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Europe in the new international monetary and financial system

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The international monetary and financial system (IMFS) is being transformed in the wake of the 2007-09 crisis. Even if Europe were not itself changing, its place in the wider international order could not help but alter. But, of course, Europe itself faces fundamental change, one way or another, in order for the monetary union to be sustainable, and that will be the deciding factor in how Europe fits into the IMFS.

This is, very likely, the last global financial crisis where the subsequent reform agenda is framed largely via deep transatlantic relationships. Already, Brazil, China, India, Mexico and others have had a seat at the table, via the G20. Next time round, they will be active, perhaps leading participants.

And next time, we might, for the first time in well over a century, live in a world with parallel reserve currencies; and in which the major banks and other intermediaries might be domiciled across the world rather than, as now, largely in the US, London, Switzerland, France and Germany. This is a world in which Europe should want to maintain a seat at the top table.

As the decades pass, the chances of doing so will, naturally, depend on developments here and, in particular, within the Continental monetary union. I give one example in this outline.

Not the least important will be the development of the euro-denominated capital market, which I deliberately put in the singular even though as of now there is plurality of euro-denominated capital marketS.

The current state of affairs impedes risk transfer within the monetary union. That is costly given the inevitability of asymmetric shocks, the limited capacity for domestic stabilisation within member states, and the political impediments to developing an EMU-wide fiscal system of some kind. Only recently have European policymakers and commentators focussed on the remarkable extent to which risk transfer within the US economic and monetary union occurs via the equity markets. Imagine that I set up a business in Massachusetts. My customers are in Massachusetts, my suppliers are in Massachusetts, all my employees are there. But my equity holders are in California. Now MA suffers a horrible local shock etc, throwing its economy into deep recession. My business goes bust. This has nasty local knock-on effects, exacerbating the downturn. But part of the costs are borne in CA. It is estimated that some 80% of US risk transfer occurs this way in normal circumstances. It is why the Capital Markets Union project is vital, urgent and needs to be ambitious.

Without measures such as this, the fault lines in the architecture of the monetary union threaten to become ruptures, and that raises the risk premium on investing in Europe. For these and other reasons, the world looks on worried, and sceptical. But a Europe with not only deep wholesale markets, which it already has, but active cross-regional investment and risk transfer could be a different matter.