

To the President of the
House of Representatives of the States General
P.O. Box 20018
2500 EA The Hague

Date: 4 September 2023

Re: Government's response to AIV advisory report no. 124, 'The euro on the world stage: the international role of the EU's currency from a geostrategic perspective'

Dear Madam President,

I hereby present the government's response to the report 'The euro on the world stage: the international role of the EU's currency from a geostrategic perspective' by the Advisory Council on International Affairs (AIV), which was published on 14 June 2023. This advisory report was drawn up by the AIV following the request for advice submitted by the government in March 2022.

The European Commission issued a communication in December 2018¹ on the same subject, which was assessed by the Working Group for the Assessment of New Commission Proposals (BNC).² In addition, the ECB publishes a report annually on the euro's international role³ and the subject is regularly on the agenda of the Eurogroup.⁴

This letter sets out a brief summary of the AIV's report, followed by an assessment. The latter comprises general remarks and an assessment of the specific recommendations.

Summary of the AIV's report

In its report, the AIV addresses the connection between geopolitical power and influence and the international use of currencies. The focus is on how the EU can strengthen its role on the world stage and/or reduce strategic vulnerabilities by increasing the international use of the euro. The AIV's key message is that the internationalisation of the euro will be a long-term investment in the resilience and autonomy of the eurozone and also of the European Union in a changing world. The AIV also considers that debate in the Netherlands regarding the future of the euro therefore merits an integrated approach, in which, besides the economic opportunities and risks, clearer consideration is given to current and future geopolitical developments.

The AIV first outlines the geopolitical context, which is characterised by China's rise and the response of the US to this development. The AIV then explains how the international use of a currency can give rise to currency power. In so doing it outlines the developments that have resulted in today's dollar-dominated international playing field. The report argues that set against such offensive currency power is the desire for autonomy and resilience in the

¹ https://commission.europa.eu/publications/towards-stronger-international-role-euro-commission-contribution-european-council-and-euro-summit-13_en.

² <https://zoek.officielebekendmakingen.nl/kst-22112-2752.html>.

³ <https://www.ecb.europa.eu/pub/ire/html/ecb.ire202306~d334007ede.en.html.2023>.

⁴ Summary of the Eurogroup meeting, Economic and Financial Affairs Council, 13-14 July 2023.

form of defensive currency power. The AIV describes the different roles an international currency can fulfil as that of a unit of account, a medium of exchange and a store of value, and the factors that determine whether a currency is used internationally. The AIV proceeds on this basis to explore the various policy options for a stronger international role for the euro. Finally, the AIV outlines a number of strategic dilemmas and formulates a conclusion.

The AIV presents eight recommendations based on its analysis. Recommendations of a more general nature are that the government should take active steps to strengthen the euro's international role in order to be better able to promote the geopolitical interests of the EU and its member states (recommendation 1) and, in so doing, demonstrate urgency and ambition, not ruling out any policy options in advance (recommendation 3). These recommendations are addressed in the government's general remarks. The AIV advocates maintaining a focus on cooperation with the US to safeguard the transatlantic relationship (recommendation 2). More specific recommendations concern greater international use of the euro as a medium of exchange through the deployment of the digital euro (recommendation 4), greater use as a unit of account in (emerging) strategic sectors such as hydrogen (recommendation 5) and greater use as a store of value by taking responsibility in international financial and currency markets (recommendation 6) and by strengthening the eurozone by completing important policy initiatives concerning the capital markets and banking unions, investing in growth capacity, and expanding the offering of safe assets (recommendation 7). Finally, the AIV advises that countries such as Denmark, Sweden and Poland be encouraged to introduce the euro in order to further increase the currency's reach and use (recommendation 8).

Government assessment

General remarks

The government appreciates the AIV's clear analysis and the recommendations that provide the government with a good starting point for weighing the various factors relevant to strengthening the euro's international role. In this regard the long-term objective must be a stronger position for the euro in international commerce and capital markets so that euro trading and European capital markets become fully fledged alternatives to the dollar.

The government shares the AIV's view that there have been various developments in recent years, including China's emergence as an economic power and Russia's invasion of Ukraine, that have heightened the need for a geopolitically stronger EU. The government acknowledges the influence of the euro on the EU's geopolitical position and endorses the recommendation to build up the currency power of the euro so that it is possible to make a full and independent contribution to stability and cooperation within the international monetary and financial system (recommendation 1). The government's primary objective in this regard is fostering the EU's growth in maturity as a geopolitical and geo-economic player by increasing the EU's open strategic autonomy,⁵ the benefits of which are shared by the Netherlands. The stance adopted by the United States on the matter of sanctions against Iran in 2018 illustrates the necessity of this. The sanctions recently imposed by the EU – together with the US among others – on Russia because of the war in Ukraine show that in exceptional cases the EU can also deploy currency power offensively.

⁵ Parliamentary Papers, 2022-2023, 35 982, no. 9.

As the AIV observes in its report, market participants themselves determine to a large extent what currency they wish to do business in. In the government's view this observation gets to the heart of what is needed to strengthen the euro's international role, namely that market participants see attractive investment opportunities in the eurozone. If they do not, they are less likely to choose the euro.

Key conditions in this regard are a large, growing and dynamic economy, plentiful investment opportunities, a deep and well developed European financial market, a high degree of legal certainty, and a high degree of political, economic, fiscal and financial stability. Without these foundations, other policy initiatives to strengthen the euro's role are less likely to succeed.

The AIV also recommends that urgency and ambition be demonstrated in the further internationalisation of the euro in order to make it possible to operate more independently in the future if geopolitical circumstances so require (recommendation 3). It argues that no policy options for strengthening the euro should be ruled out in advance. According to the AIV, options for which there is insufficient political support at present, such as common safe assets and aspects of the digital euro, may grow in utility and significance over the course of time and under geopolitical pressure.

The government does not rule out any policy option whatsoever in advance, but weighs the advantages and disadvantages of various policy options in the here and now, taking into account potential geopolitical and economic developments in the future. The impact on the international use of the euro is one of the factors taken into account. This results in the position as articulated for instance in the government's vision on the future of EMU.⁶ Because all manner of different policy options could help increase international use of the euro, choices are available.

At EU level, the Council and the European Parliament are currently studying and discussing the European Commission's legislative proposals of 28 June on a digital euro.⁷ The government sees the potential of a digital euro. A digital euro can give public money a role in the domain of digital payments; a role that does not yet exist for public money.⁸ A digital euro can also reduce dependence on foreign commercial parties. In addition, a digital euro could both compete with existing private payment options and provide a basis for the development of new private payment options. The government has set conditions for the development of a digital euro, such as with regard to safeguarding anonymity and privacy. The costs associated with a digital euro should also be in proportion to the benefits for consumers, businesses and the economy as a whole. The ECB can only proceed to issue digital euros once agreement is reached in Europe on the proposals concerning the statutory basis for a digital euro.

⁶ Parliamentary Papers, 2021-2022, 21 501-20, no. 1825.

⁷ Proposal for a Regulation of the European Parliament and of the Council on the establishment of the digital euro (COM(2023) 369) and Proposal for a Regulation of the European Parliament and of the Council on the provision of digital euro services by payment services providers incorporated in Member States whose currency is not the euro and amending Regulation (EU) 2021/1230 of the European Parliament and the Council (COM(2023) 368).

⁸ All the digital money is, after all, private money: claims on commercial banks. A digital euro can therefore add value compared with existing deposit money, which is issued by private parties and does not have the same anchor function of public money described above.

Recommendation 2: When building up the currency power of the euro, maintain a focus on transatlantic relations and continue to strive for cooperation and coordination.

In its second recommendation, the AIV addresses the transatlantic relationship and the consequences of striving more actively for a greater role for the euro for relations with the US. The government shares the AIV's analysis that major changes in the international monetary system such as the rise of China will by definition come at the expense of the dollar and will also bring costs and uncertainties in their wake. The report therefore rightly asks whether the EU should oppose such developments by standing foursquare behind the US and the power of the dollar. Especially in the context of the central role played by the transatlantic alliance and US leadership with regard to Russia's aggression against Ukraine.

The report emphasises that, at the same time, there is 'no reason to assume that building up European currency power would automatically harm the transatlantic relationship'. 'The reverse is equally likely. An internationally strong euro could boost the strategic partnership between the EU and the US.'

The government shares this analysis. It is a fact that the geostrategic interests of the EU and the US often coincide but sometimes diverge. The transatlantic relationship is vitally important to the government and to the EU and it goes without saying that the government will remain committed to cooperation and coordination with the US. The EU and the US have a common interest in a strong international legal order.

Recommendation 4: Take advantage of the opportunities for further digitalisation of the financial system: the e-€ merits a fully fledged place alongside the e-CNY, e-₹ and e-\$.

In its report, the AIV recommends taking maximum advantage of the opportunities for further digitalisation of the financial system and giving the digital euro a fully fledged place alongside the other Central Bank Digital Currencies (CBDCs). In this regard the AIV recommends placing emphasis on cross-border payment transactions between large financial institutions and service providers (the wholesale segment), thereby reducing dependence on SWIFT, and taking the geopolitical dimension into account in the design of the digital euro. The government shares the AIV's view that the digitalisation of the financial system offers opportunities and is closely involved in the development of a possible digital euro at EU level.

Since the publication of the AIV report, the European Commission's legislative proposals on the design, issuance and distribution of a digital euro have been published. The government has formulated its position on the proposals in a BNC assessment⁹ and will discuss this with the House. The government will also inform the House every month from September 2023 on developments in the EU legislative process.

The European Commission and the government see the autonomy of European payment transactions as one of the most important reasons for introducing a digital euro. The

⁹ BNC assessment on the digital euro, 18 August 2023, no. 2023Z14149, https://www.tweedekamer.nl/kamerstukken/brieven_regering/detail?id=2023Z14149&did=2023D33918.

Commission proposals focus on the digital euro as a means of payment, for both consumers and businesses. The government attaches importance to the fact that the proposal provides scope for both retail and business-to-business payments, as recommended by the AIV.¹⁰ A digital euro can help in maintaining control over European payments traffic in the future and ensuring that public money remains accessible and retains an important place in society and in the economy, supplementing cash. In this way, a possible digital euro can contribute to the EU's open strategic autonomy. As indicated in the BNC assessment, in European negotiations the government will seek to ensure that, if a digital euro is introduced, it is built upon European (payment) infrastructure, based on European legislation, and developed by European companies, and that its management is in European hands. This will make it possible to reduce dependence on commercial parties and third countries in European payment transactions, as recommended by the AIV in recommendation 4.¹¹ The government will also support options for the international use of a possible digital euro and convertibility with other currencies, as proposed by the European Commission, in order to give it full status alongside other existing or planned CBDCs.¹²

The AIV asserts that introducing a digital euro, among other things as a payment system operating in parallel with SWIFT, would lead to greater autonomy in relation to cross-border payments. Although the wording of recommendation 4 might suggest otherwise, SWIFT (Society for Worldwide Interbank Financial Telecommunication) is an international communication system for payments and not in itself a payment system. It enables financial institutions to exchange messages internationally. Based on the European Commission's proposals, however, a digital euro would not be intended and designed as a replacement for SWIFT, but as a means of payment for individuals, businesses and/or government authorities. Although a digital euro could potentially play a greater role in the monetary system, it could only do so gradually and this would take a long time. Our economy would gain nothing from a sudden full-scale introduction of a digital euro.

Besides a digital euro as a means of payment, as proposed by the Commission in its proposals of 28 June 2023, the Eurosystem,¹³ by means of TARGET services,¹⁴ gives banks the option of settling their transactions in central bank money. This is a settlement option that is also referred to as 'wholesale CBDC'. It should be stressed that this is not a legal tender means of payment for businesses (of any size) but a system for settling transactions between members of a specific group of financial institutions (TARGET participant banks). The Eurosystem is currently examining whether this settlement in the context of TARGET services can be improved on the basis of distributed ledger technology (DLT).¹⁵ The TARGET services – including the technology developed for wholesale CBDC – play an important role as regards the autonomy of the European payments architecture. The government supports this development with a view to the future-proofing of the Eurosystem,

¹⁰ Based on the Commission proposal for a Regulation on the digital euro, legal persons have access to the digital euro and digital euro payment services and may perform transactions in it.

¹¹ This is also in line with the motion submitted by MP Laurens Dassen (see Parliamentary Papers, House of Representatives, 2022/2023, 27 863, no. 125).

¹² In doing so the government will also be implementing another motion submitted by MP Laurens Dassen (see Parliamentary Papers, House of Representatives, 2022/2023, 27 863, no. 126).

¹³ The Eurosystem, which comprises the European Central Bank and the national central banks of the Member States whose currency is the euro, is the monetary authority of the euro area.

¹⁴ TARGET services are a number of services developed and operated by the Eurosystem. These financial market infrastructure services include T2 (for settling payments) and TIPS (a service for instant payments).

¹⁵ https://www.ecb.europa.eu/ecb/educational/explainers/tell-me-more/html/distributed_ledger_technology.en.html.

but emphasises that this, unlike the Commission's proposals for a digital euro, is not a political project. The TARGET services are a competence of the Eurosystem.

Both the European Commission's proposals for a digital euro as a means of payment for consumers and businesses (of every size) and the above-mentioned wholesale CBDC as a settlement system for financial institutions can contribute to the EU's strategic autonomy. The variant of the digital euro as a means of payment proposed by the European Commission cannot fulfil the role envisaged by the AIV in its fourth recommendation. However, this role can potentially be fulfilled by the Eurosystem's wholesale CBDC, mentioned above, if it becomes interoperable with similar settlement systems used in other countries outside the euro area. The government recognises the importance of the work of the Eurosystem to continue to innovate in relation to its own settlement system and will continue to monitor developments concerning wholesale CBDCs. The government will also stay closely involved in the development of a possible digital euro, in order to be able to operate efficiently and more autonomously in the future, as described in the AIV report. The government will keep the House informed of developments. At the same time, international organisations such as SWIFT will remain an important part of an effective international payment system.

Recommendation 5: Increase the role of the euro in invoicing and as a benchmark in strategic sectors such as energy/renewable energy and in particular hydrogen; whereas the 20th century fossil fuel world revolved around 'petro-dollars', there is now a place for the 'hydro-euro'.

In its fifth recommendation, the AIV advocates increasing the euro's in new emerging sectors and markets. Energy is a crucial factor for a stable economy; if energy is priced in an economy's own currency, that economy is less vulnerable to exchange-rate fluctuations than if payment has to be made in a foreign currency. Paying for strategically important raw materials such as hydrogen in euros contributes to the use of the euro by external partners and by the energy sector in Europe.

The government therefore endorses the recommendation that the use of the euro in future energy sectors is desirable. Not only because it will increase the euro's role, but also because it can contribute to the resilience of the future European economy. This is all the more important for the Netherlands given that the government, when it comes to (renewable) hydrogen imports to the EU, is aiming for as diverse a number of trading partners as possible.

The government sees opportunities to have the euro play a dominant role in transactions in the still to be developed global hydrogen market. The government therefore supports the key action formulated by the European Commission in its hydrogen strategy published in 2020 to develop a benchmark for euro denominated transactions in hydrogen. It is expected that Commission will continue these efforts through the hydrogen bank that is being established. In addition, under the German H2Global initiative in which the Netherlands is participating, which is being developed to encourage contracts with third countries for the purchase of hydrogen, it has already been proposed that transactions be conducted in euros.

But this process will be subject to certain constraints. Third countries will not automatically agree to use the euro. Their readiness to accept the euro will be determined by the extent to which they depend on trade with and investments in the US and China in other fields. The degree to which good investment opportunities exist in the EU for a surplus of euros in third countries will also play a role. This would make it more attractive to receive euros for exports of renewable energy to the EU. The factors that influence investment opportunities have already been mentioned under 'general remarks'. A greater international role for the euro cannot therefore be viewed separately from other parts of the AIV advisory report, such as improving the capital markets union and strengthening European economies.

Recommendation 6: Demonstrate solidarity with countries experiencing difficulties, take responsibility as lender of last resort in the international monetary system and contribute as an alternative safe haven to a more balanced international system.

In line with the sixth recommendation, the government is committed to making the international monetary system more resilient. In its report the AIV calls in particular for the expansion of the network of ECB swap lines beyond the EU and G7 countries to be examined. A currency swap line is an agreement between central banks to exchange each other's currencies so that they can provide their domestic banks with foreign currency in times of market turbulence. Swap lines help prevent problems in the financial markets from spilling over into the real economy when commercial banks have little or no access to a certain currency and are therefore no longer able to make any cross-border payments. Since the global financial crisis of 2008-2009, the ECB and other large central banks have been making increasing use of swap lines. The ECB belongs to a swap line network consisting of permanent bilateral agreements with five other large central banks (the Bank of Canada, the Bank of Japan, the Swiss National Bank, the Bank of England and the Federal Reserve System). In response to the pandemic, the ECB has re-activated existing swap lines with a number of central banks and established new ones.

A swap line, however, is a monetary policy instrument which the ECB uses in fulfilling its price stability mandate. In view of the ECB's independence, it is not appropriate for governments to comment on its use of its policy instruments.

The European Union also has its own instruments, separate from the ECB, that contribute to financial stability. For example, there is a balance of payments facility for EU member states outside the euro area, and the EU can extend macro-financial assistance (MFA) to partner countries experiencing balance of payments difficulties.

The member states of the Union also contribute to monetary and broader financial stability as IMF shareholders. State guarantees by the Netherlands and other countries enable the IMF to fulfil its role as lender of last resort in the global financial system. The IMF offers financial support to member states experiencing balance of payments difficulties and IMF programmes are directed at restoring financial and economic stability. Besides its regular programmes, the IMF also offers emergency funding to countries experiencing acute balance of payments difficulties as a result of shocks, such as climate disasters or sudden rises in energy and food prices due to Russia's invasion of Ukraine. Finally, the Netherlands contributes by means of loans and donations to IMF funds that provide concessional financing to low-income countries (the Poverty Reduction and Growth Trust) and financing to

help vulnerable countries build resilience to long-term macroeconomic and balance of payments risks such as climate change (the Resilience and Sustainability Trust).

Recommendation 7: Get Europe's own house in order: strengthen the euro by means of internal reforms, such as ensuring that the European financial market operates more effectively and is more resilient to stress and laying down solid macroeconomic foundations.

In its seventh recommendation, the AIV advises strengthening the euro by means of internal reforms, both in the area of the European financial markets and in the area of economic policy and solid public finances. The government fully endorses this objective and this is in line with the first building block of the government's position on open strategic autonomy. As mentioned above, market participants will make their own assessment of what currency they wish to trade or invest in and this recommendation has a direct bearing on this. Without the foundations provided by a healthy economy, supported by sound macroeconomic and fiscal policy, other policy initiatives to strengthen the euro's role will be less likely to succeed. The government has long sought to promote further deepening of the capital markets union¹⁶ and the completion of the banking union.¹⁷ As part of efforts to strengthen macroeconomic foundations, the government is committed to encouraging growth-enhancing reforms such as those currently being carried out by all member states in the context of the Recovery and Resilience Facility (RRF).

On the reform of the Stability and Growth Pact (SGP), too, the government's position is that the proposed new system should contribute to stable economic growth by means of a greater focus on the medium term, investment and reform while at the same time reducing the risks to debt sustainability. Aside from the RRF and the SGP, the government remains committed to optimal use of the European Semester, with the analysis of macroeconomic imbalances and country-specific recommendations. In this regard, primary responsibility for strengthening sustainable growth capacity and economic resilience lies with member states.

The AIV considers more safe assets in the euro area desirable. The focus in the European debate is primarily on common safe assets. The government observes that common European debt instruments already exist, such as the bonds issued by the European Investment Bank, the European Financial Stability Facility (EFSF), the European Stability Mechanism (ESM) and the European Union in the context of the balance of payments facility, macro-financial assistance to third countries, the EFSM, SURE and NextGenerationEU. As the government pointed out in its letter of 30 March 2022¹⁸ on eurobonds and common debt and in its vision on the future of economic and monetary union,¹⁹ the government is not in favour of member states' common financing of each other's budget deficits and debts on a structural basis by means of eurobonds. Nor is the government in favour of the issuance of common debt for new permanent European funds. As already indicated in the above-mentioned letter, the government considers that these instruments create a moral hazard in that they risk diminishing the incentive to pursue a

¹⁶ BNC assessment on the capital markets union action plan; Parliamentary Paper 22 112, no. 2953 (2020/2021 session).

¹⁷ See inter alia the letter on the future of economic and monetary union; Parliamentary Paper 21 501-20, no. 1825 (2021/2022 session).

¹⁸ Parliamentary Papers, House of Representatives, 2021/2022, 35 925, no. 170: Response to the motions submitted by MPs Wybren van Haga and Olaf Ephraïm against the issuance of eurobonds and other forms of debt mutualisation (Parliamentary Paper 35925, no. 167) and MP Pieter Omtzigt against common debt issuance for new European funds and projects (Parliamentary Paper 35 925, no. 169).

¹⁹ Parliamentary Paper 21 501-20, no. 1825 (2021/2022 session).

prudent economic policy and fiscal discipline. As also mentioned by the AIV, some sovereign bonds are viewed as safe assets, such as those currently issued by the Netherlands, Germany and a few other member states. The ECB's 2022 report on the international role of the euro²⁰ shows that, measured by the share of their government debt held by foreign official investors, euro area countries with a high credit rating stand comparison with the US, although in the euro area as a whole the share is considerably lower. The government sees opportunities in growth-enhancing reforms and the reform of the SGP which can give rise to improvement in the creditworthiness of national governments in the euro area and hence more European countries being assigned a high credit rating. Although this will be accompanied by a fall in the high debt levels of a number of countries, it can result in an increase in the total quantity of safe assets.

Recommendation 8: In bilateral relations and at EU level, advocate that Denmark, Sweden and Poland join the euro area.

The government shares the AIV's analysis that the accession of more EU member states to the euro area, provided they fulfil the applicable conditions, is desirable. It is moreover a step that is laid down by treaty for all member states, except Denmark. The government will, as and when appropriate, raise accession to the euro area in bilateral contacts. It must be recognised in this regard, however, that in practice joining the euro area is primarily a matter for each member state to consider at national level, with sufficient support among the population at large and in political circles in the country being essential. To date, that support appears to be lacking in the countries in question. If this were to change, for instance under the influence of the geopolitical developments outlined earlier which have also, for example, resulted in Finland and Sweden applying to join NATO after many years in which this option had not even been under consideration, the government would welcome the accession of new euro area countries.

With highest regards,

Minister of Finance,

Sigrid A.M. Kaag

²⁰ <https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202206~6f3ddeab26.en.pdf>, p.11.