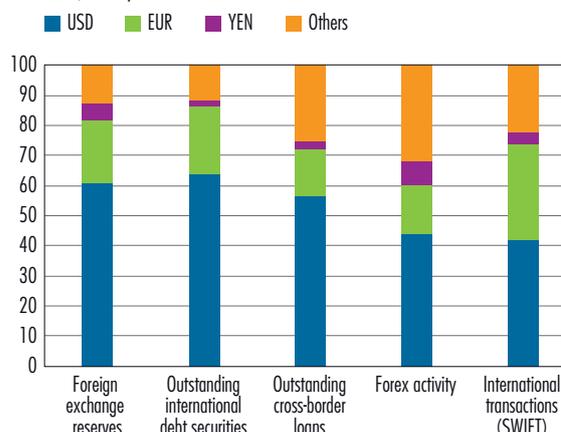
(constant Q4 2019 and current exchange rates, four-quarter moving average; in %)



Source: ECB, *The International Role of the Euro* (2020).

C2 Share of currencies in the international monetary system

(Q4 2019; in %)



Sources: ECB, Bank for International Settlements (BIS) and SWIFT.



The international role of the euro: a longstanding debate

The debate on the international role of the European currency is not new.

The “Werner Report”, which laid the foundations for the single currency in 1970, explicitly referred to it even as it defined its field of investigation not as the search “for an ideal system in the abstract” but as “the minimum that must be done”. It stressed that “in foreign relations, and more particularly in international monetary relations, the Community has not succeeded in making its personality felt by the adoption of common positions, by reason as the case may be of divergences of policy or of concept”. It is true that the report had adopted a proactive and broad approach, stressing, for example, the need to set up a democratically legitimised “centre of decision for economic policy” and to consult with trade unions.

The “Delors Report”, which paved the way for the effective launch of the single currency in 1989, was less bold both internally, for example by not providing for a central economic policy authority, and externally (Committee for the Study of Economic and Monetary Union, 1989).

In one of his first public speeches, delivered on 20 November 1998 in Frankfurt, the first President of the European Central Bank (ECB), Wim Duisenberg, took a clear stance in favour of absolute neutrality for the European System of Central Banks (ESCB): “it will neither hinder nor deliberately encourage the development of the international role of the euro, but will leave this to market forces”.¹ He stated that “the purpose of the introduction of the euro is to promote economic integration and economic welfare in the Member States, and the objective of the ESCB is to maintain price stability within the euro area”. The ECB was just one of a number of public and private players with the potential to extend the international influence of the euro. He recalled that,

under the Treaties, only the Finance Ministers were ultimately responsible for the euro exchange rate. By ensuring price stability, the ECB was making its “indirect” but non-negligible contribution.

This discourse reflects the divergences that have existed since the creation of the euro between, on the one hand, Germany and the Netherlands, and on the other, France and Italy. The former wished above all to create a currency as stable as the Deutsche Mark, hence the insistence on the independence of the ECB, the ban on debt monetisation and the silence on the international role. The latter often viewed the euro as an instrument of power in global competition. It is therefore not surprising that two great Europeans such as Tommaso Padoa-Schioppa and Otmar Issing have had different views on the subject.²

What is most interesting, in retrospect, is to see what arguments were then used to support the neutrality thesis. One of them was that the future emergence of a “broad, liquid and integrated” capital market would contribute to the empowerment of the euro. Wim Duisenberg also counted on “the elimination of the currency fragmentation in European bond markets”. Finally, he stressed that the main monetary areas (United States, Japan) were cooperative and did not pursue exchange rate objectives.

At the time of the creation of the euro, some hoped for a political driving effect, leading to further steps forward. These did not occur. In view of the unfinished nature of Economic and Monetary Union, both theses are left open.

Jean-Claude Juncker, the former President of the European Commission (2014-19), personally attached great importance to the development of the international role of the euro. After advocating this at the time when he chaired the Eurogroup, he solemnly called for more efforts in his State of the Union speech of September 2018, and in a communication

¹ Duisenberg (1998).

² Issing (1997) and Padoa-Schioppa (2005). Otmar Issing points out that “the international role of a currency depends crucially on political factors” but that “such an objective can only be achieved if the market accepts it”. Tommaso Padoa-Schioppa is more enthusiastic about the euro “playing a key role in strengthening the multilateral character of international cooperation”.



listing “initiatives to strengthen the international role of the euro”.³ These included both internal measures, such as, for example, the completion of European Economic and Monetary Union, the Banking Union and the Capital Markets Union, and measures to deepen the European financial sector, such as the strengthening of European financial market infrastructures, strong interest rate benchmarks and the integrated instantaneous payment system in the European Union. Others were related to the international financial sector, such as the ongoing cooperation between central banks to safeguard financial stability and the increase in the share of euro-denominated debt securities issued by European entities.

The European Commission is now also encouraging Member States and businesses to promote a wider use of the euro in strategic sectors.

It is calling for the development of economic diplomacy to promote a wider use of the euro and for the provision of technical assistance to improve the access of foreign entities to the euro payment system. It has pinpointed in particular the exchange rate risks and political risks associated with the use of the US dollar for purchases and sales, including within Europe. In particular, it is calling on Member States to step up their use of the euro in international transactions and agreements in the field of energy and to guard against legal actions brought by third country jurisdictions.

2 Does the Covid-19 crisis alter the terms of the debate and the issues at stake?

This set of articles was planned and partly written before the expansion of the Covid-19 global health crisis. Far from having made the questions it raised disappear, the global nature and the severity of the pandemic highlight the world interdependencies and herald profound changes. Some of the changes

had begun to manifest themselves long before the crisis, but the crisis brought them to light.

At this stage, of course, no one can say what will happen, but several observations can already be made.

The representation of the euro is fragmented

Internally, in the Eurosystem governance system, decisions are taken rapidly by majority vote by the Governing Council (made up of the supranational Executive Board, chaired by Christine Lagarde, and the nineteen national governors), which facilitated a rapid reaction to the crisis. The external governance of the euro area, on the other hand, remains fragmented: while the President of the ECB, like her predecessors, speaks with authority at the international level and is identified as such, the voices of economic policy are manifold. Moreover, the euro area is represented differently in different fora: at the G7 (the group of the most advanced economies), the President of the ECB and the European Commissioner in charge of the euro sit, together with the President of the Eurogroup (an informal body), alongside the representatives of three EU countries (Germany, France and Italy). At the Finance G20, the ECB and the Commission are represented, along with the rotating EU Presidency, alongside these same countries plus Spain and the Netherlands.

At the International Monetary Fund (IMF), the euro area is not a “constituency”: it does not have a “chair” as such; many Member States represent both European and third countries, which has the advantage of increasing the number of votes and providing Europe with relays, but also the disadvantage of weakening the European voice. Neither the ECB nor the Commission are represented.⁴ The Member States that finance the Fund through statutory or exceptional contributions are the ones that may benefit from special allocations

³ Juncker (2018) and Bussière, Lecat and Vidon (2020).

⁴ A different model is possible; for example, the euro area has a single seat in the new multilateral institution created at China’s initiative, the Asian Infrastructure Investment Bank.



of Special Drawing Rights (SDRs). The ideas put forward by Dominique Strauss-Kahn when he was Minister of Finance to merge the French and German chairs, which were taken up more recently (Fuest and Pisani-Ferry, 2019), were not followed up. Naturally, a certain pragmatism allows for informal coordination, but the fact remains that Europe does not speak with one voice. The differences of opinion that exist in crisis management debates are echoed in these fora. On other issues, even European unanimity is not enough to influence the positions of the major powers (for example, the United States on a possible special allocation of SDRs in the crisis). In some respects, maintaining formal sovereignty at the national level leads to a dilution of real sovereignty.

In some more technical fora (i.e. the so-called “standard setting bodies” such as IOSCO⁵ for markets and the Basel Committee for banking regulation), neither the euro area nor the European Union are represented as such, even though the legislation applicable in the EU is adopted jointly, following the ordinary legislative procedure, in the framework of the single market for financial services.

The permanence of structures in which Europeans disperse their forces of influence gives the other protagonists greater freedom of action (or blockage).

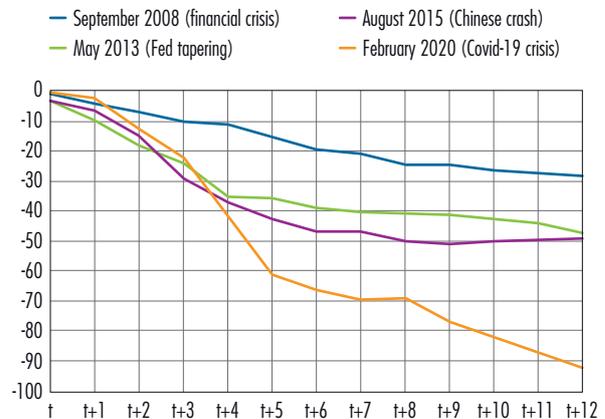
As regards the US authorities, this phenomenon is reinforced by the importance of the national currency, as the whole world is now dependent on fluctuations in “USD funding”, which are one of the indicators of global financial stability.

Capital flows

In its report on Covid-19, the Financial Stability Board (FSB) notes that “Capital outflows from EMEs observed in late March have been much larger than during 2008 in the financial crisis, or

C3 Cumulated portfolio flows to emerging countries in the event of global shocks

(USD billions)



Source: EPFR Global.

Note: Duration t is expressed in weeks.

during 2013. These larger outflows reflect the shift in USD funding gaps during the past decade from advanced economies to EMEs, and from banks to non-financial corporates⁶ (see Chart 3). In other words, over the past few years the dollar has been used on a large scale by new players: pension funds, life insurers and large corporations in emerging countries (IMF, 2019), the latter having become the engines of global growth.

In addition, during this crisis, capital rapidly and massively left emerging countries, at the risk of destabilising the global financial system;⁷ these movements, and the need for access to dollar financing, led the US Federal Reserve to take emergency measures such as the large-scale granting of dollar swap lines to central banks in these countries, and the provision of financing in exchange for US Treasury bills, via repos. Undoubtedly, the Federal Reserve has assumed its responsibilities, which confirms that being the central bank of a dominant currency gives rise not only to privileges but also to obligations. However, the system remains entirely dependent on unilateral decisions that may be subject to the vagaries of

⁵ International Organization of Securities Commissions.

⁶ Financial Stability Board (2020).

⁷ Dabrowski and Domínguez-Jiménez (2020).



individuals or domestic policy, especially in the broader context of a retreat from multilateralism.

Among the main reasons why the dollar is so popular in capital markets is the existence of a deep and liquid market for safe assets, based on US government debt securities, which Europeans have not yet been able to achieve.

External implications of euro area integration

Before the crisis, a large number of pending dossiers in the European framework were likely to impact the possible development of the euro as an international currency; this is the case, for example, of the development of the European Union's financial centres after Brexit and of the progress of the Capital Markets Union, as pointed out when recalling President Duisenberg's arguments.

With the Covid-19 crisis and the robust debate on the possible creation of joint debt securities that ensued, we touch on an aspect that was present before, as technically crucial as it is politically sensitive. It has already been noted by many authors.⁸

The absence of European Treasury securities equivalent to the US Treasury Bills (T-Bill) is objectively one of the reasons why the euro struggles to assert itself internationally alongside the dollar. This is where the euro's peculiarity – being a stateless currency – places the EU in an atypical situation (see Rey, 2013).

Even for countries that wish to diversify their assets, the absence of such securities, notably the relative narrowness of the Bund or French OATs markets, often leads them to opt out of necessity for investments in dollars, which are more liquid and accessible.⁹

Without taking a position on the issue of "corona bonds" (or any other form of jointly issued debt securities), there is a link between the degree of

internal mutualisation and solidarity and the degree of external influence. Besides, the above-mentioned Werner Report provided for a common budget as a pillar of Monetary Union. It is true that countries that are reluctant to assume the ensuing obligations may see in this argument an additional reason to oppose the creation of these bonds.

International trade

Since the sudden halt in most economies (and despite the beginning of a recovery in China), world trade has slowed down: the price of oil has collapsed and value chains are partly disrupted, without it being yet clear whether activity is just temporarily suspended or whether the just-in-time production model, which favours low production costs over stock or independence-related considerations (Gomart, 2020), is being called into question. This disruption of value chains could indeed lead to a search for diversification, without however calling into question their existence (Gaulier and Vicard, 2020).

The Covid-19 health crisis is likely to have all the more impact as new trains of thought were already starting to emerge, stressing the need to rethink economic organisation, in particular in strategic sectors.

The glaring consequences for public health of the importation of masks and of our dependency vis-à-vis the supply of ventilators and drugs needed in intensive care units could leave a lasting impression. The need to think about how to preserve a certain degree of supply autonomy could be based on specific examples, and concern new sectors: security in the broad sense, as well as food.

Already, the turnaround in the United States since the election of Donald Trump was starting to change the EU's traditionally very open positions, as shown for example by the strategy adopted on China in spring 2019 (European Commission, 2019). The

⁸ Notably Delpla and von Weizsäcker (2010), De Grauwe and Yuemei (2018) and Leandro and Zettelmeyer (2018).

⁹ See Portes and Rey (1998); Farhi, Gourinchas and Rey (2011).



Covid-19 epidemic will most certainly speed up awareness. In April 2020, European Commissioner for Competition, Margrethe Vestager, thus called on Member States to shield strategic companies from hostile takeovers by third countries, starting with China.¹⁰

Ursula von der Leyen had already called for the leadership of “a Geopolitical Commission”. This is in sharp contrast with the conditions that presided over a number of choices, including the ECB’s “neutrality” with regard to the international use of the euro. Neutrality in a cooperative world, committed to multilateral rules and a market economy, does not have the same meaning as in a more uncertain world where centrifugal forces are emerging in the areas of trade, climate change and nuclear non-proliferation. Even the health sector, in the midst of a crisis, has not been spared, as shown by the US refusal to contribute to the World Health Organization. In this context, the European Union remains the region that is the most committed to the principles of multilateralism and free trade, which is an asset for the international attractiveness of the euro.

In response to climate change, public opinion, led by NGOs, youth movements, and even Pope Francis (2015), had already shifted towards a new frugality. No one knows whether the economic recovery will be centred on jobs at all costs or whether it will also obey the imperatives of the Green New Deal in Europe. It is at least likely that some successful large-scale telework experiments will provide an incentive to reduce travel, or even, more prosaically, encourage companies to reduce real estate costs in city centres.

Finally, the major changes that are likely to occur in the aeronautics and air transport sectors if tourism and business travel decline will not be neutral on the use of international currencies. When in 2018 President Juncker mentioned the possibility for European economic players to denominate certain purchases in euros rather than dollars, he was referring specifically to the aeronautics sector.

Twenty years after the creation of the euro, a stateless currency in a world made up of states, the position of the single currency is still undefined. Is it time to review the principle of neutrality that has governed the management of this currency by the European Central Bank? What would be the configuration most conducive to stability?¹¹

There are many reasons why we should ask ourselves questions, given the changes that have taken place in the world since 1990, which the current crisis may well speed up. Among these, developments taking place in the United States are obviously central, both because of the position of the dollar in world finance and because of the pivotal role it has played in multilateralism since the Second World War.

Sometimes, even the most technical subjects may be influenced by political decisions, as shown by the effect on the SWIFT payment network of US sanctions against Iran in the area of nuclear non-proliferation.

¹⁰ Espinoza (*Financial Times*, 2020).

¹¹ For former Banque de France Governor and former IMF Managing Director Jacques de Larosière, “it is the collapse of the Bretton Woods system that paved the way for the repeated financial crises and for the over-financing that characterise and undermine the world” (*Les 10 préjugés qui nous mènent au désastre économique et financier*, Odile Jacob, 2018).



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