Wolfson Economics Prize Entry (23,000 words).

The Optional Euro (while sterling holds the ring)

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Contents

1.0 Preliminaries

"The stakes are enormous. The future of the world economy will, in large part, be governed by what happens over the next few years in Europe. I, along with most European businessmen, hope that the Eurozone will stabilise, but in the event it does not Europe must not sleepwalk into a policy vacuum [and descend] into a financial chaos that would destroy savings, jobs, and social cohesion."

Translated into the words of the official prize briefing, this statement by Lord Wolfson reads as follows: "If member states leave the Economic and Monetary Union[1], what is the best way for the economic process to be managed to provide the soundest foundation for the future growth and prosperity of the current membership?" More precisely, how might the euro be restructured into more stable currencies? What would a post-euro Eurozone look like? How could transition be achieved without detriment to employees, savers, and the international banking system? The issues to be explored are to include:

a) Whether and how to re-denominate sovereign debt, private savings, and domestic mortgages in the departing nations.

b) Whether and how international contracts denominated in euros might be altered, if one party to the contract is based in a member state which leaves European Monetary Union.

c) The effects on the stability of the banking system.

d) The link between exit from European Monetary Union and sovereign debt restructuring.

e) How to manage the macroeconomic effects of exit, including devaluation, inflation, confidence, and effects on debts.

f) Different timetables and approaches to transition (e.g. 'surprise' redenomination versus signalled transitions).

g) How best to manage the legal and institutional implications.

h) A consideration of evidence from relevant historical examples (e.g. the end of various currency pegs and previous monetary unions.

i) Optimum monetary reconfiguration.

Added to these, but not directly mentioned, are three welfare considerations, namely, how to protect savings, employment and social cohesion.

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[1] The Economic and Monetary Union (EMU) comprises the 17 European Union (EU) member states that have so far adopted the euro as their common currency and sole legal tender (see Appendix 1). Apart from the earlier few who opted out, all other EU states are obliged to join once they meet the criteria to do so.

1.1 An Impossible Question?

This is already a long list and one that has by no means reached its limit. It should also be noted that the question posed by the prize is not fully clear. Is it about a post euro Eurozone, as the European Monetary Union is now artfully and somewhat fudgily termed; or a world without the euro; or merely a rebasing of the euro? Is it about stability in the Eurozone or about a member country leaving it? Or is it, as Daily Telegraph's, Jeremy Warner, blogged on 6 January 2012, about "the most optimal, least traumatic way of achieving the breakup of the European Monetary Union"? Finally, from the point of view of pedants and lawyers, how is "current membership" to be understood? Taken literally, the remit of the prize-winning essay has to confine itself to the 17 Eurozone participants, and so cannot include Britain in its scope. Was CNN's London producer, Isa Soares, right, therefore, when she claimed that Lord Wolfson had "set an impossible question"?[2]

Whatever the arguments of its detractors and despite any perceived ambiguities – as, too, the daunting complexity of the topic – the challenge is worthwhile. The stakes are indeed enormous, and the question Lord Wolfson asks pertains to a crisis in human history that ought not to be treated lightly.

In this paper, we have taken our chances on interpreting any ambiguities. In any event, they may well have arisen because the actual situation is ambiguous, not only in the sense that it can be assessed in different ways, but also because the presumed aim of Lord Wolfson has to be to stay in business with or without the euro. His concern (as imputed to him here) is not any exiting of the European Monetary Union in absolute terms, so much as to think through the scenario of departure.

Lord Wolfson is not only asking the question for himself, but for everyone in business whose affairs are affected by the euro. Since that excludes very few of us (given that most people whether directly or via agents 'play' the markets in some way) he is also asking the question on all our behalves. This means one's thoughts need to be free of mere opinion about the euro and its larger setting – the European Project – and grounded in fact. At least, insofar as such a complex topic is capable of a factual foundation! To this end, the treatment in this essay proceeds from the idea that Europe is at a cross roads and that her affairs can be seen – and need to be seen – in three distinct (but not separate) ways: culturally, politically and economically.

1.2 The British Particularity

It is also important to be clear where Britain stands. In this essay, Britain is the country (Eire excepted and Iceland not yet admitted) that floats at the western extreme of Europe,

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[2] See posting at http://business.blogs.cnn.com/tag/isa-soares/.

that "island in the estuary of the Rhine"[3] offshore of the continent, yet with a history since the time of Joan of Arc of pre-occupation with the world as a whole.

France, of course, associates Joan of Arc with the expulsion of the English and, by extension, anyone or anything (such as today's bond markets) that interferes with her sovereignty. But Joan of Arc's effect was to free Britain from her territorial entanglements in continental Europe, setting the stage for the creation of what was to become not only the British Empire, but, on account of its scale and scope, a proto world economy. The deeper historical question – one that clearly prodded at John Maynard Keynes – is what should, or at least might, have happened once the British Empire reached it zenith? In the last 90 years or so, what has happened is that the USA with its dollar took the place of Britain and pound sterling, causing in turn the idea of the euro to compete against it. What could have happened was an invitation from Britain to all other countries to join her in the creation of a worldwide *economic* commonwealth (to use the felicitous English word), with either a shared currency or the harmonisation of their relations such that, even though independent and floating, their respective exchange rates achieved constancy. This is, of course, the essence of an optimum currency area and Keynes's 'area pound', discussed in Section 3.2.

Although the history of the British Empire and the City of London's central place in it can be seen in assertive and even aggressive terms, one can also see that such a global commonwealth is implicitly London's context. In that context, were such a commonwealth to exist consciously not just impliedly, London's primary role – of 'managing' global liquidity – would shine forth as an objective one, recognised by the world as such and not competed against (just as one cannot compete domestically against a central bank).

After the pound sterling, the natural next step would have been to go from a proto world economy to an actual world economy with an agreed shared currency. That means, instead of a national currency (be it the GBP, USD or any other) acting as a world reserve currency, the polities of the world would agree on a supranational (not supernational)[4] currency. Whether the 'area pound', the bancor, SDRs or 'euro-currencies' (not to be confused with *the* euro), the world's currency would have to be independent of the fortunes of any of them. Such a currency implicitly exists in the 'centre' of the foreign currency markets; it is also implicit as universal standards despite any number of denominations in the field of worldwide accounting.

It might also be added that any world currency would do well to take a leaf out of Britain's book, given that, as the 'owner' of the pound sterling, she has a pedigree as regards currency that is longer and more continuous than perhaps any other country now existing. Moreover, the name of her currency and the name of the cover for that currency are (originally at least) the same. Not even the dollar and certainly not the euro can rival this

[3] To use an image from Salvador de Madariaga (whose ideas are considered later) that would hold Britain to Europe's bosom more clutchingly than many British might appreciate.
[4] The terms are not identical.

history. And yet, Britain is not a "current member" of the European Monetary Union, so her inclusion in this essay is at the risk, albeit worth the running, of pedantic or legal disqualification.

1.3 The Paper's Bias

Written from the point of view of an Englishman[5], rather than a European, this paper has an evident bias. Not, however, that of a nationalist, whose view does not extend beyond national boundaries, but of one aware that for the English, as for any other people today, as well as one's national self-image, it is one's role in the world as a whole (as perceived by the world, moreover) that first needs to be identified, after which come all the relationships in between (e.g. Europe).

Quite what Britain's world role will be remains to be seen, but our relationship with Europe is complicated by the fact that when people speak of Europe today they are not thinking of classical 'Europa' – the entirety of culture between the Urals and the Atlantic – but only of certain countries within that area (see Appendix 1 and Section 2.0).

One aspect of the European Project is the idea of removing trade barriers between member countries. As such, it is to be welcomed and has a certain inevitability. But this does not of itself mean that currencies need to follow suit. There is no *economic* need for those in a shared market to be required to use only one currency.

If the rationale is political, then one understands the idea of a single European currency unit. But if it is economic, why stop at Europe? Why not go straight to the question of a world currency? It is a world currency that is really needed in place of the outworn reserve currencies of sterling and the dollar, as also to clarify the roles of petro-dollars, Special Drawing Rights and the like. To wax Hayekian, now is the time to denationalise money, universalise it, not make it a thing of supernations.

The aim of the erstwhile European Economic Community (to neutralise antagonism between France and Germany) is of course a noble one. But it is deceptive to allow people to think the EEC was only about harmonising trade arrangements. It clearly was and is not. Indeed, one of its purposes is to create the euro as a rival reserve currency to the US dollar. It is not that one objects to the endeavours of those who seek to unify their currencies and then use it geopolitically. One merely wonders what is the point and one objects to their usurping the idea of Europe in the process.

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[5] A subtle yet real point in this paragraph is the reference to England rather than Britain. In this paper, Britain is the term chosen, but the author us not in fact Welsh or Irish or Scottish. There is also the delicate question: In a UK subject to devolution, let alone dissolution, to who does London belong? Or is the City an unspoken financial and indeed global version of Washington or Canberra?

1.4 The Matter of Style

Finally, who is best placed to figure all this out? An academic with no business experience? A businessman not able or interested in explaining or codifying his conduct? Or one at home in both – a Keynes, a Soros, a Congdon? Moreover, events are moving faster than is comfortable for merely academic deliberation. It is time to think on one's feet by describing a doable strategy capable of near-term implementation. This puts a premium on being wise before, not after, the event, implying a need to rethink the existing European and global financial architecture before one tinkers with it. Avoiding icebergs rather than rearranging deckchairs.

The approach taken here is that of an economic and monetary historian. It does not see the problem of the euro as an economic one in the first place, to be solved by economics. The economics involved are and will be a combination of market theory and business experience, neither of which need explaining or defending here. The issue is how the euro is conceived and whether it can operate, as here proposed, as an *optional* currency (not to be confused with *optimal*). The numbers can and will be run on either scenario – with or without the euro – so that is not the place to begin. It is not a question of modelling economic life in support of either but of figuring out whether *conceptually* the euro can be used independently of the political purposes to which it has been seconded. It may be opined that political realities prevent this. And yet politics never prevents clear thinking, that most practical aspect of economic affairs; it only prevents the application of clear ideas.

The task cannot be to invent some concept not yet known that can rest as an academic conversation piece, remote from day-to-day economic reality and not requiring to be realised in practical life. Nor should too much time be spent reiterating well-known and well-worn arguments that turn on whether a political or economic approach is what is needed.[6] The pressing matter today is whether one has the will simply to opt for one or other of the two approaches to the euro question: Is it to be a political currency or an economic one?

This paper opts for the economic approach. To this end, its references primarily cite authors who, for all their erudition and scholarly skills, have active links to policy making and to economic life. Its treatment of the subject is hopefully both novel and of use, even though the debate is not only long-running, but has also grown stale, so that not much new can be thought or said. The situation today is not about arguing a clear case that will prevail over others. It is about Political Europe stealing a march on Economic Europe. About, in other words, whether it is too late to impede the political momentum or whether there is a chance yet to direct it into channels more apt to its political objectives, and so allow the economic argument to gain ground.

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[6] A precept this paper may well itself have sinned against.

By and large, this debate trundles along entrenched lines – either stay in or get out of the European Union. The question asked here, however, is whether on economic euro (that is, the euro as an optional currency (see Section 4.0) can yet be envisaged that allows a necessarily eurocentric Political Europe to coexist with an Economic Europe that is world-minded.

1.5 Some Terms

In general discussion, the meaning of the following terms can be various. As used here – hopefully with full consistency – these meanings are:

A people is a plurality of persons considered as an ethnic whole, as when one speaks of 'the Jewish people'. This is distinct from 'we the people', 'the people's princess', and so on. **Nation** is kept to a minimum because it connotes 'by birth' in contrast to a people which is created out of its history rather than its blood, out of what it achieves, not out of its predisposition.

Country, in the sense of 'that which lies opposite to', is a place inhabited by a people (its 'patria'). It is used here distinctly from **state**, meaning a politically defined territory in which the people vest **sovereignty** in a government (of whatever kind).

Britain is understood to comprise England, Northern Ireland, Scotland and Wales and is used here instead of United Kingdom. Likewise, **British** is used as a collective noun for all four of Britain's peoples (even if in reality we often mean English) and overlooks any separatist tendencies on any of their parts.

2.0 Europe at a Cross Roads

It is stating the obvious to say that the nexus of European countries and their economies is a complex one. Moreover, as with all complexity the devil will be in the detail, often not readily observable on first sight and discernable only from a perspective that is as broad as it is far-seeing. To mix the metaphor, here the devil is like a mouse in the stubble of some field way below the all-seeing eye of a soaring eagle. From his high vantage point the eagle can survey an entire scene and because of this note the smallest darting detail, such as the toing and froing of those who in promoting the European Project, mean to create the United States of Europe.[7] It is to such a vantage point that we must first rise, therefore.

[7] In 1994, for example, when the name 'European Union' was being brought into, the seventh aim of the Union was "To set up the institutions which will form the basis of a United States of Europe." See Appendix 2.

The issues may seem straightforward, yet they elude a ready Europe-wide consensus. Central to the problem is the need to be clear whether by 'Europe' we mean something more poetic and historically real than the narrow meaning the word has when used (unjustly) as a synonym for the European Union. Even if it is intended by some that they should be, taken as a whole the countries of classical Europe are not those of the European Union (see Appendix 1). It is surely something of a trade description problem, therefore, not to mention a sleight of hand, to allow 'Europe' and 'European Union' to be interchangeable. So in this essay they are not. Instead, we review the link between Europa and Europe, as well as make a clear distinction between Europe and the European Union. Not only that, we also distinguish between the European Union and its intended eventual form as the United States of Europe, to which end name 'European Union' serves as a bridge from the previous 'European Community', itself a change from the earlier 'European Economic Community' and 'Common Market'.[8]

2.1 Europa

The name Europe derives (initially) from 'Europa', the 'Woman of the Apocalypse' from The New Testament Book of Revelation (12:1, 2 & 5): *And there appeared a great wonder in heaven; a woman clothed with the sun, and the moon under her feet, and upon her head a crown of twelve stars... And she being with child cried, travailing in birth... And she brought forth a male child, who was to rule all the nations with an iron rod...*

The story is of course much more elaborate and goes on to tell of dragons and serpents and St. Michael and his sword, an image well known to the English with their St. George. But, to stay with Europa, her typical image is shown above, grandiose on the left and stylised in the centre. The image on the right is that of the European Union flag, whose designer, Arsène Heitz, has acknowledged his allusion to the Book of Revelation. It is an intriguing abstraction in that it omits both sun and moon. In consequence, rather than Europa, its circle of 12 yellow-gold stars on a blue ground brings to mind the Catholic tradition of the Blessed Virgin Mary and the Immaculate Conception, surely a dangerous (albeit officially denied, see next paragraph) Marian flirtation that is hardly compatible with the pluralism

[8] These name changes reveal the true political intent of the European Project as it sloughs off all reference to its supposed economic justification.

and ecumenism required of a ‘country’ whose members are as likely to be Protestant as Catholic or Moslem as Christian, let alone non-believers and people of all manner of other persuasions.

According to the EU website, the EU flag is a symbol of “Europe's unity and identity in a wider sense. The circle of gold stars represents solidarity and harmony between the peoples of Europe. The number of stars has nothing to do with the number of Member States. There are twelve stars because the number twelve is traditionally the symbol of perfection, completeness and unity.” From a skeptical point of view, this would make more sense, be more credible if the Europe to which allusion is made were a consistent thing. As Appendix 1 makes clear, however, the actual and intended borders of the Union are not coincidental with those of Classical Europe, to which the concept of completeness refers.[9]

In ancient Greek mythology, Europa was a Phoenician princess whom Zeus abducted to the island of Crete after assuming the form of a dazzling white bull. For Homer, Europa was a mythological queen of Crete, not a geographical designation. Later, Europa stood for central-north Greece, and by 500 BC its meaning had been extended to the lands to the north and west. Suffice it to say, that one needs to exercise caution here. For the Ancient Greeks, did ‘Europe’ refer to a place or to a culture? Or to a place which is the special home of that culture? Furthermore, what that culture meant to the then Greek mind would be characterised by us today as western, occidental. That is to say, not originating or located in the orient, Asia. In the classic sense, therefore, Europe is as much a place of the mind – the home of European consciousness with its special recognition of the role of the individual – as it is of the earth, as much cultural as geographical.

2.2 Europe

Geographically, Europe is one of the world’s seven continents, separated from Asia to its east by the Ural and Caucasus Mountains with the Caspian sea between them (see Map 1). Europe is bordered by Arctic waters to the north, the Atlantic Ocean to the west, and the Mediterranean and Black Seas to the south.

Very importantly, by this account Europe does not include Asia Minor, that is to say, Turkey. Indeed, Turkey is an intriguing case.[10] She originally applied for membership of the European Union in 1987 (her invasion of Cyprus notwithstanding), but is she truly European or is she included in the European Union because of the latter’s overlap with

[9] As an aside, with its 50 stars for today’s states and 13 stripes for the colonies that rebelled against the British monarchy, the flag of the USA, in contrast, is a much more precise, true and informative allusion.
[10] Similar could also be said of Cyrpus and Morocco, which also applied for EU membership in 1987, and, nowadays, what of all the other states that befringe the eastern and southern shores of the Mediterranean?

NATO[11] or some other non-European reason? Salvador de Madariaga, whose work is discussed shortly, makes a case for Turkey to be part of Europe, as also Palestine, on the grounds that in Alexander's time the Greek-Hebrew relationship made that area – Asia Minor or the Near East – the true cradle of Europe. Even so, it is legitimate to ask of Turkey: Is she part of the Balkans and in that sense European, or does she rather represent a transition between the Occident and the Orient, Europe and Asia, not only geographically but also culturally? To put the matter more philosophically, is the real Europe, Cultural Europe, to date about anything other than the birth of the individual out of the communitarian matrices of yore, while going forwards it is about how humanity needs to avoid becoming bogged down in individualism, by lessening its current egoism and self-centredness (understandable at this point in history), expanding it out instead to include the entire human family.

Map 1: Geographical Europe

Whatever meaning attaches to its origins, this Europe (see Map 2) is well worth calling to mind, existing as it does as an ideal between the mythology of Europa and the sophistry of the European Project (see Section 2.5). Indeed, on one level, it was this ideal Europe that Denis de Rougement invoked when he spoke in a packed sports stadium in Montreux in 1947. In his speech, entitled 'The Federalist Attitude', he outlined a set of principles of federation with his main point being a double one: that Europe needed a federation of its peoples, but such a federation should not be centralist, neither in spirit nor in form. It is also ideal Europe that is portrayed by Salvador de Madariaga in a perhaps now forgotten

[11] A liaison stressed by Anthony Coughlan, for example, Senior Lecturer Emeritus at Trinity College, Dublin in an address to the Bruges Group, London 5 November 2011 based on his paper, 'Ireland and the Eurozone Crisis'.

book[12] in which he spoke of "the secret [of Europe's] marvellous variety and yet [her] no less marvellous unity" (11), noting that the 'European touch' is to get the mix between them right.

Map 2: Countries of Europe

Map 3: European Union Member States

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12 De Madariaga, S. (1952) *Portrait of Europe*. London: Hollis and Carter.

Both men were keen advocates of a united Europe, with de Madariaga also a founder of the College of Europe. But, in this author's view, like all European Unionists they both made the mistake of conceiving this diverse unity as a cultural, political and economic monolith. And yet, what really animates Portrait of Europe is its rich, insightful and teemingly evidenced, if at times fanciful, picture of Europe when seen culturally (and through the eyes of an educated person). Indeed, the Spanish title uses the more telling word 'bouquet'. And on this point, who can disagree but that the peoples of Europe have ever been, and will forever presumably be, intermingled, despite the very different characteristics they also have. Hence, the better appellation used here of Cultural Europe, that aspect of Europe which, in de Madariaga's description of Don Juan for example, provides "an escape for the European imagination from the tight hold of so many laws." (53) It is this Cultural Europe that, according to de Madariaga, as we shall see, ought to have Vienna as its capital.

But is this what the word 'euro' brings to mind? And if so, what emblems might Europe in this deeper sense be represented by and are they those found on euro notes and coins? In fact, with the exception of some of the 'national' sides of the coins, the designs of both coins and notes all sport an expunged Greenland, an enlarged Malta, a relocated Cyprus and bridges that march westwards across the Atlantic. There are no allusions to culture: no people and no heroes.

2.3 Stars and Houses, Tones and Lights

Another way of understanding the peoples of Europe culturally is as the 12 stars or houses of a zodiac. This image is very valuable because it betokens completeness, unity *and* diversity, but as a cultural fact to which every 'European' can relate, not as the sign of a political union. An emblem of European cultural life, not of the United States of Europe. Then, too, those cousins of individualism, pluralism and ecumenism, are not only presupposed, but can become truly operational as a kind of cultural reflection of comparative advantage. What is it that each country or people can contribute to Europe as a whole that none of the others can?

This is reflected in Christopher Houghton Budd's concept of a 'choir of cultures'[13], entailing "a severalty of all the world's peoples … brought together in one [global] economy such that no one of them can control, ransom or fight over it… an economy that depends on each people identifying … what it can especially, even uniquely, bring to humanity's table. More than this, the huge diversity of the world's peoples will act, as does individual diversity, as a kind of perpetually functioning difference in levels on which forward movement of economic life depends (or will come to depend). Put poetically, the concomitant of a single global economy will be a choir of cultures, each able to sound its own note but able also to include the tones of all the others." (6)

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[13] Houghton Budd, C. (2011) *Finance at the Threshold: Rethinking the real and financial economies*. London: Gower .

This image of a choir of cultures or peoples also resonates with Milton Friedman's famous dictum that, '…flexible exchange rates are a means of combining interdependence among countries through trade with a maximum of internal monetary independence; they are a means of permitting each country to seek for monetary stability according to its own lights, without either imposing its mistakes on its neighbours or having their mistakes imposed on it. If all countries succeeded, the result would be a system of reasonably stable exchange rates; the substance of effective harmonisation would be attained without the risks of formal but ineffective harmonisation.'[14]

It is difficult not to see Friedman's use of the word 'lights' as an allusion to cultural life, while the paragraph when read as applying to Europe is practically a recipe for an economic alternative to the current political euro. While the euro fixes statically and forever the relationships between its constituent currencies, Friedman's concept is of working on economic fundamentals in order that the relationships between countries arise freely, but are nonetheless constant. In this consists the crucial subject and a central thesis of this paper, to which we will return: the interface between politics and economics with their different yet compatible logics. Politics is national; economics is global; culture is universal. Understood as the ability to think independently of the imperatives of the first two, it is the latter that prevents the first two from becoming muddled.

2.4 The Tree Metaphor

Salvador de Madariaga's book is also interesting on a separate account, in that he makes an evocative analogy to the three-part form of a tree, with "in the centre, its individualised, unitary and personal trunk [and] downwards and upwards, branches of diversity seeking to dissolve its unity into the common, anonymous, obscure earth and into the luminous sky where all tends to the sun." (19)

A main point of the analogy is that a tree comprises three distinct, but not physically separable, parts, but that "none of the three need give herself airs or look down on the [other] two." (63) If there is a defect in the analogy, it is that it suggests no difference between the diversity of the lower and upper parts. Every tree has a trunk which is strong, central and assertive, but its roots go into unseen depths and there become entangled in a subterranean world shared with all other trees, while, its branches rise up and out to become part of the forest's canopy, reaching to the sun which again it shares.

De Madariaga uses this analogy to liken the European countries to the trees in a forest, but this use of the metaphor is weakened by the unitary image he has of social life, whereby the cultural, political and economic aspects of society all share the same locus, a view that conflicts with his idea that Vienna should be "the capital in every way if ever Europe came to constitute itself" (177), and his reference to that "European Continent whose natural

[14] Friedman, M. (1966 [1953]) *Essays in Positive Economics*. Chicago: Phoenix.

centre [Vienna] is." (178) Given that the EU's capital is quite clearly established between Brussels and Strasbourg, could this be a display of the kind of contradiction to which diplomats are readily susceptible? It is also important to ask whether 'Continent' refers to de Madariaga's wide geographical concept, including its offshore western islands situated, as he puts it, in the estuary of the Rhine, or to the Continent that the British go *to* when they, even today, say they go to Europe in the same way as they go to Africa or any *other* part of the world?

A different but more trenchant use of the tree metaphor is to liken its trunk to the *political* life of each country, through which its uniqueness finds expression, its roots to the *economic* life, where they intertwine with the roots of the other trees, and its branches to *cultural* life, where they merge or, better put, interweave in what is generally referred to as European culture. Admittedly, this is not de Madariaga's use of the metaphor, and yet he shows well how, precisely on a cultural level, Faust and Don Juan, Hamlet and Don Quixote mirror each other, notwithstanding the animosities and wars that characterise another part of the relationships between their respective countries – England, Germany and Spain. Similarly, he characterises the cultural links between Europe's different types and peoples as a common evolving tapestry or bouquet of intermingling fragrances, even if the countries concerned also have relationships that are at times both bellicose and belligerent.

The key merit of the tree analogy as used here is that trunk, roots and branches have distinct functions that cannot be conflated or interchanged. The purposes of each require that they have a degree of autonomy, matched by the whole being a conversation between them, rather than any one of them 'having airs or looking down on the other two'. So that, while economic life (the roots) is an intertwining and cultural life (the branches) is an interweaving, political life (the trunk) is something distinct, upright, sovereign.[15] Conversely, if the trunks of the trees all become merged, then neither the economy nor the cultural life can develop as they should.

As concerns the economic dimension, the creation of a single European *economy*, as distinct from a single European *state*, can clearly be understood as a step towards something worldwide, but will it for that reason be able to remain European? In principle, the boundaries of a global economy are those of the planet itself, hence the need for a global economic commonwealth. And it is of course no revelation to regard modern economic life as interdependent. From that point of view, the question is whether in a time of global economics one can set economic boundaries supernationally any more than one can do so nationally. Does the intertwining of the roots stop at political boundaries as if they have hit some kind of subterranean wall?

[15] The meaning of the word sovereign is important, especially when discussing sovereignty and sovereign debt. In this paper it has the meaning given under 'Terms'

The interweaving of cultural life is a different story. Interweaving is not the same as interdependent. Shakespeare and English culture is not interdependent with Goethe and German culture. Rather the one speaks to the other. Neither needs to be subsumed by or compete against the other, but each without the existence of the other would be the poorer.

Let Europe interweave culturally and intertwine economically, therefore. But as regards the political life, let the image be that of a stand of trees where no trunk is merged or conflated with another, neither as between or within species. Let the forest of Europe's trees be a community[16] of sovereign states that co-exist in mutual recognition – something that is only possible, however, if cultural life and economic life, branches and roots, are allowed to express their own natures.

An important reason for this particular use of the three-part analysis is to enhance the more usual twofold distinction between political and economic life. This is a differentiation frequently made by British commentators and one that is indeed central to the argument of this paper. But it is a distinction that often becomes adversarial precisely because the third element – cultural life – is left out. Without giving it any airs or superiority, the recognition of European cultural life as a shared, evolving tapestry would allow Europe's political and economic evolutions to find their own true paths as, respectively, separate trunks forever sovereign and national, and intertwining roots increasingly and ultimately interdependent and global.[17]

Such contrasting political and economic development would present no problem because people would not feel that their cultural life was thereby thwarted in its own appropriate development. To one who appreciates Shakespeare or Goethe or Voltaire, it is a matter of indifference if one spends pounds or euros. It becomes a problem only when one's culture becomes lost or subsumed in the realms of politics or economics (or both in cahoots).

2.5 The European Project

Concerning sovereignty, if the law of another country or polity seems appropriate to it, there is no reason why a sovereign state should not, could not or would not adopt it. The surface effect would be that the same law operated in both polities, but the deeper effect would be one of having freely chosen it, not of having had it imposed. While the law may appear the same in both scenarios, the undertones are not. And even though these fade into the background, they yet live on as psychic ranklings, as despondency and resignation, rather than joy and upholding.[18]

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[16] A designation, as already noted, that was quietly consigned to history in December 1995 when 'European Union' was officially adopted.

[17] For the practicality of this approach much will depend on where money, accounting and finance are located; an important matter discussed later in Section 5.0

[18] The more so, perhaps, for an Englishman who, having dutifully conformed to a Brussels directive to which he in fact objects, finds another European Union member quietly ignoring it.

If they are to be welcomed and felt just, laws must not invade the cultural life or the economic life, neither the imagination nor commerce, anymore than the trunk of a tree should become branches or roots. The trees of Europe, at any rate, should not become confused in this way. It is on this that Salvador de Madariaga's maxim of unity *and* diversity relies. Europe's distinct countries need to collaborate not amalgamate – something the lifting of border controls but not borders shows to be possible. If they do join together they need to do so from within, as it were, not be joined together from outside. The difference is subtle yet fundamental – as is the difference between, in the event of joining, federation and con-federation.

None of these are new topics and there is little to be said about them that has not already been said from the late 18th century onwards when the prospect of a united Europe was first seriously mooted. The question is not whether we finally understand these issues, but, understanding them well enough, as we do, which option do we wish to take? Now that Europe finds itself at a crossroads, which path is one to take?

For the purposes of this essay, and to make its bias even clearer, the view taken here is that autonomous inter-country collaboration is what is called for. If union is to be the aim, then voluntary conjoining is superior to enforced, cajoled or obliged membership. Further, if one were to arrive at a universal 'yes' to joint adherence, then confederation in the Swiss sense is the better modality. What we do not countenance is enforced membership and centralised federation – the precise characteristics of the European Union as it now behaves. It deliberately uses the euro and the Eurozone as devices to promote political union, as a way of engendering a 'yes' answer to a question – Do you want to render your country a province within the United States of Europe? – that, if asked directly would almost surely be a 'no'. At the very least, the risk of a straight 'no' to the question is deemed substantial enough that a long circuitous back way into an arrangement has been devised and promoted – described by Larry Siedentop, Emeritus Fellow at Keble College, Oxford, as 'back door federalism[19] – even though it has already been decided that the eventual name of the resulting building, currently called 'The European Project', will be 'The United States of Europe'.

Here is not the place to debate in any further detail the pros and cons of a United States of Europe, the prospect of which has been on the cards ever since Napoleon's time and which includes Winston Churchill as one of its more illustrious proponents.[20] The point is to note that, for whatever reasons, the citizens of the EU's 27 and more countries are not being asked if that is where they want to go, even though it is the Union's declared destination.

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[19] *A Crisis of Belief.* Prospects, November 2011.

[20] Appendix 3 provides an overview of developments since Churchill's Zurich speech in 1946, although he was in effect quickening an already extensive history of the prospect.

2.6 Europe and the World

The previous section provided a necessary preamble to the main thrust of this paper. Not only in order to be clear as to our bias (and our justification of it), but also, as already outlined, because the entire Eurozone debate is subject to the twin fault line of whether such a polity as the EU aims to become ought to exist and, were it to do so, should it be a centralised federation or a con-federation. Judging by the EU's behaviour to date and the views of its protagonists, the answer to the first part of the question is, "yes it will come into existence before Victor Hugo's famous tree[21] on Guernsey matures." To the second part the answer is "centralised."

That being so, Lord Wolfson's question – Can an orderly exit from the European Monetary Union take place? – is more easily asked than answered. As Nigel Lawson very succinctly argued on BBC's Radio 4 recently[22], one needs to distinguish sharply between the creation of the United States of Europe, which would as a matter of course have a single currency, fiscal unity, a single polity and all the trappings of a nation state economy, and the idea of separate sovereign countries working together to create a shared, single economy. Between *monetary union* requiring a single polity, and *monetary harmony* based on separate sovereign polities working together.

Again, the focus ought not to be European in the first instance. Whatever one's view of it, one needs to distinguish between the idea (and for many goal) of a united Europe and the underlying fact of today's single global economy. And again between the possibility of a worldwide *economic* commonwealth and the idea of a three-bloc *political* concept as the precursor to a single global polity with a world president, a world central bank, and its own fiat currency.[23] Importantly, the three blocs will likely become, if they are not already, those of the US dollar, the euro and the yuan (not the yen). Where in this is the pound one might ask? Is it planning to give up its own existence in favour of the dollar or the euro or the yuan? Or is it (witness recent comments by Chancellor George Osborne concerning the yuan and The City) alive and well and intending to continue, with London as the global home for all three, while sterling holds the ring?

One needs to set the stage in this way in order to recognise the dynamics at work, not only on the European scale, but also globally. For once the European Project succeeds in establishing for the first time a governance model (including monetary governance) in which the governing and the governed are disconnected – for such, contrary to its rhetoric,

[21] Presumably one that disobeys the tree analogy used here!

[22] Interviewed on the 10pm news programme, early January 2012.

[23] This may be thought far-fetched, but it is by no means inconceivable. More to the point, given that to achieve such an outcome all the polities of the world would have to lose themselves in something greater than and superior to all of them, the European Project at times looks like a dry-run for the world government that some indeed advocate. It is well-known, for example, that there are moves to institute a President of Europe as an office above both the European Commission and the European Council.

characterises its development to date – the focus will surely turn to the global situation. At which moment, the fault lines will deepen between those who would harmonise their economies (as also their economics) without seeing the need for or requiring the creation of a coterminous polity, and those who would above all create a global polity, with any consequences for currency and monetary matters being simply those that accompany and characterise such a scenario.

3.0 The Place of Britain

Where Britain stands in all this is, of course, of crucial concern – and not just to Britain! It may be an island in the extended estuary of the Rhine, but Britain is still an island country – one of Europe's houses and the home, moreover, of four distinct peoples (even if in this paper they are all included under 'British', by which we often mean 'English'). The British play this role naturally and thus can appear isolationist. But, in a way that no other European's can, theirs can and should appear as the counsel of an islander, not necessarily separate but as one who, very importantly, sees things from the point of view of uninvaded sovereignty.[24] In this regard the British arguably have a kind of historical duty to hold out for a view that non-islanders may be as little able to understand as can islanders that of merged nationhood, supernationdom.

Of course, one is aware that Lord Wolfson's question is not specifically or expressly about Britain because Britain is not a member of the European Monetary Union and so cannot leave it. It is, however, valid to ponder the effect on Britain if the euro and/or the Eurozone were given up. Notwithstanding Britain's tetchy relationship to the European Union and her divided, or at least variegate, opinion about the European Project, her diverse views are underwritten by a common concern to further British interests.

This brings this essay to a clear point: when Lord Wolfson refers to financial effects – which most of his question does, as do also its nine sub-headings – while this is not code for Britain, it certainly touches on the future and fortunes of London. London is two things: a worldwide entrepôt centre for global capital, financial services and commodity markets; and an important part of the British domestic economy. Ineluctably, therefore, the effects of giving up the euro or leaving the European Monetary Union are of concern to Britain.

Whether we (the British) like it or not, participate in it or not, the fate of the euro and the Eurozone is not a matter of indifference to us. It is important, therefore, to map the role of Britain as *a part of* Europe, even if our stance happens to be *apart from* Europe. To this end, the rest of this paper will unavoidably have a British dimension for three reasons.

[24] At least since 1066.

Firstly, because such things as free trade areas and the International Clearing Union (discussed next) represent a British preference, or at least inkling, for what in this paper is called 'commonwealth' – the economic working together of politically sovereign countries. Secondly, because it rehearses some cogent arguments against the euro and the Eurozone, not in order to advance such arguments necessarily, but in order to elucidate the concerns they embody and the technical aspects they highlight. Thirdly, because the core idea of this paper – that of the euro as an optional currency – resonates well in our opinion with Britain's historical proclivities.

3.1 Free Trade Areas and the International Clearing Union

There are many eggs in the omelette that is the European Monetary Union. One is the careful and clever use of the idea of the European Economic Area – a device that co-opts non-members of the European Union (and of the Eurozone) into it on terms that essentially defer to the existing members. (Switzerland especially is as if surrounded by legislation that she is required to adopt in toto or made to suffer, as when European Union lorries seek to cross her territory, this no-man's land ironically located at the very heart of Europe.)

Likewise, for Britain (and others) to enter the EEC they had to give up on the erstwhile European Free Trade Area. Thereby the free trade movement with its roots in Richard Cobden and John Bright lost out to federalism, as did Britain's links with the Antipodes. Of the nine members of the European Free Trade Area in 1972 (Austria, Denmark, Norway, Portugal, Sweden, Switzerland, the United Kingdom, Finland, Iceland), only three – Norway, Switzerland and Iceland – stayed outside the EEC. Indeed, the invention and creation of the European Economic Area has effectively smothered or crowded out the memory of the free trade movement, which was arguably no less pan-European in its gesture than the European Union claims to be.[25]
Of course, it may not be possible to unscramble the omelette (a metaphor that ought not to be pushed too far), but it may yet be possible to influence our digestion of it by thinking afresh in the big picture terms of the global economy and the currency conundrums humanity has faced ever since the gold standard became unviable in the late 19th / early 20th century.

[25] "I utterly despair of finding peace and harmony in the efforts of Governments and politicians. The people of the [various] nations must be brought into mutual dependence by the supply of each others' wants… I know there are individuals …who say 'we will produce everything we want within our own boundaries [but] if nature had intended that there should be such a national isolation she would have formed the earth upon a very different plan, and given to each country every advantage of soil and climate… No, Providence has wisely given to each latitude its peculiar products in order that the different nations may supply each other with the conveniences and comforts of life, and that thus they may be united together in bonds of peace and brotherhood." On Cobden's death in 1865, the French Minister of Foreign Affairs, Drouyn de Lhuys said: "He is above all in our eyes the representative of sentiments and those cosmopolitan principles before which national frontiers and rivalries disappear; whilst essentially of his country, he was still more of his time, …an international man." Encyclopaedia Britannica, 1911 edition.

When considering the fate of the euro, it is especially instructive to consider first the idea of the International Clearing Union with its bancor currency conceived in the early 1940s by John Maynard Keynes and E. F. Schumacher,[26] and which the United Kingdom proposed be introduced after the Second World War. The plan was for a multilateral clearing system, the International Clearing Union, charged with regulating international trade, denominated in its own currency, the bancor, which would have had a fixed exchange rate with national currencies, and would have been used to measure the balance of trade between countries. Every export would have added bancors to a country's account, every import would have subtracted them, giving each country an incentive to keep its bancor balance close to zero. If a country had too high a bancor surplus the International Clearing Union would have taken a percentage of that surplus and put it into its Reserve Fund, thereby encouraging countries with surpluses to buy other countries' exports. Countries that imported more than they exported would have had their currency depreciated against the bancor; encouraging other countries to buy their products, and making imports more expensive.[27]

As Keynes said is his maiden speech in the House of Lords, "The principal object can be explained in a single sentence: to provide that money earned by selling goods to one country can be spent on purchasing the products of *any other* country." [Italics added.][28]

3.2 Optimum Currency Area

Three years earlier, Keynes had exercised his mind in ways that, as regards the nature and dynamics of international currencies, it is well worth recalling because it shows that the euro presents us with nothing new as regards the economic aspect. What is new is the use of a currency to effect political union. In a letter to Harold Nicholson on 20 November 1940, Keynes wrote: [29]

> "The essential point is this: that the area pound sterling can be used throughout this territory which contains vast resources of manufactured products, animal and vegetable

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[26] For a period during the War, Schumacher was interned as an "enemy alien". In these years, he caught Keynes's attention with a paper entitled "Multilateral Clearing". Keynes recognised the young German's understanding and abilities, and was able to have Schumacher released from internment. According to Leopold Kohr's obituary, when Schumacher's paper "was published in the spring of 1943 in *Economica*, it caused some embarrassment to Keynes who, instead of arranging for its separate publication, had incorporated the text almost verbatim in his famous 'Plan for an International Clearing Union,' which the British government issued as a White Paper a few weeks later." (Wikipedia.) See also: http://www.imf.org/external/np/arc/eng/fa/bwc/s4.htm; http://www.cesc.net/passagen/manuscripts/pe1.html

[27] Source: Wikipedia, William Krehm and elsewhere.

[28] HL Deb 18 May 1943 vol. 127 cc521-64. JMK Maiden Speech.

[29] It goes without saying that Keynes was writing some 70 years ago and was linked to British interests. The question is whether British interests are only ever egotistical and thus self-serving, or whether they metamorphose into universal considerations and serve in fact the world economy per se. It is also relevant that Keynes's ideas are now appearing on the lips of the Chinese monetary authorities.

> products of every type, grown under every climate, and enormous mineral wealth. The area of the pound sterling comprises territories in every part of the world, so the 'area pound' is a good name, and lays emphasis on its most important characteristic. [It] remains in its essence, an instrument of trade [possessed of] universality and lasting worth...
>
> [National currencies can never rival] an area which can produce vegetable products which grow in tropical, semi-tropical and temperate climates; nor can they manufacture deposits of minerals where they do not exist. The sterling area is not merely useful; it is essential, and those who are deprived of its resources know this best…
>
> [When you use] the area pound is a simple mechanism to make the resources of the area available to traders all over the world. When you use it, you use the long-established and smooth, reliable machinery of the City of London, which has grown up on conducting international trade on the simplest, most honourable and cheapest basis. It avoids the complications of barter and compensation, which hide the lack of resources and – too often – the juggling of prices to the organiser's benefit which lie behind them; and owing to its true usefulness and the backing of material behind it, the area pound is naturally maintaining the international position which sterling has always had. It is not sterling itself which is useful; it is the sterling area, to which it is the key, and that is necessary to all the world."

Shortly after, on 1 December 1940, in response to a request from Lord Halifax for an authoritative statement on post [World War 11] Germany, Keynes expressed his well-known view that, "the authors of the Peace Treaty of Versailles made the mistake of neglecting the economic reconstruction of Europe in their preoccupation with political frontiers and safeguards. Much misfortune to all of us has followed from this neglect." Similar could be said of the EU today – the economic is neglected in favour of the political. The misfortune, it seems, continues.

The key then, as now, is "the establishment of a system of international exchange which will open all our markets to every country, great or small, alike, and will give equal access for each to every source of raw material which we can control or influence, on the basis of exchanging goods for goods." Note 'every country'. This implies a world currency, not a European currency. Indeed, if Keynes's ideas had been heeded or his proposals adopted as regards the International Clearing Union and Bretton Woods, the likelihood is that the dollar would not have come to reign supreme (albeit with ever increasing uncertainty), nor would the euro have been conceived as a force against it.

From the above extracts the idea is obvious, that if a currency is to be sound, whatever its legal basis and jurisdiction, it needs to embrace, represent or be used in an area that is economically both well endowed and well balanced. The long term justification for the Eurozone is that it will become such a place. But where will its boundaries be? Where will they find the scope described by Keynes for the area pound?

In effect, more fruitful than defining, Keynes is envisaging an optimum currency area, which Anthony Coughlan in his earlier cited paper describes as ‘an area in which a common currency facilitates economic transactions between regions characterized by broadly similar levels of industrial development, labour productivity and resource endowment, and whose inhabitants are willing to pay taxes to a common government that would finance transfers to poorer citizens or communities within the area’s borders out of a shared national or communal solidarity.’

A drier definition, and one much emptier than Keynes’s or Coughlan’s, regards an optimum currency area as a geographical region in which it would maximize economic efficiency to have the entire region share a single currency. An optimum currency area is often larger than a country. For instance, part of the rationale behind the creation of the euro is that the individual countries of Europe do not each form an optimum currency area, but that Europe as a whole does. Similarly, it can also be smaller than a country, with some economists arguing that the United States, for example, has some regions that do not fit into an optimum currency area with the rest of the country.[30]

Pace the father of optimum currency area theory, Robert Mundell, such a definition is defective because it emphasises the currency not the economic background. With both ‘pound sterling’ and ‘area pound’ the point is that the name of the currency and of its backing were synonymous. The euro is anodyne by comparison and refers to what economically? At least its predecessor, the Ecu, was an allusion to something more lively – a mediaeval shield – although that, too, is a decidedly non-economic emblem.

3.4 European Clearing Union

The overarching problem is that in reality, the supreme, and in that sense only optimum currency area is the world economy as a whole.[31] Keynes (and Schumacher) thought on a global scale because that is where one needs to begin – at the end of the journey, not at a stage along the way. For that sets the frame of reference clear: Can there be anything other than a severalty of national currencies (even if reduced to but a pair of supernations) or a single world currency, between which two real possibilities the European Union and the euro find themselves? And if so, what is their *economic* purpose?

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[30] Wikipedia.

[31] Mundell seems contrary on this. In his famous ‘A Theory of Optimum Currency Areas’, published in *The American Economic Review*, Vol. 51, No. 4. (Sep., 1961), p. 662, he says in one moment that an optimum currency area cannot be the world but only a region of the world, then goes on to say that “Money is a convenience and this restricts the optimum number of currencies. In terms of this argument alone the optimum currency area is the world, regardless of the number of regions of which it is composed.”

One obvious question is why the European Union was not (and could not yet be) conceived as a European Clearing Union (or ECU!).[32] Then, instead of transferring 'regional funds' from the centre to the periphery, requiring and reinforcing a centralised structure, the challenge would be for the countries of Europe to inter-trade. For every Volkswagen bought by a Greek, how many Germans would need to holiday in the Greek islands?

The euro would then function as a *shared* rather than a single currency, a virtual form of specie flow or gold standard that neither needed a polity in order to exist, nor could be captured by any polity. This, were it to happen out of a concert of English, German and French minds, would give substance to another of Salvador de Madariaga's intriguing observations: "England and Germany must abjure their essential isolationism, merging themselves truly … into a Europe they both must lead with France…, a conversion [however, that] must come about first in England." (108) How different this image is from that of current Anglo-German-French relations!

The irony – as far as de Madariaga is concerned – is that a European Clearing Union in this sense can only be an economic, not a political enterprise. It belongs to Economic Europe, not Political Europe. Its enactment would require Political Europe to have a foundation otherwise and elsewhere than in economic affairs.

3.5 Some Standard 'Against' Arguments

Moving on from the European Union as an omelette, rather than quit the European Monetary Union or abandon the euro it might be wise first to change the metaphor to one of deconstructing its many components, which anyway do not always belong together. This will prove no easy task. There are so many vested and conflicting ideas and interests – and of many kinds, including academic reputations, financial investments, political ambitions.

As good a place as any to begin such an exercise is to consider the views expressed by some of the panel members at a recent meeting of the Bruges Group. Rehearsing these views does not entail agreeing with them. But they have the merit of delineating the subject and focusing one's mind precisely because of the stark hopes and intentions of their protagonists. The following account captures the essence of arguments presented on 5 November 2011 at a seminar optimistically entitled 'After the Euro', the pointed aim or at least focus of which was threefold: to dismantle the euro, prevent fiscal union, and deny participation in euro bail out[33] arrangements, specifically those of the European Financial Stability Fund.

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[32] See *A European Clearing Union – The Monetary Union 2.0*, by Lisa Paus and Axel Troost, members of the Finance Committee of the German Parliament, March 2011.

[33] An interesting term, does it mean bail out as when a boat is full of water, or the money paid to secure the release of a suspected criminal.

David Myddleton

David Myddleton, a chartered accountant, former Professor of Finance and Accounting at the Cranfield School of Management and Chairman of the Trustees of the Institute of Economic Affairs, made the first point, namely that the euro crisis has its near origins in the ignoring of the Stability and Growth Pact, with its twin main criteria (an annual budget deficit no higher than 3% of GDP including all public budgets for municipalities, regions, etc. and a national debt lower than 60% of GDP or approaching that value) and its no bail out provisions for the European Central Bank. Even if provided, bail outs are not permanent solutions; they presuppose subsequent performance.

For Myddleton, it is a moot point whether the euro could have worked when subject to the Stability and Growth Pact, but about one thing he was very clear: one needs to distinguish between the European Union as a political project and as an economic one. The political project is to create a supernation that will subsume the sovereignty of all polities who accede to it.[34]

According to Myddleton, the Eurozone could bumble along much as it has done to date, but at the ongoing cost of uncompetitiveness, albeit as measured by British standards which include, for example, minimised social costs. He expressed the view that even if countries did, or had to, drop out, the consequences of devaluing would be no worse than those of staying in unable to devalue. He pointed out that the European Union of today is not the European Economic Community of 1975, and that one should not forget that the European Union is grounded on Napoleonic Law, a kind of law that is, of course, a particular problem for Britain, but more generally does not comport well with free trade, Hume's 'flourishing commerce that benefits all' (see discussion in Section 6.1).

Finally, bearing in mind that it is companies not countries that trade, if Britain were to exit from the EU, or Greece from the European Monetary Union, there might well be changes in trade patterns but the World Trade Organisation prevents discrimination (and therefore retaliation), so the risk is not absolute and certainly worth taking. Indeed, it is "time for Britain to make its excuses."

[34] This, of course, is already a familiar refrain of this essay. The point is that normally, a single country comes 'ready-made' as a fiscal union (enabling wealth distribution via taxation and other governmental money transfers) with a single currency. But those who seek to advance the United States of Europe have never made a secret of the fact that one need not begin with political unity. One can 'bounce' such a union into being by creating (predictably defective) monetary union first, with fiscal harmonisation (if not full-blown union) following along behind. When this process has been impeded – typically by Britain's stance – twin tracking, hard and soft, and other arrangements have been made that, in effect, allow the political project to advance, while the economic one follows along later. The thought has always been that at moments when its protagonists seek to quicken political union, those who do not wish to coalesce their sovereignty can stay outside, and even leave. Part of this stratagem has included regular changes of the rules, such as moving from unanimous to majority voting in 2004, on the pretext that with over 20 members unanimity is inefficient (notwithstanding that democratic processes usually are inefficient when seen in the short-term economic sense).

Matthew Lynn

Adding to the robustness of David Myddleton's position, financial journalist Matthew Lynn gave examples of monetary unions not working: Austro-Hungary in the 19th century, the Rouble zone (1990-91), Argentina in 2000.[35] From these cases there were important lessons to be learned, of which he identified six, listed here somewhat aphoristically:

- monetary unions create wrong incentives
- Eurobonds will worsen matters
- debt purchase by the European Central Bank will worsen matters
- the Eurozone is not a 'natural currency area'[36]
- fiscal control not enough; one needs wider political coherence
- the strong leave first because they can afford to and because early leavers soon bounce back.

Martin Chren

Martin Chren from Slovakia's Freedom and Solidarity Party was similarly earnest and lacking in bombast and, as with the other speakers, though ardently stated, one did not get the impression that his views were anything other than level-headed. He spoke as one seeking something less Byzantine than the Eurozone, more universal (meaning for him Anglo-Saxon), but above all true to the Slovakian people. In this regard, and somewhat resonantly with the main thesis of this paper, he also spoke of a country having economic, political and cultural aspects, with cultural meant as the need for a people to take care of itself, not get lost.

Noting that the Eurozone is not an optimum currency area and that it was not the role of the IMF to lend to member states of the Eurozone (anymore than it should lend to California), his main concern was that the purpose of the European Financial Stability Fund and the conduct of the Stability and Growth Pact were morally hazardous. By solving debt with more debt in contravention of Article 123 of the Lisbon Treaty[37], the European Central Bank was putting out fire with flame. Breaking its own rules and protecting the irresponsible, its was a false solidarity.

In Chren's view, the euro crisis was born of the European Monetary Union not adhering to the Stability and Growth Pact criteria (as when, in 1997, France and Germany were not penalised when they dodged them), of corruption and gravy-train finance, and of continual

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[35] The case of Austria-Hungary is, however, seriously contradicted by Richard Roberts, Director of the Centre for Contemporary British History at King's College London, in a recent History and Policy paper (October 2011), 'A stable currency in search of a stable Empire? The Austro-Hungarian experience of monetary union.' See later discussion in 6.1.

[36] See earlier discussion in 3.2.

[37] See Appendix 4.

violation of Article 125 of the Lisbon Treaty.[38] In consequence, the euro is debt dependent and without possibility of internal devaluation, while the European Central Bank contradicts its charter by buying the bonds of and lending to European Union member states.

Tim Congdon

City economist, Tim Congdon, reminded the gathering that, although a central bank can expand the money supply too much and cause inflation, in principle, because it belongs to the currency it manages and because it can lend to its government and/or act as lender of last resort, a government cannot go 'bust' inside its own currency. By contrast, the European Central Bank cannot lend on overdraft terms to European Union members, of which there are 17 members in the Eurozone. That means 17 banking systems and 17 governments, none of them with tax raising powers as regards the euro. It is hard enough to manage the government / central bank / banking system nexus in one jurisdiction, but nigh on impossible when 17 are involved. This structural fault of the European Monetary Union is insuperable outside of political union.
In an undated UKIP newspaper circulated at the Bruges Group meeting, Congdon assessed the euro crisis as follows:

> "…the Eurozone [is] a special case, because of the distinctive and very unpleasant dynamics of a multi-government monetary union. The European Central Bank (European Central Bank) participated fully in the drive to 'strengthen bank balance sheets' that followed the Lehman failure and the AIG debacle in September 2008. The resulting pressure on banks to boost capital/asset ratios, combined with the difficulties in the inter-bank market, caused banks to stop expanding their balance sheets. The growth of the quantity of money, which had been chugging along satisfactorily at 5 - 10% annualised rates in early 2008, came to an abrupt halt. The Eurozone entered a severe recession.
>
> In early 2010, under, pressure in particular from its German representatives, the European Central Bank tightened further. Trichet, the European Central Bank's president, and Stark, its chief economist, made clear that its credit facilities to member banks – which at that stage totalled over 700 billion euros – would have to be cut back. The dilemma for banks in the Portugal-Ireland-Greece-and-Spain group (or PIGS) was that, ever since August 2007, they could not fund their assets in the inter-bank market. The implication of the Trichet-Stark tough stance was therefore that, absent some miracle or other, these banks would face worsening funding strains in 2010 and 2011.
>
> The consequence [was] a sharp divergence in macro-economic conditions between the PIGS group in the Eurozone and the rest. Over the last 18 months the PIGS have seen contractions in banks' assets and the quantity of money, and consequently another round of weak demand, while the non-PIGS countries – especially Germany – have enjoyed relatively good conditions. Some commentators have warned that, because

[38] See Appendix 4.

> banks remain so fragile, the whole industrial world could suffer 'a double-dip recession'. These warnings have become repetitive and tiresome, and – for the big countries – they are no longer credible. But in 2011 the PIGS have either been in double-dip recessions or come close to it. *It is important to understand that the European Central Bank is largely to blame for this calamity*."

This account has been shared in depth because it expresses what some would see as a typical 'anti' stance, but also because it makes clear why such a stance is taken. Similarly, as regards leaving the European Monetary Union, Congdon wrote:

> "Everyone knows that Greece cannot service its debts, and will – almost certainly – have both to default and to leave the Eurozone. Everyone also knows that Ireland, Portugal and Spain are the next that might fall in a domino collapse of the Eurozone's financial structures. Disintegration might be averted if the European Central Bank were to adopt a strongly expansionary monetary policy. This would cause asset prices – the prices of houses, commercial property, and stocks and shares – to rebound across the EU, as well as helping output and employment. The banks, at present facing big losses on both their sovereign debt and loans to the private sector, might suddenly – almost as if by magic – see their bad loans to the private sector become good loans again. They might then be able to absorb the losses on Greek and other government bonds which are inevitable. But the European Central Bank's top brass are deeply unimaginative. They will continue to clamp down on inflation, even though inflation is very low by the long-run standards of most European countries. Over the next year or two the Eurozone is likely to see the worst possible combination, of both persisting recession and sovereign defaults."

After the meeting, in an email (6 November 2011) in response to a mistaken understanding of his views on our part, Tim Congdon set out his broader views on central banking: "I think – in line with hundreds of textbooks – that (i) *solvent* banks should be eligible for loans from the central bank in the event that they have difficulty funding their assets, and (ii) that it is the job of the central bank to know at all times whether banks are solvent or not, and that indeed is the purpose of the supervision, regulation, etc. to which banks are subject. I am therefore in favour of privatising the central bank, so that this rubbish of confusing a loan from the central bank to a solvent bank with 'a government bail-out' will stop. A loan from the central bank to a commercial bank is just a rather special kind of inter-bank loan, and I have never heard anyone call a loan from one bank to another a 'bail-out'."

This clarification is helpful, not only because it sets the record straight, but also because it helps identify what one might call the fundamental British – or at least City – *optik* regarding the whole domain of monetary and financial governance. Is this to be political governance, subject to electoral considerations, the power of high office, and time frames often at odds with those of stable economics? Or is it to derive from the nature of economic life? Not without regard for untoward political or social effects, and not meant as a license to do merely as one pleases (the economic equivalent of a government printing money), but predicated on the conditions needed for undisturbed trade and investment. These, as any investor or central banker knows, are consistent with peaceable political and social circumstances.

At bottom, it is this that is so irksome about the EU. It would be different if, further down its projected route – post fiscal union or its equivalent – the then borders of the European Union would be those of an optimum currency area, especially as characterised in the earlier quotation from Maynard Keynes. But this is a very moot possibility. As also is the idea that the dynamics of the United States of Europe can match those of the USA, in which, very significantly, people are Americans first, whatever else second. It is on this ground that the analogy of the United States of Europe to the USA, while alluring, can be seen to be not only misguided but also misleading.

Anthony Coughlan

In his speech, Anthony Coughlan rehearsed themes from his earlier mentioned paper on the Eurozone crisis,[39] which begins with a quote from Bismarck: "I have always found the word 'Europe' on the lips of those powers that wanted something from others which they dared not demand in their own names." This is, indeed, the gesture of many people in the EU today, who, not finding satisfaction in their own courts, go to the next level up and seek a judgement in their favour that de facto overrules the laws and judiciary of their own country. This is not unlike a wilful or an errant child who, having been told 'no' by one parent, goes and asks the other one hoping for a 'yes', which, too, has been the gesture of those referenda that were re-run when they resulted in a 'no'. But, Coughlan being Irish, quoting Bismarck also tells the lie to the idea that diffidence about the European Project is a uniquely British phenomenon, as do the remarks of Martin Chren.

Coughlan went on to point out that "the political purpose of the original European Economic Community was to make German rearmament acceptable to France and to provide an economic underpinning to NATO in Europe." This, and the quest for "the old European imperial dream of 'Big Powerdom'." Worse, the euro "was established for political reasons, using economic means that were quite unsuitable for this purpose." The consequences were several and predictable, as the following passage headed 'The Contradictions of the Eurozone' details. It is extensively quoted here because it also serves as a fairly even-handed, informative and indeed conventional appraisal of the situation now existing:

> "In the first years of the euro-currency, interest rates … for the different Eurozone States converged on Germany's low levels, as markets assumed that all would conform to German standards of fiscal conservatism while using the same currency. Then some countries used the low rates to blow up asset bubbles. When these burst, fiscal deficits exploded, interest rates for the different Eurozone countries widened and some could not borrow at sustainable market rates, leading to a crisis for the entire Eurozone...

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[39] See Footnote 11.

> Exchange rates are always fixed for political reasons and they can never be more fixed than in a monetary union. All independent states are monetary unions, but they are political and fiscal unions as well [with] the capacity to control either the domestic price of [their] currency, the rate of interest, or its external price, the exchange rate. As fiscal unions they [also] have their own taxation, public spending and social service systems.
>
> By virtue of citizens paying common taxes to a common government in order to finance common public spending programmes throughout the territory of the State, there are automatic transfers from the richer regions and social classes of each country to its poorer regions and classes within each national monetary union. This sustains and is sustained by a shared national solidarity, a mutual commitment to the common good of the political community in question. It is this shared solidarity, expressed primarily in a willingness to be ruled by a common government, that gives a State political legitimacy and sustains its authority.
>
> By contrast the Economic and Monetary Union is … not a fiscal or political union. Joining it deprives the poorer EU States and weaker economies of the ability to maintain their competitiveness and to compensate for their lower productivity, poorer resource endowment or differential economic shocks by adopting an exchange rate or interest rate that enables them to balance their payments taking account of their special circumstances. Yet it fails to compensate them for that loss, however modestly or inadequately, by the automatic transfer of resources from the centre which membership of a fiscal union at national level entails.
>
> Compensatory fiscal transfers at EU level to the extent required to give the EU's monetary union long-run viability are impossible, in view of the volume of resources required and the unwillingness of the richer EU countries, Germany in particular, to provide them to the poorer because of the absence at EU level of anything comparable to a shared national or quasi-national solidarity which would support such transfers. Currently EU expenditure in any one year amounts to 1% of the EU's annual gross domestic product, a relatively tiny sum. This contrasts with expenditure on public transfers internally by the individual EU Member States of between one-third and one-half of their annual national products.
>
> Thus the political and fiscal solidarity that would sustain an EU political union and an EU multinational federation does not and cannot exist. Democratising the EU in the absence of a European people or *"demos"* is impossible. Unlike the USA, the EU is not one country or one people. It is comprised of many peoples, whose allegiance is to their own countries and nation states."

Lest this reads as a 'typically British' standpoint, it is important to restate that Anthony Coughlan is Irish. In other words, the British view, as the report on Martin Chren also suggests, has a universal rather than 'Little England' quality. In short, in a way that reflects Keynes's letter to Nicholson, Coughlan is detailing why the Eurozone is *not* what economists call an 'optimum currency area'. The reason is clear:

> "As Europe's biggest exporter of manufactures, Germany especially gains economic advantages from European Monetary Union. Within EMU the weaker EU countries can no longer use currency devaluation to defend themselves against a flood of German imports. Germany's trade surpluses have been recycled to the PIGS countries, where they encouraged asset bubbles instead of buying their goods and raising German imports. As these bubbles burst, markets sought a safe haven by selling sovereign bonds of the periphery and buying those of Germany and the other AAA-rated Eurozone countries. This gives the latter countries cheaper capital. Outside European Monetary Union, the German Mark would soar, while the peripheral countries' currencies would fall. So far as general economic policy is concerned, Germany, with its high rate of savings and balance of payments surpluses, is so economically conservative that it is unwilling to expand domestic demand to stimulate employment in the Eurozone's deficit economies, as should happen if the EU were really to function as a unified economic area like any [normal] State."

The flaw is obvious: "When the euro was set up the implicit assumption of its creators was that all the other countries would behave economically like Germans... The rules of the Maastricht Treaty and the Stability and Growth Pact based upon them … were drawn up on this assumption. Yet Germany and France broke those rules in 2003, after which the rule-book was effectively abandoned for all."

Coughlan's criticism is pointed in other respects also, especially when writing that:

> "…some have suggested that the euro-currency crisis was planned all along, or at least was seen as likely to happen sometime. The ideological federalists of the European Movement and the 'career federalists' in the Member State bureaucracies knew full well that the European single currency could not survive without a single EU State or quasi-State to back it. They knew that the Euro-critics were right, who had warned for decades against this outcome. Being unable to force through the EU political union they wanted, they hoped to use the single currency and the crisis it would inevitably generate to force through the thoroughgoing fiscal union that would make a political union possible. Hence their proposals for the EU to take control of national economies, including oversight of national budgets before national Parliaments see them, their proposals that the European Central Bank buy Government bonds and in effect make all Member States jointly and severally liable for the debts of other Members by means of Euro-bonds and the like."

As to what the future holds, "This could therefore be another of those 'beneficial crises' which the Euro-federalists have used over decades of deception to get their way. Unfortunately for them, the euro crisis has come on top of a global banking crisis which is far worse than expected. It has also been so long delayed by the global economic boom that popular opposition has grown to any 'transfer union', especially in Germany, the Netherlands, Finland and other Northern Eurozone countries..."

Coughlan is also critical of the role of 'finance capitalism', an economic system "in which local Wall Streets are structurally geared to triumph over Main Streets everywhere…" This is the context of the sovereign debt crisis, meaning the inability of governments to finance their debt, combined with their injudicious bailing out of banks that were insolvent and should have been allowed to go, if not to the wall, then at least to the barbers in order (to further mix the metaphor) to prune out any dead wood so that new growth can occur.

Even though Coughlan has great faith that the European Project will founder on a belated refusal by Europe's citizens, for the immediate future he sees only continuing, but futile efforts to keep the euro show on the road, matched all the time, however, by economic events that will not allow the European Monetary Union to function. Interestingly, he does not speak of Greece exiting, but of Germany, because of the 'strong leave first' argument earlier touched on by Matthew Lynn.

George Batten

For some, such as George Batten, MP, the way to leave the euro has already been mapped. He argued that the Lisbon treaty *does* allow withdrawal, but on terms that favour the European Union and are at the cost of the member leaving. He recognised that extricating an economy from the Eurozone might entail something of a Gordian knot problem, requiring an incisive Alexandrian act (by a "prime minister who understands the national interest and the nature of democracy"). That Alexandrian act would have six components:

– the repeal of the 1972 European Communities Act which would nullify all subsequent treaties predicated on it

– a stop to all payments

– the creation of a commonwealth free trade association after, *not before*, leaving

– the repeal of the jurisdiction of the European Courts of Justice and Human Rights

– the passing of an Enabling Act to allow gradual repeal of EU laws, reducing them to the minimum necessary to interact with the European Union (sans Britain!)

– the holding of a 75% referendum on secession.

Again, these are tenaciously held but level-headed proposals, consistent to the perspective Batten represents. Interestingly, in the end he did not seem to see the main challenge as legal or constitutional, but as a matter of vision, will and means. Of these, the will to act was superior, and able in fact to prompt the other considerations into being.

4.0 The Euro as an Optional Currency

To return to Salvador de Madariaga's tree analogy, by distinguishing between its three aspects (roots, trunk and branches), discerning their different 'logics' or natures but not separating them (since a trunk without branches or roots is not a tree, etc.), one can perhaps now start to make sense of the euro problem.

Clearly, this problem has always been characterised by the fault line of whether the euro is an *economic* or a *political* currency. This is a difference of view that cannot be ignored, hidden from view … or bridged. The pound became the single currency of Britain as part of its long journey into nationhood. Referring to a pound weight measure – something that is ancient but universal and enduring as well as independent of any particular location, political construct or cultural expression – the pound monetarily came to be 12 ounces silver (matched to 1 ounce of gold). Much later, in 1489 Henry VII was the first to mint a one-pound coin.[40] At that time, the word 'pound' also matched the name of the currency's cover. Moreover, until it its decimation (!) in 1970, the pound sterling was denominated in £. s. d., an anciently clear but modernly obtuse reference to the precious metal relationships, and a challenge for any mind trained only in multiples of ten. Not even the dollar has such a history, while if the same were to be said of the euro, then it is clear that its worth would be a function of 'a country called Europe' – as at least one serious textbook on modern finance already erroneously puts it – notwithstanding that no such country exists.[41]

If that country is intended to be the United States of Europe, then that should be (and always should have been) the clearly stated rationale for the euro: namely, as a device to bring the United States of Europe into being. That – as the earlier statement by Anthony Coughlan suggests was the case – would require introducing and managing a currency in such a way that it neither could nor did function without fiscal union, delivering only chaos and instability instead. Then the people of Europe would ask for fiscal union, not because they wanted it, still less in order to become citizens of the United States of Europe, but because they needed a stable economy and had been told that the euro is here to stay and that one cannot turn back the clock, or even leave.

Far from this being a far-fetched scenario, this would make clear sense of the euro's actual history. Moreover, without the clarity this version of events brings, what is the average person to make of today's situation? Unless he is monetarily literate and able to read the

[40] See Sinclair, D. (2000) *The Pound – A biography.* London: Century.

[41] 'Let us compare the United States [of America], the European Union and China to show how money issers differ immensely in these three nations.' Mishkin, F.S (2010) *The Economics of Money, Banking and Financial Markets.* London: Pearson 9th (Global) Edition.

Jesuitical subtleties (as Keynes might well have described them[42]) of the treaties created and recreated these past six decades, he can hardly ask for more than that 'experts' and 'the authorities' put him out of his misery. That means either get rid of the euro or make it work; press on with a European constitution (in whatever guise) or undo the complicated arrangements now in place.

Given today's political realities, but also in terms of the wording of the Wolfson question, getting rid of the euro seems not to be an option. The question, therefore, is whether one can give up use of the euro once one has adopted it. In this essay, the oft-cited view that this is a legal impossibility is not accepted for the simple reason that the legal fabric of the European Union to date has been – and will presumably continue to be – knitted, unpicked and re-knitted on a regular, intentional basis. 'No' referenda have been re-run but not 'yes' ones; the Stability and Growth Pact (whatever its merits or demerits) has been applied or ignored as *political* circumstances required; and so on.

The real question and the one considered in this paper is whether the euro can be conceived – today, retrospectively and going forwards – as an *optional currency*, meant here as a way of regarding the euro independently of its overt political purposes. It is interesting to re-read Valery Giscard d'Estaing writing on this subject in 1989.[43] He is, of course, bent on the outcome of the United States of Europe, but he wrote at that time of an "intermediate stage, in which the Ecu serves as an optional currency, could stand as a proposal in its own right, distinct from any subsequent phases." In the same article he envisaged the Ecu "as both the central currency in a European monetary union and a parallel currency to national units."

This again refutes the idea that the euro as a parallel, optional currency is a peculiarly and obstinately British notion. Here the possibility is recognised and articulated by one of the main architects of the European Project. It is not valid to frame the debate in terms of Britain versus Europe, therefore. It is, or ought to be, about the evolution of the global economy and the place of the European Project in that context. Likewise, it is not (or not only) about London seeking to protect its privileges and advantages; it is about maintaining London's global role as a key organ or point of awareness in the global economy, and hence as a, indeed the, centre of global liquidity. This is the financial counterpart of our era, characterised as it is by global economics, the pound part of Keynes's 'area pound'.

It is surely in this direction that the answer Lord Wolfson is seeking is to be found. Whether as a businessman, as an economist, or simply as a concerned citizen, and whether on his own account or on all our behalves, he is concerned that economic life be stable. In

[42] "…that web of sophistry and Jesuitical exegesis that was finally to clothe with insincerity the language and substance of the whole Treaty [of Versailles]." Keynes, J.M. (1919) The Economic Consequences of the Peace. London: Macmillan.

43 The Ecu as a Parallel Currency, Valery Giscard d'Estaing. Credit Suisse publication*, 'Bulletin', 1.11.89* (see Appendix 5).

a sense, it is the very insistence on the euro as a political instrument that unsuits it to economic stability. It follows that if the euro were conceived, managed and treated as an optional currency, as with all optional currencies it would only be used and therefore valued if its use *in fact* engendered stability – and did so without having to import anything of the culture or political life to which the currency belonged.

When in London or Buenos Aires I use US dollars, I do so because I know I can spend them easily the very next moment, or else remit them to my USD bank account in the US, where – at least in terms of my projected expenditure in the US, I will incur no exchange rate risks or loss of purchasing power. So it is with any currency – I am free to treat it as an option, but will only do so if I can succeed in 'passing the parcel'. That is to say, if I know the music will not stop, or, if it does, that I will be beside a vacant chair. This I achieve through the simple device of holding or using several currencies, something that is hardly rocket science in the world of finance!

In Britain, for example, one is free to use the euro as an optional currency. As long as one can readily spend euros, why not acquire them? The main question will be whether the euro has value. This will in turn depend on the well-worn question of its cover. Is it merely held in place by the fiat power of a state, and in this case one without a real polity? Or is there some *economic* ground on which the 'sole legal tender' status is also in fact predicated? This is another old chestnut, as old at least as Keynes's 1923 *Tract on Monetary Reform*[44]: If money is not based on gold, then on what? The ideal answer has to be the currencies of all other countries – floating exchange rates. Only this cannot work except universally. The practical situation has been one of 'dirty floating', with the degree of dirtiness (or cleanliness) a function of circumstances prevailing at any one moment. In the meantime, worldwide currency affairs – not just those of the members of the Eurozone – have no choice but to hover or hop about somewhere along the continuum (which includes fixed exchange rates) between the two extremes of a no-longer-viable-gold standard and yet-to-be-achieved *universally* floating exchange rates.

From 'the snake' onwards, developments antecedent to the euro tell this story well enough. When the euro finally came into force it did so as a fixed exchange rate system. The choice is now therefore a stark one: either the euro is accompanied by fiscal union (and all that that implies), or it has to be the reciprocator of some form of internally floating system. Of course, the Stability and Growth Pact was designed to approximate the conditions that would result if independent economies mutually harmonised (converged) their economic circumstances, but this assumes that one can cause a condition reversely out of symptoms. Be that as it may, it is flagrant disregard for the principle and purpose of the Stability and Growth Pact that is at the root of today's Eurozone instability.

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[44] Keynes, J.M. (1923) A Tract on Monetary Reform. London: Macmillan.

The question remains, therefore: If gold cannot operate as a universal currency, what can? For Keynes in 1923, the answer was clear: 'the point about which the exchanges fluctuate, and at which they must ultimately come to rest … is not itself a fixed point…'[45]

Was Keynes wrong? Is he anachronistic now? In our view, hardly so. He uttered a truth that haunts us still as long as we ignore it. But what is the ever moving point to be? Hayek, and many others, would say money has in the end to represent the goods it exists to buy – hence, 'means of exchange', the idea that money acts as a go-between and proxy for the goods exchanged between human beings. Whether this translates as 'a basket of basic goods' or some retail price index is a question for theorists, though no less important on that account. For the person in the street, it is a matter of pragmatism. If I am about to catch a plane to Spain, for example, and I meet someone deplaning from France who forgot to use up his euros, why would I not swap them for some pounds? (We would surely also be happy to do so directly, rather than via the nearby bureau d'échange.) Our mutual need is for a currency that the taxi driver waiting outside our respective airports will accept without question or surcharge. Theoretically it is about money being backed by goods; in practice it is about whether the money actually in my pocket will buy me bread, a train fare, a newspaper or a hotel room in the place of my immediate destination.

Moreover, as any seasoned traveller knows, whose travel is not restricted to an annual two weeks on some foreign shore, I will anyway have other currencies in my wallet or credit cards that link me to them. And with Easyjet and the like I do not even have to use the currency of my domicile when paying for an airfare. Nor do I when paying for something through PayPal. The reality today is that most people are free to use any currency from anywhere in the world. Whether they do or not is a function of the cosmopolitanism of their existence, how extensively they travel. But also of their mind. Obviously, someone who never leaves and never expects to leave his village, will have no need of or give thought to any currency other than the one most used where he lives.[46] But even he, if he knew his neighbour on one side was just back from Spain and the one of the other side was heading the next day to Italy, might act as a bureau d'échange when he invites both round to tea or meets them in the pub.

4.1 Of Money and Capital

So the matter is not as complex as one might think. Paradoxically, perhaps, it is made even more straightforward when one applies the trunk, roots and branches analogy directly to the euro (or indeed to any other currency). Any note or coin will have all three: the coin or note itself as part of the political life, representing numisma, consensual use (trunk; polity); the fact that it is used as a means of exchange for goods (roots; economy); while the

[45] Ibid., p.89.

[46] Note the subtle precision of 'the one most used where he lives'.

imagery that adorns it – that of the euro notwithstanding – will typically be an allusion to culture, whether unique or shared (branches; cultural life).

One needs only to recognise that the fiat of the state has no *inherent* economic meaning. The most one can expect, as with central bank independence, is that the state entrusts the working of 'its' currency to those in the economy who act in a stable and stabilising manner, with 'price stability' understood as the symptom of this desired effect. In the case of the European Central Bank, it holds that 'the natural role of monetary policy is to maintain price stability on a sustained basis as a crucial pre-condition for increasing economic welfare and the growth potential of an economy.' It also has to do this "with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2." (Treaty article 105.1).[47]

The idea, however, that price stability works proscriptively is nonsense. As already noted, one cannot rearrange symptoms to change an illness. One can only provide a palliative (at a cost) until the patient changes his behaviour or the circumstances that give rise to it. The head of a central bank can at most be fired for missing his target, but per se neither the government, the treasury nor the state can act as a surrogate. Any of them may have a better idea about what to do and may appoint a different governor, but in the end it is the governor's skill and understanding that affects matters. Even then, he (or she) cannot force the economy to behave in a particular way.

Added to that, of course, much then depends on whether 'the markets' believe what the governor says. That means on whether millions of individuals, acting directly or through agents, believe the central bank's policies will maintain the purchasing power of their money *and* protect the value of their capital.

The wonder is that so few people seem to realise that if one protects the value of capital too much, one crashes the value of money. No-one can in fact live from saving money alone; one has first to earn it. If one seems to live from capital alone it is because someone else created the value which is then transferred to one by way of interest or dividends. We forget this simple fact of financial and economic life at our peril. One can go a long way down a road that seems to derive value by abstracting capital from the economy, but journey's end will be an economy with no money in it, a body from which all life-blood has been extracted. After all, not every farm can be a golf course and not everyone can live by playing golf.

It is not so much about the financial economy ruining the real economy with 'real economy' understood as physical goods and manufacture. It is that economic life requires a balance between money and capital. The proportion between the two can be much stretched – as in our times – but an economy with only one of the two is an impossibility.

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[47] (http://www.ecb.int/ecb/orga/tasks/html/index.en.html.)

It can be faked by printing money at the central bank, but this money has also in the end to be made good. People have to create real values with which to repay it.

The essential problem is that when the money markets (in the general sense of the term) become emancipated from the goods market – which is arguably the process underlying economic development from the end of the Napoleonic wears until its culmination in the global financial crash of 2008 – this is not in itself a malign or untoward event. Indeed, modern existence, with the individual freedom, democracy and improved living standards that many of us nowadays take for granted, is inconceivable apart from this process. The problem is that the process of itself leads to a point where emancipation wants to become separation. At that point, where money tries to exist independently of goods, it meets a technical impossibility, as anyone who has won at Monopoly knows. Then the market crashes; there is no more purchasing power available.

Because of the sophistication of modern economic life, however, we do not experience this directly. So it necessarily occurs in two steps. First, the ability of capital to derive an income from itself (securitisation et al) becomes practically impossible. The cost of a sub-prime mortgage is not and never was thought to be a function of the mortgagee's income stream. It was and was always understood to be a function of the mortgagor's need to lend, which could only be done if normal mortgage considerations were suspended – namely, that capital plus interest have to be refunded out of income. Everyone who lent or borrowed money in the sub-primes knew he was relaxing normal considerations because money was cheap and property values were thought to have an ever-upward trajectory. This is not to moralise, but it is to make an observation that everyone, who acted as if cheap money coupled to accelerating property prices was anything other than the sign of economic imbalance, was kidding himself. People did so either out of economic desperation or because they thought the music would stop when they, not the others, had a chair to sit on. Or because they pinned their hopes on the lottery – an institution that abets the suspension of normal mortgage considerations – turning out in their favour. As if everyone who enters a casino comes out richer![48]

4.2 A User-derived Currency

The idea of an optional currency is not new or radical. All reserve currencies – whether official or otherwise – are optional currencies. The main difference for this paper is that the onus for the effectiveness of any currency now more than ever rests with its users, especially individuals, their agents and corporations, not with the issuers or 'the authorities'. If a polity-less central bank (namely, the European Central Bank) is to be accepted in real democratic terms by the citizens it affects, what it does needs in reality to derive from their decisions and actions. It needs to approximate the reputation of the

[48] Understandably, some point to greed, but that this is not the real driver. The deeper problem is coping in the face of the structural imbalance between money and capital discussed here.

Bundesbank (when it belonged only to West Germany), namely, its inflationary stance was the same as that of the German people. The question is not so much whether people who are not German can in fact behave or be brought to behave as if they were – the logic of central bank independence – but what kind of universal monetary behaviour can human beings generally (and therefore EU citizens in particular) be expected to exhibit? What can engender a low inflationary stance on all our parts?

If 'the British argument' is not merely jingoism, admixed with a kind of hand-bagging seemingly unknown to or unappreciated by Angela Merkel, it is because it seeks (and it would say approximates) this universal element. In this connection, in 2002, the Economic Research Council published a paper[49] by James Robertson which summed up the main issues very straightforwardly. As if reminding Giscard d'Estaing of his own question, Robertson asked: Why not have a common or shared currency rather than a single currency? Why not treat the euro as a parallel currency? After all, as already noted, one only needs a willing counterparty to use any currency one chooses. Acceptance by the other party will in principle be a question of (a) how soon he can get rid of it, that is, find an acceptor of it, and (b), if he holds or is stuck with it, does it have store of value properties? Will it, when finally spent, have at least preserved if not increased the holder's purchasing power?

Conceived in this way, any country, or rather any economic actor within a country, whether in or out of the Eurozone could simply opt to treat the euro as a parallel currency. The main question would still though be: What is its effective cover? What gives it value other than the fiat of a government or the printing press of a central bank – both of which function by a mix of mortgaging tax revenues and kicking economic problems down the street. And what answer will one give that is so different to the one Keynes gave to Nicholson?

In short, is there any absolute economic or financial reason for a *single* currency – nationally, supernationally or globally? Surely, in a world of *n* currencies populated by free individuals, if (other than by government fiat) only one currency prevailed and prevailed persistently, it would do so because it was regarded as universally transferable, and continually so. Even in a country with a sole legal tender – meaning (per The Royal Mint) the requirement by law for it to be accepted if tendered exactly in settlement of a debt – people only use this currency because it suits them to do so. In other words, legal tender does not mean the outlawing of the use of other currencies. Not even in the case of the Eurozone.

Are the arguments and is the situation any different, therefore, to those and that contemplated by the International Clearing Union and the bancor? Those who argue for a single currency point to the elimination of foreign exchange transaction costs, risks and

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[49] Robertson, J. (2000) *Forward with the Euro and the Pound*. London: Economic Research Council.

uncertainties, but the same can be achieved by hedging and by (non-political) economic convergence.

Another main argument is that a single currency will stimulate competition because it will reveal price differences, that the price of a cup of coffee in one country is different to another. But this argument only works if the flattened economics it implies is in fact achievable. Here, the conceptual flaw of the euro as a single currency is very apparent: it presupposes the existence of either EU-wide habits and circumstances or 'automatic' wealth transfers (the characteristic of fiscal union). As yet, neither obtain.

The most obvious *dis*advantage of the euro as a single currency is the general one, here expressed by Robertson from a British point of view, that "allowing the pound to be replaced by the euro [deprives] us, not only of our control of monetary policy, but also of our freedom to decide on our use of taxation, public spending and public borrowing…"[50] More than that, it delivers acceding members into the hands of a central bank not answerable to any electorate, a democratic deficit which a revised Stability and Growth Pact might well be advised to address, provided it set its maximum level well south of 100%!

One is tempted to say how right Robertson was, but we can leave that to Tim Congdon writing in his earlier mentioned UKIP article: "Britain's Eurosceptics warned over 15 years ago that attempts to enforce a 'one-size-fits-all' monetary policy in Europe would lead to sharp variations in prosperity between financially weak and strong countries. How right they have been! By keeping its own currency, the UK has avoided the worst of the disaster that the Eurozone has become."

5.0 Finance and Welfare

In this hugely complicated affair, particular attention needs to be paid to finance and welfare, two aspects of social life that are not as disconnected as some might believe.

5.1 Finance and Accounting

Looking first at finance, the City of London is naturally concerned to avoid undue restraint on financial services. Somewhat predictably, the debate on this subject tends to be conducted in terms of those who argue for full financial liberalisation and those, such as Seamus Milne, who see the Eurozone crisis as "the aftershocks of [the 2008] breakdown

[50] Ibid., p.12.

and the attempt to protect banks and bondholders across the Continent."[51] For such commentators, the financial economy exists increasingly at the expense of the real economy. They therefore press for remutualisation, renationalisation and Tobin taxation.

While it is clear that certain aspects of the financial services industry are exhibiting excess and even disregard for 'normal' economic conduct, the main problem, to use Lord Turner's analysis[52] is one of excess global liquidity. There is, as it were, too much capital in the world, much of which will be written off by market corrections or enforced forgiveness (as with Greek debt). Is it beyond our wit, however, to see that we could do this consciously? That the excess of capital in one part of the world ought not to be lent so much as transferred (or at least lent long term interest free) to those areas short of capital. ? For example, Germany to Greece, Finland to Greece. We would then get the effect of fiscal union wealth transfer by conscious, deliberate means. Obviously, this would require a radical rethink of the role of bond markets, but surely better that than the life bond holders can now expect to spend caught between the Scylla of chaos and the Charybdis of statist regulation. Is it really the best we can do to hang on to habits for as long as we can until debt repudiation is inevitable or the IMF polices both governments and markets?

In the view held here, much of the euro crisis that is seen as requiring fiscal union could in fact be solved by liquidity transfers. London is well suited to this. The home of the original 'euro currencies', its primary role – and the one it is seeking to protect from Europeanism – is the service it provides to global finance (that of Europe included).

If the sovereignty debate were not seen in terms of London versus Brussels, of one nation being subsumed into a supernation, but in terms of retaining national sovereignty, while allowing one's economy to become a partner among partners in a single global economy, then one could go on to distinguish national, political governance (Parliament) from economic governance, which would become a world affair. The 'organs' for this have long been present, albeit in a politically 'tainted' way: the World Bank, the IMF, the GATT (now the WTO), OECD, etc. If these could be re-conceived as the shared institutions of a worldwide economic commonwealth, then stages towards that process could also be envisaged. In one sense, this is the logic of free trade areas, where independent trading partners devise mutual 'harmonised' economic and financial arrangements. Were such existing institutions rethought (and if necessary revamped), what need would there be for lesser, that is European, versions? What could the EU's institutions do that existing instruments of global economic governance do not do already, and do so effectively?

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[51] *The Guardian*, 17 November 2011.

[52] "What is surprising is when you go to the wholesale side, and you see the enormous amounts of money that are made out of the provision of liquidity or the provision of complicated products or bits of the asset management industry or the hedge fund industry – those are activities that have ballooned in size, appear to be making hugely more money than 20 years ago…" Interview in the September 2009 issue of *Prospect*.

Lastly, the interface between politics and economics is a subtle one, represented by money and the way money is accounted. What, therefore, of the role that universal accounting standards could play as a de facto, even surrogate, world currency? Could accounting standards give the economic effect of a harmonised economic life without the need to encase it in political constructs?

There is much that can be said both for and against the work of the International Accounting Standards Board, for example, but in principle and provided it can remain apolitical (which was not the case in October 2008), it surely has to be the case that universal accounting standards can be adopted without the need for national denominations to disappear. Implicit in this idea is, of course, the need for adoption of a universal economic paradigm but also to review the efficacy of received wisdom thus far.

It is interesting, and presumably not for nothing, that precisely at this moment in history the high theory of the efficient market hypothesis became a 'train wreck'.[53] Similarly, we find the economics profession in deep soul search, witness, for example, the formation of the *World Economics Association* with over 6,000 signatories seeking to rescue their profession's reputation, or Soros's *Institute of New Economic Thinking*. In this reorientation, however, it is a moot point whether modelling is as important or as useful as it was, or whether, as Arjo Klamer and Deirdre McCloskey warned some twenty years ago:

> "…economics, like the rest of our culture, is awakening from a modernist dream of three-and-one-half centuries' duration, turning to nightmare in its last century. The dream is that knowledge can be 'objectively' founded, that one can tell whether a number is large or small without asking how it fits into a human conversation, and that the conversation is best limited to the figures of speech approved by certain philosophers around 1900 as 'positive', 'quantitative' or, in brief, 'scientific'. It has been a useful dream, but it is time in economics to wake up."[54]

But if not the numbers of maths, which numbers? For economics without numbers is something of an oxymoron. Perhaps it is time to reconnect economics to accounting, and to the concepts and methods of Luca Pacioli in particular. Alan Sangster and Giovanna Scataglini, for example, argue that,

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[53] To quote Adair Turner again: "We need a major adjustment because there has been a fairly complete train wreck of a predominant theory of economics and finance. For the regulators of the world, once you've accepted that you don't have an intellectual framework of "more market is always better," you're in a much more worrying space, because you don't have an intellectual system to refer each of your decisions, and that requires more judgement and therefore confidence. The wreck is very specific, namely the reliance of macro policy and indeed macro economics on 'light touch' regulation considered viable because of the efficient markets hypothesis." Interview in the September 2009 issue of *Prospect*.

[54] European Accounting Review 1.1 (1992): 145-160.

> "Unfortunately those who followed in Pacioli's footsteps … separated the learning of double entry bookkeeping from the context in which it exists and, so, isolated those who learnt how to apply the method from knowledge of the rules, checks, and controls needed to ensure the accounting records faithfully presented the reality of financial transactions. [And yet,] such has been the influence of Pacioli's treatise upon business that it has led some writers to suggest that it was a powerful and essential instrument for the management of business, and that its existence enabled the rise of capitalism. Whatever the veracity of such claims, there can be few school textbooks that have been so widely read, understood, copied and applied in practice, and few whose relevance to commerce has been so lasting."[55]

On this view, the future viability of economics as a respected discipline relies on its grounding itself on business experience rather than theoretical extrapolations.

5.2 Welfare and Price Stability

Although not referred to explicitly in the prize question and its sub-headings, the accompanying briefing from the Policy Exchange draws attention to the need for whatever proposals might be made to have clear regard for the protection of savings, employment and general social cohesion. In this treatment, none of these things are given express or detailed consideration. Not because they are not of concern: on the contrary, any serious economist or economic historian takes as a given that the purpose, indeed the sole justification, of economic science is that what is advocated will engender and safeguard precisely those things: savings, jobs and peaceable social relations. The problem is that how this outcome will be arrived at entails a deep and long-running debate.

Rather than rehearse that debate or even express one's own views about it, the point here is to consider what is practicable, and also likely to happen, in the near term, even tomorrow if surprise becomes the modality of change. To that end, understood in its threefold sense, welfare is what is intended by central bank independence. The question, in central banking terms, is whether one achieves this by way of a hierarchical or dual policy. That is, does one think in terms of an apparent single focus on the interest rate (operational independence) leading to welfare as a matter of course; or does one make welfare a legislated outcome, as it were, which is the dual approach.

Since this discussion is about the euro and the Eurozone, it is necessarily also about the European Central Bank, and so about welfare as a consequence of operational

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[55] Sangster, A. & Scataglini, G. (2010) 'Luca Pacioli, The Father of Accounting Education', a paper presented at the 22nd Annual Accounting, Business & Financial History Conference, Cardiff 6th and 7th September 2010.

independence. Clearly, therefore, welfare in the sense meant here would be a function of *effective* price stability, so it is a question of what monetary policy characterises the EMU as is and when reduced, and what monetary policy characterises the world outside it. Insofar as price stability in one form or another is now the norm worldwide, the question becomes whether operational independence – meaning the government sets the inflation rate leaving the central bank to achieve it via the interest rate – is robust enough to withstand the political pressures that are now substantial, even though the whole point of central bank independence is to be autonomous of them.

Since 2008, very few central banks, and certainly not those of the USA, the UK and the EU, have held their own in the ideal sense of central bank independence, which could be described as 'double independence', independence from both government *and* the markets, as Andrew Sentance, former member of the Bank of England's Monetary Policy Committee advocated on BBC's Today programme in early November 2011. In other words, principal-agent theory notwithstanding, operational *and* goal independence – the central bank setting both the inflation and the interest rate.

For many experts, this is a step too far, smacking of economic governance distinct from political governance. But in a time when financial markets have become king makers (witness Italy overtly, and Greece less so), when the World Trade Organisation presides over all economies, and when the European Central Bank is to all intents and purposes polity-less, this is surely a false objection, if not intellectually disingenuous and at serious risk of being out of track with events. After all, the government only opts for +/- 2.5% inflation because economic theory tells them to. In a sense, operational independence denigrates the role of the central bank governor because it does not believe he can set a destination and arrive there on budget and on time.

The European Central Bank's current strategy is clearly not apolitical, any more than is that of the Bank of England at this point in time. Or if they are, it is because their governors, independently of any political pressure that may or may not be at work, have professionally deemed that previously unheard of levels of *concerted* liquidity provision is now part of their remit.

Thus, they key question becomes whether the euro can become an instrument of double independence. It is here in fact, where politics and economics have their interface, that their distinct natures can nevertheless be reconciled.

This is to open a window on yet another huge and far-reaching topic; a window that will now be promptly closed. Ever since Henry Thornton in 1802, central bank literature, as also behaviour, has been replete with 'above the fray'[56] language and the need for and fact

[56] To refer to the well-known image is from Capie, Goodhart and Schnadt: 'Central bankers are, perhaps, seen as having more in common with the judiciary, than with politicians or commercial bankers; and are perceived as both technically expert, above the fray of self-seeking, and a necessary agent (of democratic

of inter-national coordination. None of this is new or revelatory. The question now is whether the crisis in the Eurozone – quite apart from any political manufacturing of it there may have been – is not, when seen economically, merely a continuation of the global financial crisis, concerning which no amount of politicking will be of avail.

6.0 Practical Implications

And so we turn to our concluding remarks, outlining how the euro can be treated as an optional currency, such that its use does not presuppose its user has 'bought into' or become implicated in the polity of its issuer?

Obviously, if the euro's use is obligatory not optional, then its fortunes are tied to the effectiveness of the fiat that underwrites it. The whole point of an optional currency is that it operates apolitically. Although the events inside the polity that 'owns' the currency, e.g. the US and the dollar, may affect the value (and thus utility) of that currency when used as a reserve currency, they remain a matter for those for whom its use, tied to its sole legal tender status, is *not* an option. But at the extreme who is that? Presumably, those who have to pay funds (e.g. taxes) to or receive them (e.g. grants) from a government that only accepts or offers its own currency. (Thereby, of course, hangs another very large tale not now for the telling.)

To remind us of the prize question: "If member states leave the Economic and Monetary Union, what is the best way for the economic process to be managed to provide the soundest foundation for the future growth and prosperity of the current membership?"

As discussed at the outset of this paper, as stated, the prize question is indeed ambiguous. Does *'if member states leave the Economic and Monetary Union'* imply a reduction in size of the European Monetary Union or full abandonment of the euro? Since the European Monetary Union means those countries that have opted to use the euro not only as their common currency but also as their sole legal tender, the first scenario entails the euro continuing this twin role in fewer countries. Less obvious, however, is which countries. If the 'strongest leave first' argument proves valid, then the risk of disintegration of the European Monetary Union is considerable. A euro without Germany – that is, the motor economy of Germany – is scarcely conceivable. If a weak country leaves, such as Greece, the strain it puts on the euro will come to an end, but only by a reduction or repudiation of any debt overload. But would Greece leave the European Monetary Union without also leaving the European Union itself? Indeed, would any country leave the EMU without also

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government) for imposing order on a potentially unruly financial system.' *The Future of Central Banking*, Cambridge University Press, 1994, p.91.

leaving the EU? For the euro as a *political* currency to become also an economic one, its options are two: either to proceed on its path to become an *optimal* currency (meaning to expand the EMU to include countries whose combined economic circumstances are those of an optimum *economic* area, not just optimum currency area) or to cut its losses, so to speak, and offer itself *as of now* as an optional currency.

'*What is the best way for the economic process to be managed…'* Again, 'best' is a matter of interpretation, even opinion. If it is to be an objective term, it presumably refers to whatever results in 'the soundest foundation for the future and prosperity of the current membership'. But what is 'soundest'? Even so, what does 'the future of the current membership' mean if one is contemplating one or more of its members having left? Presumably, it means how would the current members relate to one another when some of them are outside the European Monetary Union, something that, as already noted, depends on which ones stay in.

In this author's view, in neither case – without the weak countries or without the driver of Germany – is the euro viable. The basic, essentially political, logic of the EU requires *all* its members to adopt the same currency, which will also be their sole legal tender; but the basic economic logic of currencies is either to remain tied by law or convention to their country independently of all others, or to coalesce eventually into one global currency. In between, there is only forwards or backwards. In this sense, at this stage in its development the euro is neither one thing nor the other, neither here (national) nor there (global). Whether one is for or against it, therefore, the only possibility for the euro's continuance is for it to be reconceived as an optional currency.

Returning to *'the soundest foundation'*, surely this has to be understood as enduring stability as regards trade and investment. This is a 'no brainer' if one accepts that trade is a function of price stability as effected through domestic monetary policy, investment a function of price stability when protected from foreign influences by exchange rate policy. And that price stability is shorthand for general economic and social stability.

As already discussed, the 'price stability' doctrine divides on two main lines: single (or hierarchical) objective as with the Bank of England and multiple (or dual) objectives as with the Federal Reserve Bank. Without prejudice to the wider objectives of the Union, the European Central Bank uses the hierarchical approach. The main difference between it and the Bank of England, however, is that the European Central Bank has no clear single polity to which it is directly answerable. Instead, its Annual Report is addressed to the European Parliament, the EU Council, the European Commission and the European Council. Moreover, the fate of the euro reversely affects that of the European Central Bank. Without a currency to manage, what will it do? In economic terms, not a lot more, presumably, than become a glorified Bundesbank with a glorified Deutschmark (that is, the Deutschmark when chosen by other countries as their currency); or to shadow its value; or to mimic the attributes of the economy it represents, which is no small challenge. All this would of course be to return to the situation in the late 1980s. Then, Pohl, who argued that German reunification could best be accomplished at 1 West Deutschmark : 2 Ost Deutschmark, was overruled by Kohl, who insisted on 1:1, at least for up to 4,000 DM, the typical sum at the disposal of an ordinary citizen. The result was that it took Germany much longer to bounce back, but the bounce back was inevitable because (a) both sides of the former divide belonged to the one people (the Germans), (b) that people has a natural low inflation stance, the envy indeed of many, and (c) for both these reasons internal wealth transfers were a possibility. Some West Germans may have bridled at picking up the tab, as they saw it, for their lazier eastern siblings, but that could only ever be a transient problem.

It seems to be far less easy for Germans to pick up the tab for their Greek neighbours, however. They are happy to spend their money in Greece or invest their capital there, but not to transfer the latter. They may, of course, have to do so if their debts are written down, let alone written off. And indeed, as already discussed, it does not take much intelligence to see that this is the key problem: as long as sovereign nations will not transfer capital between one another but only lend it, and lend it punitively if circumstances become difficult, there is no choice but (a) to so over-indebt the 'weak' that (b) their debts to the 'strong' have to be written off. The point of 'sunk costs' becomes reached, when the debt load, regardless of entitlements, simply prevents the creation of the new values (growth) on which the eventual savings depend with which debt can be repaid.

It is of course not really intergovernmental transactions that are at issue here, but banks and bondholders lending to governments, but without recourse to those governments' assets (so-called sovereign debt). But the argument still holds: either banks and bondholders discount or reschedule any unrepayable debt (unrepayable on economic grounds in a way reminiscent of WW1 Reparations), or the market will correct their over-valuations for them.

6.1 Nine Sub-headings

Finally, in the light of the foregoing, we close with our deliberations on the prize question's nine sub-headings, here ordered so as to provide a coherent narrative.

Optimum monetary reconfiguration.

As regards today's financial architecture or monetary configuration, the argument made so far has two main aspects. Firstly, it looks at the nature of optimum currency areas and whether the euro already does or ever can enjoy such status. It does this by looking at the situation prior to Bretton Woods in 1944 since when, in terms of US supremacy and the European Project's reaction to it, the situation has become muddied, both conceptually and practically.

Secondly, it asks if the present architecture actually needs changing or merely rethinking. In particular, could the euro be treated – both conceptually and practically – as an optional currency? If by monetary reconfiguration is meant anything else, then one has one's doubts. In Keynes's 1940 image an optimum currency area is arguably the then area to which the 'area pound' referred, or it is that area expanded towards the entire planet.

There are of course 'alternative' currency concepts, but in what way are they an alternative? Most advocates see them as linked to state generated credit and state issued money. Likewise, there are many 'local' currencies, often with folksy names such as Bath's *Olivers* or Canterbury's (now defunct) *Tales*, but often refusing 1:1 parity with the national currency. Typically, they often 'jam up' for want of a wide range of goods being traded, or unreal pricing. They also stand in direct contradiction to the earlier-cited sentiment of Richard Cobden and have done little if anything to stop what Coughlan's describes as Main Street's domination by Wall Street.

Local, as also regional, currencies are also confronted by the challenge of needing to be optimum currency areas, especially in Keynes's image of this. More importantly, the regions of the EU, are not economic, but political, demographic, electoral constructs. And if the USA as a whole is said not to be an optimum currency area, then the EU certainly is not.

The problem is that geographical references are something of a red herring. The real continuum is not in fact national to global, but individual to global. In today's world, it is the individual who decides which currency he will use. He has 170 or more to choose from and the likelihood is that he will smell a rat if any issuer (be it private or state) insists on the virtues and value of its currency. In today's world, the virtue of a currency is not given by the issuer but by the acceptor of it. It will take a lot for the European Project to prove Bagehot wrong.

In this paper, therefore, the question remains: Can the euro operate as a currency among currencies, the validity of which is a function of its day-to-day acceptability by traders and investors, not its enforced existence by fiat?

A consideration of evidence from relevant historical examples (e.g. the end of various currency pegs and previous monetary unions.

Our considerations on this point owe everything to the earlier cited paper by Richard Roberts, the argument of which we unashamedly co-opt to our own cause, and his view that there are three types of monetary union:

> "*Aligned currencies, separate governments.* These monetary unions entailed a significantly lower level of transfer of monetary sovereignty than the Eurozone, notably the Latin Monetary Union (1865-1927) and Scandinavian (1873-1914) Monetary Union. These voluntary groupings did not have a common central bank and the common currency in the Latin Monetary Union only amounted to an alignment of the amount of gold and silver in the different countries' coinages

> (though this mattered, since coins were then the principal form of circulating money).
>
> *Single currency, single government.* National monetary unions were also forged in line with political unifications, as in Switzerland in 1848, Italy in 1861 and Germany in 1871 - but this is well beyond the scope of European Monetary Union.
>
> *Single currency, separate governments.* Neither of the previous types of monetary union provides a close parallel to the euro area, whose arrangements lie in between the two. But there is an historical precedent for this intermediate form of monetary union - the Austro-Hungarian Dual Monarchy monetary union…"

Only the latter has any relevance to the euro situation as is, concerning which Roberts concludes, as do we, that

> "It is difficult to find clear precedents for today's Economic and Monetary Union (European Monetary Union), currently encompassing 17 EU member states… The case of Austria-Hungary demonstrates that a currency union between different states can last, and prove stable, over a sustained period. [But] this worked because of a powerful central bank (which the Eurozone has), an agreed set of rules which were adhered to (the Eurozone's rules have not been adhered to by a number of countries) and the presence of a coherent monetary area: Austria and Hungary had been intertwined for centuries, unlike the disparate group making up the euro area. With an undermined set of rules and disparate member states, the alternatives for the Eurozone would appear to be a reversal of its expansionary agenda and a retreat into a smaller and more coherent optimum currency area or a fiscal (and political) deepening, meaning a single Eurozone finance ministry and taxes…"

The obvious point about the euro, which sets it apart from other monetary unions and severely limits their relevance, is its use as a device to prompt political union into being. The possibly closest example, the erstwhile Austro-Hungary, is not in fact a match because it did not have the pretension of unifying the entirety of Europe's peoples.

The link between exit from European Monetary Union and sovereign debt restructuring and whether and how to re-denominate sovereign debt, private savings, and domestic mortgages in the departing nations.

The redomination of assets will presumably be a free affair, determined by the choices of currency other than the euro, and by the validity of their respective exchange rates one to another and to the euro.

Is this, therefore, any more complicated than deciding what the exchange rate between the euro minus the departed member, and the departed member's new or restored currency will be? In the first place, in principle, this is a question of double cover: what is to be the basis of the departed members' currency and what the basis of the reduced euro? If there is a difficulty of any kind in agreeing the rate between them, perhaps the starting rate should be the one ruling when they joined together. Insofar as this rate is past history and may even have been economically fictitious, it would then be a matter of comparing that rate to the one given by today's circumstances. Then one would have to make a judgement.

At a deeper level, whatever the rate agreed, and whether 'right' first time or subsequently adjusted, the cost, whatever it is, will sum to a capital amount to be tied up (and thus perhaps devalued) until the country concerned has bounced back. If the markets have not already discounted this amount, they presumably will do so, providing a measure of the rate's perceived viability.

Whether and how international contracts denominated in euros might be altered, if one party to the contract is based in a member state which leaves European Monetary Union.

This, too, is surely a question of currency choice and prevailing exchange rates. Obviously, if the euro were abandoned altogether the situation would be somewhat dramatic. The simplest thing might then be that all Eurozone members reverted to their former currencies at the entry into euro rate, and carry whatever consequences ensue. In effect, everyone forgets the euro ever happened!

How to manage the macroeconomic effects of exit, including devaluation, inflation, confidence, and effects on debts.

These matters, as also those about redenomination and rebasing, depend on two connected considerations – the time horizon and on the ability of the countries concerned to bounce back. Leaving aside the how, the issue will be one of devising a strategy to restore price stability and exchange rate stability by *economic* means (that now being the normal approach to macroeconomic stability). There will presumably be a cost to this, but the decisions now needed can hardly be based on immediate affordability. It will cost what it will cost; the better thing is not to delay. The cost may need to be capitalised, but that need be no more, in principle, than an, admittedly substantial, liquidity problem. But so was TARP; so is QE.

The problem will be if the time horizon is made short, for then, as with any business whose credit line is withdrawn in mid-strategy, illiquidity becomes insolvency. As regards the euro, therefore, it may be a case for Chapter 11. If banks, for example, say they have to take a short term view because of the nature of their own liabilities, that simply raises the question as to whether they are the appropriate vehicle for such funding. An obvious candidate is some kind of International Monetary Fund, but it would need to be an IMF predicated on worldwide liquidity provision, not the largely political creature of today.

The effects on the stability of the banking system.

Obviously, the stability of the banking system is an over-riding consideration for all concerned. However, one needs to ask whether the banking system is any way stable *with* the euro. Clearly, the Wolfson exercise is prompted by the fact that it is not. Those who argue that the euro crisis is born of ignoring the Stability and Growth Pact criteria, for example, would say that the euro as it is today (that is, as a political currency) is a fraudulent or at least fictitious element in the world's economy. In that case, getting rid of the euro stands to be as inherently stabilising as its existence is inherently destabilising. If some countries left the European Monetary Union but the euro soldiered on, then, as already discussed, everything would depend on mitigating the effects of whatever remained of the European Monetary Union that was economically fictitious. The logic of the European Project is such, however, that the euro is unlikely to be able to withstand shrinking. It can only stay on the road if it continues to expand. It cannot, in other words, afford to stand still or stay where it is.

It is said that a main advantage of a single currency is that one loses foreign exchange costs and risks.[57] Strictly speaking, however, one does not lose but only reduces the foreign exchange problem because, as long as the euro is still one among many currencies, its value remains a function of its relationships to all the others, not merely the result of self-assertion. No less-than-global economy is secure unless and until the single internal circumstance it represents comports with the circumstances obtaining in the rest of the world. Even here, therefore, not to offer the euro as an optional currency will result in people having to decide whether to stay in or get out?

Different timetables and approaches to transition (e.g. 'surprise' redenomination versus signalled transitions).

It would be nice to think time is abundant and on the side of leisurely discourse, and that one had the luxury to choose between surprise or overnight change and signalled, presumably paced, change. Would it, however, be any surprise if Greece, or even Germany, were to leave? After all, there have been plenty of substantial surprises in recent history: Perestroika, the collapse of the Iron Curtain, the current coalition government in the UK. All these events have been taken in our stride.

As regards signals, markets and the media are abuzz with all manner of signals. In the end, people have to make their choices. Insofar as today's financial markets are (a) all powerful and (b) represent a consensus view on future financial sustainability, there can be few signals not already observed and incorporated in a range of strategies. In that sense, it is a question of which strategy is chosen, except that one cannot know which one (or ones) the markets will in fact favour.

Meanwhile, events continue on their merry way. That means, in all probability, that either ever-closer union will be affected or approximated sooner than later by way of the European Financial Stability Fund, cohered budgets, and so on. Or the European Monetary Union, and with it the euro, will collapse of its own contradiction, the fact that it cannot

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[57] Although one can also wonder if the savings on transactions costs, for example, since the euro's introduction have been less than the costs of its implementation and maintenance.

serve two masters: political union and economic reality. It could only serve both if political union *and* optimum currency area was achievable in a very soon time frame.

But even that brief amount of time is not on our side, so abrupt change is more likely to be the order of the day, not transition. The question is how abrupt, how soon and whether instigated by policy or events.

How best to manage the legal and institutional implications.

This, like the financial question, is probably not best decided by choosing between different sets of implications. The legal and institutional dimensions of sovereign nations harmonising their economics may be different to those associated with the process towards supernationdom of a United States of Europe, but they are unlikely to be any less complex. At least, for practical purposes one should assume equivalent complexity. Because, again, complexity is not the issue. The issue remains: enforced or optional, in or out, stay or leave?

The legal and institutional ingenuity of humankind is also not a problem. Its prowess is evident in the very construct of the EU, with its myriad organisations and substantial bureaucracy. The question is whether the legal and institutional dimension of leaving would be any more complicated and Byzantine in character than it is already.

If there is a substantive issue, it surely has to do with whether economic and financial affairs are better served by Napoleonic or English law. As regards the contractual setting of economic transactions, it is interesting to note that English law, undergirded by equity, is a good fit for transactions with any international dimension. In this connection, the loss of universality when GMT was restyled as Western European Time, and its further undermining by being synchronised with Continental Europe, represent a sad, to be regretted but hopefully not irreversible wresting of Britain away from its natural place as a world centre. A trivial matter or a mortal blow?

The strange thing is that if one looks at a legal paradigm equally different to English law as the Napoleonic, namely Shari'a Law, those concerned with this professionally are clear that its interests and the need it has to interface with 'western' law are best served in London. In other words – albeit another topic too vast for further consideration here – the question is whether English law is to become subjugated by Napoleonic (or even the checks and balances mindset of the American constitution) or Napoleonic law is to be enhanced as regards trade and investment by its adoption of English law (with its not entirely remote cousin in Switzerland)? Needless to say, Napoleonic law is political; English law economic (and globally so). However, behind the scenes is an even more delicate topic: economic law loves constitutional monarchy, political law is the stuff of empire building.

It may strike the reader as odd to end with such an unlikely thought. But is it really? When things become mushy inside they often show a stiff but brittle shell to the world. And there is much that is 'mushy' about the euro and its prospects. In contrast, there is a solid fact of modern economic life that seems to go unnoticed: Much of today's financial discourse proceeds as if sterling no longer exists or intends to disappear. Of course, consideration has been given to this – whether for example to abandon sterling in favour of the dollar or the euro, but Lord Wolfson's question is about the loss or continuance of the euro. It does not contemplate the demise of sterling. Indeed, while the world may focus on those historical upstarts, USD, EUR and CNY, the serene old lady, GBP, remains quietly in the background.

Sterling, the monetary equivalent of constitutional monarchy.

Appendix 1: Europe and the European Union

Within Europe	**EU**	**EU Cand.**	**EMU**
Albania			
Andorra			
Austria	X		X
Belarus			
Belgium	X		X
Bosnia & Herzegovina			
Bulgaria	X		
Croatia		X	
Czech Republic	X		
Denmark	X		
Estonia	X		X
Finland	X		X
France	X		X
Germany	X		X
Greece	X		X
Greenland	Left 2/82		
Hungary	X		
Iceland		X	
Ireland	X		X
Italy	X		X
Kosovo			
Latvia	X		
Liechtenstein			
Lithuania	X		
Luxembourg	X		X
Macedonia		X	
Malta	X		X
Moldova			
Monaco			
Montenegro		X	
Netherlands	X		X
Norway			
Poland	X		
Portugal	X		X
Romania	X		
Russia			
San Marino			
Serbia			
Slovakia	X		X
Slovenia	X		X
Spain	X		X
Sweden	X		
Switzerland			
Ukraine			
United Kingdom	X		
Vatican City			
Outside Europe			
Armenia			
Cyprus	X		X
Georgia			
Morocco		X	
Turkey		X	

Appendix 2: The Aims of the Union (1994)

1. To end for ever the conflicts that so long divided Europe.
2. To provide Europe with an economic and political structure consonant with her responsibilities, resources and civilisation.
3. To raise living standards and speed technical progress in an expanding economy.
4. To abolish outdated trade barriers which split Europe into small protected markets.
5. To facilitate large scale operations in the increasing number of industries in which this is essential, and particularly in atomic energy.
6. To make a special effort to help less developed areas both in Europe and the rest of the world.
7. To set up institutions which will form the basis of a United States of Europe.

Appendix 3: Outline Monetary History of the European Project

(Name changes shown in bold)

September 1946	Speaking in Zurich, Winston Churchill calls for a United States of Europe.
April 1951	**European Coal and Steel Community** (Treaty of Paris).
March 1957	**European Economic Community** (Treaty of Rome).
December 1969	Agreement to phase in EMU by 1980.
Aoril 1972	Currency 'snake' set-up: The Six agree to limit the margin of fluctuation between their currencies to 2.25%.
Janaury 1973	**European Community** formally enlarged to nine members. EC granted sole responsibility for common trade policy.
July 1978	Bremen European Council approves plan to set up European Monetary System (EMS) and European monetary unit (Ecu).
March 1979	EMS takes effect retrospectively from 1 January 1979.
July 1987	Single European Act enters into force.
June 1989	'Delors Plan' providing for creation of European Monetary Union in three stages.
December 1989	Start of negotiations between EC and Free Trade Area countries towards forming European Economic Area (EEA).
July 1990	EMU Stage I begins.
February 1992	Maastricht Treaty on **European Union** signed.
January 1993	Single market largely completed.
November 1993	Treaty on European Union enters into force.
Janaury 1994	EMU Stage II begins.
December 1995	Madrid European Council decides on euro as name for future European currency.
December 1996	European Council agrees a stability and growth pact.
June 1998	European Central Bank begins its business in Frankfurt.
January 1999	EMU Stage III begins and the euro becomes the currency of the participating European Union Member States.
Jan-Mar 2002	The euro notes and coins enter into dual circulation in the twelve participating Member States then become sole legal tender.
?	**United States of Europe** formally established!

Appendix 4: Lisbon Treaty

Article 123

"Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments." (http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-the-functioning-of-the-european-union-and-comments/part-3-union-policies-and-internal-actions/title-viii-economic-and-monetary-policy/chapter-1-economic-policy/391-article-123.html.)

Article 125

"The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project." (http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-the-functioning-of-the-european-union-and-comments/part-3-union-policies-and-internal-actions/title-viii-economic-and-monetary-policy/chapter-1-economic-policy/393-article-125.html.)

Appendix 5: The Ecu as a Parallel Currency

Extracted from an article by Valery Giscard d'Estaing in the Credit Suisse publication Bulletin*, 1 November 1989.*

The great EC internal market envisaged by the Single European Act will be in place by 31 December 1992. The creation of a European currency will play a key role in constructing a unified Europe and putting the world economy back on an even keel.
With a minimum of political goodwill, it should be possible for pragmatism to overcome doctrinal conflicts, problems of sovereignty and the fears expressed in certain quarters concerning future monetary stability.

In order to make progress, the Community will have to build on what already exists, the Ecu, while preparing the ground for moves towards the ultimate goal of the Ecu as both central currency in a European monetary union and parallel currency to national units.
The Ecu must be allowed to exist in its own right and not just as a basket of currencies. This is not possible if monetary discipline is not imposed in each participating nation, entailing the creation of a European central bank empowered to enforce strict regulation of national money supply management. Such an institution would have monetary stability as its sole objective, and would thus have to be fully autonomous as regards monetary policy.

In such a system, the Ecu would become the central currency for the monetary union. In its effecton international capital movements, a large unified market for Ecu-denominated securities is an essential counterweight to the dollar-denominated securities market.
This ambitious vision does not address the question of how the European currency will be used in practice by different players in the economy. This is particularly important for companies, although private use of the Ecu must be simultaneously encouraged.
Private citizens will only feel that a European currency has become reality once they can actually pay for something using Ecu bank notes. This is what we mean by parallel when we call the Ecu a 'parallel' currency: under this system, in each of the member countries both the national unit and the European currency will be recognised as legal tender.

There is clearly stiff political opposition to the idea of the Ecu as a central currency and the institutional structures that this would require. At the moment it would probably not be possible to reach unanimous agreement on the Ecu as a parallel currency. It is possible, however, to move forward via an intermediate stage. Ideally, this would be anchored in a comprehensive treaty including provisions for the monetary system the EC will ultimately adopt. Such a treaty would speed progress from one stage to the next. Alternatively, the intermediate stage, in which the Ecu serves as an optional currency, could stand as a proposal in its own right, distinct from any subsequent phases.

The half-way house approach may well have the advantage of allowing a certain dynamic to be maintained while respecting the sovereignty which, rightly or wrongly, national governments and national central banks seem determined to preserve.

European monetary integration is an ambitious project. I hope that the next European elections send a clear political message to the governments. A truly European currency, of which the Ecu is a precursor, is necessary for the unity of Europe.

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