FINANCE DIVISION

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The Editor
Foreign Affairs

Dear sir:

We were pleased to see the article entitled "The End of National Currency" by Benn Steil in the May-June 2007 issue. The topic is timely and will henceforth be more widely discussed, thanks to the distinguished standing that Foreign Affairs has always had with the intellectual community.

Steil's argument achieves a difficult and necessary task. It enlarges the boundaries of the debate about currency unification by putting the issue into an encompassing historical context. Steil shows that national currencies consisting of fiat money are all vulnerable to interference in ways that commodity money (e.g., gold) is not. His approach subsumes Mundell's optimal-currency-area argument and puts it into its proper context in intellectual history. This article is refreshing and an important step forward because Mundell's argument has dominated academic discussion of the currency unification issue for most of the past half century.

For most of his essay, Steil stays within the bounds of the conventional academic debate on fiat money versus commodity money and national currencies versus supra national currencies. By doing so, he jousts successfully against the advocates of national currencies, but fails to give full explication of the biggest advantage of unified currencies over national currencies.

To show the biggest advantage of unified currencies, Steil would have had to broaden the scope of his analysis beyond the real economy of production of goods and services, to include the financial economy of stock, bonds, and asset prices. He restricts himself mostly to the real economy, citing writers of previous centuries and using traditional arguments about domestic and international trade (e.g., how trans-border payments for goods and services have been handled under different historic monetary regimes).

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The one place where Steil allows his discussion to extend into the realm of the financial economy is in the article's final section, just a few paragraphs from the end of the article. There he writes:

> "Europeans used to say that being a country required having a national airline, a stock exchange, and a currency. Today, no European country is any worse off without them. Even grumpy Italy has benefited enormously from the lower interest rates and permanent end to lira speculation that accompanied its adoption of the euro."

Steil's analysis would have been reinforced if he had pointed out that real estate, stock, and bond prices in "grumpy Italy" have risen sharply as a result of its commitment to and adoption of the euro. These benefits began accruing to Italy after the Maastricht Treaty in 1993, and they have continued since its 1999 adoption of the euro. The spark that ignited Italy's rally in asset prices was the steep decline in long-term interest rates. Declining interest rates set off similar rallies in other EMU nations that were considered to have relatively high interest rates and relatively weak currencies. In 2007, these rallies still carry positive momentum.

Of course, lower long-term interest rates in Greece, Italy, Portugal, Spain, and the accession countries were only part of the reason for the gargantuan rallies. Changes in corporate governance practices also had an influence. But the decision to cede control of fiat money to an autonomous pan-European committee was a huge step, which supplanted several dicey, oft-mismanaged, national currencies with one that was created to be strong and has been strong.

The magnitude of the increase in asset values that Europe achieved by adopting the euro has been at least $15 trillion. This is the figure we calculated and published in our 2003 book Wealth by Association: Global Prosperity Through Market Unification (Praeger). The method we used to calculate these gains was to value the income-producing assets of several European countries at pre and post unification levels. Later, in 2005 and 2006, we published similar calculations for the accession countries and for the emerging countries as a whole. The figures for increased asset values that we arrive at were staggering: windfall gains as large as $100 trillion would accrue to the owners of assets.

The aggregate market value of assets in the world is now a much larger macroeconomic magnitude than the aggregate annual output of goods and services. It is also growing much faster. To see how rapidly the market value of assets has increased, consider that for the entire world in 1980, the aggregate value of bonds, common stocks, and bank deposits was about equal to the value of annual output of goods and services. In 2002, the value of financial assets was about three times the value of annual output, and in 2007, the value of financial assets has risen to five times the value of annual output.

We believe that currency unification has been a major contributor to this epochal rise in the market prices of assets. By not mentioning this cause-and-effect relationship, Steil avoided embroiling his argument in the debate about the source and merits of rising European asset prices. But he also weakened his argument by ignoring one of the strongest arguments in favor of currency unification.

In closing, we reiterate that Benn Steil has made a useful and significant contribution to the debate about currency unification, and are very pleased that you published these well-argued thoughts in Foreign Affairs.

For your reference we have enclosed a copy of one of our articles, which shows the magnitude of the increase in asset values that would occur if emerging countries could reduce country risk.

Sincerely,

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