Assessing Europe’s Monetary Power through the financial elites of China and Brazil

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Abstract

This paper examines the ways in which key emerging market financial elites assess Europe’s monetary power relative to the US dollar. 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 limited overseas, the ideational effects are considerable. The findings show that even if the euro does not appear to be replacing the dollar as the primary international currency, European monetary union is an example for regional and even world monetary integration. Chinese and Brazilian elites applaud and admire European efforts to create a more multilateral and regulated financial system. In this sense, European monetary union 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.


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I Introduction

The financial crisis which started in August 2007, triggered by the fallout of the subprime mortgages in the United States, has changed the monetary landscape of the world. As a result, the US model of highly leveraged financial innovation has received a blow. The five biggest American investment banks have disappeared altogether, Lehman Brothers being its greatest casualty. Indeed, the era of ever-increasing deregulation and securitization in financial markets has shown its limits. Policy-makers around the world have subsequently recognised the dangers of this approach and have called for the creation of a new financial architecture; better regulated and better supervised.

The forum of G20 major economies has now substituted the outdated G7-G8 to discuss and coordinate macroeconomic policies. Since the crisis has hit predominantly the most financially sophisticated, hence exposed, economies: the US 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 decoupling theory. Previously when the US sneezed, the EU would get a cold, and the emerging markets would suffer fever. On this occasion, with the protection of the euro, the Euro-zone has weathered the storm better and the BRICs 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.¹ The US thus appears to be losing its reputation as the locomotive of world growth.

One effect of the decoupling is that the BRIC states are increasingly questioning the US 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 to recently had been silent on this highly sensitive topic. One cannot forget that China is the biggest creditor of the US, with more than $2 trillion US dollars in foreign reserves. It is therefore in its own

national interest to avoid putting even more pressure on an otherwise already beleaguered US dollar. 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 which explains the complaints of BRIC officials. For them, the current arrangement is not optimal. It is disruptive. They would like to create a more multi-polar and multi-currency system that can provide more stability to the whole structure.

The obvious consequence of the above development this is to look for alternatives to dollar hegemony and in this case the only feasible alternative is the euro. European monetary union (EMU), which has recently celebrated its 10\textsuperscript{th} anniversary, is generally seen as a success story by academics and market players alike. Its internal achievements need not to be underestimated. The much feared transition phase from several national currencies 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 deepened; and, most importantly, in the last decade inflation targets, job creation and per head growth have been better in the euro-zone than in the US.\textsuperscript{2} Externally as well the euro has obtained major achievements. It has consolidated itself as the second most used currency in the world and it is widely seen as the only challenger to the US dollar.\textsuperscript{3}

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 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 European monetary union? Do they see the


\textsuperscript{3} 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) \textit{International Finance}, 49-73.
euro as an alternative to the dollar? Does the consolidation of the euro mean that the Europeans will have more authority to shape the new financial architecture? In essence, how do these elites perceive and understand European monetary power?

This paper seeks to answer these questions by drawing on primary fieldwork based on interviews with financial elites in Brazil, China and London. The literature in this field has produced major studies in international monetary power theory. It has also analysed US international monetary and financial power very accurately. Recent works have focused on the future of the dollar, pointing to its strengths and challenges ahead. Others have exposed deductively the structural and institutional weaknesses of the Eurozone in international economic and monetary matters. Some have even provided detailed accounts on how European monetary influence is translated into global governance institutions. In recent years broader International Relations studies have also started to explore how emerging markets perceive the European Union as a whole. Some of them have even focused their attention on Brazil and China, the two case studies here covered. However, none of the above studies have focused their attention specifically on how financial elites of emerging markets intersubjectively assess European monetary power. This contribution seeks to fill this gap through an empirical investigation.

The paper is structured in 4 sections. The first deals with the theoretical aspects of international currencies and international monetary power. The second presents the

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4 For an overview on this subject see the introductory chapter of D.M. Andrews (ed.), *International Monetary Power* (Cornell University Press, 2006).


methodological tools used for this research. The subsequent, larger, section focuses specifically on the fieldwork results. It has three subsections. The first explores whether in the eyes of Brazilian and Chinese financial elites the status of the dollar, as main international currency, and the US, as monetary leader, are contested. The second gives answer on whether the euro is an alternative to the greenback and the third on whether the EU has enough monetary influence to shape the reconfiguration of the international financial system. The fourth and last section of the paper provides the concluding remarks.

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 have provided numerous analyses of these concepts. In recent years –perhaps as a consequence of the debilitation of the dollar– a number of contributions have brought the debate again to the forefront. Two edited volumes in particular have influenced this research. Especially the contributions of Benjamin Cohen and Eric Helleiner, who both follow Susan Strange’s footsteps in analysing international monetary affairs from the perspective of International Political Economy (IPE). In this context, money is here 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.

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15 S. Strange, States and Markets (Continuum, 1994)
A Defining International Currencies

How does a currency become an international currency? The economic literature agrees broadly on five main factors: A) large economic size; B) a well-developed financial system; C) confidence in the currency’s value; D) political stability; and E) network externalities.\(^{16}\) 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 but also by ‘the broader international security power of the issuing state’\(^{17}\) or by ‘a consistent conservative monetary policy that is credibly embedded within domestic politics and institutions’.\(^{18}\) The former is epitomised by US military power, while the latter by the 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 (FSAP) –which began its implementation phase in 2004– the European Commission has shown great commitment in creating a more integrated pan-European financial market. Finally, transnational networking can also be enhanced indirectly by the political behaviour of governmental authorities. These public institutions can help to 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, ‘in the current age, 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’.\(^{19}\) The creation of a European clearing system for derivatives, for example, could be a significant move in this direction.


\(^{18}\) ibid.

\(^{19}\) ibid. 359.
Politics has also 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’.

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 world economic leadership, the currency of the predominant state in the international economy’.

The dollar has certainly deserved this status during many decades as the world locomotive of growth and consumption. But this status, as will be shown below, is now under question.

The best example of 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 paper 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 it has to induce other states to keep using its currency through aid packages, promises of market access, military protection or 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 spheres 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, but so far it is not more than a neutral currency in parts of the world still dominated by the greenback such as Latin America and Asia.

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21 ibid. 221
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’. States with great international monetary power are able to delay the adjustment of their imbalances for several decades. This is what the US has been doing due to the centrality of the dollar and Wall Street in the international monetary and economic system. The US has had the “exorbitant privilege” to increase its fiscal and current account deficits since the 1970s without major costs. Hence, thanks to US international monetary power US citizens have been able to live well beyond their means.

However, one thing is clear: sooner or later adjustment will come. The fruits of international monetary leadership are not indefinite. But when adjustment finally comes, a state with international monetary power is able to deflect the burden of the adjustment partly upon others. This is to be appreciated in today’s world. The current financial crisis is clear consequence of the huge imbalances generated in the last years between deficit (US, UK, Spain) and surplus (China, Germany, Japan) countries. The crisis should have hit only, or at least at its hardest, the US, epicentre of the turmoil. Yet, through its monetary power the US 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.

In Cohen’s framework both the power to delay and the power to deflect are based on more technical macro-economic variables beyond the scope of this work. What needs to be mentioned here is that they are constructed on 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.

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22 Cohen, ‘The Macrofoundations’
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’. Here again the US provides the best example. For several decades policy-makers in Washington have been able to determine and influence financial practices (securitization and financialization) and macro-economic policies (orthodox monetarism) around the world, in what is known as the “Washington Consensus”.

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’. 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 would have suffered the same devaluations experienced and suffered today by Eastern European, non euro-zone, EU countries.

As Cohen points out, the euro has also 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 for lower costs, they have also done so in their own currency, enhancing in this way the group’s power to delay their adjustments. As mentioned before, adjustment always comes, and similar to the case of the US, 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.

25 op. cit.
International monetary autonomy is not the same than international monetary influence, though. 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 US, are affected by its autonomy gains, but it has “conspicuously failed to covert its enhanced autonomy into greater capacity for control in monetary affairs”.27 The EU is punching way below its weight in global monetary governance. Despite their combined economic strength, the Europeans are still incapable to influence macroeconomic coordination and financial crisis management policies on a world stage under their own preferences and conditions. They have acquired new power, but they are not able to project it efficiently. This is at least Cohen’s conclusion on European monetary power. In the next sections of this paper, I will try to find out whether his argument is validated or rejected by the financial elites of key emerging markets such as Brazil and China. 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.

II 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 interviews28 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. In addition, further interviews were conducted with emerging markets specialists from the foreign exchange (FOREX) division of HSBC Bank, at its headquarters in London (n=5). Since the literature does not provide much information on how financial elites in China, Brazil and other emerging markets

27 ibid. 459
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 the institutions that participated with at least one interviewee will we 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 (CBB) and two of the biggest commercial banks in the country: Bradesco and Banco do Brasil (BB). Access was also gained to officials at the two biggest public development banks: BNDES and 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 (SAFE) in charge of managing Chinese foreign reserves; and the four biggest public commercial banks in the country: Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BoC) and Agriculture Bank of China (ABC). 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.

It is here to stress that the aim of this research is not to discover the final and uncontested views of Chinese and Brazilian elites about European monetary power. 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 above.
IV Research Findings

A The Dollar as Negotiated Currency

One of the findings from this study is that financial elites in Brazil and China are increasingly unhappy about the performance of the US dollar as main international currency and monetary anchor of the world economy. This is hardly surprising, Chinese and Brazilian government officials have shown their discontent about the dollar openly 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 clearly stated that he was ‘worried’\(^29\) about Chinese investments in US assets. Only a few weeks later and just before the second G20 meeting in London, the Governor of the People’s Bank of China (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 IMF as the new reserve currency.\(^30\) Since then, Chinese officials, with explicit support of other BRIC financially elites, have called for the end of the dollar as the main internationally currency in a number of multilateral forums.\(^31\)

These criticisms have been confirmed by the majority of participants in this research. It is worthwhile here to refer to one explicit comment just 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 explains that she/he agrees with Kindleberger when he says that the best option is always to have only one strong international currency. This is the ideal situation. But then the interviewee asks her/himself:

> 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

\(^31\) L. Thomas, ‘Dollar’s dominance under fire at G8 summit’, *Associate France Press*, 10 July 2009.
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.\textsuperscript{32}

This participant refers here first to the peg that the Chinese authorities hold with the US 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. The exchange rate volatility is of great concern and so is the understanding that US 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 \textit{Triffin Dilemma} whereby ‘issuing countries of reserve currencies cannot maintain the value of the reserve currencies while providing liquidity to the world’\textsuperscript{33} has been brought up by several financial elites and it is one of the key points of Zhou Xiaochuan’s essay on international monetary reform. Generally, the participants fear that the massive injection of liquidity by the FED, also called Quantitative Easing in technical terms, or just printing money, in standard parlance, will trigger inflation around the world and provoke a further depreciation of the dollar.\textsuperscript{34} Before this occurs, multilateral cooperation is necessary and this essentially means that the status of the dollar as the world currency is something to be debated and \textit{negotiated}. The dollar thus becomes a \textit{negotiable} currency for these elites.

These complaints about the dysfunctional performance of the dollar as the main international currency go even beyond monetary issues and reach to the growth model advocated by the US in the last thirty years. For the vast majority of participants the US model based on financial innovation and strict free market competition is now severely under question. Many recognise the dynamism and innovative capacity of the US economy. Almost for everyone there is no doubt that Wall Street will be the major financial centre in the foreseeable future. But that it will be the locomotive and role model for growth is doubtful. The financial excesses that led to the subprime crisis and the consequent credit crunch have seriously damaged the reputation of the

\textsuperscript{32} Interview with author. Interview code: C-6. Beijing, 28 April 2009.  
\textsuperscript{33} Zhou, “Reform International Monetary System”  
\textsuperscript{34} See the editorial, ‘US, a nation on credit’, \textit{China Daily}, 21-22 March 2009.
US as global economic leader. 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 US suffers now from structural weaknesses epitomised by the huge fiscal and current account deficits that it holds. They reckon that the US will have to go through a painful phase of de-leveraging, meaning that it will have to be confronted with the burden of adjustment. The so called “Bretton Woods II” system, whereby the US would get in debt and be the consumer of last resort and the rest of the world would export to it, has achieved its limits. A new, more regulated, and more multilateral, hence *negotiated*, regime is about to emerge, for these elites.

### B The Impact of the Euro

Given the discontent in relation to the dollar and the US both in China and Brazil, one obvious corollary question is whether the euro can function as a more stable alternative to the greenback in world economic affairs. The European currency has shown to be a much stronger currency than the US 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 above, a priori the euro counts with all necessary preconditions to become an international currency, even *the* international money. It has a large economy, almost equal to that of the US. Its financial system is not as deep and wide as Wall Street, but financial integration has improved considerably in recent years. Political stability is guaranteed with all its member states being liberal democracies with strong institutions and separation of powers. And, finally, the network externality factor is strong since the EU is the biggest trade and development funding area in the world.\(^{36}\)

The great majority of participants welcome the arrival and consolidation of the euro. They see it as an ‘epoch marking event’\(^{37}\), as a ‘success story’,\(^{38}\) as a “great monetary

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achievement in modern human history.” They see it is as an excellent counter-point to the US dollar, which will discipline US monetary profligacy, 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.

However, and 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 the 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. 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. Its yields would drop to the floor and prices would rise to the clouds. The euro is still too small to become an international currency. 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 over $2 trillion, following the qualitative estimations of this research) 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 heart this new policy from Zhou Xiaochuan’s lips at least three times in the last

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41 Interview with author. Interview code: C-11. Beijing, 8 April 2009.
42 The latest official account of Chinese foreign exchange reserves provided by the State Administration of Foreign Exchange (SAFE) is from September 2009 and gives the figure of: $2272.595 billion (available at: http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_list_en.jsp?id=4)
43 This is an overall estimation from all the individual estimates collected throughout the interviews.
three years. The problem is that with so many reserves coming in, at a pace of $40 billion a month, China cannot move its assets anywhere small.

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.44

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.45 They want to get out of it and they are looking for ways to do so, but the euro is not seen as an alternative yet. 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 US dollar.

This, they think, will last until the Europeans finalise their political integration process. The second biggest weakness of the euro in the eyes of the interviewees is that the euro-zone has one central bank but more than a dozen ministries of finance. In this sense, it is difficult for EMU to compete with the US who 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 European Union 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 European currency. The euro fell more than 20% as a consequence of the crisis.46 Zhou Hong, director of the Institute of European Studies at the Chinese Academy of Social Sciences, one of the

46 At the peak of the crisis (end of summer 2008), the euro went from 1.5990 to the US dollar (15 July) to 1.2460 (27 October). Data obtained from the official web page of the European Central Bank (available at: http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-usd.en.html)
state think tanks 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 would break up. Zhou, nonetheless, does not believe in this outcome. As most participants in this research, she thinks that this crisis will trigger further political integration in Europe. There is no other way out. For her, as for most interviewees, EMU is a major achievement and it is irreversible. Despite the shortcomings, its impact is so strong that it has influenced people all around the world.47

I The Ideational Influence of the Euro

This is a facet of the euro that started to come up 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 policy-makers and banking officials 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 dealing with EMU countries (a great majority of interviewees think that these is very likely and will increase in the future, with greater probability in Brazil than in China). But these are so far 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 dollar instabilities. 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 EMU if compared to the dollar, but when asked about the achievements of the European currency Brazilian

financial elites would repeat constantly that they would like to see one day something similar at Mercosur level and Chinese financial elites would consider it a good example: a) for deepening monetary cooperation with their regional partners, if possible, and if not b) 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 interviewees, the euro has initiated a race of monetary regionalization 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 (UFRJ), 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.  

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 European Monetary Union. They have understood that the euro was created 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 very successful because it insulates exporters and importers from dollar instability and now the intention is to extent the

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programme to the trade bloc as a whole and to other parts of South America in the medium term.\textsuperscript{49}

In East Asia monetary cooperation seems to develop at a slower pace. Most of the participants in China acknowledge these difficulties pointing to political rivalries between China, Japan and South Korea. However, two trends are clearly visible. One is the Chiang Mai Initiative (CMI) that might lead to an Asian monetary fund financed by ASEAN countries and the big three just mentioned: the so called ASEAN+3 regional setting.\textsuperscript{50} 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 in order to promote the regional use of its currency with several neighbouring countries and also with overseas nations such as Belarus and Argentina, and most importantly, recently also with Brazil.\textsuperscript{51} The rational 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, that 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. In the


interviews they stated 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 these 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.52

At first, linking Zhou’s article about the reform of the international monetary system to euro-influence seemed to be somehow over stretched. More so after learning that Professor Ding Yifan is a declared Chinese europeanist, who has studied and worked in France and has many European friends. 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 Chinese central bank to explain the proposal.53 European enthusiasm about SDR’s is certainly not new, as David Marsh, an expert on EMU, indicates in his latest book.54 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

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52 Interview with author. Interview Code: C-5. Beijing, 7 April 2009.
influence on Zhou. In my understanding economists such as Mundell and Stiglitz were hugely influential. They actually met with Chinese central bank officials the weekend before the publication of the article.\textsuperscript{55} Mundell is considered one of the architects of EMU, thus Yifan’s link seems not to be totally misplaced. Other participants agreed on the likelihood of this European influence on Zhou, even though the majority of them did not position themselves on the matter. Some interviewees even went so far to deny it categorically. However, they did not provide any evidence against this thesis. Evidence collected from the Brazilian interviews speaks in favour of the ideational link between EMU and SDR’s. In several of the interviews the issue of SDR’s or some sort of multi-national or supranational currency emerged right after asking about the impact of the euro in the monetary system.\textsuperscript{56} This happened 6 months before Zhou had published his article.

C European Influence in Monetary Governance

Assuming these ideational effects of the euro who 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 regionalization or does it go beyond that to the wider realms of monetary global governance and world economic activity? In essence, is EMU a role model for Brazilian and Chinese financial elites in relation to establishing a multilateral, multicurrency, more regulated and more sustainable world economy, as some European leaders have recently advocated?\textsuperscript{57} Against the backdrop of the current financial crisis, the US model of highly leveraged financial activity and consumer demand as growth engines has lost its appeal with these elites. Can Europe provide a better alternative? Is Europe able, through forums like the G20, to coordinate more efficient and sustainable macroeconomic policies around the world? Does Europe shape international monetary policies, or does it punch below its weight, as Cohen suggests?

\textsuperscript{55} Interview with author. Interview code: C-8-1. Beijing, 26 May 2009.
\textsuperscript{56} Interviews with author. Interview codes: B-1 and B-5. Brasilia, 24 July 2008 and Rio de Janeiro, 25 July 2008, respectively.
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 European Union. 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 US model. But so far this is not the case, they lament. Some even highlight the fact that the Europeans actually copied the growth model of the US by allowing their own financial intermediaries to participate from the highly leveraged and unregulated securitizing and financial engineering trends emanating from Wall Street. This is for example 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 (CASS), who in this case represents the Chinese governmental line of being extremely critical with the financialization trend seen in recent decades in western markets.

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 in to this model and now they have to cope with huge losses. This has had major effects on the performance of the euro.58

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.59 This comes as no surprise since both countries have much stricter financial oversight structures than the US and even the European countries. 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’. 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 the system. 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 familiar and 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 very possible.

Generally, with some obvious exceptions, naturally, the Brazilian and Chinese financial elites interviewed here consider that this financial crisis has started a transition phase between US hegemony in monetary and economic matters and a more multilateral, cooperative and regulated framework. For most of them the EU model of inter-state cooperation, integration and sovereignty-sharing is a good model 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 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 CASS and former member of the PBoC’s monetary policy committee:

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

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60 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.
not affect the US; it would shift voting powers from Europe to the BRICs. It is here where the Europeans can make a difference.\(^{62}\)

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 are possible and even desirable to confine US 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 to enter the EU market\(^{63}\) and Chinese elites are keen in resurrecting the long standing controversial topics of the EU arms embargo, the Tibet question and the non acceptance of China by the EU as a market economy.\(^{64}\)

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 US in its loose monetary policies, which have the potential to export damaging inflation around the world. This comes back to the Triffin Dilemma in which the monetary policies of the country that issues the international currency might work internally, for the national market, but they might not be the most efficient ones internationally, for the world economy. This is a major concern, especially in China, where the possible future devaluation of the dollar is a national topic of debate.\(^ {65}\) Some participants reckon that the same fears are also present in Europe, where the European Central Bank is known for its hawkish attitude in relation to inflation, a tendency that is heritage of the Bundesbank culture of preserving price stability at any cost. 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

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\(^{63}\) See A. Poletti, ‘The EU for Brazil: A Partner Towards a ‘Fairer’ Globalization’

\(^{64}\) These issues are covered extensively in D. Shambaugh, E. Sandschneider and Z. Hong (eds), *China-Europe Relations*. For the arms embargo topic, see N. Casarini, *Remaking Global Order* (Oxford University Press, 2009).

\(^{65}\) During the three months of the fieldwork period the topic on how to manage better the huge foreign reserves of the country was covered almost daily 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.
is here where Europe 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 US to be more prudent with its monetary policy’.

However, so far the European official reaction to Zhou’s proposal has been rather muted. A surprising move since, as shown above, the Europeans have always supported a more multilateral 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 just said that the EC ‘takes note of the proposal. This is the official line sent from Brussels’. This lukewarm response can be interpreted in three different 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 against the US in an issue that is highly sensitive for them because it goes to the core of US hegemony; option that points to EU subordination to the US described somewhere else.

3) The EU prefers to hold its cards in order to continue with the strategy of “quiet diplomacy” advanced recently by Baroness Ashton, EU high representative of foreign affairs.

Regardless of interpretations, the probability to influence outcomes is reduced. While the BRIC countries are clear on this matter, the Europeans are without voice. This weakness has been recognised recently by Jaques Delors, the former president of the European Commission, who criticises the lack of proposals coming from Europe on this matter. The only European leader that has actually explicitly supported the idea of creating a multi-currency system is Nicolas Sarkozy who has also shown his

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68 See Cafruny and Ryner, ‘Europe at Bay’
discontent about the volatilities in the exchange rates, but this is just the French view
on the matter.\textsuperscript{71} It does not represent the European position. What it demonstrates
though is that European monetary power is not influential enough to deflect the
burden of adjustment in the balance of payments between the major currency blocs.
By not having a united exchange rate policy for EMU and let the euro move at the
mercy of the markets, the European countries are actually carrying most of the
adjustment costs of China and the US. In this moment, a weak dollar is beneficial for
the US because it helps it to rebalance its current account deficit and de-leverage
more easily. For China this is fine also because it has its currency pegged to the
dollar, which is falling, and this means that it holds its competitive advantage in
exports. For the Europeans, however, the situation is not ideal since they have to live
with a high currency that drowns exporters and makes recovery in weaker economies
more difficult. To change this, the EMU troika went recently to China to convince the
authorities there to appreciate the currency.\textsuperscript{72} 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. It will only do so when it has restructured its
economy and when it has enhanced its financial markets, which are still undeveloped.

As one participant from a governmental body in China explained, the Chinese short
term proposal to avoid international exchange rates disruptions is as follows: the US,
EMU, Japan and the UK should agree to a managed-floating exchange rate band. The
Chinese yuan/RMB would be 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.\textsuperscript{73} Under this
understanding, the ball is now on the roof of the Europeans. They need to convince
the other powers, especially the US, to agree on a cooperative and coordinated
arrangement. They are 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 US the
status of the dollar as the main international currency and the reconfiguration of the

\textsuperscript{71} B. Hall, ‘Sarkozy says currency disorder “unacceptable”’, \textit{Financial Times}, 7 January 2010.
\textsuperscript{72} P. Waldmeir, ‘Rebuff for EU in pus for strong renminbi’, \textit{Financial Times}, 29 November 2009.
\textsuperscript{73} Interview with author. Interview code: C-3. Beijing, 3 April 2009.
international monetary system? 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 like this for ever.

IV Conclusions

This paper has tried to shed some light on how Chinese and Brazilian financial elites assess European monetary power considering two major events: 1) the consolidation of the euro as the second most important international currency and only challenger to the US dollar as the main international currency and 2) the possible reconfiguration of the international financial system as a consequence of the current financial crisis initiated in the US and which has jeopardised its highly leveraged financial model as paradigm for achieving sustainable economic growth. To do that, a theoretical framework has been presented in order firstly, to show what type of currencies the dollar and the euro are at the moment, and secondly to explain what 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 for future research.

One of the main results presented is that in the eyes of Chinese and Brazilian elites the US dollar is not performing well its international currency role. The volatilities associated to it (reinforced by the current financial crisis) are cause of great discontent and alternatives are needed. In this regard, the participants fall in line with public comments made by BRIC officials questioning openly the supremacy of the dollar in the world system. The criticisms are not only confined to the monetary realm. The US model of financial-led growth and excessive consumption is seriously under question. For the great majority of interviewees, the US has lost its status as world beacon of sustainable economic growth. This crisis is a clear symptom that US hegemony is eroding and that a new system is emerging.

In response to the question, “will the euro, as major contender to the US dollar, take
the opportunity and replace the greenback as 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 influence. Primarily because it has a small and fragmented debt market that cannot compete with US 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. For that, nonetheless, further fiscal (and political) integration is needed in Europe. Something that today is not very likely.

One of the unexpected results of this research, however, has been the ideational effect that the euro has had on the financial elites of Brazil and China. The successful example of European Monetary Union has motivated these elites to consolidate their monetary cooperation programmes or, in the case of China, start the internalization of its own currency. The euro seems to have started a race for monetary regionalization worldwide. One of the lessons that these elites have drawn from EMU is that they are more protected from dollar volatilities if they use their own currencies, which are now stronger because of the huge reserves that they have accumulated. Their autonomy in financial matters is so enhanced. This trend, initiated by the Europeans, might actually work against them in the future. By not having a clear political strategy of promotion of the euro abroad, they might one day see how the BRIC states have gained considerable ground in the foreign exchange markets. 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.74

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 specially

74 The Governor of the Central Bank of Brazil, Henrique Mereilles, has already confirmed that trade between BRIC nations is set to be invoiced in local currencies. See L. Rodrigues, ‘Brazil poderá ter comércio em moeda local com China, Rússia e Índia, diz Meirelles, Folha Online, 27 October 2009 (available at: http://www1.folha.uol.com.br/folha/dinheiro/ult91u643980.shtml)
its multilateral and cooperative institutional framework, are having impact in the minds of emerging financial elites. 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 is carrying to a greater or lesser extent the adjustment costs of the US and other key economic players like China, Brazil, Japan, and others who have intervened in the exchange rate markets to devaluate their currencies. 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 years 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 back him up in his endeavour, if Europe is ready to allow certain concessions in their favour. Another story will be to convince his European partners to adopt a common position on the subject. This is the greatest obstacle that he faces. Or so at least, the Brazilian and Chinese elites think.

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