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The Influence of the Euro in Reshaping Global Monetary Governance: Perceptions from financial elites in Brazil and China

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Abstract: *This article examines the ways in which key emerging market financial elites assess Europe's monetary power in the reconfiguration of the U.S. dollar-dominated monetary system. Interviews with public and private financial actors in China and Brazil record that while Europe's debt markets are limited by their size, and hence the material impact of the euro is restricted, the ideational effects are considerable. The findings show that even if the euro does not appear to be replacing the dollar as the main international currency, the European Monetary Union (EMU) is an example for regional and even world monetary integration. Chinese and Brazilian elites applaud European efforts to create a more multilateral and regulated financial system. In this sense, EMU has significant influence, and hence potential for global reach. However, this study also notes that this projection requires greater political coordination of exchange rate policy in order to fully realise its material impact in global monetary governance.*

I Introduction

The financial crisis, which started in August 2007, triggered by the sub-prime mortgages meltdown in the United States has changed the monetary landscape of the world. As a result, the U.S. model of highly leveraged financial innovation has received a serious blow. Indeed, the era of ever-increasing deregulation and securitisation in financial markets seems to have reached its limits. Policy makers around the world have recognised the dangers of this approach and have called for the creation of a new financial architecture, which should be better regulated, better supervised and better coordinated with a more 'visible hand.'

The forum of G20 major economies has now replaced the outdated G7-G8 as the place to discuss and coordinate macroeconomic policies. As the crisis has hit predominantly the most financially sophisticated economies, the United States and the European Union, the BRIC states (Brazil, Russia, India and China) have acquired greater relevance in the reconfiguration of the international financial system. The theoretical implications of this outcome are particularly important and give greater weight to the

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decoupling theory.[1] Previously, when the United States sneezed, the EU would get a cold, and the emerging markets would suffer fever. On this occasion, with the shield of the euro, the euro zone by large has weathered the storm better than in previous shocks, and the BRIC countries seem to have come out of the turmoil with minor recessions, in the case of Brazil, or just with small decelerations, in the case of China. The United States is gradually losing its reputation as world centre of economic growth.

One effect of this decoupling is that the BRIC states are increasingly questioning the U.S. dollar as the leading currency in the international monetary system. Never before have financial elites from emerging markets spoken out so clearly against the dominance of the 'greenback' in the world economy. Surprisingly, the fiercest criticisms are coming from Chinese officials, who until recently had been silent on this highly sensitive topic. One cannot forget that China is the biggest creditor of the United States, with close to $2.5 trillion in foreign reserves.[2] It is, therefore, in its own national interest to avoid putting even more pressure on the U.S. dollar, already immersed in a long-term decline spiral.[3] The recent questioning is, therefore, a marked development.

One of the necessary features of an international currency is that it needs to be stable. As anchor and central point of the system, any disruption and volatility that it produces sends shock waves throughout the world economy. This is what is happening in this crisis and what explains the complaints of BRIC officials. For them, the current arrangement is not optimal. It is disruptive. They would like to create a monetary system that can provide more stability to the whole structure.

The obvious consequence of these developments is to look for alternatives to the dollar standard. And so far, the only feasible international alternative is the European single currency. European Monetary Union (EMU), which has recently celebrated its 10th anniversary, is generally seen in emerging markets as a success story by academics and market players alike. Despite the financial turmoil caused by Greece's and other Mediterranean countries' debt problems, the euro's internal and external achievements need not to be underestimated. The much feared transition phase from several national monies to one supranational currency, with a supranational central bank, went smoothly; trade and financial integration has not been as speedy as desired but it has certainly deepened, and most importantly, in the decade before the crisis inflation targets, job creation and per capita growth have been better in the euro zone than in the United States.[4] As recognition of these achievements, externally, the euro has consolidated itself as the second most used currency in the world, and it is widely seen as the only competitor to the U.S. dollar.[5] Even in the midst of its biggest crisis, with

[1] See J. O'Neill, 'The New Shopping Superpower', *Newsweek*, 21 March 2009 and 'Counting Their Blessings', *Economist*, 2–8 January 2010.

[2] The latest account of Chinese foreign exchange reserves provided by the State Administration of Foreign Exchange (SAFE) is from March 2010 and gives the figure of $2447.084 billion, available at http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_detail_en.jsp?ID=30303000000000000,19&id=4.

[3] See D.P. Calleo, 'Twenty-First Century Geopolitics and the Erosion of the Dollar Order', in E. Helleiner and J. Kirshner (eds), *The Future of the Dollar* (Cornell University Press, 2009), at 164.

[4] For a scholarly review on the performance of the euro, see J. Pisani-Ferry and A.S. Posen, *The Euro at Ten: The Next Global Currency* (Peter G. Peterson Institute for International Economics and Bruegel, 2009). For a market perspective, see Goldman Sachs European Economics Group, *The Euro at Ten: Performance and Challenges for the Next Decade* (Goldman Sachs, 2008).

[5] For the possibility of the euro challenging the dollar, see M. Chinn and J. Frankel, 'Why the Euro Will Rival the Dollar', (2008) 11(1) *International Finance* 49.

newspaper headlines announcing the imminent break up of the union on a daily basis, the European currency holds steady at above $1.30. This is a clear proof of resilience.

The effects of money, however, go beyond sheer numbers. Historically, national monies used abroad have always functioned as an extension of sovereign prestige, reputation and influence. They represent better than anything else international monetary power. How does this model apply though to the euro, a transnational currency without a sovereign state behind it? How do financial elites in emerging markets, especially in the BRIC countries, perceive EMU? Do they see the inherently multipolar euro system as an alternative to the unipolar dollar system? If so, how do they perceive and understand Europe's influence in reshaping global monetary governance?

This article seeks to answer these questions by drawing on primary fieldwork based on interviews with financial elites in Brazil and China. The literature in this field has produced major studies in international monetary power theory.[6] It has also analysed U.S. international monetary and financial power in detail.[7] Recent works have focused on the future of the dollar, pointing to its strengths and challenges ahead.[8] Others have exposed deductively the structural and institutional weaknesses of the euro zone.[9] Some have even provided detailed accounts on how European monetary influence is translated into global governance institutions.[10] Alain Hervé's contribution to this special issue focuses precisely on this topic.[11]

In recent years, broader International Relations studies have also started to explore how emerging markets perceive the EU as a whole.[12] Some of them have even focused their attention on Brazil and China, the two case studies here covered.[13] However, none of the earlier studies have focused their attention specifically on how financial elites in emerging markets intersubjectively perceive European monetary power in the reconfiguration of the international financial system, in general, and in global monetary governance, in particular. This contribution seeks to fill this gap through an empirical investigation.

The article is structured in four sections. The first deals with the theoretical aspects of international currencies and international monetary power. The second presents the methodological tools used for this research. The subsequent, larger, section focuses on the fieldwork results. It has three subsections. The first sheds light on why Brazilian and

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6 See D.M. Andrews (ed), *International Monetary Power* (Cornell University Press, 2006).

7 See L. Seabrooke, *US Power in International Finance: The Victory of Dividends* (Palgrave Macmillan, 2001); and L. Panitch and M. Konings, *American Empire and the Political Economy of Global Finance* (Palgrave Macmillan, 2009).

8 See the special edition dedicated to the dollar in (2008) 15(3) *Review of International Political Economy*; see also E. Helleiner and J. Kirshner (eds), *The Future of the Dollar* (Cornell University Press, 2009).

9 See B.J. Cohen, 'Global Currency Rivalry: Can the Euro Ever Challenge the Dollar?', (2003) 41(4) *Journal of Common Market Studies* 575; and also A. Cafruny and J.M. Ryner, *Europe at Bay: In the Shadow of US Hegemony* (Lynne Rienner, 2007).

10 See J-V. Louis, 'The International Projection of the Euro and the International Monetary System', in M. Telò (ed), *The European Union and Global Governance* (Routledge, 2009), at J-VL 64.

11 A. Hervé, 'La représentation de l'Union au sein des instances économiques internationales', presented at 8th WISH Workshop, ESSCA, Angers, 26 February 2010.

12 See the contributions in (2007) 12(3) *European Foreign Affairs Review*, especially S. Lucarelli, 'The European Union in the Eyes of Others: Towards Filling a Gap in the Literature', 249.

13 For Brazil, see A. Klom, 'Mercosur and Brazil: A European Perspective', (2003) 79(2) *International Affairs* 351; and also A. Poletti, 'The EU for Brazil: A Partner Towards a "Fairer" Globalization?' (2007) 12(3) *European Foreign Affairs Review* 271. For China, see D. Shambaugh, E. Sandschneider and H. Zhou (eds), *China-Europe Relations* (Routledge, 2008).

Chinese financial elites are calling for the end of dollar dominance in the international monetary system. The main reasons for their discontent are linked to the volatility associated to the dollar standard and to the structural deficits of the United States, aggravated in the current crisis.

Despite these weaknesses, the second subsection demonstrates that for the financial elites in Brazil and China, the euro is no alternative to the greenback as central anchor of the system. The euro lacks liquidity in debt markets because of its political fragmentation, and hence its material capacities are limited. Notwithstanding these shortcomings, one of the unexpected results of this research is the ideational impact that the euro has had in Brazil and China. The euro is seen as a role model for regional and even global monetary integration. EMU is considered a harbinger for a more stable and multilateral financial system, and in this regard, the influence of European monetary power is larger than expected.

The third and last subsections, however, show that this influence is not used efficiently enough when it comes to reshaping global monetary governance. This is especially true in regard to creating a more stable and coordinated international exchange rate regime. By not having a common exchange rate policy on the euro, the Europeans are unable to take a more active role in international negotiations on this matter. As the concluding section highlights, this means that the Europeans are losing their leading position in the race for reshaping an increasingly multicurrency monetary system.

II International Currencies and Monetary Power

The debate on international monies and international monetary power is not new. Scholars in International Economics and International Political Economy (IPE) have provided numerous analyses of these concepts.[14] In recent years—perhaps as a consequence of the debilitation of the dollar—a number of contributions have revived this debate. Two edited volumes have influenced this research,[15] especially the contributions of Benjamin Cohen[16] and Eric Helleiner,[17] who both follow Susan Strange's footsteps in analysing international monetary affairs from the perspective of IPE. In this context, money is not only seen as a neutral instrument used by market forces to cover the three main roles associated to money: as unit of account, medium of exchange and store of value. Money is also understood as a political tool to obtain sovereign goals. It can also be used to force other states to do things that they would not otherwise do. In this regard, money is essentially *power*. And if its use and influence transcends borders, then it becomes *international power*.[18]

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[14] See B.J. Cohen, *The Future of Sterling as an International Currency* (Macmillan, 1971); C. Kindleberger, *International Money* (George Allen & Unwin, 1981); S. Strange, 'Still an Extraordinary Power: America's Role in a Global Monetary System', in R.E. Lombra and W.E. Witte (eds), *Political Economy of International and Domestic Monetary Relations* (Iowa State University Press, 1982), at SS 73.

[15] See special issue (2008) 15(3) *Review of International Political Economy*; also Helleiner and Kirshner (eds), *The Future of the Dollar* (Cornell University Press, 2009).

[16] B.J. Cohen, 'The Macrofoundations of Monetary Power', in D.M. Andrews (ed), *International Monetary Power* (Cornell University Press, 2006), at BJC 31.

[17] E. Helleiner, 'Enduring Top Currency, Fragile Negotiated Currency: Politics and the Dollar's International Role', in E. Helleiner and J. Kirshner (eds), *The Future of the Dollar* (Cornell University Press, 2009), at EH 69.

[18] S. Strange, *States and Markets* (Continuum, 1994).

A Defining International Currencies

How does a currency become an international currency? The literature in economics agrees broadly on five main factors: (1) large economic size; (2) a well-developed financial system; (3) confidence in the currency's value; (4) political stability; and (5) network externalities.[19] To simplify matters, Eric Helleiner reduces these factors to three: (1) confidence; (2) liquidity; and (3) transnational networks. Indirectly, politics can affect the main economic determinants through several aspects. Confidence in a currency can be sustained by economic factors and also by 'the broader international security power of the issuing state'[20] or by 'a consistent conservative monetary policy that is credibly embedded within domestic politics and institutions.'[21] The former is epitomised by the U.S. military power, while the latter by the unique anti-inflation stand of the European Central Bank.

Politics also matters in the creation of well-developed financial markets. With the launch of the Financial Services Action Plan—which began its implementation phase in 2004—the European Commission has shown great commitment in creating a more integrated pan-European financial market.[22]

Finally, transnational networking can also be enhanced indirectly by the political behaviour of governmental authorities. These public institutions can help open up new markets through diplomatic negotiations; they can increase governmental aid to key regions, and they can spread their own clearing and payments systems to further encourage the use of their respective currencies. As Helleiner suggests, 'European political initiatives to make euro-based clearing and payments systems as attractive as their dollar counterparts will play a significant role in influencing the euro's ability to challenge the dollar's international position.'[23] The consolidation of a European clearing system for derivatives in the euro zone is a significant move in this direction.[24] Stefano Pagliari, another contributor to this issue, elaborates further on this topic.[25]

Politics also has direct influence on the use of an international currency. To clarify this point, it is helpful to recall, as Helleiner does, Strange's taxonomy of international currencies, which is deliberately both political and economic 'consciously regarding the two as inextricably intermixed.'[26] Strange identifies four types of international currencies: (1) *top currency*; (2) *master currency*; (3) *neutral currency*; and (4) *negotiated currency*. The direct influence of politics in the master currency is obvious because Strange refers here to a *de facto* territorial domination or protection of one state by the issuer state of the master currency. A top currency, in contrast, acquires this privileged status mainly because of economic factors. It may be defined as 'the currency that has

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[19] G. Galati and P.D. Wooldridge, *The Euro as a Reserve Currency: A Challenge to the Pre-eminence of the US Dollar?*, (2006), Bank for International Settlements Working Papers 214.

[20] E. Helleiner, 'Political determinants of International Currencies: What future for the US dollar?', (2008) 15(3) *Review of International Political Economy* 358.

[21] *op cit*.

[22] See especially the directive on markets in financial instruments (MiFID), Directive 2004/39/EC.

[23] Helleiner, 'Political determinants', 359.

[24] See the European Commission's communication: 'Ensuring Efficient, Safe and Sound Derivatives Markets: Future Policy Actions', COM(2009) 563 Final, 20 October 2009; see also J. Grant, 'ECB Urges. Expansion of Eurozone OTC Clearing Effort', *Financial Times*, 4 September 2009.

[25] S. Pagliari, 'Who Governs Finance? The Shifting Public-Private Divide in the Regulation of Derivatives, Rating Agencies and Hedge Funds', presented at the 8th WISH Workshop, ESSCA, Angers, 26 February 2010.

[26] S. Strange, 'The Politics of International Currencies', (1971) 23(2) *World Politics* 217.

world economic leadership, the currency of the predominant state in the international economy.'[27] The dollar has certainly deserved this status during many decades. It is to be seen whether it can maintain it.

The best example of a neutral currency is the Swiss franc, which is a stable currency with its own attractiveness, especially in market turmoil, but which has no aspirations or means to become *the* international currency.

Finally, the last and, for this article, the most interesting type of international currency, is the negotiated one. In this case, the issuer of the master currency or top currency loses military and/or economic might and has to induce other states to keep using its currency through aid packages, promises of market access, military protection or a greater say in world affairs. In this case, politics comes very much to the forefront.

It is worthwhile noting here that Strange did not see these categories as rigid. One currency can, in some areas, be a negotiated currency and, in others, a top or neutral currency. This flexibility is very useful to analyse current events. The dollar is, in most cases, still a top currency because it is issued by the strongest economy of the world. But it can also start looking like a negotiated currency when BRIC officials call for its substitution as the anchor of the monetary system. The euro, on its part, is seen as a top currency in its regional sphere of influence (mainly Central and Eastern Europe, and francophone Africa), but so far, it is no more than a neutral currency in parts of the world still very dominated by the greenback, such as Latin America and Asia.

B Defining International Monetary Power

International monetary power, as defined by Benjamin Cohen, 'consists, first and foremost, of a capacity to *avoid* payments adjustment costs, either by delaying adjustment or by deflecting the burden of adjustment on to others.'[28] States with great international monetary power are able to delay the adjustment of their imbalances for several decades. This is what the United States has been doing due to the centrality of the dollar and Wall Street in the international monetary system. The United States has had the 'exorbitant privilege' to increase its fiscal and current account deficits since the 1970s without major costs. Hence, thanks to the U.S. international monetary power, U.S. citizens have been able to live well beyond their means.

However, sooner or later, adjustment will come. The fruits of international monetary leadership are not indefinite. Yet when adjustment finally comes, a state with international monetary power is able to deflect the burden of adjustment partly upon others. This is what the United States has been trying to do. The current financial crisis is partly consequence of the huge imbalances generated in recent years between deficit (United States, UK, Spain) and surplus (China, Germany, Japan) countries.[29] The crisis should have hit only, or at least at its hardest, the United States, epicentre of the turmoil. Yet, through its monetary power, the United States has been able to deflect some of the adjustment costs to other parts of the world. This is a fact. The consequences are visible everywhere. The question is how much of the cost will be deflected. So far, it is too soon to provide a final answer. The aim here is just to illustrate the deflection mechanism.

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[27] *ibid*, 221.

[28] Cohen, The Macrofoundations.

[29] See M. Wolf, 'How Imbalances Led to Credit Crunch and Inflation', *Financial Times*, 17 June 2008, and M. Wolf, 'Global Imbalances Threaten the Survival of Liberal Trade', *Financial Times*, 2 December 2008.

In Cohen's framework, both the power to delay and the power to deflect are based on more technical macroeconomic variables beyond the scope of this work. What needs to be mentioned here is that they are constructed upon two broader and underlying aspects on which monetary power is based: autonomy and influence. 'The more familiar of the two is the dimension of *influence*, defined as the ability to shape events or outcomes. In operational terms, this dimension naturally equates with a capacity to control the behaviour of actors—'letting others have your way,' as diplomacy has jokingly been defined.'[30] Here again, the United States provides the best example. For several decades, policy makers in Washington have been able to determine and influence financial practices (securitisation and financialisation), and macroeconomic policies and coordination (free capital flows) around the world, in what has been known as the 'Washington Consensus' in global financial governance.

Autonomy, on the other hand, has to do with the capacity of an actor to freely decide its own monetary policy, and hence be more insulated from external threats. 'In this sense, power does not mean influencing others; rather, it means not allowing others to influence you—others letting *you* have your way.'[31] The euro has precisely offered this kind of autonomy and protection to the euro zone countries. Had they not united their national monies in a common currency as they did a decade ago, the ferocity of the current financial turmoil would have sparked major exchange rate volatility in the continent as it happened in previous crises. Weaker economies within the monetary bloc with weaker currencies (the so-called PIIGS, Portugal, Ireland, Italy, Greece and Spain) would have suffered the same devaluations experienced during the crisis by Central and Eastern European, non-euro zone, EU countries.[32]

As Cohen points out, the euro has improved credit and liquidity facilities for euro zone members, again especially for the weaker ones. Public debt bond spreads between German, and other members' bonds have narrowed through EMU. Portugal, Italy, Greece and Spain have not only been able to finance their public debts at lower costs, they have also done so in their own currency, enhancing in this way the group's power to delay their structural adjustments. As mentioned before, adjustment always comes, and similar to the case of the United States, most of these countries now have to confront the adjustment process, some of them the hard way, with massive unemployment in Spain and skyrocketing public debt in Greece. This, however, does not take away the broader gains obtained through EMU membership. The political elites in these countries are aware of this. They know that current fiscal problems, whatever the difficulties, are easier to resolve inside than outside EMU.

The example of Greece shows that international monetary autonomy is not the same as international monetary influence. The latter implies the former, but the former does not lead to the latter. For Cohen, with the consolidation of EMU, the euro zone has undoubtedly achieved greater autonomy, which in itself brings what he calls *passive* influence because others, mainly the United States, are affected by its autonomy gains, but it has 'conspicuously failed to convert its enhanced autonomy into greater capacity for control in monetary affairs.'[33] The EU is punching way below its weight in global monetary governance. Despite their combined economic strength, the Europeans are

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30 B.J. Cohen, 'The International Monetary System: Diffusion and Ambiguity', (2008) 84(3) *International Affairs* 456.

31 *op cit*.

32 See P. Turgut, 'The Economic Crisis Hits Eastern Europe', *Time Magazine*, 25 February 2009.

33 *ibid*, 459.

still incapable to influence macroeconomic coordination and financial crisis management policies on a world stage. They have acquired new power, but they are not able to project it efficiently.

This is Cohen's conclusion on European monetary power. In the next sections of this article, I will try to find out whether his argument is validated or rejected by the financial elites of key emerging markets. I want to explore how they perceive European monetary power and its projection. However, instead of putting forward a structural and deductive analysis, as Cohen does, my approach follows rather an inductive and agential line. The aim here is not to measure quantitatively European monetary power; it is to grasp how European international monetary power is intersubjectively perceived and narrated by Brazilian and Chinese financial elites.

III Methodology

The hermeneutical nature of this study demands a brief summary of the methodological tools used for this research. The core of the material comes from semi-structured financial elite interviews[34] undertaken during the summer of 2008 in Brazil (n = 11) and the spring of 2009 in China (n = 27). Further material was obtained during informal conversations, seminars and conferences, which provided essential background information. Because the literature does not provide much information on how financial elites in China, Brazil and other emerging markets perceive European monetary power, most of the evidential triangulation is based on journalistic accounts, some official documents and intra-corroboration between different interview sources.

Financial elites are defined, for the purposes of this study, as officials in the ministries of finance, central banks, big private and public banks, and members of think tanks, universities, research institutes and specialised press whose main area of expertise is finance and money. Given the sensitivity of the topic, most of the government and banking officials asked for anonymity, thus their names, positions and institutions will not be disclosed in the findings section. Names of financial institutions that participated with at least one interviewee will be provided subsequently in order to show the reach and originality of the study.

In Brazil, interviews were conducted with senior officials from the Central Bank and two of the biggest commercial banks in the country: Bradesco and Banco do Brasil. Access was also gained to officials at the two biggest public development banks: Banco Nacional de Desenvolvimento Econômico e Social (Brazilian Development Bank, BNDES) and Financiadora de Estudos e Projetos (Brazilian Innovation Agency, FINEP). In China, interviews were conducted with officials at the Ministry of Finance, the People's Bank of China (PBoC), the State Administration of Foreign Exchange and the four biggest public commercial banks in the country: Industrial and Commercial Bank of China, China Construction Bank, Bank of China and Agriculture Bank of China. It is important to note that recording was permitted in Brazil and not allowed in China (it is not custom there, especially not with government and banking officials). The conversations were mostly in-depth, insightful and friendly. In Brazil, the interviews were conducted in Portuguese, and in China, in English. Only in one occasion there was the need for a Chinese interpreter.

It is important to stress here that the aim of this research is not to discover the final and uncontested views of Chinese and Brazilian elites about European influence

[34] See L.A. Dexter, *Elite and Specialised Interviewing* (ECPR Press, 2006).

on international monetary governance. The number of interviews and the qualitative nature of the study do not provide the necessary base to reach such a conclusive and general assessment. The objective is rather exploratory and the interviews indicative. The task here is to show how a certain number of key financial elites of these two countries perceive and understand the research object. General conclusions will be put forward to summarise the research results, but the reader needs to be aware that these conclusions, and the more abstract analyses that will be offered upon them, are limited to the reduced research universe presented earlier.

IV Research Findings

A The Dollar as Negotiated Currency

One of the general findings emanating from this study is that financial elites in Brazil and China are increasingly unhappy about the performance of the U.S. dollar as the main monetary anchor of the world economy. This is hardly surprising: Chinese and Brazilian policy makers have openly shown their discontent about the dollar in recent times. One of the first public criticisms came from Chinese Prime Minister Wen Jiabao at the Chinese National Congress in March 2009 when he stated that he was 'worried'[35] about Chinese investments in U.S. assets. Only a few weeks later and just before the second G20 meeting in London, the Governor of PBoC, Zhou Xiaochuan, published an article on the reform of the international monetary system questioning the dollar and calling for the use of Special Drawing Rights (SDRs) issued by the International Monetary Fund (IMF) as the new reserve currency.[36] Since then, Chinese officials, with explicit support of other BRIC policy makers, have called for the end of the dollar as the main international currency in a number of multilateral forums.[37]

These criticisms have been confirmed by the majority of participants in this research. It is worthwhile here to refer to one explicit comment to show graphically this point. It comes from a participant of one of the commercial banks from China. Showing great command of the theoretical debates focused on international currencies, the interviewee agrees with Kindleberger when he says that the best option is always to have only one strong international currency.[38] This is the ideal situation. But then the participant asks:

> But what do we do when this system doesn't work properly? Do we stick with it? No, we have to find other solutions. The problem with the current regime is that it is too unstable. It is fine to be pegged to the anchor currency when the anchor is stable, but when the anchor begins to shake, then you jump with it and this is what we have to avoid.[39]

This participant refers here first to the peg that the Chinese authorities hold with the U.S. dollar and second to the exchange rate volatilities suffered in recent years by the greenback, which have caused big losses to Chinese exporters. This negative view on the current dollar-based system is replicated by the great majority of the participants both in China and Brazil. Exchange rate volatility is of great concern and so is the

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35 G. Dyer, 'Wen "worried" About China's US Assets', *Financial Times*, 13 March 2009.

36 X. Zhou, 'Reform of the International Monetary System', People's Bank of China, 23 March 2009, available at http://www.pbc.gov.cn/english/detail.asp?col=6500&id=178.

37 L. Thomas, 'Dollar's Dominance Under Fire at G8 Summit', *Associate France Press*, 10 July 2009.

38 See C. Kindleberger, 'A New Bi-Polarity?', in A. Clesse and R. Mundell (eds), *The Euro as a Stabilizer in the International Economic System* (Kluwer Academic Publishers, 2000), at 3.

39 Interview with author. Interview code: C-6, Beijing, 28 April 2009.

understanding that U.S. authorities just look for their own national interests when they decide their monetary policies, leaving aside their international responsibilities as the main international monetary power. This so-called 'Triffin Dilemma,' whereby 'issuing countries of reserve currencies cannot maintain the value of the reserve currencies while providing liquidity to the world,'[40] has been brought up by several financial elites, and it is one of the main points of Zhou Xiaochuan's article. Generally, the participants fear that the massive injection of liquidity by the Federal Reserve, also-called Quantitative Easing in technical terms, might trigger inflation around the world and provoke future dollar depreciation.[41] Before this occurs, multilateral cooperation is necessary, and this essentially means that the status of the dollar as the leading currency needs to be negotiated. The dollar thus becomes a negotiable currency for these elites.

These complaints about the dysfunctional performance of the dollar as the main international currency go beyond monetary issues and include also the growth model advocated by the United States in the last 30 years. For the vast majority of participants, the U.S. model based on financial innovation and strict free market competition is now severely under question. Many recognise the dynamism and innovative capacity of the U.S. economy. Almost all accept that Wall Street will remain the major financial centre in the foreseeable future. But whether it will be the locomotive and role model for growth is doubtful. The financial excesses that led to the sub-prime crisis and the consequent credit crunch have seriously damaged the reputation of the United States. Most interviewees point to the high levels of leverage used in recent years, thanks to very lax or complacent regulation and how, as a consequence of this, the United States suffers now from structural weaknesses epitomised by the huge fiscal and current account deficits that it holds. They reckon that the United States will have to go through a painful phase of de-leveraging and rebalancing, meaning that it will have to be confronted with the burden of adjustment. The so-called Bretton Woods II[42] system, whereby the United States would get in debt and be the consumer of last resort and the rest of the world would export to it, has reached its limits. A new, more regulated and more multilateral, hence *negotiated*, regime is about to emerge in the eyes of these elites.

B The Impact of the Euro

Given the discontent in relation to the dollar and the United States both in China and Brazil, one obvious corollary question is whether the euro can function as a more stable anchor in world economic affairs. The European currency has shown to be a much stronger currency than the U.S. dollar in recent years, and the European Central Bank is known for its hawkish approach in relation to price stability. Confronted with the theoretical framework presented earlier, *a priori* the euro has the potential to become one day *the* international currency. It has a large economy, almost equal to that of the United States or even larger if all EU is counted. Its financial system is not as deep and broad as Wall Street, but financial integration has been improving steady in recent years. Political stability is guaranteed with all its member states being liberal democracies with strong institutions and separation of powers, and with strong political will

[40] Zhou, Reform International Monetary System.

[41] See the editorial, 'US, a Nation on Credit', *China Daily*, 21–22 March 2009.

[42] See M. Dooley, D. Folkerts-Landau and P. Garber, *An Essay on the Revived Bretton Woods System*, (2003), Working Paper 9971, National Bureau of Economic Research (NBER).

to work together. And, finally, the network externality factor is strong as the EU is the biggest trade and development funding area in the world.[43]

The great majority of participants welcome the arrival and consolidation of the euro. They see it as an 'epoch marking event,'[44] as a 'success story,'[45] as a 'great monetary achievement in modern human history.'[46] They see it as an excellent alternative to the U.S. dollar, which will discipline U.S. monetary profligacy and bring more competition, and hence more efficiency to the world markets. In essence, they see it as a great opportunity for diversification. The vast majority of them assure that their central banks have increased their euro purchases in recent years. In their view, there is no doubt that the European currency has asserted itself as the second most important international currency worldwide.[47]

However, despite these praises, they do not see the euro as a real alternative to the greenback. They point to several weaknesses. First of all, they regret the lack of financial instruments denominated in euros and the fragmentation of debt markets in the old continent. They acknowledge the possibility to buy German, Italian or Spanish bonds all in the same currency, which is something positive, but they still think that these markets are too small. There is not enough liquidity.[48] As one participant from a Chinese government body put it, if the Chinese government would invest hugely in one of these bond markets, it would collapse. Yields would drop to the floor, and prices would rapidly rise. The euro is still too small to become the international currency.[49] Or put the other way round, China is too big of a player. It has too many foreign exchange reserves in dollars (roughly 65% of one total of close to $2.5 trillion, following the qualitative estimations of this research)[50] to be able to diversify aggressively into the euro. The dollar would just start a free fall, and the euro would reach unsustainable levels for European exporters, triggering a currency war.

This point was confirmed by Jamil Anderlini, the correspondent of the *Financial Times* in Beijing. He has no doubts that the Chinese have been trying to diversify away from the dollar. They do not lower the existing dollar stocks, he points out, but they diversify the new incoming reserves. To reaffirm this statement he recalls that he had heard this new policy from Zhou Xiaochuan's lips at least three times in the last 3 years. The problem is that with so many reserves coming in, China cannot move its assets anywhere small. In his view:

> The Chinese could actually destroy the yen market, easily, any kind of small market. Let's take the New Zealand dollar, for example. They could buy all New Zealand dollars in circulation in one afternoon. But that doesn't bring them anywhere. It is clear that they want to diversify, but it is very unclear how they will achieve it.[51]

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43 See EU Focus, 'EU Strategy for Trade and Development', Delegation of the European Commission to the US, March 2008, available at: http://www.eurunion.org/News/eunewsletters/EUFocus/2008/EUFocus-Trade&DevMar2008.pdf.

44 Interview with author. Interview code: C-22, Beijing, 27 April 2009.

45 Interview with author. Interview code: C-17, Beijing, 22 May 2009.

46 Interview with author. Interview code: B-5, Rio de Janeiro, 25 July 2008.

47 For diversification of central bank reserves, see J.A. Frankel, 'New Estimation of China's Exchange Rate Regime', (2009) 14(3) *Pacific Economic Review* 346; and also Y. Xie and A. Worrachate, 'Dollar Reaches Breaking Point as Banks Shift Reserves', *Bloomberg News*, 12 October 2009.

48 A 2007–2009 survey with central bank reserve managers by Central Bank Publications reaches the same conclusion. See *Handelsblatt*, 'Position des Euros als Reservewährung gefestigt', 22 March 2010.

49 Interview with author. Interview code: C-11, Beijing, 8 April 2009.

50 This is an overall estimation from all the individual estimates collected throughout the interviews.

51 Interview with author. Interview code: C-8, Beijing, 6 April 2009.

All in all, most of the participants interviewed in China recognise that their government has fallen into a 'dollar trap,' as Paul Krugman has described it.[52] They want to get out of the dollar and they are looking for ways to do so, but the euro is not seen as an alternative. It is only a neutral international currency, sometimes maybe a top currency (for diversification purposes, as a store of value), but it is still way below the U.S. dollar.

This, they think, will last until the Europeans finalise their political integration process. The second biggest weakness of the euro in their view, reinforced during this crisis, is that the euro zone has one central bank but more than a dozen ministries of finance. There is no fiscal union. Thus, it is difficult for EMU to compete with the United States, which has one currency, one central bank, one government and one treasury secretary. Most participants, especially the Chinese (interviewed later when the crisis had hit Europe more forcefully), showed their disappointment about the lack of coordination in the EU when confronting the crisis. The subsequent fall in the value of the euro and the rise of the dollar (as investors run into the safe haven of the greenback) hurt numerous Chinese investors that had bet strongly on the strength of the European currency. This made them very disenchanted with the euro. The single currency fell more than 20% as a consequence of the crisis.[53] Zhou Hong, director of the Institute of European Studies at the Chinese Academy of Social Sciences, one of the research institutes closest to the Chinese Government, explains the feelings of her countrymen and women in relation to the European currency.

She recalls chronologically how, at the start of EMU, her institute had to do a lot of lobbying in policy-making circles to highlight the benefits of the European currency for China. Back then, the euro was depreciating, and many in China had doubts about its future. After a shaky start, the euro became stronger, overtook the greenback and the doubts disappeared. Many in the government praised her vision, and the euro became to be seen as a good alternative. Now, however, in the midst of the crisis, doubts have been emerging again. There have been even rumours that the euro zone might break up.[54] Zhou, nonetheless, does not believe in this outcome. She dismisses it as US-led scaremongering. As most participants in this research, she thinks that this crisis will actually trigger further political integration in Europe.[55] There is no other way out, despite the difficulties that countries, such as Greece, have to go through. For her, as for most interviewees, EMU is an irreversible achievement that has already become a role model for monetary integration in different regions around the world.[56]

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52 P. Krugman, 'China's Dollar Trap', *New York Times*, 2 April 2009.

53 At the peak of the crisis (end of summer 2008), the euro went from 1.5990 to the U.S. dollar (15 July) to 1.2460 (27 October). Data obtained from the European Central Bank, available at: http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-usd.en.html.

54 One year after the interviews were conducted in China, these rumours have intensified further in recent months with the deterioration of the Greek debt crisis. However, in the author's view, the general assessment of these elites remains positive on the future outlook of the euro. The interviewees would point to the financial difficulties of the southern members of the euro zone already in spring 2009, but at the same time, they would also show their confidence in the euro zone's determination to come up with legal mechanisms for fiscal emergency help and future fiscal coordination.

55 By the time of writing, the euro zone member countries have agreed an extensive rescue package for Greece, and in their official statement released on 25 March 2010, they have committed themselves to establish a task force to study possible mechanisms to strengthen euro zone economic coordination and governance. Establishing a European monetary fund is one of the options on the table, see W. Schäuble, 'Why Europe's Monetary Union Faces its Biggest Crisis', *Financial Times*, 11 March 2009.

56 Interview with author. Interview code: C-25, Beijing, 23 April 2009.

C The Ideational Influence of the Euro

This is a facet of the euro that started to emerge in Brazil when interviewing financial elites there, and that gained strength as a concept throughout the research in China. The impact of the euro in Brazil and China has not been material. Brazilian and Chinese financial leaders are not considering selling their dollars and buying more euros. Some might do so. Some exporters might even start issuing their contracts in the European currency, especially when exporting to EMU countries. But so far, these are minor trends. What has had bigger repercussions is the idea of establishing some sort of regional monetary cooperation, or even union, to be better protected against the instabilities inherent in the dollar standard regime. Hitherto, the material impact of the euro is marginal; meanwhile, the *idea* of the euro has had profound effects. The great majority of interviewees would talk at length about the weaknesses of the single currency if compared with the dollar, but when asked about the achievements of the euro, Brazilian financial elites would repeat constantly that they would like to see one day something similar at Mercosur level, and Chinese financial leaders would consider it a good example: (1) for deepening monetary cooperation with their regional partners, if possible, and if not (2) for making the yuan/RMB one day an international currency equal to the dollar and the euro. In this regard, one of the unexpected findings of this research is that, drawing on the intersubjective perceptions of the participants, the euro has initiated a race of monetary regionalisation in the world. Its effects, therefore, have been more ideational than material.

This race has already started, mostly in the minds of the financial elites of emerging markets, but the first steps in that direction are already visible on the ground. Jorge Chami, Economics professor at the Federal University of Rio de Janeiro, summarises well how many of the participants see the future.

> The euro will not surpass the dollar as the main international currency. This is very unlikely. What will happen is that more such regional currencies will emerge: one more, maybe even two. The creation of several monetary blocs is a real possibility. There will be more regional cooperation and integration; something totally understandable. The world is now a much smaller place.[57]

From the information gathered throughout this research, what seems to have happened is that financial elites in emerging markets have analysed the aims and purposes of EMU. They have understood that the euro was created partly to protect European countries against shocks coming from the dollar area, and thus acquire more autonomy in financial matters. It would be foolish for them to substitute the dollar with the euro. They would still be dependent on an external currency. What they want to do rather is to create their own regional protection by cooperating further with their neighbours. In the Mercosur region, this is to be seen with the new agreement to develop trade in local currencies. This started bilaterally with Brazil and Argentina. It has shown to be moderately successful because it insulates better exporters and importers from dollar instability, and now the intention is to extend the programme to the trade bloc as a whole and to other parts of South America in the medium term.[58]

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57 Interview with author. Interview code: B-4, Rio de Janeiro, 7 July 2008.

58 See *France Press*, 'Países do Mercosul aprovam substituição do dollar em comércio', *Folha Online*, 24 July 2009, available at: http://www1.folha.uol.com.br/folha/dinheiro/ult91u599575.shtml; see also *Xinhua*, 'South American Nations to Seek Common Currency', 26 May 2008, available at: http://news.xinhuanet.com/english/2008-05/27/content_8260847.htm.

In East Asia, monetary cooperation is high on the agenda. Most of the participants in China acknowledge political rivalries among China, Japan and South Korea. However, two trends are clearly visible. One is the Chiang Mai Initiative, which might lead to an Asian monetary fund financed by ASEAN countries, and the big three: the so-called ASEAN+3 regional setting.[59] China has, for years, tried to work on Asian monetary union within these same institutional framework, but so far, the efforts have not been fruitful. As plan B, China has now embarked in a strategy to internationalise further its own currency, the yuan/RMB. It has signed currency swaps to promote the regional use of its currency with several neighbouring countries, and most importantly, it has also signed agreements with Brazil and Russia to use the yuan/RMB in bilateral trade.[60] Thus, monetary regionalisation can soon become *trans*-regionalisation.

The rationale in all these cases is always the same: to avoid dollar volatilities. The ideational influence of the euro is conspicuous. The euro has also been partly created to avoid instabilities coming from the dollar area and, as many Chinese participants point out, the European currency is, in this case, also very interesting to study because it has become rapidly an international currency, unlike the yen, which has failed in its attempt. The Chinese, in their aim to internationalise gradually their currency, would like to follow the European example and avoid the Japanese errors. In any case, Chinese financial elites are very cautious not to jeopardise regional integration through unilateral promotion of their currency. They state that both strategies are perfectly compatible. Having confronted major difficulties to achieve regional monetary integration on a multilateral level, China has now decided to kick off the process bilaterally from below. Instead of top-down, like in Europe, monetary union in East Asia might be achieved bottom-up, by showing people that it is possible on the ground.

Chinese monetary ambitions are not only regional, however; they reach to the global level, and here again the ideational effects of the euro are also visible for some interviewees. For them, Zhou Xiaochuan's proposal in favour of IMF SDR's is based on EMU. Professor Ding Yifan, director of the Development and Research Centre, a think tank directly funded by the State Council, the chief administrative authority in China, explains neatly this argument.

> Chinese people are in favour of European integration. They see it as a reference. The euro is an example to follow. Zhou Xiaochuan's proposal of an international currency has the euro as reference. If you can achieve regional monetary integration, then you can also achieve world monetary integration. The euro is a role model. If the euro succeeds, then the idea of a world currency will get even stronger.[61]

At first, linking Zhou's article about the reform of the international monetary system to euro influence seemed to be somehow overstretched. More so after learning that Professor Ding Yifan is a declared Chinese Europeanist who has spent a number of years in France. However, further evidential triangulation has increased the likelihood of this argument. Another researcher at the Chinese Academy of Social Sciences, who asked to remain anonymous, confirmed that for several years, an Italian central banker would constantly speak about SDR's and that he had entered in contact with the

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[59] See H. Gao, 'Global Dollar Standard: Challenges for Asian Financial Integration', (2008) 41 *Economic Change and Restructuring* 369.

[60] See G. Lyons, 'When "Made in China" Becomes "Paid in renminbi"', *Financial Times*, 28 April 2010; see also C. Trevisan, 'Brazil e China realizam 1ª operação financiera em moedas locails', *O Estado de SãoPaulo*, 3 December 2009.

[61] Interview with author. Interview Code: C-5, Beijing, 7 April 2009.

Chinese central bank to explain the proposal.[62] European fondness for SDR's is certainly not new as EMU expert David Marsh indicates in his latest work.[63] For Jamil Anderlini, correspondent of the *Financial Times* in Beijing, the connection makes perfectly sense. 'The euro is the only super-sovereign currency that is around, so I guess this must have had some influence on Zhou.'[64] Other participants agreed on the likelihood of this European ideational influence on Zhou, even though the majority of them did not position themselves on the matter. Evidence collected from the Brazilian interviews speaks in favour of the ideational link between EMU and the SDR proposal or any other global currency project (an option seen by many as the ideal long-term solution to exchange rate volatility). In several of the interviews, the issue of creating a global currency to stabilise the international system emerged right after asking about the impact and influence of the euro upon the monetary system.[65] This happened 6 months before Zhou published his article.

D European Influence in Monetary Governance

Assuming these ideational effects of the euro, which point to greater European monetary influence than Cohen suggests, the obvious question is: how does this translate into the new configuration of the international monetary system? Is the influence of the euro just confined to the trend of monetary regionalisation or does it go beyond that to the wider realms of global monetary and economic governance? In other words, could EMU be a role model for Brazilian and Chinese policy makers in relation to establishing a more multilateral and regulated world economy away from the Anglo-Saxon finance-led growth model, as some European leaders have recently suggested?[66]

The reactions here are mixed: some praise the continental social market model and see it as an aspiration, while others point to the low growth, low productivity and low dynamism records of the EU. Where most agree is that there is no one European model in macroeconomic policy. Germany and France are very different from Greece, Spain and Italy. The former are good examples, the latter, not as much. Most of them regret the lack of coordination in fiscal policy. Surprisingly, the great majority of interviewees would actually like to see a more unified and efficient European project, strong enough to become a more sustainable alternative to the U.S. model. But so far, this is not the case they lament. Some even highlight the fact that the Europeans actually followed the growth model of the United States by allowing their own financial intermediaries to participate from the highly leveraged and deregulated financial engineering trends emanating from Wall Street. This is the case of Cao Honghui, director of the Financial Markets Division of the Institute of Finance and Banking at the Chinese Academy of Social Sciences, who represents the Chinese governmental line of being extremely critical with the financialisation trend seen in recent decades in western markets.

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62 Interview with author. Interview code: C-25-1, Beijing, 23 April 2009.

63 D. Marsh, *The Euro: The Politics of the New Global Currency* (Yale University Press, 2009) 43.

64 Interview with author. Interview code: C-8-1, Beijing, 26 May 2009.

65 Interviews with author. Interview codes: B-1 and B-5, Brazilia, 24 July 2008 and Rio de Janeiro, 25 July 2008, respectively.

66 See G. Brown and N. Sarkozy, 'For Global Finance, Global Regulation', *Wall Street Journal*, 9 December 2009; see also L. Davies, 'Sarkozy and Merkel Tell US That Europe Will Lead Way Towards "Moral" Capitalism', *Guardian*, 8 January 2009.

> The root causes of the crisis are based on the leveraging model of the US, a model that is completely unsustainable. The Europeans however bought into this model and now they have to cope with huge losses. This has had major effects on the performance of the euro.[67]

Most of the participants, however, acknowledge that the Europeans seem to have learned from their mistakes, and they welcome their efforts to establish a more regulated international financial system through multilateral forums like the G20 and the Financial Stability Board. In this regard, almost all participants agree that the governments of China and Brazil will stand behind continental European efforts to depart from the 'Anglo-Saxon model' of laissez-faire finance.[68] This comes as no surprise as both countries have much stricter financial oversight structures than the United States and even the Europeans. Brazil praises itself for having weathered the financial crisis without major setbacks because of its strong regulatory framework based on one 'tough financial supervisory body: the central bank, and low leverage ratios and high capital requirements.'[69] In recent times, Brazil has even gone further in its control of its financial markets by introducing a tax on inflows of short-lived portfolio investments, which are considered to be destabilising for the country.[70] Chinese financial regulation is even tougher. The capital account of the country is still highly controlled. China suffers almost from over-regulation say some of the Chinese participants in this research, especially those linked to the central bank who have a much more open attitude in relation to the creation of derivative markets. This falls in stark contrast with people sympathetic with the views of the State Council, which is very reluctant to open up the capital markets in a hasty manner. In either case, though, the willingness to work with Europe to increase world financial regulation is strong.[71]

Generally, with some obvious exceptions, the Brazilian and Chinese financial elites interviewed here consider that this financial crisis has started a transition phase between U.S. unipolarity in monetary and economic matters to a more multipolar, (and hopefully) multilateral and regulated framework. For most of them, the EU model of interstate cooperation, integration and sovereignty-sharing is a good example to get inspiration from, but to achieve this, one of the first things that the EU needs to do is to unite in order to speak with one voice on the world stage, and subsequently act on what it preaches and allow more voting power for the BRIC states in multilateral institutions like the IMF and the World Bank. This is summarised by Yu Yongding, director of the Institute of World Economics and Politics at the Chinese Academy of Social Sciences (CASS) and former member of the PBoC's monetary policy committee:

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67 Interview with author. Interview code: C-2, Beijing, 19 May 2009.

68 See Y. Le Guernigou, 'Sarkozy Wants European Economic Model to Prevail', *Reuters*, 1 December 2009. The European Commission has also shown its desire to tighten the regulatory framework of the non-banking financial sector through the proposed Directive on Alternative Investment Fund Managers, COM(2009) 207 final, 30 April 2009. See for this also the contribution of Stefano Pagliari in this same issue.

69 H. Meirelles, 'Why We Need a New Global Economic Order: Brazil, the BRICs and the World Economy'. Lecture organised by the Global Economic Governance Programme, University College, Oxford University, Oxford, 3 November 2009.

70 See J. Wheatley, 'Brazil Sets 2% Tax on Capital Inflows', *Financial Times*, 20 October 2009.

71 Other authors see also the likelihood of a possible partnership between Europe and the BRICs for tighter regulation, see E. Helleiner and S. Pagliari, 'Towards a New Bretton Woods? The First G20 Leaders Summit and the Regulation of Global Finance', (2009) 14(2) *New Political Economy* 275.

> The European model of multilateral cooperation is certainly a model to work on. They have shown that it is possible. But precisely here is where the Europeans need to make the first step and allow China and other countries to get more voting powers in the IMF. I mean this reform would not affect the US; it would shift voting powers from Europe to the BRICs. It is here where the Europeans can make a difference.[72]

Once these voting imbalances are readjusted, Chinese and Brazilian elites identify several areas where major collaboration and/or partnership between their governments and the EU is possible, and even desirable, to confine U.S. dominance in financial and economic matters. But this support does not come freely. Certain Brazilian elites, for example, point to the obstacles that Brazilian exporters face in trying to enter the EU market.[73] Chinese elites on their part are keen in resurrecting long standing controversial topics like the EU arms embargo, the interference in the Tibet question and the non-acceptance of China as a market economy.[74] For them, these issues are vital to deepen further the 'strategic partnership' between China and the EU.[75]

Apart from establishing stricter international financial regulation, the interviewees would like to see further EU–BRIC collaboration on two very interrelated areas. Both connected to the idea that the dollar is becoming a negotiated international currency. The first is to work together to restrain the United States in its loose monetary policies, which have the potential to export damaging inflation around the world. This is a major concern, especially in China, where the possible future devaluation of the dollar is a national topic of debate.[76] Some participants think that the same fears are also present in Europe, where the European Central Bank is known for its hawkish attitude in relation to inflation, heritage of the Bundesbank culture of preserving price stability. One way to solve this conundrum is to establish a world currency, hence the SDR proposal of Zhou Xiaochuan. But to create momentum for this idea, the participants recognise that it needs European support. It is here where Europe, as a brokering stakeholder, might potentially have more international monetary influence than is generally perceived in the literature. In the view of Chinese financial elites, 'Europe should join in the efforts to create a more balanced and fair economic system' . . . 'If Europe and emerging economies cooperate on the issue (creating a global reserve currency), it will at least put pressure on the United States to be more prudent with its monetary policy.'[77]

However, so far the official European reaction to Zhou's proposal has been rather muted. A surprising move since, as shown earlier, the Europeans have always supported a more multilateral and coordinated monetary system based on mechanisms like the SDRs of the IMF. Asked about the European position on the topic, one official from the European Commission delegation in Beijing explained that the EC 'takes note

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[72] Interview with author. Interview code: C-22, Beijing, 27 April 2009.

[73] See A. Poletti, 'The EU for Brazil: A Partner Towards a "Fairer" Globalization'.

[74] These issues are covered extensively in D. Shambaugh, E. Sandschneider and Z. Hong (eds), *China-Europe Relations*. (Routledge, 2008). For the arms embargo topic, see N. Casarini, *Remaking Global Order* (Oxford University Press, 2009).

[75] For a compilation of key documents on EU-China relations, see F. Snyder, *The European Union and China, 1949–2008: Basic Documents and Commentary* (Hart Publishing, 2008).

[76] During the 3 months of the fieldwork period, the topic on how to better manage the huge foreign reserves of the country was covered almost on a daily basis by newspaper articles, TV programmes and academic gatherings. To give just one example, see D. Wang, 'Foreign Exchange Assets Require Restructuring', *China Daily*, 23–29 March 2009.

[77] X. Wang, 'Big Push for Global Reserve Currency', *China Daily*, 31 March 2009.

of the proposal. This is the official line sent from Brussels.'[78] This lukewarm response could be interpreted in three possibly overlapping ways.

1. The EU does not have a common position on the topic, which points to the lack of unity described by the interviewees.
2. The EU does not want to take a position that could undermine U.S. leadership in international finance. This option would point to EU subordination to U.S. hegemony.[79]
3. The EU prefers to hold its cards on the subject in order to continue with the strategy of 'quiet diplomacy,' advanced recently by Baroness Catherine Ashton, EU high representative of foreign affairs.[80]

Regardless of interpretations, the probability to influence outcomes is reduced in all three scenarios. While the BRIC countries seem to be clear on this matter, the Europeans are without voice. This weakness has been recognised by Jaques Delors, former president of the European Commission, who has criticised the lack of proposals coming from Europe on this matter.[81] The only European leader that has actually explicitly supported the idea of creating a multicurrency system is Nicolas Sarkozy, who has also shown his discontent about the volatilities in the exchange rates.[82] But this is just the French view on the matter. It does not represent the European position as a whole. The British have recognised that this is a discussion to have, but only in the very long term and the Germans have maintained their traditional low profile on politically sensitive issues like this one.[83]

As a consequence of these divisions, European monetary power is not influential enough to shield away the burden of adjustment costs deflected by the United States. By not having a united exchange rate policy for EMU and letting the euro move at the mercy of the markets, the European countries have been carrying most of the adjustment costs of China and the United States, the two main poles of global imbalances. A weaker dollar consequence of quantitative easing is beneficial for the United States because it helps to rebalance its current account deficit and de-leverage more easily. For China, this is annoying but it is not too costly because it has its currency pegged to the dollar. For the Europeans, however, the situation is far from ideal as they have to live with a strong currency—at least up to the Greek debt crisis—that hurts exporters and makes recovery in weaker economies (like the southern EMU countries) more difficult. The Greek debt problems are partly consequence of this development. To change this, the EMU troika went at the end of 2009 to China to convince the authorities there to appreciate the currency.[84] The answer that they got must be similar to that given by several interviewees throughout this research: China is not ready to appreciate its currency in a substantial manner. It will only do so when it has restructured its economy and when it has enhanced its financial markets, which are still undeveloped.

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78 Interview with author. Interview code: C-9, Beijing, 22 May 2009.
79 See Cafruny and Ryner, *Europe at Bay*.
80 See T. Barber, 'Ashton Rejects Criticism Over Lack of Experience', *Financial Times*, 3 December 2009.
81 X. Vidal-Folch, 'Si Europa no se integra, mandarán EEUU y China' (If Europe does not integrate, the US and China will lead), interview with Jacques Delors, *El País*, 6 December 2009.
82 B. Hall, 'Sarkozy Says Currency Disorder "Unacceptable"', *Financial Times*, 7 January 2010.
83 See *Handelsblatt*, 'Peking und Paris forcieren Dollar-Debatte', 9 July 2009.
84 P. Waldmeir, 'Rebuff for EU in Push for Strong Renminbi', *Financial Times*, 29 November 2009.

As one participant from a governmental body in China explained, the Chinese short-term proposal to avoid international exchange rates disruptions and introduce a more regulated system is as follows: the United States, EMU, Japan and the UK should agree to a managed-floating exchange rate band. The Chinese yuan/RMB would remain pegged to the dollar. This would hold until China develops its financial markets. Once this is achieved, the yuan/RMB will start floating, join the other strong currencies in the band and ask to be part of the IMF SDRs basket, which hopefully will become the future reserve currency.[85] Under this understanding, the ball is now in the court of the Europeans. They need to convince the other powers, especially the United States, to agree on a cooperative and coordinated arrangement. They are *a priori* the most interested and capable player to do so, and they will count with BRIC support, if needed, the participants say. Will the Europeans be able to do it? Will they have enough monetary influence to negotiate with the United States the end of the flexible dollar standard? As several interviewees pointed out, it all depends on European political leadership. European monetary power is still weak, but it does not have to stay this way forever.

V Conclusions

This article sheds light on how Chinese and Brazilian financial elites assess European monetary power in monetary governance considering two major events: (1) the consolidation of the euro as the second most important international currency; and (2) the possible reconfiguration of the international financial system as a consequence of the current financial crisis initiated in the United States. To do that, a theoretical framework has been presented in order: first, to show what type of currencies the dollar and the euro are at the moment, and second, to explain what the concept of international monetary power actually signifies. The research has primarily been based on data collected from financial elites interviewed in China and Brazil. The study is of a qualitative, interpretative and exploratory nature, and its aims and claims do not go beyond the research universe and the secondary literature provided. Despite these limitations, the findings point to some general trends and directions.

One of the main results presented is that in the eyes of Chinese and Brazilian elites, the U.S. dollar is underperforming as the main international currency. The volatilities associated to it (reinforced by the current financial crisis) are a cause of great discontent, and alternatives are needed. In this regard, the participants fall in line with public comments made by BRIC policy makers questioning openly and repetitively the supremacy of the dollar in the world system. These criticisms are not only confined to the monetary realm. The U.S. model of financial-led growth and excessive consumption is seriously under question. For the great majority of interviewees, the United States has lost its status as world beacon of sustainable economic growth. For them, this crisis is just another step in a gradual erosion of U.S. hegemony.

In this context of U.S. decline, will the euro, as major contender to the U.S. dollar, take the opportunity and replace the greenback as the main international currency? The answer from this research is a clear no. Dollar hegemony is eroding, the dollar is sliding in some areas from top currency to negotiated currency, but this does not mean that the euro is near to it. The euro is still a neutral currency outside its regional sphere of

[85] Interview with author. Interview code: C-3, Beijing, 3 April 2009.

influence. Primarily because it has a small and fragmented debt market that cannot compete with U.S. treasury bonds. Key participants in this research have pointed to these weaknesses and lamented the lack of progress in the integration of these markets, which could be a vital instrument for foreign exchange diversification and certainly a good credit facility for EU countries in need of modern infrastructure. For that, nonetheless, further fiscal (hence political) integration is needed in Europe. How European leaders solve the current debt crisis in Greece and what kind of mechanisms they set up to prevent future crises will be crucial issues in this regard. The EU has shown in numerous occasions that it needs severe crises to move forward. It is to be seen whether this crisis will trigger the same effects.

Nevertheless, one of the unexpected results of this research has been the ideational effect that the euro has had on the financial elites of Brazil and China. The example of EMU has motivated these elites to consolidate their monetary cooperation programmes or, in the case of China, start the internalisation of its own currency. The euro seems to have started a race for monetary regionalisation worldwide. One of the lessons that these elites have drawn from EMU, independently of its future, is that they are more protected from dollar volatilities if they use their own currencies. Their *autonomy* in financial matters is so enhanced. This trend, initiated by the Europeans, might actually work against them in the future if they do not unite further. By not having a clear political strategy on monetary governance, they might one day see how the BRIC states, which are individual states and not a currency union, have gained considerable ground in shaping the monetary system on the basis of using their own currencies. China has started to promote its currency in neighbouring and overseas countries, and trade between China and Brazil, two emerging economic giants, is already beginning to be invoiced in their own currencies. This is a tendency that is set to continue among BRIC states.

The EU has surely the potential to be a major force in shaping the new financial architecture. Its *influence* is not only passive, as some of the literature suggests. Its efforts in the promotion of IMF SDRs and tighter financial regulation, and especially its multilateral and cooperative institutional framework, are having impact in the minds of financial elites in emerging markets. The interview material collected for this research provides evidence of this.

However, it is true that these efforts are still fragmented and uncoordinated. Active and efficient projection of European monetary power has not been optimised. For that to happen, European states need to integrate further their macroeconomic policies and act with one voice at the world stage. Until they achieve this, their position will be weak. This is to be seen with the distribution of the adjustment costs triggered by this financial crisis. By not having a united exchange rate policy on the euro, EMU has been carrying, to a greater or lesser extent, the adjustment costs of the United States and other key economic players like China, Brazil, Japan, and others who have intervened in the exchange rate markets to devaluate their currencies. The delaying of emergency funds for Greece and the consequent drop in the value of the euro has certainly helped exporters in France and Germany, and other EMU countries, but if that was a deliberate strategy (which is doubtful), it certainly came at a huge cost, demonstrating again that the current flexible dollar standard is inherently unstable and harmful.

EMU is in this awkward situation, where it has an international currency that permits it to have greater monetary power, but it does not use its full potential. The French government seems to realise this situation. Nicolas Sarkozy has declared that in the next year, when France hosts the G8 and G20 meetings, he wants to take the issue of international exchange rate coordination seriously. The results of this research show that the BRIC states are ready to start negotiations as long as they acquire greater institutional voting power in the IMF. Quite a different matter will be for Sarkozy to convince his European partners, especially the reluctant Germans, to adopt a common position on this controversial topic in economic governance that all stakeholders agree needs to be fixed but not all want to see resolved by a more 'visible hand.'

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