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POLICY IN INTERNATIONAL STUDIES

Are Monetary Unions Inevitable?

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With the rapid growth of cross-border competition among currencies, informed observers predict that the new monetary unions are virtually inevitable in many parts of the world. In fact, predictions of such alliances are misleading and almost certainly wrong. Monetary unions necessarily imply a measure of *collective* action in the issue and management of money. An alliance requires allies—other states with similar preferences and a disposition to act cooperatively. A survey of proposed monetary unions shows that willing partners among sovereign states are just not all that plentiful. Conceivably some governments could be attracted to less demanding forms of monetary alliance, depending on bargaining context. But prospects for many full new monetary unions are dim at best.

Keywords: monetary union, currency competition, currency deterritorialization, monetary sovereignty

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One of the most remarkable developments in the world economy in recent years has been the rapid growth of cross-border competition among currencies—a demand-driven process of currency substitution that I have elsewhere called the *deterritorialization* of money (Cohen, 1998). No longer, in many countries, are market actors restricted to using the national money alone, despite governmental efforts to preserve the exclusivity of their currencies. Now popular foreign monies are also widely employed, competing directly with the state's own monetary issue for the favor of transactors and investors. In effect, currencies are increasingly caught up in an intense Darwinian struggle for survival, posing difficult choices for policymakers.

What will be the outcome of this struggle? In the opinion of many informed observers, the answer is obvious. The number of currencies must necessarily shrink, as the least competitive monies fall by the wayside. At present there are more than 150 state-sanctioned currencies around the globe, from market leaders like the U.S. dollar and Europe's euro to dozens of weaker rivals in many of the world's poorer economies—what one economist scornfully dismisses as mere "junk currencies" (Harris, 2001:35). Can anyone believe that such a crowded population, including large numbers of small currencies with very limited circulation, represents a stable equilibrium? As another economist, George von Furstenberg (2000b:112) remarks, "small really is not beautiful in matters of

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money." For many the only solution is monetary union, a strategy of currency alliance on the model of Europe's Economic and Monetary Union (EMU), replacing diverse "junk currencies" with more appealing joint brands of money. Typical is the prediction of Michel Camdessus (2000:35), former managing director of the IMF, who suggests that "[i]n the long run, we are moving toward a world of fewer currencies." Von Furstenberg (2000a:199–200) is even more forthright. Monetary unions, he asserts, are "inevitable ... the wave of the future." As he summarizes (2000b:109): "[Governments] will reclaim co-ownership and co-management of their monetary asset in multilateral monetary union with like-minded countries."

But are monetary unions truly inevitable? In fact, predictions such as these are misleading and almost certainly wrong. The aim of this article is to explain why they are wrong. Previously (Cohen, 2001) I have used comparative historical analysis to identify the key conditions that appear to determine the *sustainability* of monetary unions over time: that is, the factors that influence whether joint currencies, once established, are fated to live or die. In this article I use the same conditions to assess prospects for the *creation* of monetary unions. A survey of possible candidates around the world, from Canada to Argentina and from East Asia to West Africa, suggests that prospects for full new monetary unions are dim at best, though conceivably some governments could be attracted to less demanding forms of currency alliance depending on bargaining context.

The key issue is *commitment*. A currency merger implies an upward shift in the delegation of formal authority. Involved is what Karen Litfin (1997) calls a "sovereignty bargain"—a voluntary agreement to accept certain limitations on national authority in exchange for anticipated benefits. Monetary sovereignty is pooled in a partnership of some sort. The main advantage is that participating governments might find it easier to promote the market share of a single joint currency as compared with the thankless task of trying to defend separate national brands. But therein also lies the main disadvantage, since pooling necessarily implies some measure of *collective* action in the issue and management of money. An alliance requires *allies*—other states with similar preferences and a disposition to act cooperatively. In practice, willing partners among sovereign states are just not all that plentiful.

Monetary Union

Monetary union, in the strictest sense of the term, means complete abandonment of a separate national currency. Only a newly created joint money is recognized as legal tender for a designated group of countries, and all decision making is lodged in a single central agency with strong supranational powers. As compared with the status quo of separate national currencies, a full monetary union offers distinct advantages. But there are also potential disadvantages that create serious obstacles to a successful sovereignty bargain. The conditions needed to facilitate the requisite degree of commitment are demanding and exist only rarely in practice.

Effects

Analytically, the effects of a monetary union are easy to identify. Most obvious are potential costs, which are not inconsiderable. Each state individually loses all the benefits that are traditionally associated with a national monetary monopoly: first, a powerful instrument to manage the macroeconomic performance of the economy; second, a possible source of revenue (seigniorage) to underwrite public expenditures; third, a potent political symbol to promote a sense of national identity; and finally, a practical means to insulate the nation from foreign influence

or constraint.[1] For sovereign governments, these are not easy sacrifices to contemplate.

All is not lost, however. On the positive side, partners can anticipate a reduction of transaction costs—an efficiency saving on all exchanges and investments within the group. Moreover, what is sacrificed at the national level is recouped at the group level. Authority is not surrendered but pooled—delegated to the joint institutions of the currency partnership, to be shared and in some manner collectively managed by all the countries involved. Each partner's loss, therefore, is simultaneously also each other's gain. The individual state may no longer have much latitude to act unilaterally, but every government retains a voice in decision making for the group as a whole. They are all, in this sense, gainers.

Net effects for participants, therefore, could turn out to be distinctly favorable. Like a cartel, a monetary union aims to improve the market position of its members—to create a single joint currency that, as compared with weakly competitive national monies, will have more appeal to market actors. The greater the appeal of the new currency, the more the benefits of monopoly, eroded at the national level, will be replicated at the group level; the more governments will be able to resurrect the privileges once enjoyed before the advent of deterritorialization, albeit now collectively rather than separately. By joining together, policymakers will be more strongly positioned to resist market pressures. They will thus be better able to guide macroeconomic performance, generate seigniorage revenue, promote a sense of community, and avoid external dependence. On all these scores the group could gain substantially as compared with what each government might achieve on its own. Joint gains could exceed the sum of individual losses by a sizable margin.

Obstacles

Why, then, do we not see more monetary unions sprouting up around the globe? Despite potential advantages, the number of monetary unions remains tantalizingly small. In addition to two arrangements left over from the era of colonialism—the CFA Franc Zone in Africa and the Eastern Caribbean Currency Union (ECCU)—only one new union, EMU, has come on the scene in recent years. Clearly, obstacles lie in the path of an alliance strategy—most notably, in the very fact that the strategy must be *shared*. Monetary union is by definition mutual, an exercise in collective action. An alliance requires allies, and it must be negotiated. Willing partners in a sovereignty bargain like monetary union are difficult to find and may be even more difficult to negotiate with.

Can the obstacles be overcome? Regrettably the contemporary empirical record, with only one new monetary union—Europe's EMU—to date, offers few direct clues. Indirectly, though, much can be learned from my previous analysis of the conditions that have determined the sustainability of monetary unions in the past (Cohen, 2001). The historical sample of currency unions, including all those that have eventually failed as well as those that survived, is quite a bit larger—certainly large enough to make clear just why an alliance strategy can be so challenging. The same factors that *sustain* monetary unions can be assumed to be instrumental in promoting their *creation* as well.

Economic linkages, my previous analysis suggests, are clearly insufficient on their own to sustain the necessary commitment. In assessing prospects for monetary unions, economists typically rely on the familiar theory of optimum currency areas (OCAs), which compares the benefit of reduced transaction costs with the potential cost of doing without either an autonomous monetary policy or a flexible exchange rate. A diverse range of variables is identified that arguably will affect the

[1] For more discussion see Cohen (1998).

magnitude of losses at the macroeconomic level, by influencing either the severity of payments disturbances or the ease of needed adjustments. Included among these so-called country characteristics are wage and price flexibility, labor and capital mobility, geographic trade patterns, size and openness of economies, and the nature, source, and timing of potential economic shocks. States are expected to be more amenable to an alliance strategy to the extent that prices and wages are flexible, factors of production are mobile, trade interdependence is high, economies are open, and shocks tend to be synchronized rather than asymmetric.

As often noted, however, the explanatory power of OCA theory appears limited at best. For every one of the characteristics stressed in this approach, there are contradictory historical examples—cases that conform to expectations suggested by the theory and others that do not (Cohen, 2001). Moreover, for any one country it is rare that all the factors cited point in the same direction, adding to the difficulties of forecasting; nor are all the variables necessarily mutually independent or easy to measure or compare for relative importance. In practice, none appears sufficient to explain observed outcomes. This is not to suggest that economic factors are therefore unimportant. Clearly they do matter insofar as they tend, through their impact on adjustment costs and speculative incentives, to ease or exacerbate the challenge of an alliance strategy. But it is equally clear, as one astute observer concludes (Goodhart, 1995:452), that OCA theory on its own "has relatively little predictive value."

Nor is much help offered by the details of institutional design—that is, the legal provisions agreed to govern the issuing of currency and the management of decisions. Such organizational formalities have differed sharply in various cases. In principle, such differences might be thought to matter insofar as they affect the net costs of commitment by individual states. Recent theoretical literature on transactions costs emphasizes the key role that institutional design can play in promoting credible commitments, by structuring arrangements to match anticipated incentive problems (Martin and Simmons, 1999). The higher the exit costs involved, the greater the disincentive for any government to defect. In looking at historical experience, therefore, we might reasonably expect to see a direct correlation between the degree of centralization of a monetary union and its practical sustainability over time. In practice, however, no such relationship can be found. Again, contradictory examples abound (Cohen, 2001).

Most decisive, it appears, are *political* linkages, which may take either of two forms. One, suggested by traditional realist approaches to international relations theory, is the presence or absence of a powerful state committed to using its influence to keep a monetary union functioning effectively on terms agreeable to all. The other, suggested by more institutional approaches to world politics, is the presence or absence of a broad constellation of related ties and commitments sufficient to make the sacrifice of monetary sovereignty, whatever the costs, basically acceptable to each partner. Judging from the historical record, I conclude that one or the other of these two types of linkage is necessary to sustain the requisite degree of commitment among independent states. Where both types have been present, they have been a sufficient condition for success. Where neither was present, unions have tended to erode or fail.[2]

The first type of linkage calls for a locally dominant country—a leader or "hegemon"—and is a direct reflection of the distribution of interstate power.

[2]This interpretation of the historical record, first articulated in 1994 in an earlier edition of Cohen, 2001, has been explicitly endorsed by most subsequent discussions. See, for example, Goodhart, 1998; Bordo and Jonung, 1999. Objections to my analysis have been raised by only one source, Andrews and Willett, 1997, who contend that a combination of economic and organizational factors perform as well as the political considerations I identify as decisive—despite the fact that, as Andrews and Willett themselves admit, half the cases examined fail to confirm their alternative view.

Scholars have long recognized the critical role that the leadership of a powerful state can play in maintaining the stability of a monetary regime. At issue, as David Lake (1993) has emphasized, is the provision of a type of public good—an essential "infrastructure" that will support both short-term stabilization and longer-term growth. The leader must be not only able but also willing to use its power, via side-payments or sanctions, to lower the costs or raise the benefits of commitment for its partners.

The second type of linkage calls for a well-developed set of institutional connections and reflects, more amorphously, the degree to which a genuine sense of solidarity—of *community*—exists among the countries involved.[3] Scholars have also long recognized the demanding psychological dimension of bargains to pool sovereignty. Participating states, at a quite fundamental level, must come to accept that individual interests can best be realized through joint commitments—through what Keohane and Hoffmann (1991:13) call a "network" form of organization "in which individual units are defined not by themselves but in relation to other units." Without such a sense of solidarity, governments will be more preoccupied with the costs of commitment than with the benefits.

The underlying logic of these linkages is clear. Sovereign governments need strong incentives to stick to bargains that might, at some point, turn out to be inconvenient. In practice, such incentives may derive either from the encouragement or discipline supplied by a single powerful state or from the opportunities and constraints posed by a network of institutional linkages. Economic ties may be weak or strong; likewise, organizational details may differ. But such factors appear to be of secondary importance at best. What matters most is a convergence of state preferences, supported either by a committed local hegemon or by a common project of integration. Von Furstenberg's reference (2000b) to "like-minded countries" is apt.

In turn, this logic suggests why a full monetary union may be so challenging to implement in the first place. In how many places can a suitably committed hegemon or necessary sense of community be said to exist? Where in the quarrelsome family of nations can the requisite like-mindedness be found? The obstacles to finding willing partners are formidable and, in most instances, likely to turn out to be insurmountable.

Europe

As a case in point consider Europe, home to the one new monetary union to be successfully negotiated in recent decades. For EMU, willing partners were in fact found—twelve in all by the time euro notes and coins made their appearance in 2002—with even more countries throughout East Central Europe and the Balkans clamoring to join at the earliest possible date. At first glance, the successful launch of the euro would seem to suggest that the obstacles to a full currency merger are not so formidable after all. But upon reflection it is clear that just the opposite conclusion is warranted, given the considerable time and effort Europeans had to put into getting the enterprise to this point. In many ways a unique undertaking, EMU is best understood not as evidence for enthusiasts but as the exception that proves the rule.

That EMU is exceptional is unquestioned. Never before, in modern history, has a group of fully independent states voluntarily agreed to replace existing national currencies with one newly created type of money. Even while retaining political sovereignty, member governments have formally delegated all monetary sover-

[3]This type of linkage is stressed as well by Scott Cooper (1999), in a systematic political analysis of regional monetary cooperation. Cooperation is facilitated, he argues, by a high level of intraregional trust, which may be understood as synonymous with what I call a sense of solidarity or community.

eignty to a common authority, the European Central Bank (ECB). These are not former overseas dependencies like the members of ECCU or the CFA Franc Zone, inheriting arrangements that had originated in colonial times. Rather, these are established states of long standing and include some of the biggest national economies in the world engaged in a gigantic experiment of unprecedented proportions. Not without reason, EMU is being closely watched around the globe as a test case for an alliance strategy.

But what does EMU prove? Obviously, the Europeans have demonstrated that the obstacles involved are not insurmountable. Participating governments did indeed find it possible to make a firm commitment. Under the 1992 Maastricht Treaty, which set the timetable for EMU, four so-called convergence criteria were specified, including tough restrictions on inflation, interest rates, fiscal deficits, and public debt. By the time the euro came into existence in 1999, most members of the European Union (EU) were judged to have met the Maastricht conditions or at least to have made substantial progress toward achieving them. The one exception, Greece, was permitted to enter the monetary union two years later.

But it is also obvious that the path to EMU was not easy, requiring more than four decades of determined effort despite unusually favorable circumstances. The European Union was in fact a near ideal setting for implementation of an alliance strategy. On the one hand, members were already intimately connected to one another through a dense network of institutional linkages that have only continued to spread and deepen over time. Growing like-mindedness was implicit in their common integration project. At the same time there was also a powerful local hegemon, Germany, whose policy commitment to monetary integration was never in doubt. For historical reasons, the Federal Republic has long found it useful to confirm its European credentials in this way even at the cost of sacrificing its own monetary independence. Yet resistance to creation of a joint currency was fierce. Two generations had to pass before EMU could be realized. If it took so long to get a monetary union started in Europe, why should we expect it to be any easier elsewhere?

Reasons for the long resistance to monetary union in Europe are not difficult to find. The problem has never been the prospective loss of the seigniorage privilege, to which little attention is paid. Unlike in many developing nations, governments in Europe have long ceased to rely regularly on money creation to finance public deficits, and most have developed ample alternatives to augment spending when needed. But many Europeans do worry about removing yet another layer of insulation against outside influence, to be wielded in this instance by a supranational ECB. Many worry as well about the diminished capacity of national governments to manage their own economy in the event of unanticipated shocks. With activist fiscal policy severely constrained by the Maastricht Treaty's restrictions on budget deficits, what would compensate for the loss of the money supply and exchange rate as instruments of macroeconomic policy? And in at least some member countries, there was also a deep reluctance to sacrifice what many regarded as a vital symbol of national identity. This is more than just a matter of what one noted economist has dismissed as mere "misplaced pride" (Alesina, 2001:223). Politicians concerned about remaining in office could hardly afford to ignore such strongly held sentiments.

What EMU proves, therefore, is that even in the most favorable circumstances, monetary union is difficult if not impossible to achieve. An alliance strategy is bound to encounter stiff resistance, for reasons both rational and emotional. In Europe, opposition has stemmed from worries about outside control, macroeconomic stabilization, and political symbolism. Elsewhere, potential seigniorage losses could also be a legitimate issue of concern. The obstacles to monetary union are surely not insurmountable, given appropriate leadership and political linkages. But even in

those exceptional circumstances where willing partners might be found, the process is unlikely to be consummated swiftly or easily.

Unwilling Hegemons

In this light, the outlook for many new monetary unions around the globe seems dim at best. The idea of currency alliance has been touted in almost every region of the world. In some cases, the aim of proponents has been to marry a smaller state in bilateral union with a larger neighbor. Examples include Canada, New Zealand, and Belarus. In each of these countries there has been lively discussion of the possibility of a currency merger with a larger power next door—respectively, the United States, Australia, and Russia. In other cases, the aim has been to build on regional integration projects comparable, in some degree, to the successful model of the European Union—including, most notably, groupings in Southeast Asia, South America, the Caribbean, West Africa, and the Persian Gulf. Talk, however, is cheap. The real question is whether the necessary political linkages exist or can be promoted. In practice, the obstacles remain overwhelming. Smaller countries considering a bilateral union have not found a suitably committed hegemon; likewise, in existing regional projects, the necessary sense of community has been most notable for its absence. A survey of all these cases confirms the difficulty of cultivating the requisite like-mindedness among potential partners.

Canada–United States

We begin our survey with the three bilateral cases. Consider, first, Canada, where the possibility of a monetary union with the United States has been actively debated in recent years.[4] The two neighbors are already closely linked economically through the North American Free Trade Agreement (NAFTA), which came into operation in 1993, as well as through a variety of other political and military arrangements and through closely related cultures and social histories. Though by no means a single community, the two certainly do not lack for a significant sense of solidarity. If in similar circumstances Europeans could agree to complement their free-trade zone with a common currency, many Canadians ask, why cannot North Americans do the same? A name has even been invented for a future joint money—the *amero* (Grubel, 1999), in flattering emulation of the euro. Unfortunately for its advocates, however, the idea of the amero has elicited no interest whatsoever south of the longest unguarded border in the world.

Most prominent among Canadian champions of a North American Monetary Union (NAMU) are economists like Thomas Courchene (1999) and Herbert Grubel (1999), who naturally tend to focus on the standard economic benefits and costs of currency regionalization. Efficiency gains, in particular, are stressed. Canada, it is argued, is becoming an increasingly open economy, in terms of both trade and investment. With up to 85 percent of Canadian exports now going to the United States, accounting for upwards of 40 percent of GDP, transaction costs would be significantly reduced by a merger of currencies. The result could be a substantial growth of trade and income. At the same time, potential costs are discounted. Little, allegedly, would be sacrificed in terms of macroeconomic stabilization, since Canadian inflation and employment rates are already so sensitive to developments below the border. Owing to the overwhelming dominance of America's economy, which is twenty times larger than Canada's, business cycles in the two countries have long been highly synchronized. Nor would the government be forced to forego any of the seigniorage that it currently earns from printing

[4]Though of recent origin, the current debate in Canada actually has roots going back to the first days of Canada's national currency in the nineteenth century, as Eric Helleiner (2003) has ably demonstrated.

money, estimated at about C$2 billion a year (Grubel, 1999:16), since NAMU would presumably include provisions for seigniorage-sharing. On balance, Canada would come out a winner.

Not everyone agrees, of course. The NAMU also has its opponents, who raise two principal types of objection. The first, essentially economic in nature, concerns exchange rates.[5] Canada's dollar—familiarly known as the "loonie" after the loon, a native bird, depicted on dollar coins— is presently allowed to float freely vis-à-vis all other currencies, including its U.S. counterpart. The advantage, in principle, is that a floating rate can function as a shock absorber to help cushion producers of primary goods from external disturbances. Commodity prices, as we know, tend to be relatively volatile, and among advanced economies Canada remains disproportionately dependent on its farming and extractive sectors, which still account for as much as a third of all exports. Independent analysis confirms that exchange-rate flexibility plays a useful role in buffering the Canadian economy against asymmetric shocks (Arora and Jeanne, 2001). By contrast, the currency cushion would be lost in the event of a monetary union with the United States. For all the synchronization of business cycles, the structures of the two economies remain strikingly divergent, with their terms of trade tending to move in opposite directions in response to fluctuations of commodity prices. The pair can hardly be described as an optimum currency area.

There are some grains of truth here, reply NAMU proponents. The exchange-rate cushion does help buffer the domestic economy—but at what price? In fact, they contend, the costs of preserving a separate Canadian dollar with a floating rate are considerable. In the short term, Canada's flexible rate tends to be volatile and subject to a good deal of "noise," sending confusing signals to the domestic economy. Over the longer term, floating is said to contribute to poor economic performance by reducing labor-market flexibility and delaying adjustment to a secular decline in global natural resource prices. Overall, NAMU proponents conclude, Canadians have suffered a marked loss of real income relative to their American neighbors, reflected in the sustained drop in the value of the loonie from near parity with the greenback as recently as the mid-1970s to not much more than sixty U.S. cents at the end of 2001—the currency's lowest level in over a century. The NAMU, by contrast, would supposedly send clearer price signals and encourage a quicker shift of resources from commodity production to more profitable sectors such as technology and services, accelerating growth of productivity and living standards.

The second type of objection encompasses familiar concerns about sovereignty and symbolism. Are Canadians really prepared to give up their embattled loonie and all it represents about the distinctiveness of Canada's culture and society? As Eric Helleiner (2003) writes, "the political battle over NAMU is inevitably a debate over Canada's national identity." More tangibly, are Canadians really willing to become junior partners of the Americans, as they inevitably would in any joint institution created to manage the amero? With less than one-tenth of America's population, Canada could hardly expect to receive equal representation in decision making. More likely, the country would simply become "a thirteenth district of a widened Federal Reserve System," as one critic suggests (Laidler, 1999:327).

Again some grains of truth are there, reply NAMU proponents, but are they overwhelming? Critics are cautioned against exaggeration. Many of the same arguments were made against NAFTA before its ratification and ultimately proved far from the mark. In fact, giving up a national currency by no means implies surrender of cultural autonomy or political independence. In all respects other than money, the nation would remain as sovereign as ever. As Grubel (1999:19–20), a former member of Parliament, concludes:

[5] See, for example, Laidler, 1999; McCallum, 1999.

> The basic fact is that the introduction of the amero does nothing to the existing national border and the ability of Canadian governments to pursue policies that get them re-elected. Nationalists do not have a good case to oppose the amero except on the grounds that it results in the loss of national monetary sovereignty. But [even] this loss is incurred in the expectation of large economic gains.

Though neither side in the debate lands a knockout blow, it is clear that the case for the amero cannot be dismissed out of hand. In fact, NAMU has roused widespread interest among Canadians and has even been the subject of parliamentary hearings in the nation's capital, Ottawa. Popular support is substantial, including key elements of the business community. At the end of 2001, according to a major opinion survey (Centre for Research and Information on Canada, 2002), some 55 percent of Canadians favored a monetary union of some kind with the United States. Typical are the remarks of one prominent business economist, once an opponent of a currency merger who has now come around to champion it. "Let's face it," she says, "our currency does not float, it sinks.... Let's [negotiate a currency union] and get it over with.... I do believe it's inevitable."[6]

Inevitable or not, though, Canada faces a serious problem. Even if approval among Canadians were to become universal, a towering impediment remains—namely, a total lack of interest on the part of the United States. As the much larger of the two countries, the United States clearly is in a position to play the role of supportive hegemon. But as even the most enthusiastic of NAMU proponents acknowledge, currency union holds little appeal below the border and has attracted even less attention. Americans show no enthusiasm whatsoever for the idea of sharing their traditional monetary sovereignty. The point is well put by Canadian economist John McCallum (2000:2), who observes, "the European Union model, in which independent states share decision-making and sovereignty, is alien to American thinking and American history.... [The United States] is obviously light years away from according [Canada] any formal role in the setting of US policy, let alone contemplating a move to a supranational, euro-style currency." Grubel regretfully concurs. "The biggest obstacle," he concedes (1999:39), "will be indifference in the United States."

In short, Canada lacks a willing partner; and without a willing partner, no collective action will be possible.

New Zealand–Australia

A similar problem looms in the South Pacific, where the possibility of a monetary union between Australia and New Zealand is also actively debated. Like the United States and Canada, the two antipodean neighbors are already closely linked through a free-trade accord, the Closer Economic Relations (CER) Agreement dating from 1983, as well as through other political and military arrangements and closely related cultures and social histories. And as in North America, interest has been piqued by the precedent of the euro. Here too a name has even been invented for the future money to replace the present Australian and New Zealand dollars. It would be called the ANZAC dollar—"Zac," for short. The problem is that here too the debate so far has been largely confined to the smaller of the two neighbors, New Zealand.

Interest at the eastern end of the Tasman Sea is evident. Acutely aware of their country's tiny size and geographic isolation, many New Zealanders feel that close integration with Australia, a market seven times larger, is imperative to ensure their future economic security. The CER is viewed as just the beginning, with monetary

[6] Sherry Cooper, as quoted in the *Globe and Mail*, 9 November 2001:B1.

union a natural corollary—simply, as one source puts it (Grimes, 2000:14), "the next logical step in the CER process." Discussion received a particularly strong impetus from the appearance in 2000 of a public manifesto for monetary union authored by two locally prominent economists, Arthur Grimes and Frank Holmes (2000).

Direct savings on transaction costs, advocates admit, would not be especially large, since only about a fifth of New Zealand's trade is with Australia, accounting for less than 5 percent of gross domestic product (GDP). At most, according to a study at the country's central bank (Hargreaves and McDermott, 1999:23), savings might amount to a minuscule 0.13 percent of GDP. But New Zealanders could gain substantially from lower and more stable interest rates, which by promoting economic growth might, in turn, generate further expansion of trade and investment.

Furthermore, advocates argue, New Zealand would have relatively little to lose in terms of macroeconomic stabilization, since the two economies are essentially alike both structurally and cyclically. Because each exports mainly primary commodities, terms-of-trade movements in the two countries are highly correlated, and business cycles tend to be synchronized. Consequently, New Zealand should have less need of a flexible exchange rate to buffer itself against adverse developments originating from its larger partner. Indeed, empirical evidence is cited to suggest that a joint money with Australia might actually provide a more effective shock absorber than the New Zealand dollar can do on its own (Grimes, 2000:12). Likewise, as in Canada, there would presumably be little, if any, revenue loss for the government, since an arrangement for revenue sharing could be anticipated.

In fact, the evidence on the cushioning role of New Zealand's floating exchange rate is mixed, as numerous studies demonstrate (Scrimgeour, 2002). While the correlation of shocks is high, it is far from perfect, owing to the differing composition of commodity exports from the two countries. Whereas Australia relies more on minerals, New Zealand ships more dairy and forestry products. Simulation exercises suggest that if New Zealand were to lose its ability to set monetary policy independently, the variability of both inflation and output could increase, rather than decrease, over the course of a typical business cycle (Drew et al., 2001).

Nonetheless, support for an ANZAC dollar is widespread among New Zealanders. In a survey of some four hundred local business firms, Grimes and Holmes (2000) found nearly 60 percent—three of five—in favor of a monetary union with Australia, with only 14 percent against. Opinion polls show a majority of the general public also backing an alliance strategy.[7] Even the prime minister, Helen Clark, has reversed her long-standing opposition. "If the largest countries in Europe see benefit in a currency merger," she said in late 2000, "what is so sacrosanct about the currency of a country with 3.8 million people? It might be one of those things that becomes inevitable as we have closer economic integration with Australia."[8]

But would Australians agree? The problem for New Zealand, as it is for Canada, is that the potential partner is just not interested. Like the United States, Australia clearly is in a position to play the role of supportive hegemon. But the issue is hardly debated at all by Australians, largely because direct benefits of a merger with their smaller neighbor would appear to be negligible at best. Australia's currency already enjoys a modest leadership role in the South Pacific and might even acquire additional followers. If New Zealand is so eager for a monetary alliance, Australians suggest, it should simply adopt Australia's dollar as its own, just as have some other

[7]As reported in the *Dominion* (Wellington), 20 September 2000:12.

[8]As quoted in the *International Herald Tribune*, 19 September 2000:17.

nearby island states (de Brouwer, 2000). When asked by a reporter what he thought of Helen Clark's remarks, Australia's finance minister flatly declared:

> We're not interested in any new currency, any third currency. We are happy with our monetary arrangements and we intend to keep them.... It's open to other countries to say we would like to adopt your currency.... We are not proposing to change the Australian dollar nor are we proposing to go into some new currency.[9]

Unless New Zealanders can find some way to change Australian minds, the whole notion of an ANZAC dollar must be regarded as a nonstarter.

Belarus–Russia

A third example is provided by Belarus, formerly a republic of the Soviet Union, which in Czarist times was known as White Russia or Little Russia. With only eleven million people, an economy overwhelmingly dependent on Russian oil, and an uncertain sense of its own nationhood, Belarus has attached little importance to preservation of any significant degree of monetary sovereignty for itself. On the contrary, its own currency, the Belarusian rubel—derisively known as the "bunny" (zaichyk) after the rabbit that appears on the face of bank notes—was adopted only reluctantly, when the old Soviet ruble zone broke up in 1992–93. Repeatedly, agreements have been signed with Russia calling for renewed monetary union between the two countries, most recently in 1999. Negotiations have been driven by the country's autocratic ruler, Aleksandr Lukashenko, whose fondest dream has been to engineer a political reunification with Russia. Moscow, however, is at best a grudging partner, wary of taking responsibility for Belarus's feeble economy. The Russians have been prepared to sign one document after another to appease a strategically placed segment of their "near abroad." But they have clearly been averse to going any further, toward any kind of practical implementation. Each accord, Russia's foreign minister has said pointedly, is "a declaration, not a treaty."[10] Belarus may be eager for monetary union, but like Canada and New Zealand it lacks a willing partner.

Insufficient Solidarity

Elsewhere, as indicated, monetary unions have been proposed that would build on regional integration projects already in existence. But nowhere does the local sense of solidarity seem sufficient to sustain the requisite degree of commitment.

East Asia

One region where monetary union has come up for a good deal of discussion is East Asia. Particularly since the financial crisis that hit the area in 1997–98, the idea has been widely mooted as a safeguard against future disruptions. The crisis seemed to suggest that the cost of defending diverse national currencies was, for most regional governments, becoming too high to bear. Perhaps a single regional currency could serve their interests better.

Typical were the remarks of the head of Hong Kong's monetary authority in early 1999, calling for an Asian monetary union to make the region less vulnerable to speculative attacks. "The time may come," he averred, "when we may want to consider the possibility of our own Asian currency."[11] The goal of a joint money has been promoted by Mahathir Mohamad of Malaysia[12] and has been formally

[9]Press conference, 13 September 2000 (available at http://www.treasurer.gov.au).
[10]Igor Ivanov, as quoted in the *New York Times*, 26 December 1998: A1.
[11]Joseph Yam, as quoted in the *Financial Times*, 6 January 1999.
[12]See, for example, *The Economist*, 19 December 1999:47.

endorsed as a "distinct possibility" by the heads of government of the Association of Southeast Asian Nations (ASEAN).[13] Numerous private specialists have also spoken in favor, including most notably Nobel laureate Robert Mundell.[14] Most experts emphasize the potential saving of transaction costs involved as well as the prospect for greater insulation against future crises. A common currency would reduce the risk of incompatible exchange-rate movements or other negative regional spillovers of the sort observed after the Thai baht's crash in 1997. One economist with expertise in the region flatly predicts an Asian Monetary Union (AMU) by 2010 (Walter, 1998).

But there are problems—not least, the challenge of identifying just which countries might become involved. The ASEAN would seem to be the most natural focus. Its ten members are in the process of building a free-trade area, first agreed to in 1992. An AMU, like an ANZAC dollar or NAMU, would seem a logical next step. But not even ASEAN's most ardent admirers think it likely that a monetary merger can be negotiated any time soon. When asked about prospects for a common currency, ASEAN's secretary general looks around the room for the youngest person present and responds, "Perhaps in her lifetime."[15] Noting how long it took Europe to conceive the euro, the Philippines finance minister has grimly commented, "perhaps it will also take us that time."[16]

The reasons for such doubts are evident. In the first place the ASEAN partners are an obviously diverse lot in terms of economic structure and development, ranging from modern high-tech Singapore and emerging manufacturing centers like Malaysia and Thailand, to rural and still primarily agrarian economies such as Cambodia, Laos, and Myanmar. Trade relations tend to be highly diversified geographically, with relatively little intragroup trade, and there is no evidence of significant convergence in terms of either economic shocks or macroeconomic performance. Econometric studies confirm that the group remains far from anything that might be described as an optimum currency area (Eichengreen and Bayoumi, 1999), meaning that the economic costs of a merger could be painfully high.

Even more critically, ASEAN is still at an early stage of evolution as a political community. For all their protestations of amity, member governments remain noticeably distrustful of one another and place a high premium on preservation of as much national sovereignty as possible. In fact, the group is rife with historical antagonisms, ethnic and cultural conflicts, and border disputes. Unlike Europeans, East Asians are as yet unwilling to pay even lip service to the notion of "an ever closer union" among their peoples. Most, having only recently emerged from colonial status, are more intent on individual state-building than on promoting regional solidarity. Few demonstrate much inclination to define themselves in relation to one another rather than in their own terms.

Efforts to promote regional solidarity have not been absent, of course. On the contrary, ASEAN governments have invested considerable effort in building a variety of linkages across their borders, including not only their free-trade accord but also agreements to integrate key infrastructure elements like railways, highways, and electrical grids. In monetary matters, central banks have cultivated closer ties through annual meetings of governors and enhanced cooperation on training and technical matters, and member-states have several times pledged to institute a system of mutual surveillance of economic policies. For the most part, however, ASEAN governments continue to rely primarily on informal arrangements and market processes rather than formal institutions to pursue their

[13]Final communiqué of the meeting of ASEAN heads of government in Manila, Philippines, 28 November 1999.

[14]As reported in *IMF Survey*, 8 October 2001:318–319.

[15]Rodolfo Severino, as quoted in *The Economist*, 12 February 2000.

[16]Edgardo Espiritu, as quoted in *The Economist*, 12 February 2000.

objectives. The ASEAN, they insist, is a voluntary association of independent states, not an EU in the making. Representative are the admonitory words of the managing director of Singapore's monetary authority: "Eventually some form of cooperation will emerge as market forces bring about economic integration. I would caution against forcing the process."[17]

Mercosur

The story is much the same in Mercosur, the four-member Common Market of the South located in the southern cone of South America, where there has also been discussion of a possible monetary union. These countries too have had their share of currency crises, including Brazil's devaluation in 1999 and the collapse of Argentina's currency board in late 2001. However, these too are a diverse lot in terms of economic structure and development and are still at an early stage of evolution as a political community. Willing partners for a monetary merger are in scarce supply in Mercosur as well.

Recent discussion was kicked off by Carlos Menem when he was still president of Argentina, who began calling for a common currency for Mercosur as early as 1997. Part of Menem's motivation was to find a way to prevent Argentina's peso—tied as it was by its now-defunct currency board to the strong U.S. dollar—from appreciating relative to the Brazilian real. Argentina needed to maintain price competitiveness in relation to its biggest trading partner. Partly also he was driven by a genuine commitment to Mercosur as an integration project. Although his proposal initially received a frosty reception from the government of Brazilian President Fernando Cardoso, a common currency has now officially become part of Mercosur's agenda. Brazil's early response was motivated mainly by a visceral distaste for any sharing of monetary sovereignty. But by the end of 1999, President Cardoso had publicly warmed to the idea, saying that "[i]t takes some time to realize just how ... important it is."[18] Cardoso's newfound enthusiasm was echoed in turn by his successor, Luiz Inácio Lula da Silva, following presidential elections in late 2002.[19] At the end of 2000, a timetable was agreed for a "mini-Maastricht"—a set of macroeconomic convergence targets similar to those specified by the EU's Maastricht Treaty—aiming to establish the preconditions for an eventual monetary union. The long-term goal of a joint currency is now regularly endorsed at Mercosur meetings.

In practice, however, no one expects to see a monetary merger any time soon. The idea has its fans. But as one informed observer suggests (Wheatley, 2001:25): "The idea of creating a common currency à la the euro remains a distant dream." One reason is that like ASEAN, Mercosur is still far from anything that might be described as an optimum currency area, as numerous studies attest (Levy-Yeyati and Sturzenegger, 2000). Hence, as in ASEAN, the economic costs of a merger could be painfully high. Price trends and cyclical developments in the participating economies remain highly divergent. Mercosur is still not even a true common market, despite the pledges that were made to remove all mutual trade barriers when the group was started back in 1988. In fact there was some regression after the start of 1999, when Brazil's devaluation led to new import restraints in Argentina and tit-for-tat retaliation by the Brazilians. Intra-Mercosur trade dropped from a high of 25 percent of member exports in 1998 to under 18 percent three years later. Some hope for greater macroeconomic convergence was raised after Argentina abandoned its currency board in late 2001, but little progress seemed likely in the short term.

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[17]Tharman Shanmugaratnam, as quoted in the *Financial Times*, 5 June 2001.

[18]As quoted in the *Financial Times*, 10 November 1999:19.

[19]See, e.g., the *New York Times*, 3 December 2002:A6.

Even more critically, the four participants are also still far apart politically, all protestations to the contrary notwithstanding. This is especially true of the group's two dominant members, Argentina and Brazil, traditional rivals for South American leadership. Despite their historic reconciliation in the late 1980s, which made Mercosur possible, the Argentines and Brazilians remain wary of one other and fundamentally resistant to any initiative that might make one subject to the dominance of the other. On both sides, political elites have shown great reluctance to cede any significant amount of policy autonomy to joint institutions (Kaltenthaler and Mora, 2002). Real progress toward a Mercosur common currency will be impossible without a much higher level of mutual trust between these two uneasy neighbors.

The Caribbean

Monetary union has also come up for discussion in the Caribbean, building on the already established Eastern Caribbean Currency Union. The six sovereign members of the ECCU, embedded in a network of related agreements including the Eastern Caribbean Common Market and the Organization of Eastern Caribbean States, are in turn partnered with eight neighboring states in a broader regional grouping known as the Caribbean Community and Common Market (CARICOM).[20] In 1992, the governors of CARICOM central banks put forward a detailed proposal to launch a Caribbean Monetary Union (CMU) to include all members of CARICOM by the year 2000. The plan was quickly accepted in principle by CARICOM heads of government and officially remains a key objective of the organization.

In practice, however, CMU remains a distant dream. The 2000 deadline has long since passed, and few in the region expect to see the birth of a new joint money any time soon. Typical are the words of the prime minister of Barbados, speaking in 1999: "The ideal is to achieve the common currency.... We know it can work. But it took the Europeans forty years to do it.... This will take some time."[21] Little has been done to formally implement the 1992 plan, which many informed observers regard as unrealistic for such a diverse set of economies (Anthony and Hughes Hallett, 2000). Though all are relatively small and open, they differ greatly in level of development and export structure. Some, like the ECCU states as well as Bahamas and Barbados, rely mainly on tourism and services, while others depend more on mining (Guyana, Suriname), oil and petrochemicals (Trinidad and Tobago), or light manufacturing (Haiti, Jamaica). The CMU has been justified, first and foremost, as a way of imposing discipline on the more inflationary members of CARICOM. (The worst offenders have been Jamaica and Suriname.) But despite the existence of multiple economic and political linkages, the notion has been resisted by some non-ECCU countries, fearful of any compromise of their traditional monetary sovereignty. Most of the non-ECCU countries prefer to continue producing and managing their own separate currencies, however uncompetitive they may be.

West Africa

A detailed plan to launch a new monetary union has also been agreed to by six countries of West Africa—Gambia, Ghana, Guinea, Liberia, Nigeria, and Sierra Leone. All are members of the Economic Community of West African States

[20]The six sovereign members of the ECCU are Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines (along with two British dependencies, Anguilla and Montserrat). The eight neighboring states that are their partners in CARICOM are Bahamas, Barbados, Belize, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago.

[21]Owen Arthur, as quoted in *Journal of Commerce*, 7 December 1999:17.

(ECOWAS) together with the eight members of the West African Economic and Monetary Union (WAEMU), which in turn is part of the CFA Franc Zone. In April 2000, the leaders of the six non-CFA members of ECOWAS declared their intention to complete a "second" monetary union among themselves by January 2003, as a first step toward a wider merger to include all ECOWAS states by 2004. Initially, the six agreed to create a Convergence Council to help coordinate monetary policies, as well as a West African Monetary Institute to begin setting up a central bank. Eventually, the new monetary authority would be consolidated with the already existing central bank of WAEMU, the Banque Central des Etats de l'Afrique de l'Ouest (BCEAO).

The West African plan is ambitious and, if ultimately it were to combine with all of the CFA Franc Zone, could encompass nearly half the states of sub-Saharan Africa. Proponents stress the usual efficiency gains of a common currency and discount any costs that might be involved. In the words of a member of the ECOWAS Secretariat,[22] "Given the propensity over the years for monetary mismanagement in West Africa, the costs associated with the loss of national monetary instruments would not really amount to much." Much emphasis is also placed on the psychological importance of monetary union as a high-profile symbol of regional integration. Officials acknowledge that their inspiration comes directly from the euro and its role in the promotion of European unity (Irving, 2001).

Others, however, question whether the project is realistic. At a technical level, the challenges are considerable. On the model of the EU's Maastricht Treaty, the plan calls for each country to meet a number of macroeconomic convergence criteria no later than 2003, requiring inter alia steep reductions in inflation rates and budget deficits. Given past policy performance in the region, many wonder whether all this could really be accomplished in two years—or even in ten or twenty. As one analysis dryly comments (Masson and Pattillo, 2001:7), "it is not clear how the list of planned policy measures can be reconciled with the timetable." Likewise, does it really make sense to create an entirely new monetary authority for the six, only to merge it with the BCEAO a year later? Once established, would the new central bank truly be prepared to give up its institutional independence? The practical obstacles to implementation seem imposing.

Even more formidable are challenges at the political level. Apart from their common membership in ECOWAS, the six states have few direct linkages. Even a minimal sense of community is missing. Mutual trade is small, at a little over ten percent of the average of exports and imports, while historical antagonisms in some instances remain deep and persistent. Moreover, most of these countries have only recently emerged from extended civil strife, making implementation of such demanding new commitments highly problematic.

The project's best hope is that Nigeria, by far the biggest state in the region, might play the role of supportive hegemon. The political will appears to be there. Indeed, it was as a direct result of Nigeria's leadership, together with Ghana, that the six countries were able to reach agreement in the first place. But even if the Nigerians are willing to lead, will others be prepared to follow? It could be difficult enough to persuade other former British colonies in the region, each determined to assert its own distinct nationality, to cede pride of place to Nigeria. It would undoubtedly be even more distasteful to the francophone states of the CFA Franc Zone, with their quite different cultural and political orientations.

In fact, prospects for full implementation of the West African plan are limited at best. Nor, despite much talk, does there seem any likelihood of new currency mergers elsewhere on the African continent, according to recent studies (Honohan and Lane, 2001). In Africa, as in the Caribbean, there is still much resistance to any significant compromise of monetary sovereignty.

[22]R. D. Asante, head of the Money and Payments Division of the ECOWAS Secretariat, in Irving, 2001:26.

The Persian Gulf

Finally, there is the strategic Persian Gulf, where since 1981 the six Arab monarchies of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates have been grouped together in a loose association known as the Gulf Cooperation Council (GCC). The GCC was initially established as a security alliance, to help safeguard members against possible fallout from the 1979 revolution in Iran and the Iran-Iraq War that began in 1980. To say that the Gulf region was—and, for that matter, still is—unstable would be an understatement. Six countries that otherwise had never felt much solidarity with one another were drawn together in hopes of better protecting themselves against threats of external aggression or internal unrest.

Interpreting security broadly, the GCC soon added an economic dimension with a Unified Economic Agreement in 1982, inter alia calling on the six partners to "seek to coordinate their financial, monetary and banking policies and enhance cooperation between monetary agencies and central banks, including an endeavor to establish a common currency."[23] In matters of trade the economic agreement has been relatively successful, leading to the elimination of all customs duties among the members and a broad harmonization of external tariff rates. But in matters of money little has been done, in practical terms, to translate rhetoric into accomplishment, despite repeated reaffirmations of monetary union as a goal. The closest members have come to serious action was in 1987, when they agreed in principle to coordinate their exchange rates. But the effort was soon abandoned when governments could not concur on a common anchor. Little evidence exists of any degree of macroeconomic convergence.

More recently, at a summit meeting in January 2002, GCC leaders renewed their call for a common currency as part of a broad plan for deepening their economic integration. But the deadline for the projected monetary merger was set for 2010, far enough in the future so that, conveniently, no immediate action would be required. Few observers expect to see significant progress any time soon.

Conclusion

The conclusion, then, is plain. Predictions of many full new monetary unions around the globe, on the model of Europe's EMU, appear premature at best. The difficulty of defending uncompetitive national currencies is certainly growing. But for most governments, the disadvantages of monetary union continue to look more formidable still. Few states share enough group loyalty to make the requisite sacrifice of monetary sovereignty seem acceptable; and even for those that might be prepared to make the commitment, willing partners are hard to find.

Of course, full monetary union is not the only option. Less demanding forms of alliance strategy are also possible, requiring something short of a complete pooling of monetary sovereignty. Indeed, much room exists for variation in the degree of formal authority to be delegated to joint institutions to accommodate the interests of individual countries. Monetary powers need not be as centralized as they are in the ECCU and EMU. The merit of a more decentralized alliance is that it offers a possible compromise between the pressure of defending uncompetitive national currencies and the lack of willing partners for a full monetary union. Policies can be decided jointly, including especially goals for monetary growth and interest rates, but implemented individually in accordance with local circumstances. Likewise, the degree of fixity of exchange rates can be made a matter of negotiation. The idea is to enhance the market appeal of participating currencies while retaining at least

[23] GCC Unified Economic Agreement, 8 June 1982, Article 22.

some of the historical advantages of monetary sovereignty. Might some governments elect this more limited option?

In the case of possible bilateral mergers, the answer is almost certainly negative. Smaller countries like Canada, New Zealand, and Belarus, seeking an alliance with a much larger neighbor, might see virtue in the option. They would gain a voice in joint decision making yet not lose their own national currency. But they would face the same problem as with a full monetary union—namely, lack of a willing partner. For the United States, Australia, or Russia, there would be little direct benefit in sharing even a limited amount of their monetary authority with a smaller neighbor. Their interests would be better served if the smaller neighbor simply adopted the larger neighbor's currency as their own, as Australians suggest to New Zealand.

Elsewhere, where monetary union is discussed in the context of a broader integration project, the probability of some lesser form of monetary alliance is greater. In some instances, a foundation is already laid—in Mercosur, for instance, with its intended "mini-Maastricht," or in West Africa with its Convergence Council and Monetary Institute. In others, the task will be to build on related institutional links and commitments. Chances that governments will elect to go this route are lowest in places like the Caribbean or Africa, where ties to the United States or Europe are also strong. In these regions, many countries might be attracted more to some form of currency board or hard peg anchored on either the dollar (in the Caribbean) or the euro (in Africa). Chances would be higher in regions where there is no obvious alternative to such an approach, as in ASEAN, Mercosur, or the Gulf. In these groups, there will be more incentive for a mutual commitment of some sort. At a minimum, a limited partnership might enhance the market appeal of their individual currencies. At a maximum, it could eventually generate the kind of like-mindedness that is needed to realize the still distant goal of a common currency.

In short, pace Michel Camdessus, George von Furstenberg, and others, the number of currencies around the world is not about to shrink dramatically. The world's monetary map may include a growing number of limited alliances but few, if any, new joint currencies like the euro. Monetary unions are not inevitable. Quite the contrary, in fact. The purported wave of the future, most likely, will turn out to be little more than a ripple.

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