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La Casa di San Giorgio: il potere del credito

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Are national currencies becoming obsolete?

Benjamin J. Cohen

Thank you, Mr. Chairman. I want to begin by thanking the sponsors of this conference for their invitation to speak here today. It is an honor to participate in this celebration of the long history of the Casa di San Giorgio.

My aim on this panel is also to take a long historical view. My focus, however, will be more on the history of years to come than on years and centuries past – future history, as it were, rather than past history. Specifically, I shall focus on the future history of money. I shall ask a single but momentous question: Are national currencies becoming obsolete? Just a brief time ago, Italy gave up its national currency for the euro. So did eleven other European Union countries; eventually, so too will all new members of the EU. Monetary unions are also under discussion in many other parts of the world, from South America to the Persian Gulf to Southeast Asia; while elsewhere, in recent years, several governments have simply abandoned their national moneys, replacing them with a popular foreign currency in a process known generically as "dollarization". Ecuador and El Salvador have adopted the United States dollar, the famous greenback. In the Western Balkans, both Montenegro and Kosovo now use the euro even though neither has any hope of joining the EU any time soon. Are many more currencies also destined for extinction?

According to many noted specialists, the answer is obvious. The future will see a radical shrinkage in the number of currencies in circulation – a proposition that, for convenience, I call the Contraction Contention. Typical is the prediction of Michel Camdessus, former managing director of the International Monetary Fund, who has suggested that « in the long run, we are moving toward a world of fewer currencies ». The Contraction Contention has rapidly become conventional wisdom among monetary economists.

But is it correct? In these remarks I shall argue, to the contrary, that the Contraction Contention is wrong. Yes, the future will be different from the present. But no, it will not be a world of fewer currencies. National monies are not becoming obsolete. And the long history of the Casa di San Giorgio helps us to understand why.

The logic of the Contraction Contention

Let me begin with the underlying logic of the Contraction Contention. The reasoning is clear. We live in an era of globalization. The barriers separating national economies are rapidly disappearing – and as they do, people around the world are discovering that they are no longer limited to using their own national currency for transactional or investment purposes. More and more, people can now *choose* what money to use in their daily lives. Many already make use of an attractive foreign alternative, such as the greenback or the euro. Effectively, currencies now compete for market share. And as in any competitive market, weaker rivals will simply be driven out of business. Only the strong will survive.

Driving the process is the power of economies of scale. Once people have a choice among currencies, they are naturally drawn to the strongest competitors with the broadest user networks, since this reduces transactions costs. Moreover, as market share grows, so too do network externalities, making the strong even stronger. The process is cumulative and self-reinforcing. For money's users, the fewer the number of currencies, the better. How few? The American economist Paul Krugman suggests perhaps twenty to thirty. Nobel Prize-winner Robert Mundell goes further, suggesting that the optimal number of currencies is like the optimal number of gods – « an odd number, preferably less than three ». For Mundell, as well as others, the logical conclusion of the process of currency competition is a single global currency – one money for all.

Is this logic persuasive? There can be no doubt about the empirical premise of the Contraction Contention. Currency competition clearly does exist in many countries and appears even to be accelerating. The evidence, though partial, is daunting. Economists at the International Monetary Fund estimate that foreign currency notes in the mid-1990s already accounted for twenty percent or more of the local money stock in as many as three dozen nations inhabited by at least one-third of the world's population. At least sixty percent of Federal Reserve bank notes circulate permanently outside the United States and perhaps ten percent of euro bank notes. Focusing on foreign-currency deposits, the IMF has identified some eighteen nations where by the mid-1990s foreign money accounted for at least thirty percent of broad money supply. The most extreme cases, with ratios above fifty percent, included Azerbaijan, Bolivia, Cambodia, Croatia, Nicaragua, Peru, and Uruguay. Another thirty-nine economies had ratios approaching thirty percent, indicating "moderate" penetration. Yet other evidence suggests that all these trends have persisted into the new millennium.

Nor can there be any doubt about the power of economies of scale in this context. For money's users, efficiency considerations clearly do suggest a preference for the smallest number of currencies possible.

But does it necessarily follow, therefore, that weaker currencies will simply disappear? That conclusion rests not on economic analysis but on a calculation that is essentially *political* – an assumption that governments, faced with superior competition, will voluntarily abandon currencies that fail to keep up with rivals. To say the least, that calculation is flawed. In reality, there is little reason to believe that in matters of money, governments will meekly accept the verdict of the market. Quite the opposite, in fact. The core political assumption of the Contraction Contention may be faulted on three grounds. It is contradicted by the contemporary record, by the logic of state sovereignty, and, finally, by the evidence of history.

The contemporary record

Consider first the contemporary record. Outside Europe, very few countries can be found that do not insist on preserving an exclusive currency of their own, regardless of how much competition they face. In all, only some ten non-European states are formally dollarized, including Liberia in Africa and Ecuador, El Salvador, and Panama in Latin America – all using the U.S. greenback – along with six tiny micro-states in the Pacific that use either the greenback or the Australian dollar. But of these ten, only two – Ecuador and El Salvador – actually made a discrete decision to abandon a national money. The rest never had a currency of their own. They simply relied on monetary arrangements that grew out of older colonial or client relationships. Likewise, there are some twenty-one non-European states that participate in monetary unions – fifteen in Africa's CFA Franc Zone and six in the Eastern Caribbean Currency Union – but these arrangements too grew out of older colonial relationships. None of these countries ever had a currency of their own, either.

It is true that monetary unions are presently under discussion in many parts of the world where existing currencies appear increasingly uncompetitive – including Mercosur (the Common Market of the South) in South America, the Economic Community of West African States, the Gulf Cooperation Council in the Middle East, the Association of Southeast Asian Nations, and elsewhere. In some cases, talk has even led to formal agreements establishing schedules and deadlines for implementation. But as we say in English, talk is cheap. In practical terms, little progress toward monetary union has been made anywhere, mainly because few states appear to share enough group solidarity to make the necessary commitments. Nor, outside Europe, do we see any countries rushing to dollarize, following the precedent set by Ecuador and El Salvador. The revealed preference of most governments is to hold out – to preserve their existing currencies at all costs, no matter how uncompetitive they become.

The obvious exception, of course, is Europe itself. The euro has already replaced twelve separate national currencies and could eventually become the joint money of two dozen countries or more. But Europe, clearly, is a special case. The creation of the euro was driven not by currency competition but rather by a half-century old project, starting with the Rome Treaty, to build « an ever closer union among the peoples of Europe ». And even now there remain some stubborn holdouts – Britain, Denmark, and Sweden – who seem unlikely to join in any time soon. Europe's monetary union cannot be taken as a harbinger of events elsewhere.

Moreover, there is no need for governments to abandon their existing currencies even if they do become increasingly uncompetitive. States have other choices. Rather than dollarize, they can establish some form of currency board, which would preserve their national money even while anchoring it to a stronger foreign money like the dollar or euro. Or instead of a monetary union, they can agree to a more limited form of regional cooperation that leaves national currencies in place. Options are by no means as limited as the Contraction Contention suggests.

The logic of state sovereignty

Now consider the logic of state sovereignty. Why is there so little evidence in the contemporary record to support the Contraction Contention? Fundamentally, it is because decisions on national money are driven, first and foremost, not by market competition but by the logic of state sovereignty. And the logic of state sovereignty dictates that governments will do whatever they can to promote their own practical authority – to build an arsenal of policy instruments sufficient both to pursue social objectives at home and to defend against enemies abroad. Historically, an exclusive national currency has been one of the most valued instruments of public policy.

What makes an exclusive national currency such a valued instrument? Simply put, money represents *power*. When we speak of the power of credit, we are really speaking of the power of money. Control over the issue of money, which is mostly created through credit, means control over the distribution of real resources – control, in the most fundamental sense, over who gets what. And what better way to exercise that control than by excluding all monies other than your own – in other words, by maintaining a strict monopoly within the territorial frontiers of the state?

From a government's point of view, four key benefits are derived from an exclusive national money, two political and two economic The two political benefits are, first, a potent symbol to promote a sense of national identity; and second, a practical means to insulate the nation from foreign influence. The two economic benefits are, first, an instrument to manage the macroeconomic performance of the economy; and second, a source of finance to underwrite public expenditures. Of these, perhaps the most vital to governments is the last – the famous, or infamous, power of *seigniorage*.

A monetary monopoly gives governments a natural capacity to augment public spending at will. Technically, seigniorage is defined as the excess of the nominal value of a currency over its cost of production. In practical terms, seigniorage can be understood as an alternative source of finance for a government beyond what can be raised by either taxation or borrowing. The authorities can simply create the money they spend. In the old days, this meant minting new coins or running the printing press. Its modern-day equivalent is borrowing from the central bank, which results in an expansion of bank reserves. Public spending financed by money creation appropriates real resources at the expense of the private sector – a privilege for government if there ever was one. Because the privilege is often abused, resulting in inflation, the process is also frequently dubbed the "inflation tax".

Despite the economic disadvantages associated with the risk of inflation, the privilege of seigniorage makes sense from a political perspective as a kind of insurance policy against risk – an emergency source of finance to cope with unexpected contingencies, up to and including war. Decades ago the great British economist John Maynard Keynes wrote that « a government can live by this means when it can live by no other ». Others have called seigniorage the « revenue of last resort » – the single most flexible means available to mobilize resources in the event of an sudden crisis or threat to national security.

Can many governments really be expected to voluntarily surrender such a valuable policy instrument? To do so means, in effect, to "outsource" monetary policy. A key element of a state's sovereignty is delegated to a foreign supplier, such as the United States or EMU, or to the joint institutions of a monetary union. The privilege of seigniorage can no longer be exercised freely. Public spending can no longer be expanded at will. Instead, whatever cannot be financed through taxation must be borrowed, either at home or abroad, making the government dependent on the good will of creditors. This may not matter much to European governments, most of which have long since disavowed the inflation tax. But it certainly does matter in most other parts of the world, where seigniorage still frequently supports a sizable fraction of government spending. No wonder so few countries, outside Europe, seem eager to give up their national currency. Resistance to monetary outsourcing is strong.

The evidence of history

Finally we come to the evidence of history, which clearly confirms the importance that governments attach to the privilege of seigniorage. We often forget that state control of money is by no means a natural condition. The idea was never a categorical imperative. Rather, it developed over time as a deliberate, calculated strategy – one policy option among many – and directly reflected the desire of governments to maximize access to their « revenue of last resort ». The history of money reveals a constant struggle by governments to promote seigniorage as a substitute for borrowing.

The struggle was not always successful, of course. In fact, until as recently as the nineteenth century, there never was such a thing as an exclusive national currency. From the time money first appeared in recognizable form, in the Greek city-states of Asia Minor some two and a half millennia ago, coins of diverse heritage tended to circulate freely across political frontiers. For the users of money, choice among rival currencies was virtually unlimited. Competition, not monopoly, was the norm. Government access to seigniorage was therefore limited, since people could not be forced to use one single money to the exclusion of others. Hence dependence on creditors could not be avoided so long as tax revenues were insufficient to underwrite public spending (which, of course, was often the case).

It was only during the nineteenth century that the picture began to change. The nineteenth century was an era of rising nationalism, a period when the principles embodied in the Peace of Westphalia of 1648 – above all, the concept of absolute sovereignty based on exclusive territoriality – achieved a new level of tangible expression. Governments undertook to suppress all threats to their rule, whether from counterparts abroad or rivals at home. Their goal was to build up the nation, as far as possible, as a unified community led by a strong central authority. Centralized management of money was simply a logical part of the process. As one economist has written: «Just as all rival centers of power were absorbed into one monopoly of power so too all rival sources of money were absorbed into one monopoly of money creation». Throughout the Western world, governments began to claim an exclusive right to control the issue and circulation of money within their borders, abolishing currency competition.

The task was not easy. In fact, an enormous and sustained effort was required to overcome centuries of monetary tradition. States labored long and hard to establish their monopolies. Control was asserted in two principal ways – first, by promoting the development of a robust national money; and second, by seeking to limit the role of rival foreign currencies. A robust national money was achieved by consolidating and unifying the domestic monetary order, standardizing banknotes and coins, and firmly lodging ultimate authority over money supply in a government-sponsored central bank. The role of rival foreign currencies was limited by means of new laws abolishing their status as legal tender, as well as by so-called public-receivability provisions specifying what currency might be used to pay taxes or satisfy other obligations to the state. Yet however difficult, the effort ultimately proved successful. Exclusive national currencies became the new norm in monetary affairs.

Nowhere is this struggle better illustrated than in the long history of the Casa di San Giorgio and its uneasy relationship with the governing authorities of the Republic of Genoa. The Republic had its own coinage, stretching back centuries. Genoa's first mint was established by Conrad of Swabia, King of the Romans, as early as 1138. But because Genoa's coins never enjoyed exclusive legal-tender status, even within the city-state itself, government access to seigniorage remained limited. The city council was forced to look instead to borrowing to keep up public spending. The origin of Genoese government debt, Michele Fratianni tells us, goes back to the 12^{th} century. By the 14^{th} century, interest payments at times were consuming as much as ninety percent of the city's income. The looming risk of default led creditors to join together as best they could to protect their interests. Eventually, in 1407, this resulted in creation of the Casa di San Giorgio, which as we know quickly gained great power in relation to the state – a « state within a state », as Machiavelli famously described it. Despite vigorous efforts, successive governments were never able to redress the balance before the Republic's demise during the Napoleonic Wars.

Genoa's coins were not uncompetitive, of course. Indeed, some enjoyed considerable popularity – especially the full-bodied gold *genovino* (or *genoin*), first struck in 1252. Confidence in the *genovino* was inspired by the coin's sustained high quality as well as by Genoa's strong position as a maritime power, and it was widely used for commercial purposes around the Mediterranean region. But the *genovino* was also persistently overshadowed by its better known rivals, the celebrated *fiorino* (or *florin*) of Florence and *ducato* (or *zecchino*) of Venice. Between the middle of the thirteenth century and the end of the fourteenth century, according to the historian Carlo Cipolla, it was the *fiorino* that enjoyed the greatest prestige in international trade; in the fifteenth century, it was the *ducato*, described by Cipolla as the era's « international currency *par excellence* ». A certain amount of seigniorage could be harvested from the *genovino's* broad acceptability – but not much.

Accordingly the Republic resorted to debt, which in turn gave pronounced leverage to creditors once they became organized for collective action through the Casa di San Giorgio. The story of subsequent centuries was one of persistent contest between the Casa and the city's authorities for control of the public purse – in effect, for control of the government itself. On one side mostly were newly rich merchants, determined to preserve the value of their investments. On the other side were the nobility, equally determined to retain their traditional prerogatives as a ruling class. Successive governments did what they could to sustain the competitiveness of Genoa's coinage. But the Republic failed to survive long enough to learn the trick of creating an exclusive currency that would maximize access to seigniorage. Had that option been imagined before the nineteenth century, can anyone doubt that Genoa's authorities would have seized it?

Back to the future?

My conclusion, then, is clear. The Contraction Contention is wrong. We are not progressing toward a world of fewer currencies. That view is supported neither by the contemporary record nor by the logic of state sovereignty nor by the evidence of history. National monies are not destined for extinction.

What, then, will the future of money look like? In my opinion, as I have written in two recent books, the years to come will have more in common with the distant past than with the recent present – with the millennia when currencies competed freely rather than with the brief century or two when exclusive national monopolies were attempted. State control of money was a product of unique stage of history and is already beginning to fade away. Territorial currency monopolies are once again yielding to rivalry for market share. The arrow of history is not flying in straight-line fashion toward Robert Mundell's optimum of a single world currency. Rather it is behaving more like a boomerang, taking us « back to the future », to borrow from the title of the popular Hollywood film series – back to a future where currency competition will become more and more intense and the privilege of seigniorage will become less and less accessible. To prepare for that future, governments might do worse than study the illuminating history of Genoa and the Casa di San Giorgio.

Relazioni

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