

Currency Internationalisation: Analytical and Policy Issues

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Summary

Interest in currency internationalisation among policy makers as well as the general public has intensified in recent years. One reason is a view that the global impact of the recent financial crisis has been intensified because of the dominant role of the US dollar in the international financial system. According to this view the system would be less prone to instability if international trade in goods and assets were denominated in a greater variety of currencies and if international reserve holdings were more diversified. Another reason is the perception that having an international currency is associated with significant benefits for the issuing national authorities. This raises the question whether there is a case for policy intervention by national authorities to promote the international use of their currency. This paper addresses this issue. It argues that authorities should not focus their primary attention on climbing the currency internationalization charts. Instead they should consider the pros and cons of policies and institutional changes that may pave the way for the private adoption of the currency in international transactions. The reason is that full internationalization of a currency will not come about unless a certain number of pre-requisites are met. Arguably the most important is that there be no restrictions on cross-border transfers of funds and no restrictions on third party use of the currency in contracts and settlements of trade in goods or assets, and no restriction on including assets denominated in the currency in private or official portfolios. In short, full internationalization of a currency requires full capital account liberalisation.

Although there are gains from currency internationalisation, it is an open question whether public policy should attempt to promote it beyond establishing preconditions such as full capital account liberalisation, a deep and dynamic domestic financial market, a well-respected legal framework for contract enforcement, and stable and predictable macro and micro economic policies.