L.5.2 RFD 305

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 3, 1958

A Common Currency For The Common Market? 24 pages

Ralph C. Wood

NOT FOR PUBLICATION

This Review is intended primarily for internal circulation and should in no case be cited or quoted. It consists of personal and informal contributions by the author, which in many cases represent tentative analyses of the subject considered.

June 3, 1958

A Common Currency For The Common Market? — Ralph C. Wood

Since the beginning of the European Recovery Program (the "Marshall Plan") a decade ago, there has been sporadic suggestion of a common currency for Europe. 1/ The suggestion has been made most often in connection with proposals or programs for some form of European "integration," and the concept of European integration has been increasingly identified with what is now known as the "common market" approach; it is therefore not surprising that there have been increasingly-frequent references to the common-currency idea during the past two or three years, during which time the European Economic Community 2/ suddenly became a practical possibility and, later, an existing fact.

One of the most recent notable allusions in this country to the idea of a common currency in Europe was made by former Secretary of State Dean Acheson in a speech in Kansas City, Missouri, on April 15, 1958. In discussing the "development of unification" of Western Europe, Mr. Acheson said that "this fusion [of Western Germany with the other five member countries] occurs when the coal and steel community of the six states is followed by Euratom 3/ (both

1/ The concept of an "international currency" is not of modern origin; it goes back at least to the Middle Ages, and the idea "was urged repeatedly from the sixteenth century on." (See Axel Nielsen, "Monetary Unions," in Encyclopaedia of the Social Sciences, Vol. X, pp. 595-601.) However, although similarities with the current conception can be traced, historical examples of monetary unions seem to have little in common with the present-day notion of a "common currrency," which, for reasons which will emerge presently, implies much more in the way of economic and political unification than was visualized by most of these earlier plans.

Proposals for a common currency in the contemporary sense were implicit, if not actually mentioned, in some of the pre-World War I, inter-war, and postwar plans for a United Europe--see Andrew and Frances Boyd, Western Union (Washington: Public Affairs Press, 1949)--as well as in various proposals for wider political unions or federations, such as Clarence Streit's Union Now. See Howard O. Eaton, Federation: The Coming Structure of World Government (Norman, Oklahoma: University of Oklahoma Press, 1944), and Otto Tod Mallery, Economic Union and Durable Peace (New York: Harper & Brothers, 1943).

2/ The official name of the common-market association of the Benelux countries (Belgium, Luxembourg, and the Netherlands), France, Germany, and Italy, which came into existence under treaty on January 1 last. Main elements of the association include the elimination of tariffs and other restrictions on trade among the members of the association (which may be summarized as the customs-union aspect of the plan), plus a host of other features which form the basis for use of the term "common market" instead of "customs union."

3/ Official abbreviation of "European Atomic Energy Community," the common market (among the same six countries) for nuclear energy.

now accomplished), by the common market, which is about to be realized, then by a common currency and, finally, by a political community. These last could come, with some wisdom and luck, before too long." 1/

Mr. Acheson's statement has several interesting aspects. First and most obviously, there is the reference to a common currency as one of the noteworthy features of a broad program of unification. Second, there is the sequence in which events are pictured: a common currency next, and then a political community. Finally, there is the suggestion that for the six countries of the common market, both a common currency and a political community may already be visible on the horizon.

In view of the extent of current interest--in government as well as in private circles--in the question of a common currency in Europe, it may be useful to re-examine the idea at this time. The present paper will attempt primarily to clarify certain aspects of the matter which are fundamental to it, and which must be clearly understood if the nature and proportions of the problem are to be seen in accurate perspective. In the course of this attempt at clarification, an effort will be made to answer the following two specific questions: Under what conditions would the establishment of a common currency for the E.E.C. (European Economic Community) be possible? Is a common currency essential to the success of the E.E.C.?

Although the subject will be explored here primarily with the E.E.C. in mind, most of what will be said would have equal relevance to proposals for a common currency for any group of countries associated (or contemplating association) on some special basis--as, for example, in the proposed Free Trade Area. 2/ If no allusions to the Free Trade Area are made below, it is mainly because no serious suggestion that the Free Trade Area should have a common currency has come to light.

---

1/ As reported in the New York Times, April 16, 1958, p.12. The meaning of the reported reference to the common market as something "about to be realized" is not clear. The Treaty itself was signed last year, and--as indicated above--the Community formally came into existence on January 1 last. From this point of view it is already "realized." On the other hand, the putting into effect of some of its most essential provisions is scheduled to be done over a period of 12 to 15 years.

2/ As proposed for Europe, the Free Trade Area would include all or most of the Western European countries, including the six member countries of the E.E.C. A free trade area, like a customs union, calls for the elimination of trade barriers between member countries; unlike a customs union, it does not require the equalization of member-country trade barriers against the rest of the world. See Jacob Viner, The Customs Union Issue (New York: Carnegie Endowment for International Peace, 1950), esp. pp. 5, 112-5, 124; General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, Vol. 1, revised (Geneva: The Contracting Parties to the General Agreement on Tariffs and Trade, 1955), pp. 46-9; Marc Ouin, The OEEC and the Common Market (Paris: Organization for European Economic Cooperation, 1958).

The meaning of a "common currency"

Defining a "common currency" involves mainly the problem of distinguishing different types of monetary union, and determining which type or types should be regarded as giving rise to a common currency for a particular group of countries.

For present purposes it may be useful to distinguish three fundamental types of monetary union.1/ First, there are various possible monetary unions based on international agreements under which each member country retains its own national currency, and its own ultimate control of it. In an extreme and purely hypothetical form, such agreements would provide that the basic units of all the national currencies would be identical in value (defined in relation e.g. to gold); coinage and note issue would be in identical denominations; all the national currencies would have complete legal-tender status at face value among the participating countries; and bank balances would be freely transferable within the area. The common denominator of all monetary unions of this first type is that each member country retains ultimate control of its own currency.

The second major type of monetary union involves the absorption by one government of the currency function of another. The third type involves the creation of a unified currency under the control of an international monetary authority.

Clearly, the third type would give rise to an unambiguously common currency. For the type of integration with which we are dealing--the E.E.C., and any essentially similar arrangement--the second type can be ruled out of consideration. But what about the first type--some kind of monetary union in which member countries retain separate monetary sovereignty?

While it is by no means inconceivable that at some stage of its development the E.E.C. may experiment with monetary union based on international agreement of the kind stipulated, at this juncture it is reasonable to rule it out also, as not providing an adequate basis for a common currency of the sort contemplated in contemporary discussion. There are three reasons--which may all be related--for this view. First, the more important monetary unions of the past, although comparatively limited in their aims, have not been especially successful, and--more important--except under arrangements that ended in political unification, have ultimately broken down. Second, the more important advantages of a common currency which have been suggested in connection with the E.E.C. (to be discussed later in this paper) are essentially based on the assumed elimination of the uncertainties of national action. Tacitly, therefore, they assume a currency which is controlled by international authority.

1/ For a more detailed classification, see Nielsen, loc. cit., p. 595.

Third, practically all published treatments of the question at hand clearly assume an international authority.

The main conclusion, then, is that a common currency for the Common Market would be a currency controlled by international authority within the E.E.C. It would be the only legal currency in the E.E.C. countries. The meaning of "currency" in this usage is of course not restricted to currency in the banknote sense; it would also include bank deposits and coins. Its basic unit would have a value defined in relation to some real article (presumably gold), and the currency would be convertible or inconvertible into that article, or convertible only for certain purposes. The degree of its convertibility into other currencies would be governed essentially by its "hardness" relative to that of other currencies. Its basic unit could have any name: taler, mark, franc, écu, unit of account, or any other name that struck the fancy of its originators.1/ In other words, in all essential respects it would be a currency like any other.

Triffin has suggested, as an interim arrangement, the adoption by each member country of new national currency units of "équal value," and the "intercirculation privilege" for banknotes in all these new units throughout the area of the associated countries.2/ Such notes reaching central banks in member countries other than the one in which the notes originated would be redeemed by the issuing central bank. However, an arrangement of this kind would not constitute a "common currency" system as defined above (and Triffin does not claim that it would), because each central bank would retain

1/ Two comments are relevant. First, if and when a common currency is established, it would be advisable to avoid duplication with the name of another existing currency, particularly if the basic units are (at least at the outset) of equal value. Such duplication may give rise to the notion that there is a perpetual "par value" relationship between the currencies; in the case of the U.S. dollar and the Canadian dollar there has been confusion on this point. Second, it is not excluded that different names for the basic unit could be used in different member countries, on condition that the difference between various note-issues was merely in name (and perhaps in color and size of notes, and language printed). Such differences need create no problems so long as the note-issues were all controlled by one authority, and were homogeneous in all except these superficial aspects.

2/ Robert Triffin, Europe and the Money Muddle (New Haven: Yale University Press, 1957), pp. 291-2.

control over its own currency issue.1/

## The essential basis for a common currency

Current expressions of hope for a common currency in the Common Market are seldom accompanied by references to the great political obstacles which lie in its path. This fact warrants a surmise that there is insufficient public awareness of all that a common currency implies. Consideration of what a common currency implies strongly suggests that hopes for a common E.E.C. currency in the near future are over-sanguine, or at least premature.

1/ The proposal is put forward as one "implying in practice the acceptance of full monetary unification as a future goal." The suggestion that all the currencies concerned be made "of equal value" clearly seems intended as a device for speeding the realization of that goal. Triffin's thought is, patently, that if all member currencies were of equal value, and circulated freely side by side in all member countries for several years, the public would begin to ask: "Why all these differently-colored pieces of paper, of different sizes, in different languages, when they all mean the same thing? Why not a single currency?"

As a preparatory step, to be taken when full unification is imminent, some such plan might be desirable. The case for taking it at any other time is much more doubtful.

Currencies can of course be made equal in value in the purely formal sense that one unit of each has the same legally-defined "gold content." (At the present comparative values of the German mark and--*de facto*--the French franc--4.2 marks = 420 francs = 1 dollar--the two could be made of "equal value" by e.g. redefining the franc in terms of its gold content to eliminate two zeros, with the result that 4.2 marks would "equal" 4.2 francs.) However, no way has yet been found to perpetuate a given set of exchange-rate relationships. Triffin tacitly recognizes this problem when he contends that the existence of intercirculation would greatly strengthen opposition to "later exchange readjustments." One must form his own judgment as to whether a government would give a currency-intercirculation arrangement priority over what it regarded as vital national interests, if the latter appeared to require exchange-rate readjustment; and as to whether a country would even enter into such an arrangement if it believed its freedom of action in crucial situations might thereby become inhibited.

In any case, the question as to whether there would or would not be "opposition" to exchange-rate readjustment is not the main point. The real question is rather, what would actually happen if one of the currencies was obviously in jeopardy? The answer is obvious: in such a situation, "Gresham's Law" (the principle that bad money drives good money out of circulation) would operate. In the absence of other corrective action, the weak currency would eventually have to be devalued.

A common currency implies a single monetary authority for the countries concerned; as a result of monetary unification, there would have to be substantial centralization of control of other important elements of economic policy; but with or without such centralization, unified monetary control alone would almost certainly require political unification of the associated countries.

A single monetary authority. A single monetary authority has already been stipulated, in the foregoing definition of a common currency; and the reasons for rejecting other conceptions were stated or implied.

Insufficient awareness of the need for unified control of monetary policy may stem simply from lack of familiarity with the nature and implications of modern money supply. Many people may regard money supply in general in much the same way as they probably regard currency (banknote) supply: as a kind of public utility that must exist in some objectively known or knowable quantity sufficient to turn the wheels of industry and trade, of consumption and investment. In fact, of course, monetary policy can--at least in some situations--powerfully influence the volume and character of economic activity, the level of prices, and the entire economic climate within the area of its jurisdiction. Great issues of public policy are therefore involved in what monetary authority does; governments of different countries may and do differ widely in their views as to what policies are appropriate, and what policies are politically possible; and the division of monetary authority in respect to a "common" currency among different national states is therefore not feasible. There can be a substantial amount of decentralization of control, provided it is inside the framework of a rational system of unified control.

Control of other economic elements. Monetary policy is one of the essential instruments of general economic policy. It is now generally understood, however, that monetary policy cannot "do the job alone"; fiscal policy is also an essential instrument. Is it feasible, then, to contemplate separation of the control of these instruments between national and international authority?

Triffin contends that monetary unification would not require "uniformization" of the budgetary, economic, or social policies of the member countries.1/ While there is something to be said for this view, there is a question as to whether it is the most relevant point to be made, and whether, in fact, it does not give a wrong impression as to what may be required in these matters under monetary unification. It is common knowledge, of course, that subsidiary areas of a common-currency area (e.g. the separate states of the United States) can and do have separate budgets and, within limits, different budgetary policies (although it is significant that individual states are thought to be able to influence to only a quite limited extent the general level of economic activity in their respective jurisdictions). In view of this fact, the relevant question is the following: would not monetary unification (as defined in this paper) require that the central monetary authority be paralleled by e.g. a central taxing and expenditure authority, the scale of whose operations could substantially influence levels of economic activity?

As was pointed out above, it is now generally agreed that monetary policy cannot "do the job alone," and that fiscal policy is also needed. Under the kind of monetary unification assumed, there would be only one monetary authority in the field--an international authority. It could not

1/ ibid., p. 289. From the entire context of his discussion it is quite clear that by "monetary unification" Triffin means a common currency as defined in the present paper.

Whatever can be said for the view that monetary unification would not require "uniformization" of various economic policies among the member countries, Triffin's reasoning is not persuasive, for it consists merely of the citation of two examples, neither of which is applicable. One is the fact that the United Kingdom, India, South Africa, and Australia "belong to the same monetary area in spite of widely divergent policies in all these respects." However, the various currencies of a monetary area are by no means necessarily a common currency. One test is whether they can be separately devalued or revalued, and the currencies of the countries mentioned can be. The mere fact that their relative values have been kept unchanged for long periods at a time means nothing in this connection, for the same is true of various national currencies not associated in a "monetary area." This comment also applies to Triffin's second example, the long-defunct Latin Union, which, moreover, related mainly to coins; in addition, it existed before the era of large government budgets and of preoccupation everywhere with full employment as a major tenet of government policy--considerations which obviously have an enormous bearing on the question under discussion.

evade its responsibilities, for even policy inaction by it would be, in effect, a policy; it could not be expected to "do the job alone" (i.e. the job of maintaining economic stability with growth); and it could hardly rely, for its indispensable fiscal accompaniment, on the hope that a half-dozen sovereign taxing and spending powers would agree at all, or that they would necessarily agree on a fiscal policy which would be appropriate in any given set of circumstances.1/ The conclusion seems inevitable that there would have to be a central taxing and spending authority whose actual or potential scope of operations would be substantial. However, an important degree of centralized control of budgetary policy would be a possible alternative.

The foregoing reasoning all flows from two crucial facts: the creation of an international monetary authority, and the intimate relation between monetary policy and fiscal policy. So long as sovereignty in both monetary and fiscal matters remains at the national level, there is a rational framework of policy control (however inadequate the use of the framework may be in some countries). The moment the traditional nexus between national monetary and national fiscal policy is broken by the creation of an international monetary authority, a new situation arises, with implications along the lines suggested above.

Most published treatments by economists have assumed some degree of centralization of budgets, or of budgetary policy, to be a necessary consequence of monetary unification. For example, in discussing the single-currency idea nearly a decade ago, Hawtrey showed the interdependence of monetary and fiscal problems; and he concluded that "a common currency would almost certainly mean fiscal union. . ." 2/ More recently, Meade has suggested that partial centralization of budgetary and fiscal powers (in connection e.g. with defense, or any other function involving substantial amounts of taxation and expenditure) might provide the central authority with adequate "fiscal influence upon the total demand for goods and services throughout the union." In the absence even of such partial centralization of actual budgetary operations, Meade insists that the central authority would have to have some control over the fiscal policies of the separate national governments.3/

1/ It is true that the separate member countries would no longer have the power to print money; but within limits they could borrow. If they chose, they could also run budgetary surpluses.

2/ R. G. Hawtrey, Western European Union (London: Royal Institute of International Affairs, 1949), pp. 87-8.

3/ James E. Meade, Problems of Economic Union (London: George Allen & Unwin 1953), pp. 42-3.

The conclusion, therefore, is that monetary unification would require a significant degree of centralization of budgetary and fiscal policy. Centripetal forces would also be at work on other economic factors. For example, centralization of monetary policy, and substantial centralization of budgetary and fiscal policy, would point in the direction of a permanent pooling of gold and foreign exchange reserves: because of the need to centralize the "cover" of the liabilities represented by the centralized money supply, and--more importantly--because the separate member countries could no longer expect (or be expected) to deal separately with the external effects of policies they no longer controlled.

In turn, the centralization of the gold and foreign exchange reserves, as well as the centralization of monetary and fiscal policy, would both argue for centralized control of trade and capital movements between the Community as a whole and the world outside.

Finally, a strong case has been made that the establishment of a common currency would also probably require an integrated capital market and an "integrated employment policy" within the Community.1/

There may be many other factors in economic life which would tend to be pulled into the framework of centralized control. Clearly, however, centralization of control of the factors discussed or mentioned above would justify the assertion that the establishment of a common currency would lead to substantial centralization of control of economic policies in addition to monetary policy.

Political unification. If a group of independent countries were to adopt a common currency with its concomitant, a single monetary authority, under a framework of arrangements in which all member countries had the same or substantially the same voting power,2/ no member country would have independent control of its money supply. Is this a situation consistent with national sovereignty?

---

1/ Tibor Scitovsky, "The Theory of the Balance of Payments and the Problem of a Common European Currency," Kyklos, Vol. X (1957), Fasc. I. By an "integrated employment policy" Scitovsky means primarily a centrally-directed economic policy which would normally operate to permit differences in the attractiveness of employment opportunities in the different sub-areas of a common-currency area to have their equilibrating effects. He shows, however, that a policy of aid to heavily depressed sub-areas would not be inconsistent with balance-of-payments equilibrium among all sub-areas.

2/ The voting arrangements in the E.E.C. give to the whole of Benelux approximately the same voting power as that of each of the other three Common Market countries.

The reasoning on this is familiar. Two of the principal preoccupations of governments are prosperity in peace, and victory in war. Control of the domestic money supply can be vital to any hope of achieving these objectives: to peacetime prosperity because of the broad questions of economic policy which are bound up with monetary policy, and to victory in war because in war a rapid expansion of money supply may be absolutely essential. The aim here is not to glorify national sovereignty, or to suggest that a common international currency is impossible because sovereignty precludes it; the aim is rather to indicate reasons for the view that the establishment of a common currency without political unification is improbable. To believe otherwise is to believe that countries would, of their own free will, surrender so vital an element of sovereignty as the control of money supply, in exchange merely for the economic advantages that a common currency would yield.1/ As will be shown below, although these advantages are real, and some are important, they are unlikely to be judged indispensable. It seems reasonable to conclude that member countries of the Six are unlikely to be willing to surrender their monetary independence unless and until they are also willing to become unified politically.

If that is so, it is clearly the dominant consideration at this juncture, concerning the common-currency concept in relation to the E.E.C. Given this consideration, there would seem to be little point, at present, in repeated insistence on the desirability of a common currency for the Common Market, unless one is also prepared to defend the view that political unification of the Six is a practical possibility in the foreseeable future.

Most published treatments of the common-currency question by economists conclude that a single currency implies political union. Reference has already been made to Hawtrey's view that a common currency would "almost certainly" mean fiscal union; and Hawtrey added that "fiscal union means formal federation." Haberler has stated categorically that

---

1/ In substance, no member country of the E.E.C. has, in ratifying the Common Market Treaty, in fact surrendered any sovereignty as yet; for the E.E.C. has no police power, the ultimate sanction of political power. It would be ridiculous to suggest, however, that for this reason the member countries could agree to a common monetary authority, even without political unification, since they could always withdraw from the arrangement if necessary. For one thing, emergency needs might be too pressing; a new monetary system cannot be improvised overnight. For another, the Treaty powers seem to have followed the sensible practice of agreeing to no more in the Treaty than they could honestly commit themselves to at this stage.

"economic unification is impossible without political unification." 1/ Smithies reached a similar conclusion: "It is difficult to see how the European countries can accept the implications of full economic union without being willing to accept the full implications of political union."2/ Meade is of the same opinion, and goes further in expressing a view as to the prospects for the single European government he sees as necessitated by the "integration approach" (his term for the single-currency approach): it is "in my opinion ultimately desirable; let us hope that it will prove ultimately practicable; but it is not a starter at the moment . . ." 3/ Triffin, while arguing against dismissing the objective of a single currency for the E.E.C. "as a mere utopian dream," obviously sees the political obstacles to it.4/

An especially authoritative view on this whole question as it relates to the E.E.C. is provided by a statement of Dr. Otmar Emminger, member of the Central Bank Council of the Deutsche Bundesbank (German Federal Bank), Executive Director for Germany in the International Monetary Fund, and one of the two German members of the recently-constituted Monetary Committee of the E.E.C.

> The question could be raised--it has already been raised several times--as to why the ultimate responsibility for the settlement of the balance of payments rests with the individual member countries. Why run this risk? Why does not the Common Market take on this responsibility? Why could not a currency union which would eliminate all the payments problems among the various states be established? The answer to this is very simple: the organs of the Common Market simply would not have the means to assume such a responsibility. Even for the final stage of the Common Market the participating states have reserved for themselves essential parts of their sovereignty,

---

1/ Gottfried Haberler, "Economic Aspects of a European Union," <u>World Politics</u>, Vol. I, No. 4 (July 1949), p. 434.

2/ A. Smithies, "European Unification and the Dollar Problem," <u>Quarterly Journal of Economics</u>, Vol. LXIV, No. 2 (May 1950), p. 174.

3/ J. E. Meade, "The Balance-of-Payments Problems of a European Free-Trade Area," <u>Economic Journal</u>, Vol. LXVII, No. 267 (September 1957), p. 388.

4/ Triffin, <u>op. cit.</u>, pp. 287-94, esp. p. 290.

among them the right of national parliaments to make decisions on domestic undertakings and to determine how they shall be covered: as it has been so well expressed by Mr. Holtrop, the Governor of the Netherlands Bank, the "sovereign right to inflate." So long as this sovereignty exists--and it will exist so long as there is an individual sovereign domestic and foreign policy in the member states--the individual state cannot be relieved of ultimate responsibility for its balance of payments. This means, of course, nothing more nor less than that the internal economic and monetary policy of each individual member state ultimately will determine the success or failure of the entire integration experiment.1/

## Advantages of a common E.E.C. currency

Given the conclusions already reached, it might appear that the whole matter could now be dropped. If a common currency requires political unification, and the latter is not visible on the horizon, why discuss now such questions as the advantages or objectives of a common currency?

There is one important reason for doing so. It is being asserted in some quarters that without a common currency the Common Market will fail, or at least fall far short of realizing its major economic aims. If this were true, it would obviously be extremely important. Why pursue, with monumental labor, a vast project like the Common Market, if, on its present course, it is unlikely to achieve any significant part of its economic objectives? 2/ It is clearly necessary to examine this question.

1/ From an article in Die Welt (Essen), March 23, 1957. Translated from the summary given in Bank deutscher Laender, Auzüge aus Presseartikeln, No. 32, March 27, 1957.

2/ The broad economic aims are mainly: an increased scale of production made possible by the establishment of "one large market"; the economies of greater specialization; and increased competition. Whether the economic analysis underlying the common-market concept is valid--or has nearly as much validity as is so widely assumed--has been questioned; see, for example, Harry G. Johnson, "The European Common Market--Risk or Opportunity?" Weltwirtschaftliches Archiv, Band 79 (1957), Heft 2, pp.267-278. Johnson is concerned mainly with common-market theory in relation to the proposed Free Trade Area, and particularly to Britain; but much of his analysis is of wider applicability. For a different view, see Tibor Scitovsky, "Economies of Scale, Competition, and European Integration," American Economic Review, Vol. XLVI, No. 1 (March 1956), pp. 71-91.

It is conceivable that the Common Market may succeed for a reason not related to the validity of the underlying theory, i.e. an irrational reason. The mere ferment which common-market discussion, planning, and action has already engendered may become a strong motor-force for progress.

One way to do so is to study the various real or assumed advantages of a common currency; for one or more of these must constitute the missing link whose absence is thought to threaten the success of the entire Common Market project. The rest of the present paper will be devoted largely to an examination of the possible advantages of a common currency, principally in relation to the question which has just been posed. (The advantage of a common currency as a symbol of unity will be ignored; it seems obvious that this advantage could not have great bearing on the question at issue.)

1. Convenience. Some of the lay suggestions for a common currency in Europe may have sprung directly from personal experience in having to use, and to exchange, numerous currencies while traveling in Europe; almost every tourist abroad acquires at least one personal anecdote involving foreign currency. Some people may even assume that such experiences imply that the mere existence of different currencies creates continuing difficulties in carrying on normal international trade.

In fact, however, except where severe foreign-exchange restrictions are in effect--and such restrictions are rare in present-day Europe --the use and conversion of different currencies normally entails no major difficulties or expense. For tourists, business travelers, and traders, currency exchange is normally a simple and relatively inexpensive matter. As for difficulty or confusion in the use of different currencies, traders and business travelers become accustomed to this problem; and there is no evidence that tourist travel is inhibited by it significantly if at all. For many tourists, in fact, handling and using different currencies is probably one of the tangible pleasures as well as one of the tangible proofs of their travels!

It may be objected that some European countries still have relevant restrictions, e.g. limitations on the amount of foreign exchange obtainable for travel and "tourism"; and this is true. However, one of the objectives of the E.E.C. is "free movement of persons"; and the important obstacles to realization of this aim do not include the absence of a common currency. The nearest that any such obstacle comes to the common-currency question is in connection with possible balance-of-payments problems; and these constitute a separate matter, to be considered below.

2. Economy in gold and foreign exchange reserves. In modern times, past preoccupations with the adequacy of gold holdings--or holdings of gold and foreign exchange--regarded as "cover" for the domestic money supply have given way, in most countries, to primary emphasis on their adequacy in relation to international trade. If the six countries of the E.E.C.--which already have an extensive trade among themselves as well as with the rest of the world--were to integrate so thoroughly that they were politically unified and had a common currency, their trade among themselves, previously a part of their "foreign" trade when they were separate countries, would be absorbed as internal trade. Thus, their

combined holdings of gold and foreign exchange would represent a much higher percentage of any given volume of "foreign" trade than had previously been the case, thereby increasing the adequacy of such holdings. Triffin mentions this phenomenon as one of the by-products of the "monetary integration" of the Six.1/

The phenomenon is interesting, and not without importance. Even, however, in these days of widespread and continuing interest in the question of the "adequacy" of external reserves, the phenomenon in question has no essential relevance to the prospects for the success of the Common Market. The chief reason this is so is that if and when it is demonstrated that the external reserves of the E.E.C. countries are inadequate, there are alternative ways in which they could be effectively increased. Triffin's characterization of the phenomenon therefore puts it in correct perspective; it would be a "by-product" of complete monetary unification, not one of its main objectives. Thus, this second advantage of a common currency, like the first, is in no way vital to the success of the E.E.C.

3. Elimination or reduction of balance-of-payments problems. The recognized difficulty of achieving international coordination of policies on a sound basis has been urged as one of the major reasons why the Six *must* have a common currency. Countries in balance-of-payments deficit are averse to taking deflationary action. They are said to face a "conflict of objectives"--external balance vs. domestic full employment--which allegedly would disappear if the Six had a common currency, because the fact of a common currency would eliminate balance of payments problems among the Six.

Buried in this line of thought are several misconceptions regarding the nature and significance of balance-of-payments equilibrium, both outside and inside a common currency system. It is important to clear up these misconceptions.

In the first place: *in the absence of a common currency, balance-of-payments equilibrium "among the Six" is not or at least should not be a major aim of policy.* In a world in which there is as much convertibility as now exists, most of the Western European countries--including the Six of the Common Market--must concern themselves primarily with the problem of an adequate degree of equilibrium in their (individual) *overall*--as distinct from their *regional*--balance of payments. There is no *a priori* reason for any member country of the Six to expect to find itself in equilibrium within the Six; and any such equilibrium would in fact be--at first glance--suspect, although it could of course happen by chance.

1/ Triffin, *op. cit.*, pp. 292-3. According to Triffin, E.E.C.-country holdings of gold and foreign exchange would rise from 44 per cent to 74 per cent of their foreign trade--an increase of 68 per cent. For an interesting attempt at a theoretical measure of the "adequacy" of the external reserves of a country, or of an economically-unified group of countries in a currency union, See Scitovsky, "The Theory of the Balance of Payments . . ." *Kyklos*, Vol. X (1957) Fasc. I, pp. 38-42.

This truth has been stated so often, and so well,1/ that one might suppose everyone interested in these matters would by this time be aware of it, and of its significance; but as this apparently is not the case, it must be re-stated and emphasized on every possible occasion.

It follows that each member country of the E.E.C.2/ should expect as a normal matter of course to be either in surplus or deficit with the other members as a group. Either position will be largely without significance provided (1) each member country is in overall payments equilibrium, and (2) the degree of currency convertibility in the world remains at least as high as it is now.

It further follows that when one speaks of the need for coordination of the policies of the Six, one must have in mind coordination which is consistent not only internally in the E.E.C., but also in relation to what is happening in the rest of the world, or at least in that part of it which is effectively within the world multilateral system. At a time when the outside world had largely stabilized prices, a policy of "coordinated" inflation within the E.E.C. could not be defended on the ground that such a policy maintained the balance of payments of the Six among themselves. If, in 1955-57, all the six countries concerned had inflated (relative to their respective availabilities) at the same rate as the most inflationary among them, the outside world would in all probability have witnessed (and also suffered from) a boom and subsequent collapse of such dimensions as almost to defy the imagination; and the Six would have developed a gigantic balance of payments deficit with the rest of the world. "Coordination" among the Six will be a blind alley unless it is understood to mean coordination on the basis of sound policies. Fortunately, there is no misunderstanding on this point among responsible officials of the Six--although they realize full well that achieving appropriate coordination will be a difficult task.

In the second place: establishment of a common currency for the E.E.C. would not provide a blank check for unrestrained expenditure by any member country of the Six. There is a glaring deficiency in the line of thought which is under examination. The essence of the deficiency is the implicit assumption that simply by a change in the mechanical aspects of currency arrangements--hardly anything more than a sleight-of-hand maneuver--means can be found which would permit a country in balance-of-payments deficit (whether as a result of its own improvidence or for other reasons) to remain indefinitely in that position, with no change in

1/ See e.g. Meade, *loc. cit.*, pp. 379-81. Meade brings out clearly the fact that a situation of overall balance may well *require* imbalance in regional relationships. He also points out that the principle of balance-of-payments equilibrium is valid, even if it is not a precise criterion for policy (need for building reserves, etc.)

2/ For this purpose, Belgium and Luxembourg constitute one member country.

its economic policies.

The best clue to the deficiency is the reference to the "conflict of objectives"--external balance vs. full employment. Thinking of this kind is invariably suspect. Most persons in the world live on incomes which are smaller than what they would like to have. To speak of a national "conflict of objectives" like the one indicated makes no more sense than to say that an individual faces a conflict of objectives--between living within his means and spending as freely as he would like to. It can be said, correctly, that on the national level the question may pose political problems; but this cannot alter the fact that the solution must normally be found within the framework of solvency. For solvency itself is a problem which must be solved; it is not a phantom to be exorcised.

Analytically, there are two main errors in the "conflict of objectives" argument. First, it tacitly assumes that under a common-currency system, each member country of the Six would still have substantially complete control of economic policy within its borders; specifically, it assumes the country would be free to follow expansionary policies regardless of what was happening elsewhere in the Community. In effect, it assumes that each country would still have control of its own money supply, in the sense that it retained the "sovereign right to inflate" by printing money; for without this right, the only means by which a country could pursue independent expansionary policies would be through deficit financing of government expenditure. Continuation of such activity, however, would depend upon borrowing, a resource which is hardly comparable with the "sovereign right to inflate." The implicit assumption that each country separately would retain the "sovereign right to inflate" cannot, of course, be accepted, because it is not consistent with the assumption of an international monetary authority.

More important, however, is the second analytical error, which relates to the circumstantial (as distinguished from what might be termed the legal) limitations on the possibility for a sub-area to pursue an independent economic policy. Within a common-currency system, there is a mechanism of balance-of-payments adjustment; and one of its noteworthy features is its resemblance to gold-standard principles of international adjustment.1/ Detailed exploration of this mechanism would lead the discussion far afield; for present purposes it will suffice to point out that while there are various factors that can enable a sub-area of a common-currency area to remain in continuing deficit with the rest of the area

1/ "There is a close analogy between adjustments made by the banking system in response to interregional flows of funds and the theoretical equilibrating process of a smoothly functioning international gold standard." Norman N. Bowsher, J. Dewey Daane, and Robert Einzig, "The Flow of Funds Between Regions of the United States," Journal of Finance, Vol. XIII, No. 1 (March 1958), p.2.

for prolonged periods (investment inflow, federal assistance, etc.), a sub-area "policy" of full employment cannot normally be regarded as one of them. Deficit expenditure to maintain employment within the sub-area will give rise to a deficit with the rest of the common-currency area; and the corrective mechanism will normally entail some deflation in the over-extended sub-area.1/

It should now be clear that a common currency would "solve" the alleged "conflict of objectives" problem, first by eliminating the right of independent national determination of policy, and second by re-introducing the possibility of deflationary movements in over-extended member countries. As a "solution," the common-currency prescription therefore seems both draconian and self-defeating. The point, of course, is that it is not the "solution" which is faulty, but the "problem." Inside or outside a common-currency system, no country or area can evade forever the compulsive need for solvency. The stated "conflict of objectives" does not exist.

In this review of the balance-of-payments argument for a common currency in the E.E.C., it may be of interest to touch on the question of "gold-standard policies," of which much has been made in connection with the Common Market. It has frequently been asserted that in view of the open character which the E.E.C. is scheduled to achieve (i.e. each member country to become "open" in relation to the other five), the member countries will--even in the absence of a single currency--be driven into following "gold-standard policies"--in effect, passively permitting all necessary adjustments to external balance-of-payments positions regardless of the impact on domestic prices, production, and employment. The assertion is essentially correct; but stated this baldly, it may tend to produce spine-tingling chills of horror. Most of the "horror" can be eliminated, however, if one keeps in mind the many mitigating considerations.

First, to the extent that the argument is correct, a common currency provides no way out, for the reason already indicated. Second, even

1/ For further discussion of the problems and principles involved, see Meade, *op. cit.*, pp. 30 and 38 ff.; Triffin, *op. cit.*, p. 289; and Albert Halasi, "International Monetary Cooperation," *Social Research*, Vol. Nine, No. Two (May 1942), pp. 185 ff. Note Meade's striking formulation: "The second method of regaining international equilibrium involves the deflation of money incomes, costs and prices in the deficit regions of the union and their inflation in the surplus regions. The institution of a common currency for our economic union is a special case of this second alternative." (Underlining added.)

relatively large balance-of-payments deficits normally represent only a very moderate proportion of gross national product, and can usually be eliminated by reasonable anti-inflationary programs; actual deflation is seldom required.1/ Third, the problem posed is the reason there has been so much stress on the need for "coordination" of economic policy, which means essentially no more than that every member country in the group must at all times face up to the need to follow sound policies. Fourth, the problem involved is not peculiar to the E.E.C.; with the progress of European trade liberalization and convertibility during recent years, the necessity for every European country to follow sound policies has become progressively more evident.2/ Fifth, to the extent that the problem is of especial relevance in the E.E.C., in view of the intention to remove all trade restrictions among the Six, it means essentially that in the last analysis the Community cannot deny to any of its member countries both the possibility of outside assistance and the right ultimately to reimpose trade restrictions if such action becomes necessary.3/

The conclusions to be drawn regarding the balance-of-payments aspect have already been implied. There is nothing about the balance-of-payments problems of economic arrangements like those of the E.E.C. to suggest that in the absence of a common currency the E.E.C. need fail to achieve its economic objectives. Secondly, for the Community as a whole a common currency would not

1/ Much of the terror frequently inspired by references to the gold-standard mechanism of adjustment probably stems from confusion of the effects of that mechanism itself with the effects of the vicious circle of trade restrictionism during the heyday of the "beggar-my-neighbor" approach to problems of declining trade during the depression of the early 1930's.

2/ It is important to bear in mind at all times that excessive inflationary tendencies by one or more countries in any multilateral trading system will, if they continue, ultimately destroy that system. The inflationary countries will exhaust their external reserves, and other countries will supply only finite amounts of credit. In the end, either the system will collapse into bilateralism, or sanity will be restored. It has generally been recognized that the balance-of-payments problems in the open trading system represented by the E.E.C. (at the end of the "transitional" period of 12 to 15 years during which the internal barriers to trade are to be gradually eliminated) differ only in degree, not in kind, from the balance-of-payments problems of the same countries under pre-E.E.C. arrangements.

3/ M. W. Holtrop, "Les aspects monétaires de l'intégration économique," Handelsoverzicht, January 1957, p. 14.

eliminate the central balance of payments problem of any country or unified group of countries: the problem of balance-of-payments equilibrium with the rest of the world. Third, within such a unified group of countries, the existence of a common currency would presumably eliminate internal balance-of-payments problems for any country in the group, but only at the price of loss of national independence in the determination of the main lines of economic and financial policy. The advantage is obtainable if and when member countries are prepared to take the last main steps toward economic and political unification.

If, however, the member countries of the E.E.C. ultimately decide to take all the steps necessary to the establishment of a common currency, and actually establish such a currency, it seems doubtful that their main motive will be the desire to rid themselves of their separate national balance of payments problems, or because the E.E.C. will otherwise collapse on the balance of payments difficulties of its members. To retain the major policy controls in their own national hands, and to prevent the collapse of the E.E.C., the member countries need only maintain their separate balances of payments in overall equilibrium--a difficult but by no means impossible task.1/

4. Centralization of responsibility for economic stabilization. Meade points out that establishment of a common currency would "automatically" provide an important weapon--namely, a central monetary authority--of centralized control of booms and slumps throughout the integrated area. (He adds that as the monetary weapon alone is insufficient, there would also have to be centralized fiscal control.)2/

Economic stabilization by each country separately is more difficult, but far from impossible. Again, therefore, we are dealing with what is clearly in some sense an advantage of a common currency, but one that does not appear crucial to the success of the E.E.C. Like the other advantages already considered, it is one that the Six can have if and when they, as separate nations, are prepared to take the steps that would make it possible.

5. Freedom and safety for capital movements and investment decisions. One advantage of a common currency in Europe has been clearly stated by Scitovsky, along with his own view of its significance, in the following way.

---

1/ Floating or fluctuating exchange rates have sometimes been proposed as a method of eliminating or alleviating balance-of-payments problems. In order to focus attention entirely on the question of a common currency, the present paper does not examine such proposals.

2/ Meade, op. cit., p. 42.

> If the creation of an all-European market is to have its full beneficial effects on the Western European economy, it must modify the nature, scale, and geographical distribution of Europe's manufacturing equipment; and it can do this only by influencing the investment decisions of private business. These decisions, however, being long-run decisions, will only be influenced if those making them are given full assurance that a free all-European market is not only established but here to stay, and that intra-European economic relations will no more, or not for a long time be disturbed and disrupted by trade restriction, exchange control, or exchange-rate revisions. The fulfillment of these conditions amounts, in effect, to the establishment of a common currency; furthermore, in view of the checkered history of European exchange relations, I doubt if anything short of the formal introduction of a common currency would be regarded as adequate guarantee that these conditions will be fulfilled.1/

As indicated, Scitovsky's language has been drawn on because it puts very clearly the most important argument for a common currency. Except in connection with one or two points, the interesting article from which this language is drawn is not involved in the discussion below, because the article is not an attempt to prove that a common currency is essential. What the article does mainly is to make an impressive case (as was mentioned earlier) that *if* the countries of Western Europe were to become "integrated," and *if* they established a common currency, the mechanism of balance-of-payments adjustment within the integrated group (in the same sense that there is a mechanism of balance-of-payments adjustment within the United States) would probably have to include "an all-European integrated capital market and an all-European integrated employment policy."

Scitovsky's comment (in the quoted text) is that a common currency is necessary if the creation of an "all-European" market is to have *its full beneficial effects*. This is a sound and unobjectionable proposition. Agreement can be stipulated at the outset that, other things being equal, the extent of actual economic integration likely to be achieved by the creation of a common market among a group of countries will be higher if they establish a common currency (with all that that implies) than if they do not. But this is vastly different from assertion that in the absence of a common currency the E.E.C. will fail, or fall far short of its objectives.

In order to make clear why, in connection with the question of freedom and safety for capital movements and investment decisions, a common currency is not vitally necessary to the E.E.C.--at any rate, in the

---

1/ Scitovsky, "The Theory of the Balance of Payments . . ." *Kyklos*, Vol. X (1957), Fasc. I, p. 18.

foreseeable future--it will be useful to outline some of the principal factors or considerations which can be expected to militate in favor of substantial economic progress, of the kind generally anticipated under the Treaty, even in the absence of monetary unification.

(a) In the first place, fears that capital movements and investment decisions in Europe will be inhibited in the absence of a common currency must relate primarily if not solely to intra-European investment by Europeans. While the establishment of a common currency in the E.E.C. would eliminate certain investment problems of Europeans within the area, e.g. fear of inability to liquidate and repatriate funds invested in other member countries, this would not be true for investors outside the area investing funds inside the E.E.C. group.1/ If there are, in fact, important profit opportunities connected with the expansion which the Common Market is expected to achieve, it is certain that outside capital will be interested. (It is already evident, for example, that many U. S. interests are exploring new investment possibilities in the E.E.C. area.) Foreign investment in the E.E.C. area is good in two respects: it brings in outside capital, and it introduces outside competition for the profit opportunities that exist.

(b) It is sometimes assumed that the only factor inhibiting intra-European capital movements in the postwar period have been such things as trade and foreign exchange restrictions or the threat of them--viewed mainly from the standpoint of possible problems of repatriation. But barriers to the inflow of capital have also been significant. The Treaty will, among other things, operate against such restrictions.

(c) The magnitude of the problem, as viewed by the long-term investor, should not be exaggerated. The general direction of movement in the postwar period has certainly been toward greater freedom both for capital inflow and for later repatriation. New restrictions on repatriation can arise, but there is a basis for assuming that these would develop mainly in connection with relatively temporary balance-of-payments problems. For the long-term investor this may not be too serious a matter. If a problem does arise for him, it is much more likely to be one of the timing of repatriation, than one of whether he will be able to repatriate at all. In addition, some European governments have been willing to give fairly strong guarantees in connection with foreign investments they were anxious to encourage.

1/ It might even be argued that at least some outside investors would prefer a situation in which it is possible to diversify repatriation risks by investing in different countries with different currencies.

(d) Automatic and semi-automatic forces will not have ceased to operate. To the extent that important investment opportunities exist in particular E.E.C. countries, and the lack of a common currency inhibits capital inflow from partner E.E.C. countries, the rise in interest rates in the first group of countries should stimulate internal saving and thus facilitate realization of the new opportunities. It should also stimulate capital inflow from outside (i.e. from non-E.E.C.) countries.

(e) The institutions of the E.E.C.--especially the European Commission and the Monetary Committee--can be expected to concern themselves with problems like the one here under discussion, and to take whatever action is both possible and appropriate. It would be a mistake to underestimate what might be accomplished along these lines.

(f) Finally, there can easily be a substantial amount of institutional investment which is probably less inhibited than private capital by such questions as repatriation uncertainties. A large institutional investor such as the International Bank for Reconstruction and Development can afford to be less concerned about such questions because good standing with such investors is of course a very important matter for most countries.

It would certainly be misleading to suggest that movements of capital and of enterprise inside the E.E.C. would be almost as uninhibited without a common currency as with one. There is even a question whether it will be possible to achieve the freedom for such movements that is envisaged by the Treaty.1/ In the light of the considerations outlined above, however, there seems to be no basis for the view that without such freedom, and without completely uninhibited movements of capital and enterprise, the Common Market is doomed either to failure or to only a mediocre success.

On the basis of the foregoing analysis of what would seem to be all the principal advantages of a common currency--some very important, some very much less so--the view that a common currency is essential to the success of the E.E.C. appears to be wrong.

## Preparatory steps

The present paper has focussed on the two questions posed at the beginning. The conclusions reached, in relation to these questions, are: (1) that establishment of a common currency in the E.E.C. would require an international monetary authority, substantial centralization of control of other economic policies including budgetary and fiscal policy, and (probably) political unification; and (2) that nevertheless a common currency is not indispensable to very substantial success for the E.E.C.

1/ For an insight into some of the serious questions that remain on the score of freedom for capital movements, see Holtrop, loc. cit., pp. 14-15.

However, a common currency would admittedly help the E.E.C. to achieve its "full beneficial effects." In addition, ultimate political unification is clearly one of the aims of the founders of the E.E.C.1/ Thus, it is only to be expected that efforts will be made to lay the basis for a common currency.

One of the first public indications of work along these lines was the announcement by the International Chamber of Commerce of a program prepared by a committee of bankers and businessmen headed by Maurice Frère,2/ approved by the Council of the Chamber in Paris on May 9 last, and recommended to the member countries of the E.E.C. According to newspaper reports,3/ the program consisted of three main suggestions: first, that the E.E.C. central banks conclude agreements, "later to become statutes," to coordinate their private lending policies; second, that member governments of the E.E.C. agree "not to borrow from the central banks except in unusual circumstances and then only with the approval of a competent body designated by them "(presumably the E.E.C. Monetary Committee); and third, that the central banks gradually "disengage" themselves from their present loans to governments, by transforming them into negotiable securities, which would then be marketed.

Should the existence and tenor of this program be construed as evidence that in the opinion of well-informed persons, an E.E.C. common currency may be realizable in the not-too-distant future? The Chamber's own statement was modest enough; it said, according to the New York Times story, that "the aim would be to insure the smooth functioning of a single market and perhaps one day, when political conditions make it possible, lead to a single currency." And from various newspaper reports it is evident that Mr. Frère and his working group themselves stressed that a common currency would be merely the ultimate and possibly rather distant goal.

Whether the proposed program can be adopted remains to be seen; its present significance, however, seems quite clear. The program as outlined is entirely consistent with the kind of monetary behavior which is desirable in any case for the successful functioning of the Common Market. And the hope for achievement of a common currency "perhaps one

---

1/ For an illuminating report on the privately-expressed views of some of the founders of the Common Market on this point, and particularly on their conception of the way in which political unification will come about, see Raymond Aron, "Problems of European Integration," Lloyds Bank Review, New Series, No. 28 (April 1953), p. 15.

2/ Former Governor of the National Bank of Belgium and president of the Bank for International Settlements.

3/ e.g. New York Times, May 23, 1958, p. 6.

day, when political conditions make it possible," does not suggest any unrealistic expectations as to how soon that day may come.

Further work along these lines may well go forward, in various quarters, in the months and years to come. At the moment, the best guess would seem to be that if the ultimate goal is in fact reached much sooner than now appears likely, it will probably be because of political developments the nature of which cannot now be clearly foreseen.