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EUROPE'S MONETARY FUTURE

I am convinced that to a very large extent the future of the European Union depends on the strategy of monetary unification we are going to follow in the next few years. Should we continue with the present strategy, based on gradual convergence according to the Maastricht parameters, a common currency for Europe is unlikely to be achieved. Furthermore, the "convergence paradigm" might result in the division of Europe, in the separation of the group of "virtuous" countries that have succeeded in meeting Maastricht's arbitrary criteria from all other European countries, presumably unfit to be admitted to the exclusive club of the virtuous. Such an outcome would represent yet another illustration of the disastrous political consequences of unsound economic decisions.

In order to illustrate this view, I shall analyze the future of Europe's monetary unification in the light of the experience of the past twenty five years and in the perspective of what I consider a necessary revision of our strategy. I maintain that pegging the exchange rates and trying to impose uniform convergence criteria on all European countries will not only produce undesirable consequences, it will not bring us any closer to a common Euro-

1. What follows is based, with modifications, on my paper "A Monetary Constitution for Europe?," *The Cato Journal*, Volume 10, Number 2, Fall 1990, pp. 519-533. Needless to add, these are my personal views and do not necessarily reflect the Italian government's position.

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pean currency. That outcome depends on whether we adopt a monetary Constitution or not, that is on whether we succeed in spelling out a set of rules of monetary conduct capable of providing adequate guarantees against European monetary mismanagement.² In other words, a monetary rule is a necessary precondition for moving toward a common European currency. If, on the other hand, money continues to be used as an instrument of discretionary *policy*, monetary unification is unlikely to be achieved.³ Therefore, those of us who believe that monetary unification is desirable should concentrate on identifying the rules most suited to that end.

ADVANTAGES OF A COMMON CURRENCY⁴

Let me start by refuting some mistaken notions on the need for monetary union. First of all, it's simply not true that a single

2. By monetary Constitution I mean a regime "in which the discretion of the policy making authorities is constrained, at least in the short run." (Leijonhufvud 1987, p. 130).
3. Agreement on the need for a monetary rule is far more important than the choice of the actual monetary Constitution. As pointed out by J. M. Buchanan, agreement on the need for a monetary Constitution should take precedence over that on the specific kind of rule to be adopted :
 "I think that this debate-discussion (on monetary reform) is prematurely joined when we start referring to the advantages and disadvantages of this or that rule, this regime or that regime ... Debates about which of the alternative regims is to be preferred must take place. But, prior to this discussion, we should try to attain consensus on the need for some alternative regime that will embody greater predictability than the unconstrained monetary authority that describes that which now exists. The familiar analogy is with the traffic chaos that would exist if there were no rules. The first requirement is that there be some rules of the road. Whether or not these rules require driving on the left or the right is of secondary importance to the requirement that there be a rule." (Buchanan1983, 1987, p. 124.)
4. What follows draws on my 1989 paper, and, to a lesser extent, on previous work; see, Martino 1971a, 1971b, 1976, 1977, 1978a, 1978b, 1986, 1988.

market is unachievable without monetary unification. It is perfectly possible to have one without the other : Commonwealth countries had a common currency without economic integration; Canada and the USA have economic integration without a common currency. At present, we have a single European market without a European currency. Secondly, it's dubious, to say the least, that claiming that there is a "fundamental link" between political and monetary union would bring us closer to a common currency for Europe.⁵

But, would Europe benefit from a common currency ? If, for the moment, we ignore both the difficulties of achieving that result and the preoccupations with the conduct of monetary policy after the establishment of a common currency, the answer is positive : Europe and the world would probably benefit a great deal from a common European currency.

Interestingly enough, most commentators seem convinced that the only advantage of a common currency for Europe would be that of reducing uncertainty in foreign exchange markets.⁶ I do not wish to deny the importance of reduced uncertainty in foreign exchange markets and of a saving in transactions costs, but first of all I think it's reductive to see no other advantage in a common currency for Europe; as I shall try to show, there are other, possibly more relevant, advantages. Secondly, I believe it is this reductive interpretation of the benefits of a common currency that has led to the fallacious identification of monetary unification

5. As maintained by Karl Lamers, "Compelling case for Monetary Union", *Financial Times*, Monday November 7, 1994. p. 16.

6. For example, in the words of a European central banker :

"(I)n what circumstances would the benefits of a single currency exceed the costs? The Benefits are fairly easy to identify. Where prices within an area are quoted in a common currency, uncertainties arising from unpredictable exchange rate fluctuations within the area are removed. In consequence,

with fixed exchange rates, which is responsible for some of the difficulties which we have encountered thus far. Let me first start to list what I consider to be some of the main advantages other than the reduction in transactions costs.

International stability. A common European currency could provide an alternative to the US dollar as an instrument of international liquidity. The "national" currency of such a large market could achieve the same degree of acceptability presently enjoyed by the dollar. The competition between the two major international currencies would result in some kind of "Gresham's law" in reverse, because the more stable currency would be preferred in international transactions. The overall stability of the international monetary system would increase.⁷

business decisions are not complicated by a need to take account of possible exchange rate changes within the currency area, which would help to improve confidence, particularly in relation to investment decisions with long time horizons. Furthermore, there would no longer be any transaction costs associated with exchanging one currency for another or with trying to hedge against changes in rates." (Leigh-Pemberton 1989, p. 12) Apparently, this has also been the consensus among professional economists and public opinion :

"There is little disagreement among economists about the benefits of monetary union, i.e., of a system in which exchange-rate risks, exchange control risks, payments restrictions, the costs of information about exchange rates and exchange-market prospects, and hopefully the costs of money-changing are eliminated. Monetary union fined in this way intensifies competition and international integration of product as well as factor markets." (Vaubel 1979, p. 19).

"There would also be a big saving in transaction costs. The story goes that somebody setting out of Britain with £1,000 to visit each of the EEC countries, changing his money into local currency evrey time but buying nothing, would arrive back with only £500. Monetary union would be such a blessing to people like that. And to everybody else." (*The Economist*, June 24, 1989, p. 20).

7. For the analysis of currency competition, see, for example, Hayek 1976, Vaubel 1986, and Dowd 1988.

In particular, Europe would benefit in that it would be able to use its own currency, rather than the US dollar, as a reserve asset.⁸ Needless to say this would not be a minor advantage, and, by itself, might in fact be as important as (if not more important than) the saving in transactions costs. The US would also benefit to the extent that a monetary system based on two currencies would make the external value of the dollar less volatile.

Balance of payments equilibrium : Inside Europe, a common currency would eliminate balance of payments problems, making the "adjustment process" smooth and automatic. There would be no balance of payments problems between, say, England and France because both countries would be using the same currency. National economic policies would, therefore, be relieved of one of their present worries.

Internal stability : With a common European currency, provincial considerations would play no role in monetary decisions, which would aim at overall stability rather than respond to "local" pressures. As a result, for example, there would only be one rate of inflation rather than twelve. This is a very important consideration indeed: I know of no economist willing to argue that a proliferation of regional currencies within a given country would increase overall monetary stability on a national level.⁹

8. If Europe had a common currency, there would be one Central Bank rather than twelve. Even more important, the dollar reserves presently used by the national Central Banks would become unnecessary and, if the common currency was allowed to float freely in international markets, the European Central Bank's reserve requirement would be very small.
9. It is in the light of this argument that one should read *The Economist's* point : "simply ask whether America would be better off with separate currencies for each of its states." *The Economist*, June 24, 1989. Strangely enough the only problem that the authoritative publication sees in having the USA use 50 different currencies is that of the cost of converting one into another !

Freedom and efficiency : A common currency would make the liberalization of capital movements within Europe automatic and irreversible, with all the known advantages in terms of personal liberty and economic efficiency. It would be as difficult to restrict capital movements in an area using the same currency as it is within a given country. The overall efficiency of the single market would be enhanced.

These are not necessarily *all* of the benefits from a common currency for Europe, but it seems to me that they are possibly more important than the advantage of reduced uncertainty in foreign exchanges and of savings in transactions costs. Furthermore, while the smoothness of the adjustment process and the elimination of balance of payments problems could also be achieved by a system of freely floating exchange rates among European national currencies, all the other advantages can only be attained by a single currency for Europe.

OBJECTIONS TO A COMMON CURRENCY

Several objections have been raised to the idea of adopting a single European currency. While some are undoubtedly well-founded (if not insurmountable), others are, in my view, definitely dubious. Here are some of the major objections.

The most common objection is that "*money does not manage itself*" : discretionary monetary management requires political control. Europe's present political institutions are inadequate for that kind of task. A variation on this theme is that the surrender of monetary sovereignty is unjustifiable at this point, since the existing European political institutions could not guarantee member states that the common currency would be managed in a way of which they would approve.

Another objection is that a common currency would be premature, given the present heterogeneity of the various Euro-

pean national economies. Monetary unification according to this view, should follow, not precede, "economic integration."

A third objection states that monetary unification would be beneficial to "high-inflation countries" and harmful to "low-inflation countries." The idea here is that with a common European currency inflation in Europe would settle at some kind of average of the existing national inflation rates.

Finally, there is a problem which is seldom explicitly stated : money creation is an important source of revenue for national governments, and they are not ready to give it up easily.

ARE THE OBJECTIONS VALID ?

None of the preceding objections is insuperable. Some are totally false : for example, different regions of the same national economy are often very heterogeneous, yet this does not prevent them from using the same currency. As previously mentioned, no one has advocated the introduction of separate regional currencies as an instrument to reduce national heterogeneity.

A different version of this argument draws on Keynesianism : a monetary union would prevent "individual member countries from each attaining their optimum combination of inflation and unemployment on the so-called Phillips curve." *See* (Vaubel 1979, p. 20) However, as Vaubel pointed out, the "trade-off between inflation and unemployment has disappeared," and few economists today believe that much good can result from monetary instability. From this point of view, therefore, Vaubel's conclusion seems as valid today as it was fifteen years ago : "If national monetary policy can no longer be used to raise employment, the economic cost of joining a monetary union must be small indeed." (Vaubel 1979, p. 20.)

Also, there is no reason to suppose that a common currency would result in an inflation rate equal to the average of today's national rates. If Europe would adopt a common currency, it would have one rate of inflation (rather than twelve), which would be "high" or "low" depending on whether the rate of growth of the money supply at the European level was "high" or "low." The classification of countries in "high inflation" and "low inflation" is highly misleading because it suggests that somehow the degree of monetary stability/ instability of a country is determined by some "inevitable law of historical destiny," and it has nothing to do with the country's actual monetary policy. Monetary history provides irrefutable evidence that this is not the case.

It seems to me that there are only two valid objections to a common currency. One is related to the use of money as an instrument of discretionary policy; the other is connected with its use as a source of revenue by European national governments. But, before discussing these, I shall make a few remarks on the transition process.

THE TRANSITION PROCESS

"Does all this mean that European monetary union, let alone European political integration, is not an aim worth striving for? In my view, such a conclusion would be premature. It may very well be that European monetary union would be a great achievement, but that the road by which we are trying to reach it is conducive to serious breakdowns and accidents and, indeed, does not lead to its ultimate destination. What must worry all advocates of European integration is precisely that the choice of an unworkable strategy will—again, and this time fatally—discredit the whole idea of a united Western Europe." (Vaubel 1979, p. 19)

Vaubel was right : even today, much of the discredit surrounding the idea of a common European currency is due to

the political attempts at planning a strategy for the transition process. This is true of the earlier efforts as it is of the present one. The "original sin" is that of identifying monetary unification with fixed exchange rates.¹⁰ It is an old mistake : it was the basic assumption of the Werner plan of 1970, of the 1972 "snake," and of the present European Monetary System. As for the Maastricht strategy, it is based on the notion that irrevocably fixed exchange rates between national currencies and coordination of policy between separate national authorities are necessary (and sufficient?) first steps toward monetary union. Once fixed exchange rates are attained, monetary unification will be completed.

Despite the experience of the past twenty five years, we still proceed on the assumptions that fixed rates are almost indistinguishable from monetary union, and a necessary step toward that goal. I find this view unacceptable.¹¹

10. "The adoption of a single currency, while not strictly necessary for the creation of a monetary union, might be seen for economic as well as psychological and political reasons - as a natural and desirable further development of the monetary union." (Delors Report , April 1989, p. 10)

Strangely enough this identification of monetary union with a system of fixed exchange rates is explicitly accepted even by *The Economist*: "A fully fixed system would eliminate the bonds within which the currencies are allowed to fluctuate. Monetary union would then go one step further by adopting a single currency ." *The Economist, op. cit.*, p. 18.

11. In the words of Professor Milton Friedman :

"The basic fact is that a unified currency and a system of freely floating exchange rates are members of the same species even though superficially they appear very different. Both are free market mechanisms for interregional or international payments. Both permit exchange rates to move freely. Both exclude any administrative or political intermediary in payments between residents of different areas. Either is consistent with free trade between areas, or with a lessening of trade restrictions.

On the other hand, national currencies linked by pegged exchange rates, whether or not through the mechanism of gold, and a system of variable

Furthermore, while a single European currency automatically implies a single monetary *regime* and is, therefore, immune of balance of payments problems¹², a system of fixed exchange rates among different national currencies does not. It can survive if, and only if, it succeeds in imposing coordinated patterns of behavior on all member countries. This last possibility, witness the events of September 1992, is rather remote.¹³

Finally, it isn't true that fixed exchange rates would bring Europe closer to monetary unification. In fact, the opposite might very well be true.¹⁴ This is so, because under fixed exchange rates,

exchange rates, controlled and manipulated by governmental bodies, either through an adjustable peg or day-to-day market operations, are also members of the same species. Both are interventionist standards. Neither, in my opinion, is consistent with a permanent lessening of barriers to international trade, but only with oscillating barriers as nations shift from surplus to deficit." (Friedman 1968, p. 271-272).

12. Professor Milton Friedman has repeatedly argued that the two necessary and almost sufficient conditions for disequilibria in the balance of payments are fixed exchange rates and autonomous national central banks.
13. In the words of Roland Vaubel : "The snake approach, the monetary-harmonization approach and the combined money-supply and exchange-rate approach all belong to one family : they are all co-ordination strategies. They do not lead to the creation of a common currency. The crucial defect of all co-ordination strategies is that they rely on discretion instead of automaticity.
(...) Since the co-ordination approach lacks automaticity, it fails to make exchange rates predictable, If it involves the fixing of parities, it may indeed lead to more errors and uncertainty than exchange rate flexibility and the pre-announcement of definite rates of national money supply growth which exchange rate flexibility makes possible." (Vaubel 1979, p. 25).
14. As Sir Alan Walters has argued : "Compared with a floating system, the EMS entails a considerable politicization of exchange rates. The occasion for realignments involves a great political bargaining session rather than an occasion on which to review the fundamentals of real exchange rates. (...) If the ultimate objective is the monetary integration of Europe through a European Central Bank in a single currency area, then the EMS seems to be hardly a step in the right direction. It creates too many tensions, both economic and political." (Walters 1988, pp. 505-506).

domestic policy goals are at times incompatible with external balance. When such a dichotomy arises, the alternative to a change in the exchange rate is that of imposing the burden of the adjustment process on domestic macro-variables. Balance of payments equilibrium is then achieved without any change in the exchange rate parity but at the cost of sacrificing domestic stability.

Such a choice is neither desirable nor likely to be made : should a country find itself forced to choose between pursuing domestic policy goals or adhering to "irrevocably fixed rates," it would most likely let the exchange rate adjust to a new equilibrium. The arrangement suggested by the present transition strategy is, therefore, unlikely to succeed. Needless to add, the failure of the authorities to maintain their "irrevocably fixed rates" for an indefinite period of time would result in frustration and it would discredit the idea of monetary unification.

GRADUALISM AND CONVERGENCE

The crucial error of identifying fixed exchange rates with monetary unification is probably the result of a mistaken concept of gradualism. Gradualism is a very useful political tool, but it can be applied only to problems which have a divisible solution, it certainly cannot be used for problems with an indivisible solution (of the all-or-nothing type). A common European currency is indivisible : we either have it or we don't - we cannot have just a bit of it.¹⁵ It has been possible to liberalize trade gradually, because tariffs are divisible, and can be reduced progressively. But I don't see how a common currency can be divided into separate allotments to be incrementally added to the existing bundle. And, in any case, fixed exchange rates do not represent the "partial" creation of a common currency.

15. Of course, this does not imply that its introduction cannot be gradual, as Vaubel recommends. (see Vaubel 1979, pp. 28-30)

Similar considerations apply to the convergence criteria adopted at Maastricht. While financial discipline is undeniably desirable *per se*, it's hard to understand why financial convergence should be a precondition for a common currency. Belgium and Luxembourg have a common currency, despite wide differences in their public finances. As for economic performance, regions within a given country show extensive variation in their economic structure, rate of growth and unemployment. Yet, these differences do not prevent them from using the same currency. The obvious conclusion is that convergence is neither a necessary nor a sufficient condition for monetary unification.

A COMMON CURRENCY AND FISCAL DISCIPLINE¹⁶

A major obstacle in the introduction of a common European currency is the obvious one that money creation is an important source of revenue for national governments, and we must assume that they are reluctant to give it up.

On the other hand, this would also be one of the main advantages of a common European currency. Some supporters of a united Europe, in fact, saw this as the major reason for having it (Einaudi, pp. 102-103). If Europe had a common currency, this would in and of itself represent a significant change in the existing fiscal Constitution of national governments, as they would have to forego the use of inflationary finance, the "inflation tax," debt monetization as a means to finance public spending. As Luigi Einaudi maintained, it would be a substantial improvement over present fiscal procedures. Of course, it is an open question

16. "...money can be a potent tool for controlling and shaping the economy. Its potency (...) is exemplified (...) by the extent to which control over money has always been a potent means of exacting taxes from the populace at large, very often without the explicit agreement of the legislature." (Friedman 1962, p. 174)

whether national governments can be persuaded to give up such a source of revenue.

A EUROPEAN MONETARY CONSTITUTION

The preoccupations with the issue of monetary sovereignty are entirely justified: money matters and, as Milton Friedman has often repeated, it is too important to be left to central bankers. The reasons that make us worry about monetary management by national central bankers are even more valid when referred to a single currency for Europe. Monetary mismanagement on a national level can be a disaster, on a European level it would be a catastrophe of unbearable proportions.¹⁷ Moreover, the argument against binding rules that they are "undemocratic" because they prevent "elected officials from responding as best they can to the wishes of the electorate" obviously does not yet apply to the case of Europe.¹⁸

The problem arises because, with the end of the gold standard, money, in addition to its traditional functions, has become an instrument of discretionary policy to an extent that was inconceivable before. Discretionary manipulation of monetary aggregates on the part of "independent" Central Banks can produce pro-cyclical rather than anti-cyclical consequences.

17. "In a monetary union the design of the central authority is crucial. It must be the anchor against inflation that gold was in the gold standard and the D-mark is in the present EMS. An EMU under a badly run European central bank would be much worse than the EMS under the well-run Bundesbank. In setting up the new central bank a balance would have to be struck between accountability and independence." (*The Economist op. cit.*, p. 20).

"The main costs (of monetary union) arise from the loss of autonomy over domestic monetary policy ..." (Leigh-Pemberton 1989, p. 12).

"Who would control such a central bank?" (Minford 1989, p. 28).

18. See, Leijonhufvud 1987, for a criticism of such an argument.

Instead of achieving a higher degree of stability, monetary policy becomes an autonomous source of instability.¹⁹

This in no way implies incompetence on the part of the monetary authorities: even the most competent central banker does not possess all the knowledge that would be required to make a discretionary anti-cyclical monetary policy succeed. Information about the working of our macroeconomic systems are inadequate ; short-term predictions are seldom sufficiently reliable.

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19. It is not enough, in other words, to say that empirical evidence does not support the view that stabilization policies have in fact had a stabilizing effect on the economy (Romer 1986). The problem is that empirical evidence suggests that they may have had a destabilizing effect. According to Friedman : "Anna Schwartz and I have examined the cyclical behavior of the quantity of money in the United States for the whole period since 1867. Throughout that period monetary growth has risen and fallen not with but before economic activity. The cyclical peak of monetary growth regularly precedes the cyclical peak of economic activity by an interval that varies a great deal, but on average is something like six to nine months; the cyclical trough of monetary growth regularly precedes the cyclical trough of economic activity by an average interval of roughly the same length. Moreover, sizable monetary accelerations and decelerations tend to be followed by sizable expansions and contractions in economic activity : modest accelerations and decelerations, by modest expansions and contractions. ... The evidence is clear: variability in the rate of monetary growth is associated with variability in economic growth. High monetary variability accompanies high economic variability, and vice versa. ... The Federal Reserve has sought to use monetary policy to stabilize the economy that is, to vary monetary growth in order to offset forces introducing disturbances into the economy. Had it succeeded, high monetary variability would have been associated with low economic variability, not with high economic variability. The correlations between the moving standard deviations that we have calculated would have been negative or zero, rather than systematically positive. The implication is again that monetary variability has been a source of economic variability, not an offset." (Friedman 1984, pp 33-34).

ble; decisions may be untimely, and lags in the effects of monetary changes are largely unknown in advance.²⁰

In any case, the outcome of discretionary monetary policy in terms of increased economic instability, already harmful at the national level, would be disastrous at the European level. It's hardly surprising, therefore, that so many people consider that risk unacceptable, and oppose a common currency for Europe altogether.

A EUROPEAN MONETARY CONSTITUTION

The need to constrain discretion in the conduct of monetary affairs has long been recognized. From the pioneering, classic paper of Henry C. Simons (1936)—arguing that "an enterprise system cannot function effectively in the face of extreme uncertainty as to the action of monetary authorities"—to contemporary times, several economists have supported the view that monetary policy should be entrusted to rigidly specified rules rather than to the discretion of "authorities."²¹

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20. "A common criticism of policymaking is that economists and policymakers do not know enough about how the economy functions to have a model that describes accurately the behavior of macroeconomic variables like real GNP and the price level. In this case, it has been argued that policy action based on a flawed or incomplete model might cause more harm than good." (Bradley and Jansen 1989, p. 37). As a result, "one cannot be confident that relaxing ... constraints on discretionary policymaking will bring a net social benefit". (Leijonhufvud 1987, p. 131).
21. For example: "The monetary authorities of the United States—that is, the Administration, the Congress, and the Federal Reserve System—do not obey any reasonably well defined set of policy rules that would tend to produce some particular, reasonably predictable path of the price level over the long haul. There is no monetary constitution in effect that limits the short-run options of the authorities for the purpose of providing long run stability ... none of these uncertainties would matter very much if some set of constitutional constraints were in force that would prevent the rapid cumulation of moves in one direction." (Leijonhufvud 1984).

For public choice theorists, for example, only a constitutional set of rigid rules can prevent the ordinary working of political incentives from resulting in monetary instability.²² For them "the absence of an explicit monetary constitution is unacceptable." (Brennan and Buchanan 1981, p. 65).²³

22. For example : "For many of these politicians, 'doing good' comes down to the spending of public monies. Hence, even for the most benevolent of politicians, revenue becomes a goal to maximize, an instrument through which they can promote public happiness and well-being. Would it not then follow that, for such well-meaning politicians, revenue-increasing policy is to be preferred to revenue-decreasing policy? Would it not follow that, for such agents, inflation might still offer a very tempting source of gain? (Brennan and Buchanan 1981, p. 58).

Which leads Kevin Dowd to the pessimistic conclusion: "Whenever the government is involved in the monetary system, monetary policy becomes an inherently political matter determined by the interplay of political (and to some extent, bureaucratic) interests. There is no mechanism to ensure that this non-market incentive structure delivers a desirable outcome." (Dowd 1988, p. 21).

23. As is well known, the main proponent of a monetary rule has been Milton Friedman:

"If ... we cannot achieve our objectives by giving wide discretion to independent experts, how else can we establish a monetary system that is stable, free from irresponsible governmental tinkering, and incapable of being used as a source of power to threaten economic and political freedom? A ... possibility is to try to achieve a government of law instead of men literally by legislating rules for the conduct of monetary policy. The enactment of such rules would enable the public to exercise control over monetary policy through its political authorities, while at the same time preventing monetary policy from being subject to the day-to-day whim of political authorities." (Friedman (1962) 1968, p. 190).

See also: "Proponents of stable monetary policy have studied the quality of specific rules. If central banks would concentrate on keeping the money supply on the path they have committed themselves to they would provide a public good: Price level stability. Such a predictable policy would, as empirical evidence shows, contribute to a stable development of overall demand, a result which has not been achieved by the discretionary policies actually pursued in industrial countries. It would eliminate a great deal of the price variations on financial markets about which many observers complain so much." (Langfeldt, Scheide, and Trapp 1989, p. 40).

A common currency for Europe would be desirable if its adoption meant an end of discretionary short-term policy. Should European nations agree on some kind of monetary Constitution, making discretionary manipulation of monetary aggregates impossible, a common currency for Europe would greatly increase overall stability both in Europe and in the world. One could think of a rule fixing the rate of growth of some monetary aggregate to a predetermined level and mandating its continuation for an extended period of time (say, three-five years).²⁴

The adoption of a monetary rule would be highly desirable *per se* if it would eliminate the variability of monetary growth, with its accompanying economic instability and uncertainty. But, it would also be the solution for the creation of a common currency for Europe. All the justified worries about the surrender of national monetary sovereignty to a (politically irresponsible) European central bank would lose meaning if money was entrusted to predetermined (and agreed upon) rigid rules rather than to the whim of policy makers possessing discretionary power. Furthermore, all the advantages of a common currency for Europe, referred to before, could be attained.

The problem is that even among those who believe in rigid monetary rules, there is no general agreement on the specific type

24. A monetary Constitution would also impose fiscal responsibility on national governments, thereby achieving two goals at once. In this case, Jerry Jordan's opinion, according to which a fiscal reform is needed in order to achieve the desired monetary reform, would not apply: the monetary reform would achieve both.

"... meaningful monetary reform cannot precede reform of the fiscal regime. ... Reform of the fiscal regime is a necessary, but not a sufficient condition for reform of the monetary regime. Reform of the monetary regime is neither necessary nor sufficient for reform of the fiscal regime." (Jordan 1986, p. 741).

of rule to adopt.²⁵ This is, however, less important than the decision to have a rule at all. Once the principle of a discretionary manipulation of monetary aggregates by an "independent" European central bank is rejected, and the opposite one of a rigid monetary rule is introduced, the specifics of the rule can be progressively improved upon, as experience dictates.²⁶

What I mean is that the main point to be made about rules is that there is no such thing as "the ideal" rule, because, among other things, as our knowledge progresses, new devices are thought of, which can replace older arrangements.²⁷

Once the principle of entrusting money creation to a rule is accepted, in other words, the choice of the best possible rule will be determined by accumulation of experience and analytical progress.²⁸ What is essential, regardless of the kind of rule adop-

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25. Personally, I agree with the view of Langfeldt, Scheide, and Trapp: An important element in a policy rule is that the central bank uses a monetary aggregate that it can control with sufficient precision. Broader aggregates (M1, M2 or M3) can be influenced through changes in the monetary base, but the link seems to become weaker the broader the measure is. So it appears best to use the monetary base which reflects precisely the actions of the central bank." (Langfeldt, Scheide, and Trapp 1989, p. 40).
 26. See Buchanan's opinion quoted above.
 27. This has always been explicitly recognized by Milton Friedman: "I should like to emphasize that I do not regard this proposal as a be-all and end-all of monetary management, as a rule which is somehow to be written in tablets of gold and enshrined for all future times. It seems to me to be the rule that offers the greatest promise of achieving a reasonable degree of monetary stability in the light of our present knowledge. I would hope that as we operated with it, as we learned more about monetary matters, we might be able to devise still better rules which would achieve still better results." (Friedman (1962) 1968 pp. 193-194).
 28. As is well-known, in the light of the American experience, Milton Friedman has recently changed his proposal of stating the rule in terms of M1 (Friedman (1962) 1968 p. 193), and has suggested instead that "the quantity of high-powered money — non interest-bearing obligations of the U.S. government—be frozen at a fixed amount," (Friedman 1984, pp. 48-49)

ted, is, that the target rate of growth of the chosen monetary aggregate is adhered to for several years (so as to favor stable expectations). The concrete design of a European monetary constitution would also have to consider the problem of enforcement, so that it should contain the principle of accountability of the person(s) in charge.²⁹

CONCLUSION

A common currency for Europe could provide a good chance for introducing the kind of constitutional discipline monetary economists and public choice theorists have advocated for years. It's hard to tell whether politicians and central bankers will in the end become convinced by this argument, but one thing seems clear enough: the present approach does not seem likely to bring about a common currency for Europe. Since it does not solve the problem of the shift of monetary sovereignty, it will lead nowhere. Furthermore, committed as it is to the enforcement of fixed exchange rates among European currencies, it is likely to promote

This clearly illustrates the need for "trying out" proposed rules in order to ascertain how well they work in practice, and formulating alternative proposals when the "experiment" is not as successful as it was hoped. No matter what rule is chosen, however, it seems to me that it must conform to the principles spelled out by Langfeldt, Sheine, and Trapp (1989, p. 43).

29. The need for a monetary constitution governing the common European currency would be reduced, but not eliminated, if it was introduced through a competitive process of the kind advocated, for example, by Vaubel (1979) and Minford (1989). For, if the competitive process would lead to a monopoly in money enjoyed by either the "European" or a national currency, the need for some kind of monetary constitution would again present itself. The mere *possibility* of creating an alternative to the dominant currency would not be sufficient to constrain the inflationary tendencies of the monetary monopolist. This is why, though I agree with the parallel currency approach to the introduction of a common European currency, I still believe that a monetary constitution is needed.

political conflict and disagreement rather than the harmonization it attempts to achieve.

If Europe does not get a common currency, it will not reap its great advantages and monetary policy will continue to be in the hands of national central bankers. Money will remain exposed to the temptations of national governments to use it as an instrument for financing public spending, and monetary stability will be harder to achieve. Those of us who believe in a united Europe and in the advantages of a common currency should abandon the economically fallacious and politically dangerous strategy of gradual convergence and work towards the goal of a monetary constitution for Europe. This is, I believe the greatest challenge of our time.³⁰

30. Unless European countries are prepared to give up discretion in the conduct of monetary policy (which means giving up money as an instrument of policy), the only kind of monetary unification that can be achieved is that which will spontaneously arise from the liberalization of markets. As indirectly recognized by the "Delors Report," "full freedom of capital movements and integrated financial markets" would discipline "incompatible national policies." Stable currencies would be preferred in international transaction, and some kind of competition among national currencies would be established. Countries with a high degree of monetary instability would see their national currency rejected by increasingly competitive markets, and would, as a result, be forced to change their policy. Therefore, even if a common currency for Europe is not introduced Europe might still get some kind of discipline in monetary affairs thanks to the "filter mechanism" inadvertently introduced by the Single Act.

As pointed out by Victoria Curzon Price : "It is often said, and rightly so, that creating a single European currency would represent such a loss of sovereignty that were we to get there, we would not be far off full political integration. And yet, if EMS governments stick to their stated commitments (...) they will have tied their hands as firmly as if they had actually created a European central bank (...) Even if they retain the right to vary their exchange rates within the EMS, the need to compete for their citizens' savings will force them to behave with extreme fiscal and monetary caution." (Curzon Price 1989, p. 37).

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