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How Many Currencies?

JANUARY 12, 2010 12:13 PM

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Some commenters on my [Europe/euro post](#) offer a reductio ad absurdum: if Spain should have its own currency, why state/town/family in America?

Strange to say, economists have thought about that — a called [optimal currency area](#) theory. (Optimal? Optimum seems to know — or care).

The basic idea is that there's a tradeoff. Having your own makes it easier to make necessary adjustments in price an argument that goes back to none other than [Milton](#). As opposed to this, having multiple currencies raises the cost of doing business across national borders.

What determines which side of this tradeoff you should choose? Clearly, countries that do a lot of trade with each other have an incentive to adopt a common currency: the euro makes more sense than a currency union between, say, Malaysia and Ecuador. That, the literature suggests several other things that matter. High labor mobility makes it easier to adjust to asymmetric shocks, so does fiscal integration.

When EMU began as a project, there were a number of arguments comparing the EU with the United States. What all of them suggested was that Europe was less suitable as a currency union basically because of lower labor mobility and lack of fiscal integration. That didn't settle the question of whether the euro was a good idea, but it did suggest that appealing to the success of the US with a single currency didn't tell you much.

What I've always found interesting is the way many Europeans insist that a single currency is absolutely essential, when the example of Canada — which is closer to the United States than it is to itself — provides an obvious counterexample. But people tend to forget that Canada exists ...

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scientella January 13, 2010 · 1:59 pm

So optimal currency theory is optional.

Davidus Romanus January 13, 2010 · 2:02 pm

What everyone seems to forget, is that paper currency used to be a receipt for gold or silver. The only reason it had value was because you could go to the issuer (bank or gov't) and get gold or silver back for your paper currency. Now we (in the US) have Federal Reserve Notes. There is no intrinsic value in our paper currency. It is all based on the trust that you can trade them for something of value. When that trust is eroded, so is the value of the paper currency. In some cases, Weimar Germany and Zimbabwe, that value effectively reaches zero. We have not reached that point yet, but that does not mean that it cannot happen.

Competing currencies would put a break on inflation because people would flock to the currency that retained value and stop using the currency that lost value, or at least stop using it on an equal footing. The problem is that, with legal tender laws, people have no alternative to use in place of inflated dollars. That is why prices go up. Because the value of dollars have gone down. The purchasing power of gold is roughly the same as it has been since 1913, yet it takes over a thousand inflated federal reserve dollars to buy an ounce today, when in 1913 it only took 20 dollars. If legal tender laws were repealed, it would take about a day and a half for people to start trading in something other than inflated dollars. Any currency which retained its value would be popular. Any which lost it's value through inflation would be abandoned. That's what bank runs used to be about. The bank would issue currency which was not backed by reserves of gold. People would lose trust in the currency, and take it back to the bank to be redeemed. If the bank did not have gold to redeem it's currency, it failed and closed it's doors. People would find a new currency which was fully backed by gold.

Today, no currencies are backed by gold, silver, or any other commodity of value. If there were such a currency, it would immediately put the breaks on inflation since the inflated currency would lose value and people would refuse to use it, instead using the "hard" currency. That's why the US Gov't arrests anyone using anything but Federal Reserve Notes for money and puts them out of business, because the inflated dollar could not withstand the competition.

Bob M January 13, 2010 · 2:04 pm

"Single" currency seems a misconception when its value changes every minute of every day.

Claude January 13, 2010 · 2:12 pm

I have read some comments about mobility in Europe. I do not have figures about it, but maybe I could give some hints of why it is not such a problem.

The language barrier. In Europe, most educated people learn at least one other European language, usually English. However, English is usually not enough if you want to move to another place. Try surviving in Germany or in France for many years without any knowledge of the local language and you sure will have a very limited and poor life.

However, there is one thing that Americans do not see or understand about Europe. Borders have been drawn according to various reason, none of them

being cultural. German for instance is still widely understood and spoken in many places, in France (Alsace and Lorraine), in North Italy, in Denmark, in Belgium. It is an official language in four European countries (Germany, Austria, Switzerland and Belgium) It is also very close to Dutch, and a Dutchman can be quite proficient in German in less than a year.

French is spoken in five countries: France, Belgium, Switzerland, Monaco and Luxembourg (very small countries I admit for the last two)

In the case of France, it is quite common for people on the borders to live in France and work in Germany, Belgium, Luxembourg or Switzerland.

Latin languages are so close to each other, that it takes less than six months for a Frenchman to feel comfortable in either Italian or Spanish. The reverse is of course true. I have many colleagues who spoke either Italian or Spanish and who after six months in France could work in French.

People from East Europe show even more skills in learning languages than we do.

Frank Gado January 13, 2010 · 2:19 pm

As one who enjoys the friendship of many who join us south of our border, I'd be happy to recognize that Canada exists. Maybe it would help if the so-called Canadians finally established that national identity. To us in Vermont, it seems that Canada is an inflated version of Belgium, topped with lots and lots of wilderness. But the Flemings and Walloons haven't resolved their national identity over many more centuries of wrangling, so I shouldn't expect too much of the provinces to the north.

woofus72000 January 13, 2010 · 2:20 pm

as an American living in Europe, it seems to me the euro has done pretty well for itself. After the initial price rises, it has stabilized and, in comparison to the \$, is probably stronger and healthier (see the exchange rates) I wouldn't be surprised to see the euro replace the dollar as the world's leading currency soon , especially if the US can't control it's spending., and continues to weaken it's currency...

Stirling Newberry January 13, 2010 · 2:32 pm

A return to the gold standard is about the one thing that could partially rehabilitate marxism...

Observer January 13, 2010 · 2:37 pm

Leave Canada alone.... they don't need the FOX network, the guns, the sub-prime mortgages, the wingnuts, the Hummers, the reality shows,

giovanni January 13, 2010 · 2:38 pm

No labor mobility in the EU?

Stereotypes have a hard time to die... I have personally worked in several different EU countries, simply by getting a job there (that was before getting any job anywhere became difficult because of the current economic situation). The real reason Europeans are reluctant to move for a job is cultural, language, friendships, and all these other things we on the other side of the Atlantic tend to value perhaps in a different way from people in the US. That mobility is impossible not true: just ask the Poles, Italians, Spaniards, Portuguese, Bulgarians, etc. who work in northwestern Europe. Or the Germans who work in Denmark. People just have to have a good enough reason (like a really bad economy or blocked job market at home) to do it.

kv505 January 13, 2010 · 2:38 pm

I agree with #25! Of course most American's tend to forget or don't care (or understand) that anything exists outside the US.

Kevin January 13, 2010 · 2:55 pm

I'm okay with one currency, just don't call it a loon.

Karl Smith January 13, 2010 · 2:58 pm

Iceland still officially has its own currency, but unofficially you can use euros and dollars (euros preferred). My friend who runs a small hotel there lists her rates in euros-mostly because the euro is a stable currency as opposed to the krona. Most in Iceland would like to keep the local currency, but have euro as well.

Martin LaToad January 13, 2010 · 3:00 pm

I hate to sound pessimistic, but... If I were Canada I would run, run, run away from this subject. They did quite well during the fiscal crisis. They wouldn't if they were bound to the U.S..

The U.S. is a sinking ship that can't seem to be able to do anything quite right, and hasn't been able to in years. I'm not sure where it all went wrong here, and nobody in a position of authority would publicly back what I'm saying here. but I'm not sure things will look as they do even now in a couple more years.....

Lonely Pedant January 13, 2010 · 3:13 pm

The AOL-Time Warner merger was transacted in a "currency" called AOL stock. Shares aren't legal tender, of course, but they are used as media of exchange every day; so in a sense we already have a society that sustains multiple currencies.

Don January 13, 2010 · 3:37 pm

#2 – heck no! Dollarization of North America would impose the USA's corrupt and coniving bankers on the innocent Canadians. Why would they want that?

Brian M. Reilly January 13, 2010 · 3:56 pm

Currencies exist as long as they are accepted as storehouses of value. As soon as they are no longer accepted in trade for goods, services, or in exchange for other units of currency, they go away. Many currencies have gone away, and so will all the ones we use now.

The universal (there are no exceptions) manipulation of fiat currencies over the centuries makes people rightly leery of absolute trust, hence the continued and widespread (Universal? Not so sure.) desire to hold some gold as a hedge against the certain devaluation that always occurs with fiat currencies. Whether this is an effective hedge, I do not know.

The world needs as many currencies as the market will bear, and not one more. If you want to see the future of currency, go to a money museum.

Brian Reilly

eurodollar project : 2020 January 13, 2010 · 3:59 pm

. . . a currency is not only a share price in a country, or region, but in an idea.

[Poor old Venezuela, eh ?]

Currencies, are just like languages, whilst there may be 6,000 different of them, out there, 90% of the world's population speak just 40 of them.

Never mind Canada, when are the USA and Europe going to merge their currencies ?

[Still selling 1.40/1.50 strangles on the Euro/USD, hope the FED and the ECB are doing the same . . .]

Kim January 13, 2010 · 4:00 pm

What if the US's currency didn't have such, um, currency world wide (as is happening already)? What would you say then?

eurodollar project : 2020 January 13, 2010 · 4:00 pm

Just as an aside . . . isn't the \$ symbol, Spanish in origin ?

Rigoletto January 13, 2010 · 4:06 pm

The "mighty" USDollar is scrap paper used by Wal-Mart for their import from China.

It is easy to have the wide Public pay for this policy.

When the Yuan will be going up, you will feel it and how!

And naturally you will blame the Chinese.

The USA are blameless, correct?

No, the Euro is one of many ways to achieve a better and peaceful Europe and look forward together. We are all kids of the same house, even while talking many different languages.

Nothing is perfect but one can always try to improve.

Instead of erecting barriers we do away with it, and you should do the same with all your neighbours Canada and Mexico.

Joe January 13, 2010 · 4:11 pm

Each country in the Euro zone still maintains a certain degree of control over the currency. The central banks in each Euro zone country still print their own money. Look at your Euro notes some time. You might be surprised to see several different countries central banks on them if they have traveled around the zone a bit. Euros printed in Ireland are accepted in Italy and Euros printed in Germany are accepted in France, etc. The states in the US should band together and take away the right to print money from the federal government and issue and withdraw money as required to meet their own needs and none would be going bankrupt. It would be much harder to corrupt the financial system in a country with 50 central banks than with just one. Then the federal government would have to come begging to the states for money or go without, as it should be.

Global Urbanist January 13, 2010 · 4:12 pm

Labour mobility is the single most important factor to define an optimal currency area. As exemplified in the linked article... Argentina had to abandon its fixed dollar currency because its unemployed could not move to the stronger US economy that their currency reflected.

<http://www.helium.com/items/1639074-global-currency-immigration-economic-growth-and-employment>

Joe January 13, 2010 · 4:12 pm

Tucker,

Are you in favor of the Amero and the North American Union? That's what you're talking about.

David Hersey January 13, 2010 · 4:15 pm

JJ 81

"The B of Canada is more concerned with controlling domestic inflation. In fact, in the early 90s, we invented the zero inflation rate policy– which turned out to have horrendous consequences for unemployment."

This is correct and the prime directive of Canadian monetary policy. Further, we do not set or strive to stay within any US dollar range. I believe this action carried out consistently for the last twenty years has provided our businesses a framework that other nations should emulate. A predicable response is the first order of capital.

David

HubertB January 13, 2010 · 4:16 pm

Canada is large enough for two currencies to work. Some Latin American nations have had enough problems establishing their own currencies they have had to go with the dollar. In others the dollar is the de facto currency. It is de facto by default. The Europeans have a better system where the smaller nations participate in the benefits of the Euro in which all have a part instead of being forced to accept the currency of a foreign power.

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