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The "four I's" of the international monetary system and the international role of the euro

Jean-François Ponsot

Department of Economics, CREG-Université Grenoble Alpes, 1241 rue des residences, 38400 Saint Martin d'Heres, France

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ABSTRACT

This article highlights the main sources of negative externalities in the current international monetary system, through a "four I's" approach (instability, incertitude, inequity and insufficiency of the aggregate demand). It then questions the ability of the euro to contribute to a more balanced and sustainable international monetary regime. The euro cannot become a major international currency without long-term growth in the Eurozone, without the creation of a unified marketplace for public debt backed by the European Central Bank, and without shared desire to internationalize the euro, particularly as an invoicing currency for trade.

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It is a matter of regret that the international dimension of the euro was so greatly underestimated by its creators in its original form of a single currency, and that this underestimation still prevails today. Not that it should compete, or even replace the US dollar in its role of primary international currency, but rather because the new currency could have been the key factor in laying the foundation of a new international monetary system that would have replaced the current one that has been dominant since the abrupt retirement of the Bretton-Woods system after the announcement of the end of the US dollar convertibility in August 1971 (Cohen and Benney, 2014; Angeloni et al., 2011). This international monetary regime, solely based around the US dollar, has been given the name of "Bretton-Woods II".

The paper analyzes this international monetary regime through an original "4 I's" approach which highlights the four major negative externalities generated by the current monetary system. This approach allows us to identify the toxic effects of the US dollar standard and show its unsustainability in four ways. It then offers a framework that help us to question the ability of the euro to contribute to a more balanced and sustainable international monetary regime. We show that the euro cannot become a major international currency without long-term growth in the Eurozone, without the creation of a unified marketplace for public debt backed by the European Central Bank, and without shared desire to internationalize the euro, particularly as an invoicing currency for trade. The Euro, given its current weaknesses, is not a major international currency capable of providing the world with the public good that is international monetary and financial stability.

E-mail address: jean-francois.ponsot@univ-grenoble-alpes.fr

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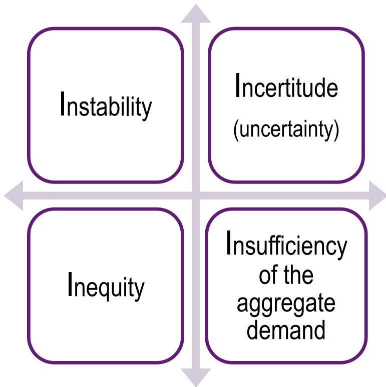

Fig. 1. The "4 I's" of the current international monetary regime.

1. The negative externalities of the international monetary regime: The "4 I's" approach (instability, incertitude, inequity, and insufficiency of the aggregate demand)

The four negative externalities generated by the international monetary system are the following: *instability*, the rise of *incertitude* (uncertainty), *inequity*, and the *insufficiency* of the aggregate demand (Fig. 1).

The first "I" characterizes the instability of the international monetary system: the volatility of the exchange rates obviously, but also the financial instability that is inherent in the dynamics of international indebtedness. The rise of major global imbalances, that is to say, the accumulation of significant current account surpluses for some countries (China, oil exporting countries, Germany), and significant current account deficits for others (mainly the United States), forms the main vector for this international financial instability, and leads the main international monetary powers to engage in a "currency war".

The second "I" is related to the incertitude – or uncertainty – generated by the supremacy of the US dollar at the international level: incertitude concerning the supply of international liquidities, as put forth by the Belgian economist Triffin in the 1960s, via the "dilemma" that is now associated with his name. When the currency of a country is also used as the main international currency, the world becomes prisoner of the position of the balance of payments of that country. When the supplier of the international currency is in a surplus situation with the rest of the world, then there is a shortage of international liquidities that might compromise the development of international trade. On the other hand, when the supplier of the international currency operates with a deficit, it helps to supply the rest of the world with the means for international payment; but at the same time it undermines confidence in this monetary instrument. Today the external position of the United States being in deficit poses the question of the sustainability of this imbalance and the future stability of the US dollar exchange rate. There is thus a great uncertainty about the future value of the US dollar.

The third "I" refers to the inequity of the current international monetary system. The United States benefits from an "exorbitant privilege" (Eichengreen, 2011). They can borrow, in an almost unlimited way, in their own currency. Their debt is absorbed by the need for international trade. We say here *almost* unlimited however, because this can only work if the dollar inspires confidence and remains the international currency by its continuing acceptance by others. In the case of dollars leaving the United States, there is no payment, meaning no liberation of debt, but rather the dollars generated for the rest of the world are nothing but a simple IOU universally accepted. . . for the moment. On the other hand, small countries, particularly emerging and developing countries, cannot borrow, and generate debt in their own currency. This is the "original sin", a syndrome highlighted by Eichengreen et al. (2003) and Ponsot (2015). These countries must thus borrow in other currencies, which subjects them to exchange rate risk, and greatly constrains them for financing. They must voluntarily accumulate unreasonable amounts of currency reserves in dollars, as a precaution, to anticipate against financial crises, and speculative attacks. This process is very costly in terms of growth (Rodrik, 2006).

Inequity also means that the distribution of power in international monetary relations is not optimized. International monetary power is asymmetric.[1] More particularly, the hierarchy of currencies in the world system means that the issuer of the "top currency" has the ability to delay and deflect the burden of adjustments to external balances (Cohen, 2011, 169). The hegemonic position of the US dollar structures the world economy in such a way that the United States determines the international transmission mechanism for global economic activity (Fields, 2015).

The burden of external balances is also related to the last "I", concerning the insufficiency of aggregate demand. The current international monetary regime generates a deflationary bias on the global economy, creating a sub-optimal growth level at the expense of the aggregate demand and also affecting the level of unemployment. The weight of adjustments in

[1] For a stimulant and collective analysis of international monetary power, see Andrews (2006).

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