
Round Table on a North American Currency

On March 25 the Senate Committee on Banking Trade and Commerce invited five economists to give their views on the prospects for a Common Currency in North America. Professor Herb Grubel is a former Member of Parliament and presently a professor in the Department of Economics at Simon Fraser University. Thomas Courchene is a professor in the Department of Economics, Queen's University. John W. Crow is an Economic Consultant and the Former Governor of the Bank of Canada. Jack Carr is a professor in the Department of Economics, University of Toronto. Bernard Wolf is a professor of economics in the Schulich School of Business at York University. The following extracts are based on their testimony to the Committee. For the entire discussion see www.parl.gc.ca/sencom.asp.

Herb Grubel: Let us suppose that on January 1, 2000, all Canadian, U.S. and Mexican prices, wages, assets and liabilities are converted into a new currency, which might be called the "Amero". With the U.S. dollar set equal to one amero, the Canadian conversion might be .5 amero for every Canadian dollar. The precise conversion rate would be chosen so that Canada's international competitiveness remains unchanged.

At the end of such a conversion, Canadian living standards and wealth would be totally unchanged. Your income, instead of being \$100,000 a year, will be 50,000 ameros. However, the car that you buy, which used to be a very nice BMW at \$100,000, will now be costing you only 50,000 ameros. Therefore, you will find that your real living standard has not changed. However, there would be a number of economic benefits sure to accrue in the longer run.

First, there would be reduced costs of foreign exchange dealings. It has been estimated by the Delors Commission that this might be as much in some European countries as .5 per cent of national income, all of which would accrue in perpetuity. It has been estimated that about 85 per cent of the foreign exchange business of banks in Europe will disappear.

Second, interest rates in Canada would fall by perhaps as much as 1 percentage point as the currency risk for investors is eliminated. These lower interest rates would

reduce debt service costs for all governments and private borrowers. The federal government savings alone would be about \$6 billion annually at the current level of the debt.

Third, elimination of the exchange risk is equivalent to the lowering of the cost of international trade and capital flow. It is like the elimination of a tariff. This effect has been estimated, in the case of the free trade agreement, to come to several percentage points of national income in the longer run. Hence, we could expect a similar, but smaller effect resulting from the elimination of the currency risk.

Fourth, labour market discipline would be increased as union leaders and managers face the fact that currency devaluation can no longer be counted on to maintain the competitiveness of firms which have allowed real labour costs to increase. Labour unions in countries like Italy during the postwar years used to demand higher wages even when there were no corresponding increases in productivity. Managers used to give in to these pressures even though higher wages caused their business to become uncompetitive and threatened to cause recessions. They did so in the knowledge that the central bank of Italy would bail them out by letting the exchange rate depreciate. I believe that a similar process was at work in Canada until at least the early 1990s.

The fifth benefit would be that economic adjustment to the secular decline in world commodity prices would take place at a more appropriate pace, as the depreciation of the exchange rate no longer protects domestic producers from the reality of falling world prices. The present system is like having protection appear every time that there is a fall in world prices. Like all protection, it prevents or at least slows the adjustment is needed in these industries.

Sixth, price stability around any existing inflationary trend would be greater, since in the larger currency area positive and negative price shocks are more likely to be offsetting than they are in Canada alone. When we have a bad wheat harvest, there might be a good harvest of oranges, and vice versa. As a result of this, when prices are down in Florida and they are up in Canadian regions that grow wheat, we will find that the two price changes are offsetting each other, and the overall level of prices measured in the Consumer Price Index would be more stable. The more stable prices are, the greater is economic efficiency.

The seventh advantage is that monetary policy adventures driven by ideology or politicians would no longer be possible in Canada. The 1970s were characterized by excessive monetary expansion in all of the industrial and developing countries because, finally freed from the restraint of fixed exchange rates, politicians and policy makers said, "Now we can print as much money as we want to in order to get lower unemployment, even if it results in a higher rate of inflation." When that happened, reserves of natural resources, which historically have always been adequate to cover demand for the next 15 years, became adequate for shorter and shorter periods in the future.

These developments, together with high rates of global inflation, induced the tightening of monetary policy in many countries including Canada. Many still remember interest rates around 20 percent and the havoc they played with their lives and those of their friends and neighbours. After the inflation ended economic conditions returned to normal, but the entire cycle of inflation and deflation brought huge economic and social costs. These costs could have been avoided if fixed exchange rates had been maintained and prevented the monetary adventure. The proposed monetary union will assure that such adventures cannot take place in the future.

The eighth advantage is that Canada would gain more influence on monetary policy in "Ameroland". We would have representatives on the monetary policy-making committee of the North American Central Bank. While we would have only a few votes on that committee, there would be opportunities to vote strategically

with US representatives from regions that have economic characteristics like Canada.

Ninth, the profits from the printing of notes and minting of coins, called seigniorage, would remain in Canada as we would produce in our own existing facilities the currency used here. The loss of seigniorage, which in Canada in 1997 was \$2 billion, is one of the disadvantages of the system used in Panama, which has no currency of its own but simply employs US dollar notes and coins.

The tenth and final advantage is that the creation of the amero system is likely to require that governments limit their deficits, much as happened in the European Monetary Union. This requirement would benefit the Canadian economy and future generations.

The costs at which these benefits are acquired are as follows: First, economic sovereignty would be reduced because of the inability to adopt monetary, fiscal and exchange rate policy to the specific needs of Canada. I do not wish to belittle those who consider this cost to be high. The issues are complex. However, let me summarize my view briefly as follows: Concern over economic sovereignty grew out of Keynesian economic theory. It led to the adoption of the flexible exchange rate system of the 1970s. The economic sovereignty attained did not lead to lower unemployment rates and higher growth as had been expected. To the contrary, it worsened these indicators of economic performance in Canada and elsewhere. Keynesian theory, in this respect, is in disrepute. Economic fine tuning is out. For these reasons, European governments agreed to form their monetary union.

The loss of national economic sovereignty should not so much be bemoaned, but should be welcomed.

Herb Grubel

The second disadvantage is the loss of cultural and political sovereignty. Again, I do not wish to belittle those who hold such concerns. However, the fact is that Canada's sovereignty in these areas would remain unchanged, just like it has in the wake of all of the numerous free trade agreements signed since the end of the Second World War.

Let me conclude my brief remarks with some musings about the political feasibility of a North American monetary union. There are mixed signals, at least in Canada and Mexico. I have found a surprisingly large proportion of Canadians in favour of such a union. I have heard of growing support for the concept in Mexico. Americans have not paid much attention to the issue, though they followed with great interest the development of the

euro. However, I expect political acceptance of monetary union to increase if we succeed in having a widespread public discussion of the proposal and its merits.

Thomas J. Courchene: The advent of the euro in January 1999 represents a watershed in the annals of economic and monetary history. At one level, the euro signals the de-nationalization of national monetary regimes. At another and related level, the euro is also signalling that in a progressively integrated global economy, currency arrangements are emerging as one of those supra-national or international public goods, an international public good that will be fully consistent with the 21st century notion of what national sovereignty will be all about.

Understandably, this is not the view of Canada's macro officials. In recent weeks, the Governor of the Bank of Canada, Gordon Thiessen, noted:

The euro is not a blueprint for North America. The political objectives that motivated monetary union in Europe do not have a parallel in North America.

I grant that NAFTA is largely a trade and economic blueprint, and European integration in addition incorporates some confederal and, in some areas, some federal overarching infrastructure. However, to link the euro solely to political evolution in Europe is to ignore the compelling economic rationales for a supra-national currency. It is highly unlikely that the British will ever buy into the political projects in Europe. It is highly likely, however, they will buy into the euro, and that will be driven by trade and economic grounds. Indeed, even Switzerland, not a member of the EU, is going to have a tough problem; and right now, it is undergoing what one might call "market Euroization" as it has been from policy Euroization. Policy Euroization would mean the Swiss would adopt the euro. Their institutions are going to do it. Their private sector institutions are en route to doing it.

The floating exchange rate is not serving us well. There are persuasive arguments for greater exchange rate fixity. The long-term objective of exchange rate fixity should be what I call the North American Monetary Union. While a "NAMU" is not on the immediate horizon — it may well take a decade to get this; it took the Europeans that long — there is an urgency, nonetheless, in terms of focusing on this, and that is because policy development elsewhere in America appear to be moving in the direction of dollarization. I will talk about that a little bit later. Dollarization is simply using the U.S. dollar; it is very, very different from common currency or North American Monetary Union. In the latter, we would

maintain all our institutions. We would actually maintain our ability to have some Canadian symbolism on our bills. The problem is that if dollarization proceeds, and we discover five years from now that we want to have a North American Monetary Union, it is too late. That option will be cut off. That is why I think it is incredibly important to be looking at this today.

In 1974 the Canadian dollar was worth 104 U.S. cents. Now it is worth roughly 66 cents. It was as low as 63.5 cents last summer. This represents an enormous fall in our living standards vis-a-vis the Americans. It not only puts Canadian prices at bargain basement levels, as with the Canadarm last week. What is it going to be this week? It provides an enormous incentive for young skilled Canadians to ply their trades south of the border, as they are doing in increasing numbers.

Why did we do this to ourselves? One always hears that a floating rate enhances our economic sovereignty, but the implications of a dollar less than two-thirds of what it was 25 years ago represents a dramatic counter to the sovereignty argument.

The greater the degree of integration between two economies, the greater will the benefits be of a common currency or a permanently fixed exchange rate. We have not yet in Canada realized just how dramatic our north/south integration is. In 1996, all but two of the provinces exported more to the rest of the world than they did to the rest of the country. Probably by now all of them probably do that. For each dollar exported in 1996, international exports were running at \$1.83. More recent data put international exports twice as high as international exports. Since over 80 per cent of Canada's international exports go to the United States, it is clearly the case that our exports to the U.S. now substantially dominate our exports to other provinces.

Ontario is a particularly interesting case. In 1980 in Ontario, international exports were \$40 billion, and exports to the rest of the provinces were \$40 billion. In 1996, exports to the rest of the provinces were something like \$50 billion. International exports are \$150 billion, nearly three times as much. Ontario has dramatically become north/south. Other parts of Canada are doing this as well. If you look at the European example, we are more integrated to the United States than the average euro country is to the rest of the European union. On economic integration grounds alone, the case for exchange rate fixity in Canada is at least as strong as the case for the euro in Europe. On economic grounds, not on political grounds.

Dollarization is the ultimate fix. We simply abandon the Canadian dollar. No more central bank. Probably no more financial deregulation in Canada; we eventually adopt the American stuff. It might be useful to distin-

guish between market dollarization, where you and I try to do it, and policy dollarization, where the Prime Minister officially says we should do it. Market dollarization is alive and well, and we have to be careful, because I do not think market dollarization is the way to go. I would much prefer a North American Monetary Union, which is far more sovereignty preserving. A willy-nilly drift into dollarization triggered by an unstable exchange rate would be enormously costly to the country.

I want to turn now to the North American Monetary Union and why I think it is a good idea. It would be equivalent to the euro. There would be an overarching supra-national federal bank, probably called the Federal Reserve Bank of North America, with a board of directors selected in part from the still-existing banks. Our Bank of Canada would still be around, just like the Bank of France is still around under the euro. The Bank of Canada would have to decide on its share of the voting rights; they would have to be agreed upon. However, since the dollar is already the world's foremost reserve currency, there is no point in destroying it. The dollar would still be the American currency. We have flexibility here. Our side, we would have a currency that says this is equivalent to one North American Monetary Unit, or one U.S. dollar on one side. On the other side, on the \$5 one, we would put on the prairies; the \$10, the Rockies, or whatever we want. The Europeans call that the landscape side of their currency. At the eleventh hour, they decided not to do this. They are going to have a single landscape side with all the emblems rather than 13 separate currencies. Their coins are going to be different. The German coin is going to have an eagle on it. This gives us some ability to preserve the symbolism that I think Canadians think is important. We have to revalue our prices in order that we can be one-to-one with this new currency. Every single European currency is doing that right now. There is a mark price, and there is a euro price. We will have to watch that process, because that is what we would do.

Whether the Americans would be on side or not, I do not know. I am trying to make sure the Canadians are on side.

I want to conclude with some geo-politics here. Argentina's president, confirmed recently proposed that his country move away from its currency board towards full dollarization. More importantly, in January of 1999, the head of the Mexican Bankers Association called for some version of a common currency. When I was in Mexico, the equivalent of Canada's BCNI called for full dollarization. Intriguingly, U.S. economist Robert confirmed Barro, who is one of the leading American economists, writing in *The Wall Street Journal*, said, "These are good ideas; we Americans have got to figure out some way to support this." Hence, what he said was Argentina needs

about \$16 billion of U.S. currency to run dollarization. Give it to them. It doesn't cost us anything. Just print it; you have the cost of the paper and ink. We will take papers in return. We will get all the seigniorage as those dollars start rising over time. Then he said, "There is another problem with dollarization; there is no lender of last resort." America can be the lender of last resort to anybody who joins the dollar area. He even suggested that the U.S. should take the lead in promoting this monetary integration. Since President Clinton is looking again for some legacy, this could be it. Robert Barro was not the U.S. government, but it is significant that this issue is now raised in the financial papers of *The Wall Street Journal*. My concern is that all this emphasis is on dollarization, not on a monetary union. If we want to keep the NAMU option alive, we must become party to these negotiations and these deliberations elsewhere in America. The 'we' I refer to is not only academics, but presumably our peak business associations and, at the political level, perhaps the senate could play an important role here.

It would be most unfortunate if, when Canadians finally realize that they really want a common currency of the North American Monetary Union type, we cannot get it because the dollarization process that we were watching has taken over the Americas, and the common currency option is no longer open.

Thomas J. Courchene

John W. Crow: I am very skeptical of this whole initiative, the common currency for Canada. What I think is constructive in the debate is we have shifted off the so-called pegged or fixed but adjustable exchange rates to something which is more unconditional. In the Americas, Argentina took the lead, in this direction, with a currency board. Now Argentina has been, in response to the troubles in Brazil, talking about going to official dollarization. Why did Argentina go to currency board in the first place? Because Argentines were basically using the U.S. dollar as their currency. If Argentina wanted to preserve the peso in any form, it had to reform its financial arrangements, and that is why it essentially went to a currency board a number of years ago. Whether this is a common currency, however, is yet another question. It

would certainly depend upon what the U.S. wanted to do in this regard to make it common. Euroland does have a common currency; it has a central bank in common where every national central bank is represented. No central bank, in Europe, is any more important than any other central bank, at least among the five who are members of the executive board as well as the governing council. There are five members: Germany, France, Spain, Italy and Finland.

Why would Canada want to change its system? Falling living standards is what we hear. I would question that very seriously. Whether our living standard has fallen or not is a very important question. Whether it has much to do with the exchange rate is a very relevant question for this committee. I am rather skeptical about the productivity arguments. As anybody who reads the newspapers knows, StatsCan put out some different numbers recently. What I would suggest is the productivity question is basically off the table now, given the new numbers. In any case, I would argue that from a conceptual or theoretical point of view, the argument would go from relatively poor productivity to the exchange rate, rather than from the exchange rate to a relatively poor productivity. I think there is more theory and more justification, let us say, for that kind of view of the world than there is for the rather more exotic one that it is the exchange rate that causes less-than-ideal productivity in Canada.

I will note, however, that the so-called "lazy manufacturer" argument for having a common currency, which I think is a very thin thread to hold this whole thing together by, has resonated in one place. That is with the Government of Quebec. Anybody who saw the reports on the Davos meeting will remember that the Deputy Prime Minister made a lot of this. I guess the interesting question there is once the productivity argument is demolished, whether the Government of Quebec would favour officially a common currency. That is what they based their argument on, at least in Davos. I suspect that they will not change their argument, for reasons fairly obvious to a politician.

How has Canada done with flexible exchange rates? I would say we have done pretty well. It would have been, inappropriate to push up interest rates to hold the dollar at 72 cents in 1998, for very good reasons given what happened to Canada's terms of trade, which deteriorated substantially in that year on the basis of declined economy prices and in fact shaved about a half a per cent off our GDP in that period. It was a perfectly sensible response for our exchange rate to adjust and to shift resources within the Canadian economy. I would say that the Canadian flexible exchange rates experience has essentially been positive. In this more recent period, we

can go back over less positive experiences, perhaps, but in the recent period everything has worked out the way you would expect. The currency has depreciated; that is for sure. Interest rates have stayed down. There has been no inflationary effect particularly, and the Canadian economy has continued to perform pretty decently. There are other factors in how the Canadian economy performed besides this, but I do not think one can lay too much blame at the door of the exchange system.

I also refer to Professor Barro's piece, "Let the Dollar Reign from Seattle to Santiago". He did not say, for example, let it reign from Vancouver to Valparaiso or from Toronto to Tierra del Fuego. Why did he not say that? His argument about what should happen vis-à-vis the countries south of his border was that they had basically screwed up on financial policy, and therefore they would be much better off using the U.S. dollar. An impolitic corollary of what I have just said about this, if Canada screws up on financial policy, maybe it would be better off using the U.S. dollar as well. Whether we are going to screw up is another question, which we will have to see.

In my view there are virtually no lessons from Euroland as regards the North American arrangement.

John Crow

We can debate back and forth to what extent European union is political versus economic. Clearly, both factors are there. The central bank is very much a pooling setup. One bank, one vote. No one is seriously suggesting that for North America. One of the interesting questions to explore is why Germany would be interested in Euroland, and what are the issues there. They are as much political, as economic. Why the U.S. would be interested in a U.S. dollar area that would in any sense constrain U.S. behaviour is difficult for me to fathom, but that is a question for the Americans, not for us. We tend to assume that they would be interested. One can ask, I guess, the same question: Why would the U.S. be interested in having a free trade agreement with Canada in the first place? We certainly put much more effort into that exercise than the U.S. did. One could argue, that it emanated from geo-political considerations in the United States.

In terms of Euroland, one important question, and I am harking back to theory here is that one of the principles of something that makes a common currency or a fixed exchange rate work is that there is mobility of factors across borders, that people can move backwards and forwards in response to economic advantages. Europe does have mobility in principle. Whether people use it as much as they could or should is another question, but you can

move anywhere in Europe in response to shifting economic circumstances. Labour flexibility is definitely not on the table in North America. In fact the North American Free Trade Agreement, from the U.S. point of view was to basically stop Mexican labour coming across the border. Quite the reverse of what one would argue in the case of a common currency. That is just to illustrate some of the kind of undercurrents of this issue.

Jack Carr: In the question of a common currency between Canada and the United States, there are only two real possibilities. Either Canada and the U.S., and perhaps Mexico, form some sort of North American currency union, or Canada adopts the U.S. dollar. My own feeling, as a monetary economist, is the second option would be the only real possibility open for Canada. People underestimate how expensive it was for the euro to be adopted. The U.S. dollar now is a reserved currency used all over the world. It has taken the U.S. government a lot of time and money to establish the position of the U.S. dollar as an international currency. The U.S. government is not going to get rid of the U.S. dollar for some new type of North American arrangement, a North American currency. They have that brand name. The U.S. dollar is staying. We can say all we want, but I do not think there is a real possibility that there will be some type of North American currency. Because of that, I think the only real possibility, if we are going to have a common currency, is for Canada and perhaps Mexico to adopt the U.S. dollar. Dollarization is the proposal I am going to talk about, because I think it is the only one that has even a chance of being adopted.

Monetary unions are more a political than an economic statement. Many of the supporters of the euro believe that monetary union is the necessary first step for political union, and I think that is why some supported it who otherwise would find it difficult to support a common currency. In Canada, there does not appear to be any sentiment for closer political union in the North American environment. Hence, this argument falls by the wayside. The only real political impetus that I see for a common North American currency really comes from the government of Quebec. Bernard Landry, Quebec's Finance Minister, has stated that this option of using the U.S. dollar should be given serious consideration. They have used a number of rationales, and if those rationales fall by the wayside, I am certain they will find other rationales. If we adopt the U.S. dollar, there will be substantial adjustment costs. I think the Quebec separatist government would like that adjustment cost to be borne by the Canadian union as a whole, so that if Quebec does leave the

union, there will not be any further adjustment costs imposed on Quebec, and Quebec can tell its citizens that life after separation is going to be very much like life before. We are going to still be using the U.S. dollar. You could say: "Why do they not simply say to the Quebec people that even the status quo is okay? After separation you will still be using the Canadian dollar." I think this is a very difficult statement for separatists to make, because it means if they use the Canadian dollar that they will have no independent monetary policy, and they will be subject to the dictates of the Bank of Canada in which they will have no influence. What is the purpose of separation if you cannot have autonomy in both the fiscal and monetary areas? Having a lack of autonomy with regard to a broader North American union is not as bad as having to rely on Canada.

Let me look at the economic considerations. In the economic literature, there are primarily two strands of argument concerning currency union. One of these strands is made by monetary economists; the other by trade theorists. I am primarily a monetary economist, and I will concentrate on that but I will mention some of the trade theorists' arguments. The adoption of the U.S. dollar essentially means that we replace the monetary policies of the Bank of Canada by the monetary policies of the federal reserve system. Of late, the federal reserve has followed a sensible monetary policy, and the U.S. economy is one of the strongest economies going. If you look at a broad picture of U.S. monetary policy, they have had periods of time when, in the 1970s, things were fairly uncertain with U.S. federal reserve policy. They had high and volatile monetary growth rates. We would have had those same high and volatile monetary growth rates. In fact the price level in Canada from 1910 to the present is very similar. We have had really very similar monetary policy to the Americans. If we look at the 1970s and 1980s, we have had a slightly higher inflation rate. We have had 6.7 per cent average inflation; they have had 5.8 well within the error of measurement in the Consumer Price Index.

For countries such as Panama, which has a very unstable government, it makes a lot of sense for them to say, "We cannot let this government have control of the printing presses" or "We are simply going to not have printing presses; we are going to simply use the U.S. dollar." For them it makes sense. For Liberia it makes sense. Maybe even for Argentina now it makes sense. For Canada, it does not make sense. We have had a fairly sensible monetary policy. We have had periods where things have not been so good, but so have the Americans. In fact when John Crow was in office, that was one of the times we had almost the most sensible of monetary policies.

We have a lot of trade that takes place within corporations. General Motors imports engines from the United States. They do not pay their U.S. parents in U.S. dollars; they re-export finished cars. It is really mostly bookkeeping transactions that take place. There is not a lot of exchange cost that takes place there.

The other thing about our current system is that in some sense it is optimal. High tech companies are listing on the NASDAQ, and if you want to buy their stock, you have to pay in U.S. dollars. Why are they doing that? They are not doing it because of the nature of the exchange regime. They are doing that to access huge U.S. capital markets. The Toronto Blue Jays pay their players in U.S. dollars. They are not doing it because the exchange rate is floating and there is risk; they are doing it because the players are American, and the players want U.S. dollars. There are areas in the Canadian economy where it is optimal to use U.S. dollars. In our current system where it is most optimal to use U.S. dollars, we do. For most transactions people, do not want to use U.S. dollars.

Both from a political and economic point of view, I do not see any argument in favour of adopting a common North American currency.

Jack Carr

Let me look at the optimum currency area arguments. This is an argument which was first made in 1961 by a noted Canadian economist, Bob Mundell. Professor Mundell said, "Canada is not an optimum currency area; the U.S. is not an optimum currency area." He said, "Canada plus the U.S. are not optimum currency areas; optimal currency areas are areas in which the economies are similar like regional economies, and most of the external shocks are similar." That is not the case for Canada/U.S. If you look at the correlation between shocks hitting the Canadian and U.S. economies, they happen to be negatively correlated. So, this idea that Canada plus the U.S. would be an optimum currency area is not the case, and people who have looked at that data know that there have been real forces that have buffeted the Canadian economy. Of course it has hurt our living standards. It has not been because the exchange rate is floating. It is because of these real shocks that have hit the Canadian economy. There is nothing we can do, no matter what exchange rate we are on. If the price of the things we sell go down relative to the price of the things we buy, if oil prices fall, if gold prices fall, if lumber prices fall, it is going to hurt Canadian living standards whether we use

the U.S. dollar, whether we have a floating exchange rate, whether we have a fixed exchange rate

There is another problem with the optimum currency area. What is an optimum currency area in 1960 may be different in 1970 or 1980 or 1990. California was part of the western region with a resource-based economy in 1960. It is certainly not a resource-based economy in 1990. Optimum currency areas change over time. Given the huge cost of adopting some type of monetary unit, you cannot keep exchanging that unit as optimum currency areas change.

Bernard Wolf: The desirability of pursuing a common currency between Canada and the U.S. is clearly something that should not be taken lightly. The effects are far reaching and affect every Canadian. Thus, it is very important to look at this thing with a very clear perspective, and also to look at the theory and to look at the history, because I think they both tell us quite a bit. Sometimes the ideology gets in the way.

I would concede given the way the global economy is going, you might have a common currency for the whole world. I am never going to see it in my lifetime; I am not sure that my children will; but it is certainly conceivable, and there are some very strong arguments. However, for Canada today, I would submit that the costs associated with monetary union dwarf the benefits, and that the time for this fundamental change is certainly not here.

The costs of monetary unions are sizeable, and they exist in the Canadian context. Probably the most significant of these costs is that with respect to the loss of monetary policy, loss of an independent monetary policy. Despite the strides taken in recent years, Canada's economy remains significantly more exposed to the resource sectors than does the U.S. economy. Forty per cent of our exports are still resource oriented. The sharp decline in the Canadian dollar related to falling global commodity prices over the past 18 months is testimony to this kind of exposure and provides the obvious example of the benefit of flexible exchange rates. I do not decry the fact that the Canadian dollar has gone down. The fact is commodity prices have gone down, and that has got to be reflected. It happens to have been reflected in a lower dollar. In the absence of such downward flexibility in wages and prices in our economy, we could not absorb the shock that way. The currency decline provided the necessary offset and support to the domestic economy which allowed exports to be fostered, and encouraged import-competing production which stimulated investment. If we did not have the flexible exchange rate, we would have had to have had a very different monetary

policy, and that monetary policy that we would have had to have would have been extremely detrimental to this economy. It would have had to have been really kind of Draconian.

It is clear that there is no arrangement that is possible if you were to consider it now, other than adopting the U.S. dollar. There is no way that the U.S. dollar is not going to be the currency of the United States.

Bernard Wolf

We should also take into account the history here. In the past the effect has worked the other way too. If we go back to 1950 or 1970, the generalized rise in commodity prices, which also led to a significant capital inflow into this country, put upward pressure on the currency, making the maintenance of the existing fixed exchange rate and those either impossible, or at least very, very difficult. Again, if we had not stuck to a floating rate, there would have been problems. Commodity exposure is the best example of the risk of asymmetric shock, a risk that obviously has been realized historically and is still with us. The currency cushion has no obvious substitute at the moment, and its elimination would be extremely risky.

Currently, the factors which would tend to offset the asymmetric shock effect are not significantly in evidence in North America. First, labour mobility between Canada and the United States is not high. Except for Quebec, there is the common language, to some extent a much more common culture than exists in Europe. But the reality is that current immigration policy on both sides of the border does not allow that kind of mobility. It is even hard enough to get people across the border for temporary positions. On either side of the border there are real problems. Labour mobility really does not exist at the moment.

Second, fiscal policy maybe could substitute for monetary policy. If you do not have the monetary policy lever, maybe fiscal policy could work. Unfortunately, given that Canada's public debt is relatively high, somewhere around 90 per cent of GDP, we are not going to be able to use that lever for expansionary fiscal policy.

Third, the other thing that would help in terms of adjustment would be transfer payments between the areas. Within Canada we have these transfer payments, but you are not likely to see them going across a Canada/U.S. border. In the future some of these things may change, and common currency might make some sense.

The Canadian economy has seen structural change in the 1990s: freer trade, exposure of Canadian industry to more competition, the quashing of inflation, and the end to fiscal profligacy. All of these changes, while intensely positive for the fundamental health of Canada's economy, have been painful for Canadians. I would submit that the process of adjustment has not yet ended; it is not yet complete. Significant work remains to be done on various fronts, particularly on the issues of taxation and productivity. Yes, the numbers indicate that we have not done as badly as we thought we had, but productivity in Canada is still considerably below that in the United States, and that needs to be addressed. In fact the historic lows on the Canadian dollar must at least in part be recognition that the Canadian economy has not fully worked through these changes and remains vulnerable on a fundamental level. It is also worth noting here that the Canadian dollar's historically low valuation itself represents a significant barrier to monetary union, in that a large appreciation of the currency would be needed to reach a suitable level at which to enter into a union, posing yet another burden to the Canadian economy. Surely the US would object to a pegging of the Canadian dollar at a level below 70 cents US. At the moment Great Britain has the opposite problem. One reason it hesitates to adopt the Euro is the overvaluation of Sterling. Joining the Euro with too high a valuation of the Pound would inevitably lead to unemployment.

I worry also about what might happen in terms of transparency. Usually, I prefer transparency, but in this case, the ability of a Canadian worker to compare, without exchange conversion, his wage with that of comparable workers across the border, could give him impetus to close the gap. I think the resulting possible inflation-push should not be underestimated.

We can look at another case where in fact we have gone to a common currency, that is the case of Germany with reunification. The conversion of the East German mark into the D-mark provides an illustration of the lasting costs of adopting an inappropriate rate. We still have a situation in East Germany where the unemployment rate is roughly double that of the rest of Germany, something like 18 per cent.

It is always possible to argue that the environment for just about anything may be better down the road. The European Monetary Union (EMU) provides a contemporary case of a common currency where the "one size fits all" monetary policy is creating economic difficulties. For example, the great disparity between strong growth in some of the peripheral countries such as Portugal and Ireland, compared to relative weakness in some of the core countries, particularly Germany, is a serious concern. I would suggest that the recent decline

of the euro is partly a reflection of the incompatibility of the business cycles. I would go further by suggesting that the economic problems associated with the adoption of the Euro were well understood by policy makers who were interested in the creation of the European Monetary Union not for the questionable net economic benefits but for political reasons.

As has been indicated before for Canada, the political imperative works against currency union with the United States. Certainly Canada has no need at present to find a mechanism to provide peace and political stability with its neighbour. Additionally, the loss of sovereignty involved in a currency union is a more pressing issue for Canada than for the individual European countries.

Finally, another benefit to the currency union among some countries in Europe, and that again is absent in the

case of Canada, is the reduction of risk premiums on medium- and long-term interest rates. That is largely absent. If you look three years ago at Italian ten-year bonds, they yielded 5 percentage points over their German counterparts. The participation of Italy in the monetary union and the corresponding drop in the risk premium assigned to Italian assets has narrowed that spread by a factor of 20 to roughly a quarter of a percentage point, which is really very small. Conversely, the yield on Canadian ten-year bonds is already very close to that of U.S. 10-year bonds. Thus, the scope for an additional fall in the risk premium would be very limited. In contrast, Argentina is seriously considering this adoption of the U.S. dollar as its currency. With major creditability problems, Argentina would have quite a bit to gain in terms of a reduction in the risk premium and consequently, a reduction in the interest rate burden.