

Contents

	Page
List of Tables	XII
List of Graphs	XIV
Acknowledgements	XV
Introduction and Outline	1
1. The Aim of Currency Union	1
2. Strategies for Currency Unification	4
3. Outline	6

Part One

Towards a Theory of the Optimum Currency Unification Process

Chapter I: Strategies for Currency Unification	13
A. The Basic Options	13
B. The <u>Economics of Economic-Policy Coordination:</u> A Critique of the Traditional Approach	15
1. Exchange-Rate Unification	16
2. Ex Ante Harmonization of Domestic Monetary Expansion	22
3. Simultaneous Ex Ante Commitments with Regard to Exchange Rates and Domestic Monetary Expansion	30
4. Common Drawbacks of the Coordination Strategies	33
a. Collusion and the Lack of Automaticity	33
b. Coordination versus Currency Unification: The Case for Predictability	34

	Page
C. Currency Unification	38
1. Prefatory Note: Currency Unification and Fiscal Integration	39
2. Currency Unification Uno Actu: Big Leap versus Gradualism	42
3. Currency Unification through <u>Free Currency Competition</u> : The Intercirculation Approach	45
a. The Meaning of Free Currency Competition	46
b. Present Obstacles to Free Currency Competition	47
c. The Rationale of Free Currency Competition	50
i. Fighting Inflation	50
ii. Towards Optimum Currency Domains in the European Community	64
iii. Currency Competition for Currency Unification	71
d. Objections to Free Currency Competition	75
i. Externalities	75
ii. "Gresham's Law"	82
iii. Stabilization Crises	89
iv. Economic Disincentives and Political Friction	90
4. The Case for the <u>Parallel-Currency Approach</u>	90
a. The Concept of Parallel Currency and its History	90
b. A Dual Currency as a European Pivot?	92
c. An External European Parallel Currency?	94
d. A European Parallel Currency of National Origin?	96
e. The Creation of a New European Parallel Currency and the Theory of the Optimum Currency Unification Process: A Summary	98
 Chapter II: Implementing the Parallel-Currency Approach	 103
A. A Useful and Attractive Parallel Money	103
1. Incentives versus Coercion	103
2. Is there an "Infant-Currency Argument" for EPC Subsidization?	104
3. Distortive Incentives	106

	Page
4. The Case for Value-Maintenance Provisions	108
a. The Options	111
b. Characteristics of an Optimal EC Standard of Value . .	119
i. Currency Information Cost	119
ii. Nominal Exchange-Rate Risk	121
iii. Reducing Purchasing-Power Risk through Currency Diversification	124
iv. Eliminating Purchasing-Power Risk and Reducing Real Exchange-Rate Risk: The Indexed Basket . .	126
v. The Case for Index Clauses and the Objectives of Economic Policy	129
a. Growth	130
b. The Distribution of Income and Wealth	132
c. Full Employment and Price-Level Stability . .	133
d. External Equilibrium	135
vi. Macroeconomic Objections to Index Clauses . . .	136
a. Price-Level Stability	136
b. Full Employment	138
c. Growth	139
d. The Distribution of Income and Wealth	142
e. External Equilibrium	143
vii. The Maintainability of Value Guarantees	144
c. Characteristics of an Optimal EC Store of Value . . .	146
i. Attractiveness to Individual Holders	146
ii. Micromonetary Efficiency	151
iii. Implications for the Effectiveness of Monetary Policy	153
d. The Choice of the EPC Value Guarantee: A Synthesis .	153
e. "Backing" the Value Guarantee?	155
B. The Issuing Mechanism: Minimizing Interference with National Monetary Policies	158
1. A Private Issuing Bank?	158
2. The Organization of a Community EPC Bank	164
3. The Mechanics of EPC Issuance and their Implications for the National Money Supplies	165

	Page
4. Reserve Requirements for EPC Deposits?	171
5. Limiting the Supply of EPC?	173
6. Restricting the Use of the EPC?	175
7. Preliminary Stages for the Introduction of the EPC? . .	176
8. Transition to the Final Stage	178
 Chapter III: The Prospective Process of EPC Penetration.	180
A. Speed: Gradualism, Acceleration, Deceleration	180
B. The Pattern of EPC Expansion	181
1. The EPC's Expansion as a Standard of Value	182
a. Inflation Risk	183
b. Real Exchange-Rate Risk	184
2. The EPC's Expansion as a Store of Value	186
3. The EPC's Expansion as a Means of Payment.	188
4. The EPC's Expansion and "Gresham's Law"	190
C. The Pattern of EPC Penetration and the Theory of Optimum Currency Areas	191

Part Two

Monetary Coordination and Currency Competition: The Empirical Evidence

Chapter I: <u>Real Exchange-Rate Changes in the European Community:</u> The Empirical Evidence and Its Implications for European Currency Unification	195
A. Introduction	195
B. Problems of Measurement	196

	Page
C. Has EC Monetary Union Not Been Attained Because the European Community is a Relatively Undesirable Currency Area?	203
D. Can the European Community's Failure to Implement its 1971 Plans for Monetary Union be Attributed to Unfavourable External Disturbances?	215
E. The Prospective Price-Level Implications of EC Monetary Unification for Individual Member Countries and the Choice of a Pioneer Group for Currency Unification	220
Summary of Chapter I	229
 Chapter II: Currency Competition and Currency Diversification: A Regression Analysis	
A. Introduction	231
B. Currency Shares of Foreign-Currency Deposits	235
1. The Hypotheses Formalized	235
a. Rates of Return: Mean Expected Values	235
b. Yield Risk	240
c. Transaction Cost: Mean Expected Values	243
d. Transaction Cost: Risk	246
e. Wealth Effects	247
f. Non-Market Factors	248
2. Data Problems, the Choice of Proxies and the Length of Built-in Lags	250
a. The Dependent Variable	250
b. Return Variables	257
i. Arbitrage Opportunity on Deposits Covered	257
ii. Arbitrage Opportunity on Deposits Covered Net of Transaction Costs	258
iii. Arbitrage Opportunity on Bonds	259
iv. Forward Factor Ratio	260
v. CPI Deflator Ratios	261
vi. Cumulative Basic-Balance Difference	262
vii. Arbitrage Opportunity on Deposits Uncovered	262

	Page
c. Yield (Exchange-Rate) Risk Variables	262
d. Transaction-Cost Variables	264
i. Autonomous Payment Root Share	264
ii. Changes of Export Shares	266
iii. Cumulative Basic-Balance Difference	267
iv. Autonomous Payment Share	268
v. Gross National Product Share	268
e. A Transaction-Risk Variable: Autonomous Payment Cube-Root Share	268
f. Wealth Variables	269
i. Domestic Credit Share	269
ii. Gross National Product Share	270
g. Non-Market Variables	270
i. Velocity Ratio	270
ii. Restriction Dummies	270
iii. Seasonal Dummies	271
h. Summary	271
3. Methods and Problems of Estimation	271
a. Market-Share Analysis	271
b. Simultaneity	273
c. Lags	275
d. Constrained Stepwise Regression	276
4. Evaluation of the Results	277
a. Seasonal Patterns	277
b. Transaction Costs	279
c. Rates of Return	281
d. Yield Risk	283
e. Other Variables	284
f. Conclusion	285
C. Currency Diversification of Non-Bank Deposits	286
1. Changes in the Variables	286
a. The New Dependent Variable	286
b. Changes in the Explanatory Variables	287
c. Summary	289

	Page
2. Changes in the Method of Estimation	290
3. Evaluation of the Results	291
a. Transaction Cost	291
b. Rates of Return	293
c. Exchange Risk	294
d. Non-Market Factors	295
e. Conclusion	295
D. Currency Preferences of Central Banks	295
1. The Variables	297
a. The Dependent Variable.	297
b. Return Variables	298
c. Exchange-Risk Variables	300
d. Intervention and Other Transaction Variables	300
e. Other Variables	302
f. Summary	302
2. Evaluation of the Results	302
a. Transaction Demand	304
b. Rates of Return	304
c. Yield Risk	305
d. Window Dressing	305
e. Conclusion	305
E. Currency Shares of Foreign-Currency Bond Issues	306
1. The Variables	306
a. The Dependent Variable	306
b. Return Variables	307
c. Yield-Risk Variables	310
d. A Debt Variable	310
e. Other Variables	311
f. Summary	311
2. Problems of Estimation	312
3. Evaluation of the Results	312
a. Rates of Return	312
b. Yield Risk	314
c. Other Variables	315
d. Conclusion	315

	Page
F. Currency Diversification of Bond Issues	316
1. Changes in the Variables	316
a. The New Dependent Variable	316
b. Changes in the Explanatory Variables	316
2. Evaluation of the Results	317
G. Gross Issues of Unit-of-Account Bonds	319
1. The Variables	319
a. The Dependent Variable	319
b. The Explanatory Variables	320
2. Evaluation of the Results	321
Summary of the Main Findings of Chapter II	322
Appendix	324
1. Glossary of Symbols	324
2. Statistical Sources and Concepts	330
 Chapter III: The Demand for Indexation: A Regression Analysis	334
A. Introduction	334
B. The Variables	335
1. The Dependent Variables	335
2. The Explanatory Variables	336
C. The Estimation Procedure	338
D. Evaluation of the Results	339
Summary of Chapter III	346
Appendix	346
 Chapter IV: Parallel Currencies and Private Currency Competition in Monetary History: A Survey	362
A. Introduction	362

	Page
B. Duometallism	362
C. Specie versus State Paper Money	367
D. Government Issuance of a New Stable Parallel Currency .	373
E. Competition between Union Money and Provincial Money .	380
F. Free Currency Competition between Private Issuers . . .	387
 Summary	 402
 Postscript	 417
 References	 419
I. Books and Articles	419
II. Official Documents, Corporate Publications and Newspaper Reports (Anonymous)	468