Conference « The Werner Report, 50 Years On »
EMU in Uncertain times :
Learning from the Past to Navigate the Future

How could a stronger international role for the euro and the EU pave the way to a reform of the international monetary system ?

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Luxembourg, 8 October 2020

The euro is crucial for a more geopolitical EU

- The geopolitical ambition was already present in the Werner Report :monetary power was needed to give Europe clout on the global stage and to promote a more balanced international monetary system.
- 50 years on , theme of President von der Leyen State of the Union Address on 20 September 2020 was « Building the world we want to live in : a Union of vitality in a world of fragility » . There should be a monetary dimension.
- In 2019, President von der Leyen stressed her ambition to lead a « geopolitical Commission » and her commitment to multilateralism on global issues.
- Together with the European Green Deal, Europe ’s Digital Decade, a more assertive response to world’s events, an enhanced international role of the euro and a stronger commitment of the EU to reform the international monetary system are essential to achieve these objectives.

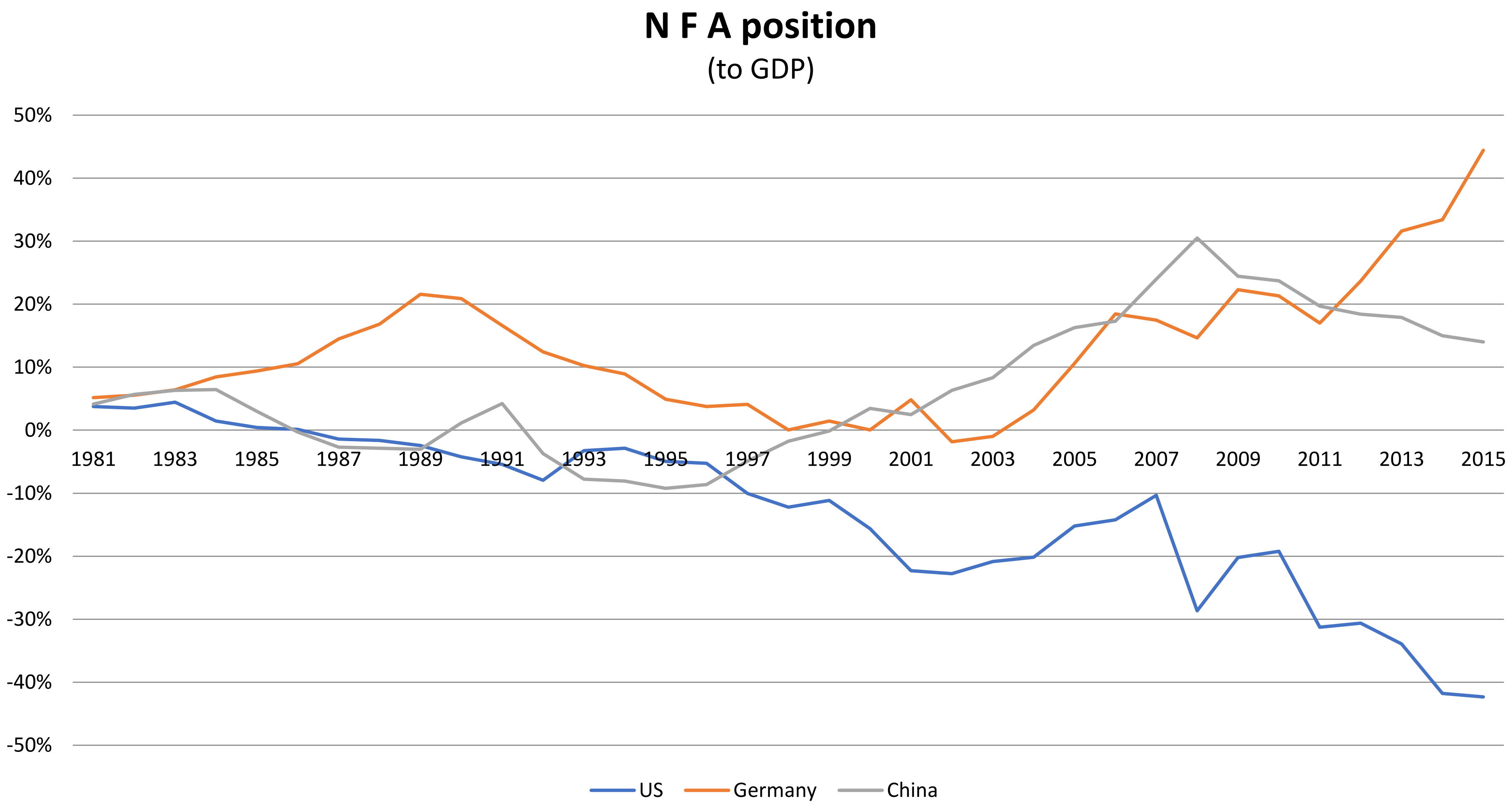
The collapse of the Bretton Woods System has created a very fragile, unstable, crisis prone and unsustainable financial system

- Huge macroeconomic imbalances, ineffective global adjustment process, lack of macroeconomic discipline, weak multilateral surveillance and coordination.
- Unprecedented and unsustainable levels of global indebtedness, stimulated in recent years by non-conventional monetary policies (QE), persistent low interest rates and increasing divorce between risk and remuneration of credit exposure.
- Financial excesses and destabilising capital flows
- Volatility in exchange rates, excessive fluctuations and deviations from fundamentals
- Absence of mechanism to manage international liquidity as an international public good : excessive expansion of international reserves
- Lack of effective global governance and of a genuine global Lender of Last Resort : decline of multilateralism, overdue reforms and insufficient fire power of the IMF

The lack of resolution of the Triffin Dilemma is at the heart of this dangerous instability

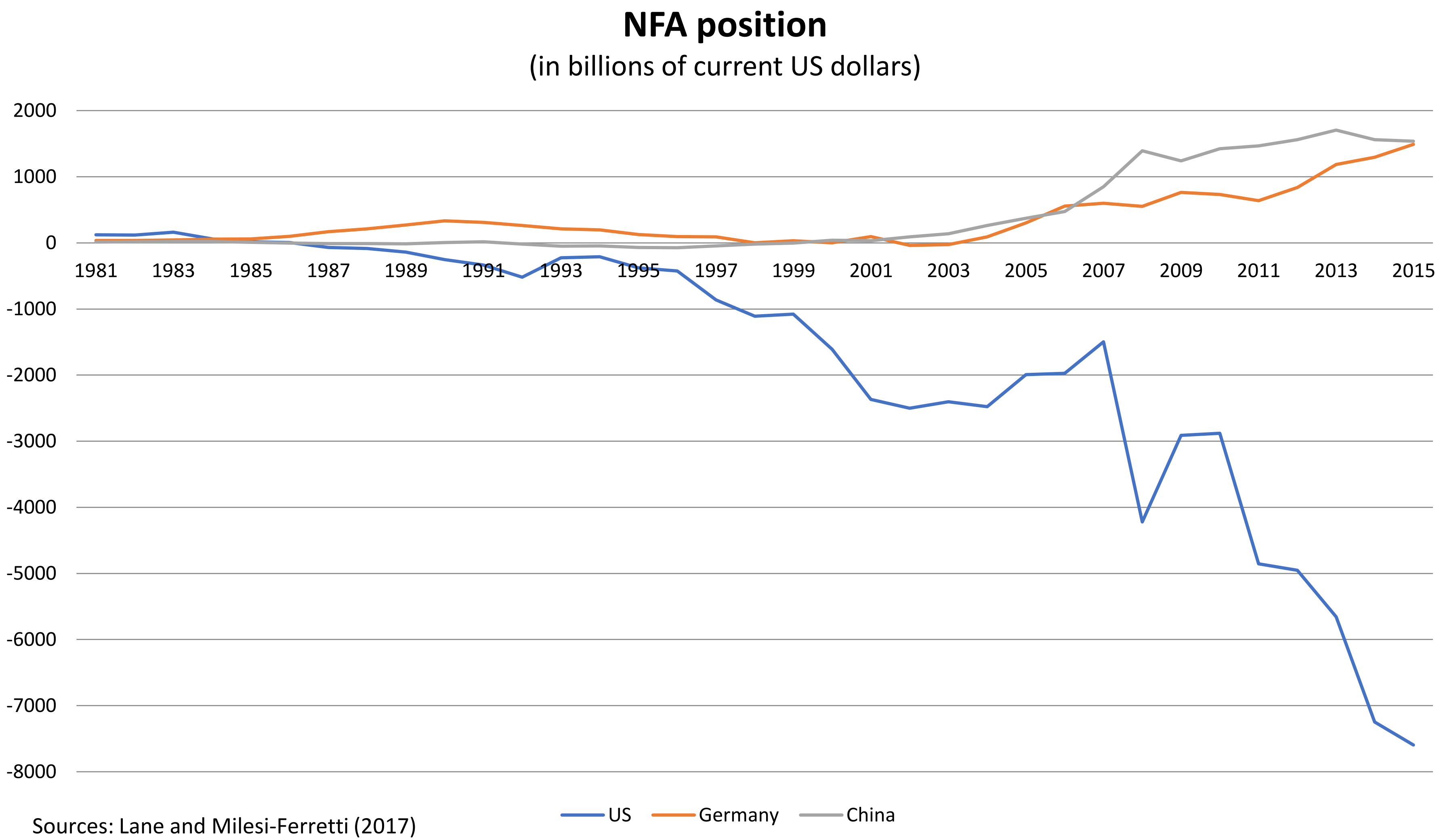
- Robert Triffin enunciated in 1960’s that : «It is impossible for a national currency used as a world currency to serve properly both the needs of the national economy of the country issuing that currency and the needs of the international economy »
- Obvious tendency for the interests of the national economy to prevail over the needs of the global economy, resulting in a continuing risk of excess or shortage of global liquidity.
- Today, demand for safe and liquid assets is rising faster than the capacity of the United States to supply them, where that capacity is limited by the ability of the US Government to raise taxes and service the goverment debt securities that are held as reserves and used in cross border transactions by other countries.

Stock imbalances



Sources: Lane and Milesi-Ferretti (2017)

Stock imbalances



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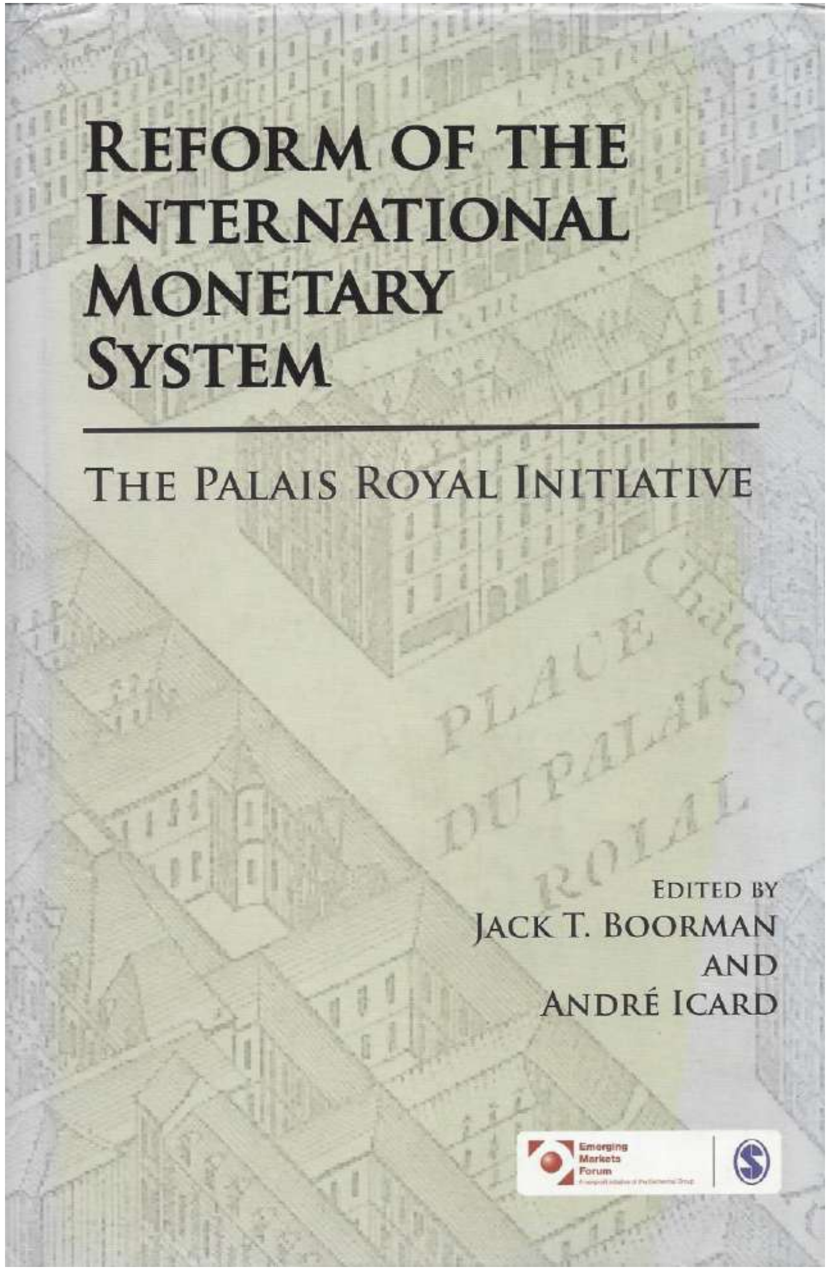
REFORM OF THE
INTERNATIONAL
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SYSTEM
THE PALAIS ROYAL INITIATIVE
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DU PALAIS
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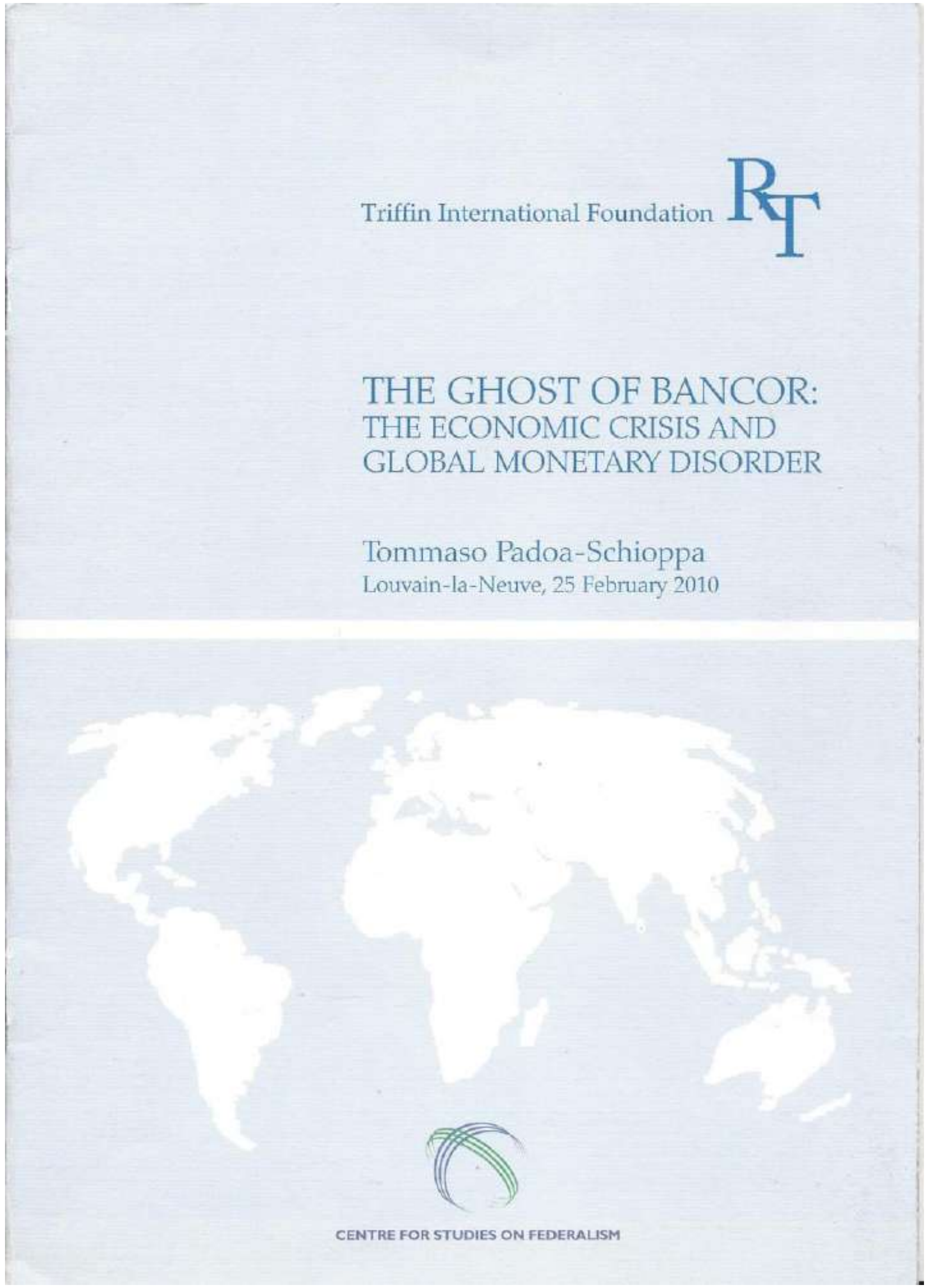
EDITED BY
JACK T. BOORMAN
AND
ANDRÉ ICARD
Emerging
Markets
Forum


Triffin International Foundation
RT
THE GHOST OF BANCOR:
THE ECONOMIC CRISIS AND
GLOBAL MONETARY DISORDER
Tommaso Padoa-Schioppa
Louvain-la-Neuve, 25 February 2010
CENTRE FOR STUDIES ON FEDERALISM

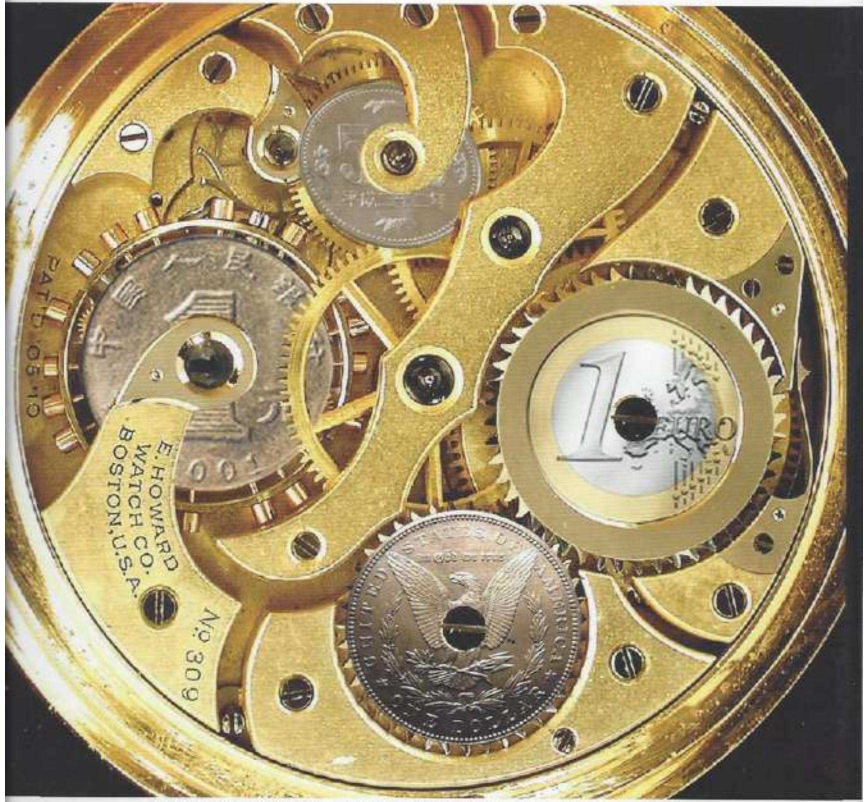
Two mechanical channels behind the persistence of Triffin's dilemma

- Weakening of the external constraint on the issuer of the reserve currency exacerbates its macroeconomic imbalances , pushing down its saving rate (currently negative in the US): US enjoying « exorbitant privilege » and becoming « consumer/borrower of last resort ». Although this function has fulfilled a positive role in some business cycle situations, its other external impacts tend to generate systemic instability through the following vicious circle :
- Liquidity spillover through the transmission to the rest of the world of monetary conditions prevailing in the reserve currency country: other creditor central banks are inclined to pile up additional reserve, resist appreciation of their currencies and reinject in reserve currency assets their holdings, lowering these assets' yields.

The persistence of the dollar « exorbitant privilege »

- Triffin underestimated the resilience of the dollar and the willingness of central banks and private banks and non-banks worldwide to accumulate dollar denominated assets despite severe, persistent unsustainable US deficits
- Structural power in the global economy rooted in US geopolitical dominance and enduring military supremacy, US banks dominance in global finance (and influence on global regulatory standards) and unrivalled financial markets in terms of size and sophistication
- Inertia in quoting and invoicing as shown by Eichengreen (2018)
- Absence of immediately available alternatives: the Renminbi is not backed by deep and resilient financial markets and China’s capital account and financial industry are not yet liberalised. Quid for the euro?

HOW GLOBAL CURRENCIES WORK
PAST, PRESENT, AND FUTURE



BARRY EICHENGREEN,
ARNAUD MEHL & LIVIA CHIŢU

Relative lack of attractiveness of the euro until recently

- Eurozone not an optimal currency area : small EU budget, no Euro-zone budget, weak labour mobility
- Perceived lack or uncertainty of adequate institutional support and political cohesion in crisis time.
- Unfinished Banking Union
- Uncertain Capital Markets Union project
- Lack of a common safe asset with a deep and liquid market
- Too weak fiscal instruments in case of asymmetric shocks
- Surplus countries not willing to take their fair share in the macroeconomic adjustment process

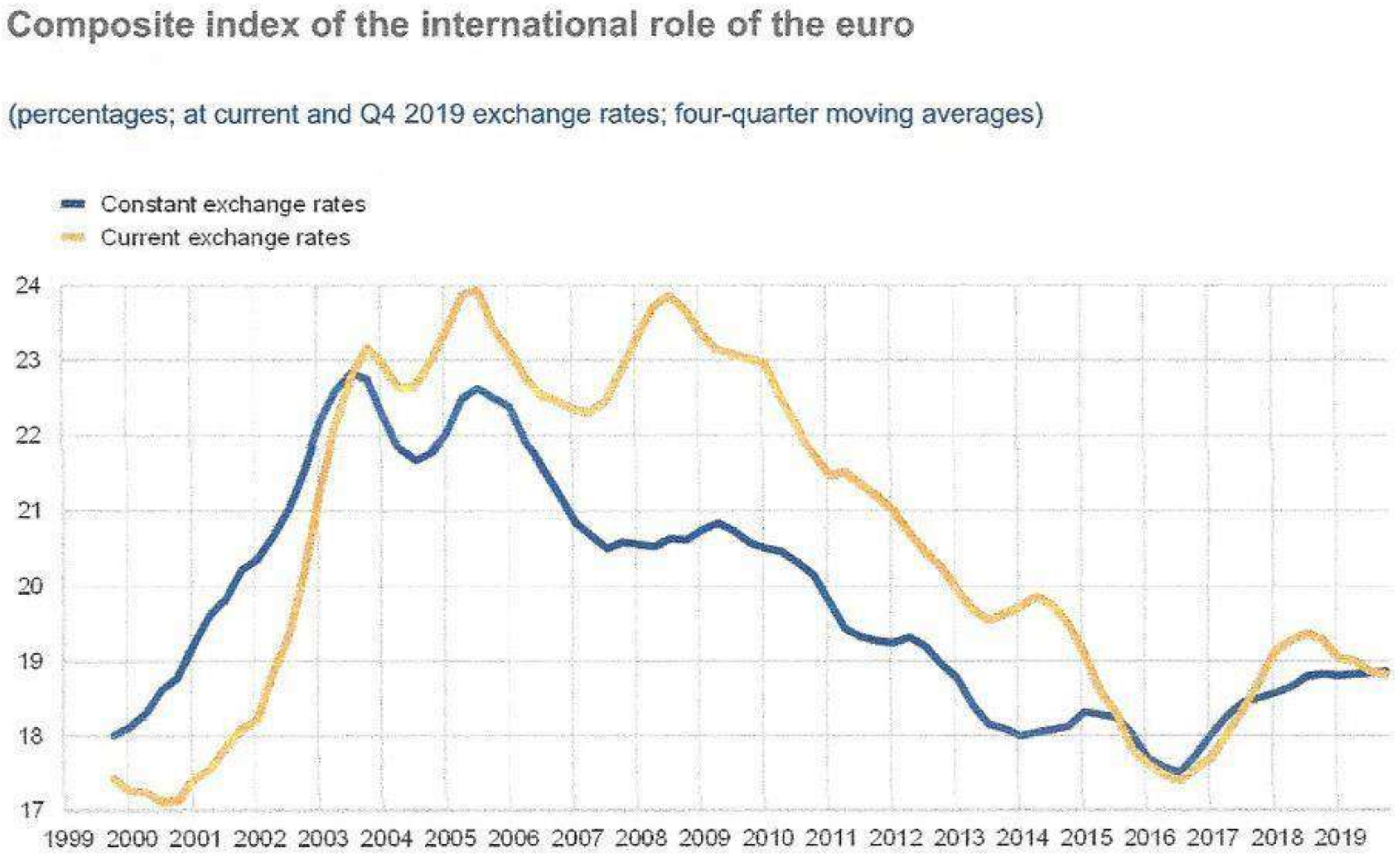
What has changed, particularly since the COVID-19 crisis?

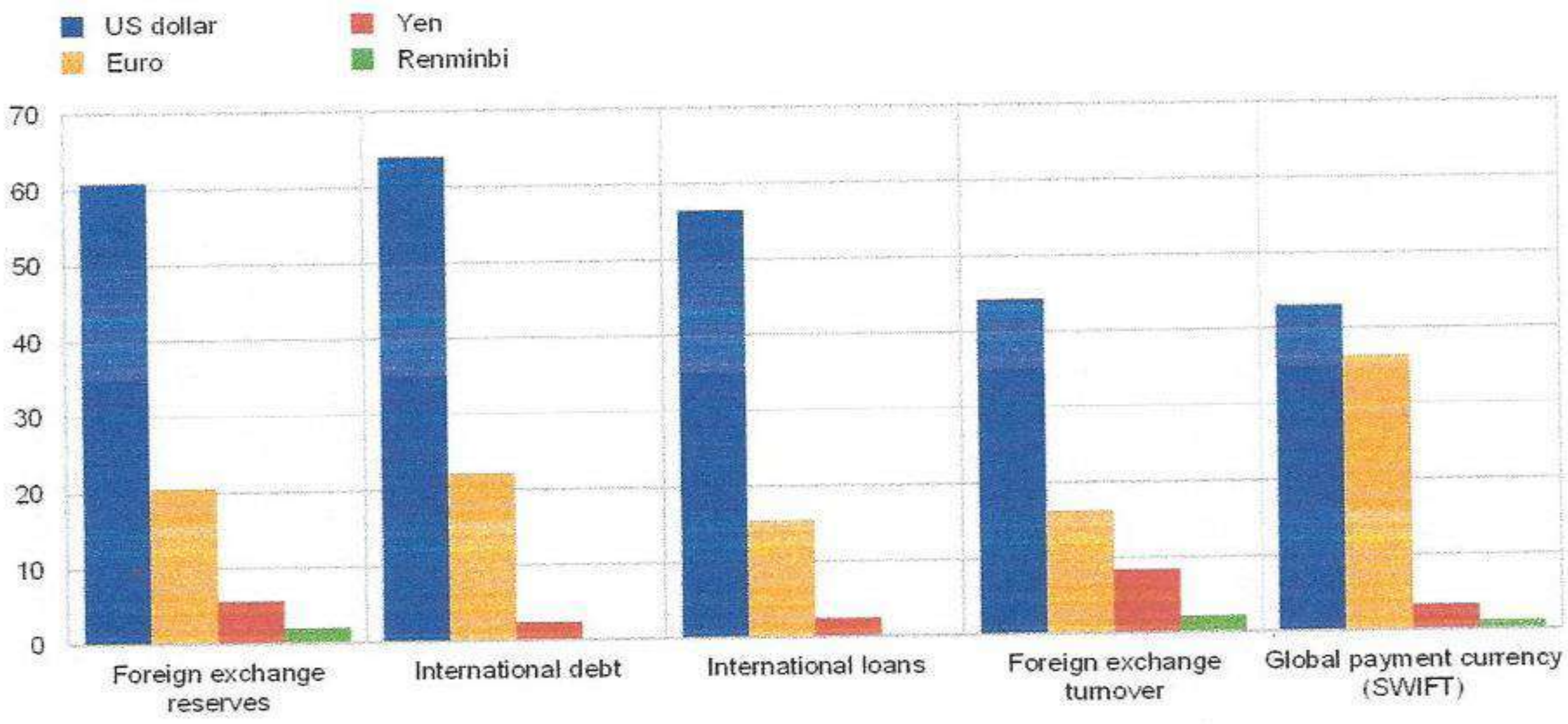
- Kind of an EMU coming of age at 20!
- The European Central Bank has further enhanced its credibility in times of crisis : the « Whatever it takes » of Mario Draghi in September 2012 is now followed by Christine Lagarde’s 2020 Pandemic Emergency Purchase Programme (PEPP)
- The von der Leyen Commission flexibilised the fiscal rules under the Stability Pact and proposed NewGenerationEU Fund in the context of an ambitious 2021-2027 Multiyear Financial Framework, on which the European Council was able to reach a consensus in July 2020. There was real solidarity.
- The New GenerationEU Fund will entail the issue by the European Commission of 750 billion euro in bonds of various maturities in the coming years, creating the prospect for a deep and liquid common euro safe asset over the entire yield curve.
- Confidence in the euro has never been stronger.
- More explicit political commitment to completing the EMU
- Surplus countries, particularly Germany, have begun to enhance their public expenditures
- « President Trump is doing more than the Commission could ever do to foster the international role of the euro » (Francesco Papadia)

Benefits of an increased international use of the euro

- Lower cost and lower risk of trading internationally for European businesses. Trading in euro rather than in a foreign currency will remove the exchange risk and other currency related costs especially for small and medium-sized European businesses.
- Additional choice for market operators across the globe.
- Lower interest rates paid by European households, businesses and Member States. A more attractive euro as a safe store of value reduces the interest rate (or return) demanded by investors.
- More reliable access to finance for European businesses and governments, even in periods of external financial instability, as European financial markets would become deeper, more liquid and integrated.
- Stronger autonomy of European consumers and businesses, allowing them to pay or receive payments for their international trade, and finance themselves with reduced exposure to legal actions taken by third country jurisdictions, like extraterritorial sanctions.
- Providing central banks, investors and operators worldwide with an alternative, reducing their dependence on the dollar.

The euro is consolidating, albeit from a low base, its position as the second most important international reserve currency





The euro remains the second most important currency in the international monetary system
International use of currencies in percentage 2019 Source : European Central Bank

There are also costs of an increased international use of the euro

- More exposure to capital flow volatility
- Possible appreciation of the euro above its desired level in global stress periods; this could be a problem for euro-zone countries with a weaker competitiveness and balance of payments.
- More difficult control of monetary aggregates
- Lower effect of monetary policy on import prices
- Sharing in the « exorbitant privilege » entails sharing in the « exorbitant duty » (e.g. consumer and lender of last resort in times of crisis)
- Higher responsibility for shaping global financial and monetary governance.

Incentive to the completion of the EMU
A possible virtuous cycle

- An increased international use of the euro creates a strong incentive for the strenghtening of the architecture of the EMU : better balance between the economic and monetary pillars, completion of the Banking Union, progress towards the Capital Markets Union, Common Safe Asset, better balance between surplus and deficit countries, etc.
- Need of proactive measures to encourage wider use of the euro in imports and exports of energy, raw materials, agriculture and food commodities, aircraft, maritime and railway transport equipment.
- Providing technical assistance to improve access to the euro payment system by foreign entities.
- Leading by example : increasing the portion of the euro denominated debt of European multilateral institutions : EIB, EBRD, CEB, etc.
- Making sure the euro is fit for the digital age.

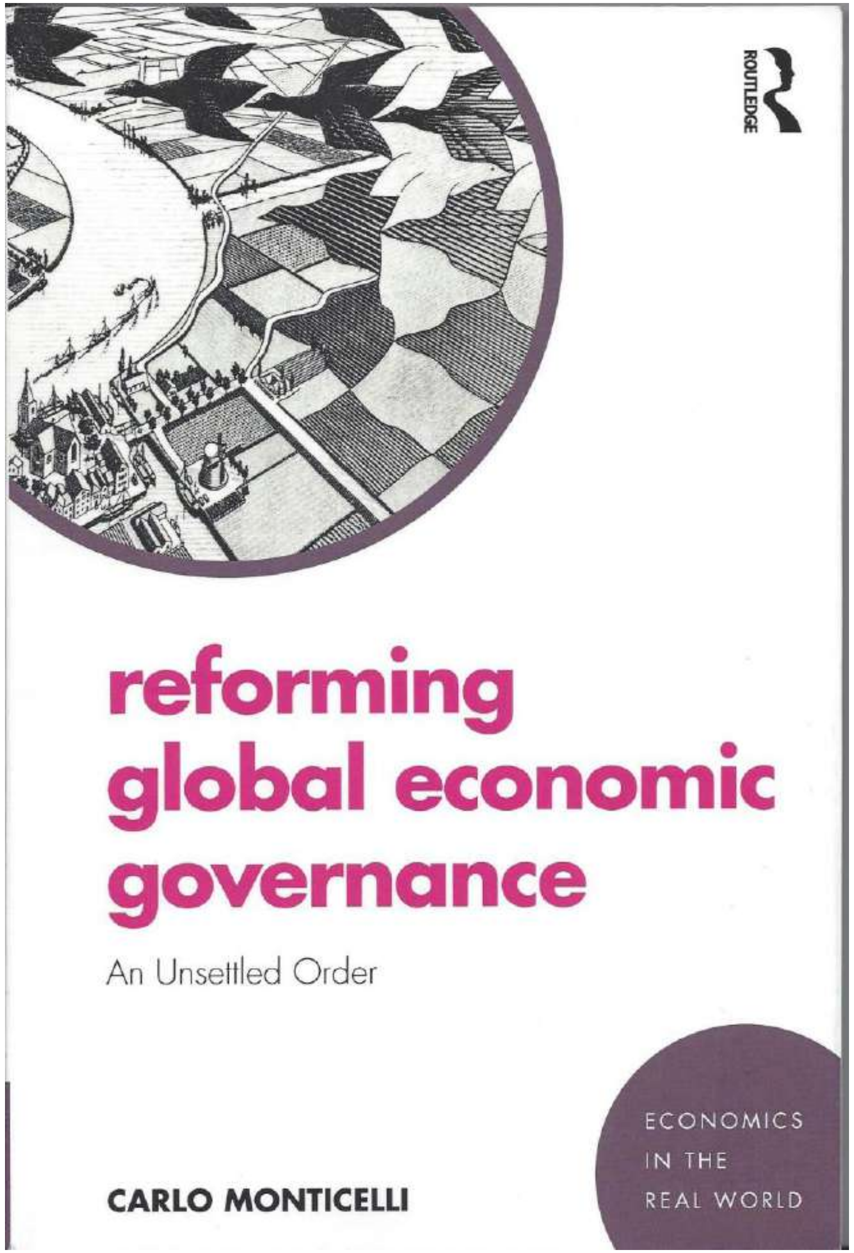
Incentive for a stronger involvement of the EU in the reform of the international financial and monetary system

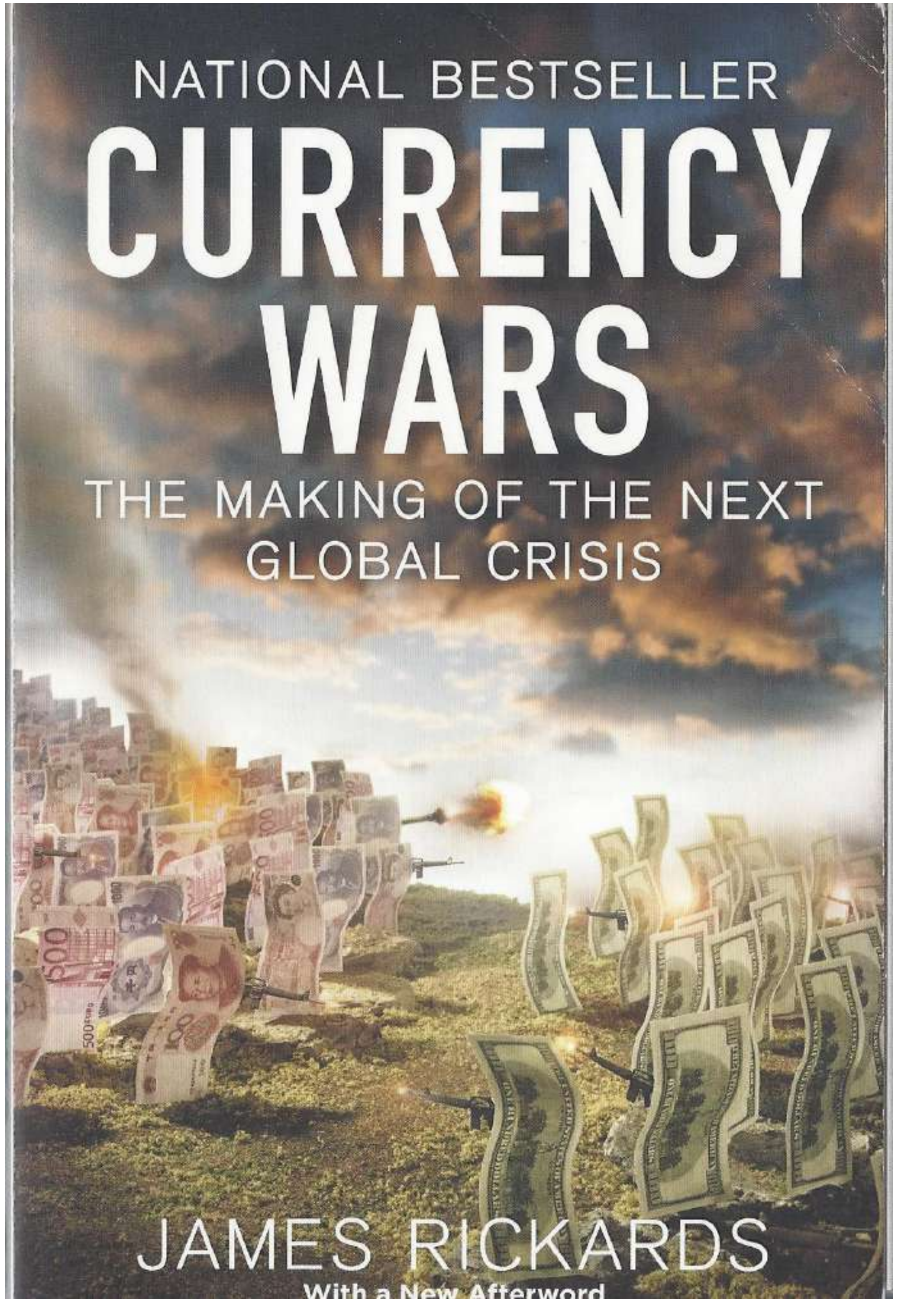
- Need for the EU and the ECB to engage more with international actors: other major central banks, BIS, IMF, FSB, etc. in view of influencing global standards and global financial stability
- Nurturing relationship with Africa, in particular countries having linked their currency to the euro.
- Renewed attempt to unify or at least to better coordinate representation of euro-zone countries in IMF and frameworks of cooperation such as the G20 and the G7.

Europe’s long tradition of punching below its weight in the global arena

- **Europe’s weakness as international power has its roots in the aftermath of the WWII:** *Bretton Woods system* as the economic embodiment of the *pax Americana*. ***Kissinger:*** “Who do I call when I want to call Europe?”
- A long tradition of **fragmented representation** (IFIs, G10, G7, G20). **Treaty of Lisbon** (2009) introduces major institutional innovations, but still lukewarm support for a single European position
- In the reform of global governance **Europe played** a much smaller role than its size, political influence and tradition would have warranted because of
  - contrasting views on the European (sovereign) crisis
  - unwillingness to relinquish sovereignty in external representation

Source : Carlo Monticelli, Reforming Global Economic Governance : an Unsettled Order, 2019


ROUTLEDGE
reforming global economic governance
An Unsettled Order
CARLO MONTICELLI
ECONOMICS IN THE REAL WORLD


NATIONAL BESTSELLER
CURRENCY WARS
THE MAKING OF THE NEXT GLOBAL CRISIS
JAMES RICKARDS
With a New Afterword

The COVID-19 Crisis may provide an opportunity for a renewed EU engagement in Global Governance Reform

- The COVID-19 pandemia, with the resulting lockdown of economic activity, is leading to the worst global depression since the 1930s Great Depression, a depression more severe than the 2008-09 one, exposing the financial vulnerabilities denounced in the recent RTI report on global liquidity management.
- In particular, the massive build-up of dollar debts world-wide means that there is now a danger of a dollar credit-crunch as severe as in 2008/09. At the same time, we cannot exclude a serious crisis of confidence in the dollar (see article by Stephen Roach, Professor at Yale, former Chairman Morgan Stanley Asia, in FT of 6/10/20).
- This dollar credit crunch affects particularly emerging countries, facing a slump in their export earnings and in the remittances of their citizens abroad as well as massive portfolio outflows as international investors are shifting their portfolio to safer dollar paper: hence the scramble for dollar safe assets and the strong downward pressure on US Treasury yields in recent months.
- We could face a new generalised public debt crisis in the coming months, with grave economic, social and political consequences. While the pandemic is an exogenous shock, the unsustainable global indebtedness, facilitated by decennia of dysfunctional international monetary system, incapable of addressing the Triffin dilemma, is the source of a global fragility magnifying the impact of the crisis.

Robert Triffin International

MANAGING GLOBAL LIQUIDITY AS A GLOBAL PUBLIC GOOD

A REPORT OF AN RTI WORKING PARTY

Chaired by **Bernard Snoy**
Rapporteurs **André Icard** and **Philip Turner**

December 2019

CENTRO STUDI SUL FEDERALISMO

What about the response so far to the COVID-19 crisis

- National governments and central banks have responded with monetary and fiscal stimulus packages, cushoning the worst damage of the crisis and stabilising financial markets somewhat. The 8 trillion dollars of fiscal stimulus programmes are larger than the 5 trillion dollars mobilised in 2008-09 and monetary accumulation by the US Federal Reserve (Fed) and the ECB has become almost open-ended.
- However, the response as been less well coordinated at the G20 level than in 2008-09 and and involves many gaps. In particular, emerging markets facing « a perfect storm » remain at risk.
- To alleviate the dollar funding pressures non US entities are facing, the Fed has offered currency swap lines to 14 central banks, including those of South Korea, Singapore, Mexico and Brazil. The Fed has also offered repurchase facilities to other monetary authorities to enter agreements to exchange their holdings of US Treasuries for cash. Nevertheless, these swaps have also a geo-political dimension and exclude, for instance, China. Selective Lender of Last Resort (LLR), not a tryuly international LLR.
- The IMF is also responding with its existing instruments and new facilities, as well with a call for debt relief for the poorest countries, but its existing lending capacity does not exceed dollar 1 trillion dollars , which creates doubt about its ability to act as the world's lender of last resort, as the needs of emerging market and developing economies are estimated by UNCTAD to be about 2.5 trillion dollars;
- A new SDR distribution – a magnitude of 500 billion SDR was proposed - would be the right answer to this liquidity shortage. There is the precedent of the 250 billion SDR issue in 2009. However, the US Treasury and others blocked the proposal at the G20 meeting of April 15 2020.
- In the formulation of the response at the global level, the voice of the EU or of the euro-zone as such has remained rather timid

The dangers of the current situation point to the urgency of IMS Reform

- A long period of low interest rates has caused investors to embrace risky assets in search for yield, making the Triffin dilemma even more present and costlier for the world welfare.
- « Coronavirus and debt: a toxic mix » (Hung Tran, FT April 2020)
- The global financial situation is approaching a turning point as it appears that quantitative easing, while probably necessary in the short run, cannot solve the long term systemic imbalances. As stated by Jacques de Larosière, former Managing Director of the IMF, « central banks can't bury risk with more money » (2020)
- In this environment, exacerbated by the current crisis, emerging economies and indebted countries could be particularly hurt, justifying the need for making their voice stronger in the IMS.
- Looming « Trade wars » leading to « currencies war ». A multi-polar reserve currency world does not preclude periods of high instability if the major actors do not fully cooperate. It does not solve fundamentally the Triffin dilemma.
- « Never waste a good crisis » : The COVID-19 pandemia should provoke a fundamental rethinking of priorities in our global objectives and of global governance, pointing the way towards long delayed systemic reforms.

The sequenced agenda proposed under the Palais Royal Initiative and supported by RTI

- Overdue IMF reforms, already proposed in the Palais Royal report
- Introduce a reliable mechanism for calibrating global liquidity in function of global needs
- A new Bretton Woods : transforming the IMF into a full-fledged global monetary institution

Overdue IMF Reforms

- **Reinforcing the IMF's surveillance function**, making it more effective and more equitable, developing indicative guidelines of acceptable imbalances, broadening the surveillance on capital movements and capital accounts balances and developing a statutory mechanism for sovereign debt resolution, among others through the introduction of collective action clauses (CACs) in the issuance of sovereign bonds on international capital markets.
- **Mitigating large swings in exchange rates among major currencies** and addressing cases of serious misalignment: making countries' obligations of exchange rate policies more specific, through the use of benchmarks based on macroeconomic fundamentals;
- **Strengthening the IMF's legitimacy and governance**: adjusting quotas and voting rights to reflect the increasing importance of emerging countries and reforming decision making, entrusting final decision-making power to a Ministerial Council or to the existing IMF's International Monetary and Financial Committee (IMFC), comprising ministers and central bank governors, rather than the present Executive Board of senior officials.
- **Reforming the make up of the G20**, restructuring it along the lines of the IMFC, based on the 24 Bretton Woods constituencies, to ensure that the full membership of the IMF is retresented. .

A mechanism to regulate global liquidity

- Michel Camdessus, former IMF Managing Director, and Anoop Singh, a former IMF Director, proposed in 2015 the creation of a high level group of central bank governors (the governors of the central banks whose currencies are included in the SDR currency basket) , who would periodically submit to the IMFC a report on global liquidity and measures for calibrating global liquidity.
- Restoring the potential of the SDR by ensuring that the managers of the system have the power to use it much more flexibly and as needed by the global liquidity situation: SDRs should be promptly issued if needed and, just as rapidly, mopped up to stabilize global liquidity situation.
- More specifically, follow suggestions of RTI Working Party on the SDR of 2014 : reform of irrational present regime of allocations, based on quotas and change anachronic denomination, build the SDR competitiveness by developing use for both official and private payments and bond issues. SDR bonds should become the world preferred safe assets.

The long term need for a systemic reform eliminating the Triffin dilemma

- Doing worldwide what was done at national level
- Regulating in a collegial, rational way global liquidity needed for a globalized economy would imply the creation of a single global currency issued by a single multilateral central bank, as Keynes proposed in Bretton Woods. We need a new Bretton Woods for managing global liquidities.
- The best solution would be to create a multilateral reserve currency (e.g. Multilateral Drawing Rights), issued by an IMF transformed into a global central bank, in other words a liquid liability that is not the debt of any individual country.
- This first best solution seems today out of reach because political forces, voting, decision making processes and regulations remain mostly national (to some extent regional in the case of the EU), while economic and financial developments are global.

Second best solutions compatible with existing constraints

- Making the best out of the current system.
- Consolidate the EMU and promote an increased international use of the euro as an alternative to the dollar
- Drawing attention to vulnerabilities in international capital markets and « blind spots » in the current regulatory and supervisory framework.
- Using the SDR as a lever to reform the IMS towards a more balanced and representative way for managing rationally global liquidity creation: follow the recommendations of the RTI Working Party on the SDR.
- Making international public opinion more aware of the ongoing risks of instability inherent in the current system leading possibly to a new, large-scale crisis. « Never waste a good crisis ».