THE CASE FOR A NORTH AMERICAN MONETARY UNION

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INTRODUCTION

NAMU: THEORETICAL OR IMMINENT REALITY?

- Over the past decade, there has been much speculation and controversy surrounding the possibility of a proposed North American Monetary Union (NAMU) of the American Dollar, the Canadian Loonie and the Mexican Peso, to create a new, single currency, often dubbed the "Amero."

- NAMU was proposed in 1999 by economist Herbert Grubel and encouraged further by the CD Howe Institute after the successful launch of the Euro. The "Amero" is thought to be a natural development of the North American Free Trade Agreement (NAFTA) already in place and is considered to be a good complement that could enhance the benefits of the agreement for each of the respective nations.

- Despite all of the hype that the "Amero" has received, it remains purely theoretical at this time. Proponents of the "Amero" maintain that a currency union is the best way to rid Canada of its floating exchange rate and improve on its poor economic performances of the past. However, there are many, including the Canadian and American governments, that do not see sufficient benefit in a currency union in the near future

A EUROPEAN COMPARISON

SUCCESS OF EU VS. PROSPECT OF NAMU

- With the continued success of the European Union since its establishment in 1993, there have been calls on North America to follow suit and to create their own monetary union. However, the reasons that precipitated the establishment of the EU, are not entirely consistent with the conditions faced by North America:
  - The establishment of the EU was largely a **political move** for peace through the creation of a political union. Its continued success, however, extends from its involvement in economics. There was much support for the currency union from many southern European countries whose currencies had a history of instability. (Helleiner 212) The transition to a common currency allowed Europe to remain competitive on the world market. There is/was not a similar push from democrats and labour leaders in Canada and even more so now because of the better exchange rates Canada has experienced over the last decade.
  - In Europe, regional financial power and increased international capital mobility were important factors that led to the monetary union. These two factors have an opposite effect on the Canadian exchange rate regime, reinforcing Canada's case for a floating exchange rate. A fixed exchange rate that a monetary union would require would thus be **counterintuitive** for the Canadian economy. (Helleiner 14)
  - The United-States is **not** as willing or accommodating when it comes to creating a common currency as was Germany for the Euro. (Helleiner 13) The proposed "Amero" is not possible without the approval of the United-States and it has received very little support from the American population. The "Amero" could result in the United-States losing hard-earned political power, something it is most certainly not willing to give up easily. Also, the Dollar is a key currency and the United-States relies on its ability to freely print money when needed, so a move to the "Amero" could hurt their mass consumption oriented economy, more than help it.

OPTIMAL CURRENCY AREA

DOES NORTH AMERICA REPRESENT ONE?

- Joining a common currency area would permanently fix the Canadian exchange rate, so it must be decided whether or not fixing the exchange rate will bring an improvement to the Canadian economy.

- Robert Mundell outlines two conditions needed to form an OCA:

  - The real shocks affecting the US and Canada must be symmetric ➡ This means that exchange rates must be constant. However, this has not been the case, as the fluctuations in the Canadian Loonie over the past forty years have resulted from asymmetric real shocks. Under a fixed rate, without the shock-absorption that floating rates provide, Canada's economy would be more susceptible to external shocks. (Carr 25)

  - There must be free mobility of labour between the US and Canada ➡ The US border acts as barrier to free mobility of labour and capital. (Carr 25) There is not complete freedom to take advantage of the opportunities found in the US because of the regulations regarding work and the entrance into the US market. 9/11 only added to the difficulties in cross-border mobility.

  - **Neither** of these two conditions are met, demonstrating that the United-States and Canada **do not** form an optimal currency area, therefore, a NAMU does not currently seem feasible.

- Canada's economic structure, originally more commodity based, has moved closer to a service based economy like that of the United-States. Having similar economic structures, could make a transition to an OCA more feasible if it were done.

PROPOSED BENEFITS

OF A NORTH AMERICAN MONETARY UNION

- As previously stated, a NAMU could be an effective extension of NAFTA, and it could enhance the benefits that NAFTA already delivers for the countries involved.

- It would greatly reduce the FOREX risks of banks, firms and travellers in Canada, the United-States and Mexico, as there would be only a single currency to deal with. Additionally, less FOREX risk could save a lot of time and money when dealing with bonds, financial derivatives and other monetary contracts. This would free up labour and capital, improving productivity and improving living standards. (Grubel 8)

- A greater price stability is achievable through a currency union. Price fluctuations due to exogenous factors would become dampened when there is a greater number of geographical locations and a greater mix of industries involved. (Grubel 11)

- An added benefit from reduced FOREX risks and greater price stabilities is an enhanced competitiveness and efficiency in the market.

PROPOSED WEAKNESSES

OF A NORTH AMERICAN MONETARY UNION

- As previously stated, based on Robert Mundell's two conditions of an optimal currency area, a monetary union between the United-States and Canada would not be in their best interests.
- By creating a monetary union, each country would lose some autonomy in the formation of monetary policies, with the bigger losers being Canada and Mexico.
  - This loss of autonomy would lead to an overall loss of economic sovereignty for the countries involved. Monetary policies and even interest rates would be set by monetary boards.
- Decisions made by respective countries could have adverse effects on the other members of the monetary union. It is probable to assume that decisions made by the United-States would have the largest impact due to its relative size and scope.

SOVEREIGNTY

IMPORTANT FOR CANADA TO MAINTAIN?

- Milton Friedman states, “currency is a very important symbol of sovereignty.” (Helleiner 181) In creating a NAMU, Canada would potentially be giving up part of their economic sovereignty and also portions of their political and cultural sovereignties.
    - Economic sovereignty refers to the ability of the government to change the monetary, fiscal and exchange rate policies. To lose the power to shape economic policies, would mean when external shocks hit Canada, it could lead to lower output and lower employment in the country.
    - Political and cultural sovereignty are very important to Canadians. A monetary union would interfere with national pride/sovereignty and would be a step in the direction towards further “Americanization.” This sentiment shared by many Canadians will likely keep any politicians from considering such a venture in the near future as it would be ‘political suicide.’ Not surprisingly, many Americans feel the same way about the sovereignty of the United-States.
- Sovereignty will allow Canada to keep its floating exchange rate.

IMPACT ON AMERICAN ECONOMY

OF A NORTH AMERICAN MONETARY UNION

- Overall, the American economy would not gain much and therefore would not accept a NAMU or need to because of the dominance of their Dollar.

- One major incentive for the Americans to consider the “Amero” is to defend against the steady growth of the Euro over the past decade. A monetary union could perhaps offset the competitive threat of the eurozone. While the US Dollar is still double the Euro in total foreign reserves, Alan Greenspan of the Federal Reserve said that it is “absolutely conceivable that the euro will replace the dollar as reserve currency, or will be traded as an equally important reserve currency.” (Reuters) This is a long ways off, but if this were to happen, it could give Canada leverage in establishing a monetary union.

  - Also a factor is the fact that the US is running a 700 Billion dollar current account deficit. This poses large risks for the currency if a country like China were to make substantial conversions through the exchange market. This remains unlikely, but is nonetheless a reason for monetary union, if not at least dollarization.

Table 4 Official foreign exchange reserves: currency shares

(as a percentage of total identified holdings; end-of-year values expressed in US dollars)

	1999	2000	2001	2002	2003	2004	2005 [1]
All countries [2]							
US dollar	71.0	70.5	70.7	66.5	65.8	66.0	66.4
Euro	17.9	18.8	19.8	24.2	25.3	24.9	24.3
Japanese yen	6.4	6.3	5.2	4.5	4.1	3.8	3.7
Pound sterling	2.9	2.8	2.7	2.9	2.6	3.2	3.6
Swiss franc	0.2	0.3	0.3	0.4	0.2	0.2	0.1
Other currencies	1.6	1.4	1.2	1.4	1.9	1.9	1.9

Source: IMF.
1) End-of-September data.
2) Shares are calculated only for the group of countries reporting reserve currency composition to the IMF, which account for around 70% of world reserve holdings.

(ACCUMULATION OF FOREIGN RESERVES 19)

IMPACT ON CANADIAN ECONOMY

OF A NORTH AMERICAN MONETARY UNION

- There are many contradicting opinions about the potential welfare of Canada under the proposed monetary union with the United-States.

  - Canada would save about 3 Billion a year in transaction costs, however would lose about 1.4 Billion a year in domestic seignorage revenues. Not to mention the previously stated loss of sovereignty. (Cusson)

  - Many economists feel that the currency regime would be dominated by the United-States. Canada would lose control over the monetary policy and in essence the Bank of Canada would become the thirteenth reserve district of the United-States. (Carr 200) It is a controversial topic as it is tough to determine how much say Canada would have in terms of interest rates and policy decision making.

  - Without the floating exchange rate, working under a fixed rate regime, there would be little to no buffer to external shocks to Canada's economy. This would leave other factors like employment and wage to take a big hit. Where the exchange rate would normally decrease to create more demand for commodity products in poor economic times, there would be little room to manoeuvre, with the economy taking the brunt of the damage.

- The NAMU was proposed in 1999 when Canada's economy was experiencing hard times. The current economic conditions are more favourable for Canada. Part of this change is due to the increased amount of debt in the United-States and the decreased debt in Canada. (Statcan) As debt factors into the value of currency, it is not an optimal time for Canada to merge currencies.

PRODUCTIVITY

OF CANADIAN ECONOMY

- Canada’s productivity has waned over the decade in comparison to the rise in productivity in the United-States. In 2009, the US had a productivity growth of 7.4%, where Canada had a growth of 1.1%. (Cooper 2)
  - Reasons attributing to such a low productivity measure from Canada’s smaller market size, inadequate innovation and a labour market inflexibility largely due to unions.
- With lower productivities, Canada cannot hope to produce goods at the same efficiency as the United-States. Therefore labour costs will be higher in Canada, leading to higher unemployment. So as the productivity rate has been stagnate in Canada, the establishment of a monetary union would create less demand for Canadian goods than American made goods, which could lead to the failure of manufacturing plants and a poor economic performance.
  - The productivity in the resource based maritime provinces tends to be much lower, so the impact of a monetary union would take a heavy toll on these small economies.

BENEFIT OF TWO CURRENCIES

OVER NORTH AMERICAN MONETARY UNION

- ☐ With the lower productivities that Canada has, it clearly does not make sense to enter into a North American Monetary Union at this point in time. Having separate currencies is what has worked for Canada and will continue to work for the near future.

- ☐ If Canada keeps its own currency, it can keep the floating exchange rate. So with low productivity, Canada lets the exchange rate take the beating instead of the labour. As the exchange rate goes down relative to the American Dollar, it can make Canadian goods look more appealing artificially. This will save Canadian jobs. This of course is not always easy to accomplish if the Canadian Loonie depreciates or appreciates too fast.

    - ☐ For example, the substantial decrease in the Loonie from $0.89 to $0.62 over the 1990s. The exchange rate was offset to account for low productivity, but stopped working when the Loonie began to depreciate too quickly. A more recent situation with the production of oil, the Canadian Loonie has appreciated at a pace that the productivity of the country cannot match. In this case it is largely overvalued. (Courchene 26)

    - ☐ While these two examples serve as reasons to forgo a floating exchange rate, in most circumstances the floating rate serves its purpose well and a fixed rate would most assuredly only bring more problems for the economy.

CONCLUSIONS

NAMU: PURELY THEORETICAL, FOR NOW.

- A North American Monetary Union does not seem likely in the near future and as long as the United-States can manage its dominant currency, their will be little reason for them to agree to such a union.
  - The EU should not be viewed as a guide to for a North America Monetary Union. The circumstances in Europe were very much political and the economic state of many of the countries created a need for a monetary union.
  - Canada and the United-States do not form an optimal currency area because of strict American laws and asymmetric external shocks. Under a fixed rate, these external shocks would hurt Canada's economy and Canada would have very little flexibility to protect the economy. A floating rate is needed to take the beating for the economy.
  - Canada's low productivity, although slightly increasing in the latter part of the decade, makes a monetary union a futile venture until the productivity of the country can be brought up.
- The adverse costs of a monetary union, at this point, far outweigh the benefits it could deliver for both Canada and the United-States.

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