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**NORTH AMERICAN MONETARY UNION:  
A UNITED STATES PERSPECTIVE**

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Few issues of public policy roil Canadians more than the idea of a North American Monetary Union (NAMU), establishing one currency for Canada and the United States. As other contributions to this special issue testify, opinions among Canadians differ sharply and divisions run deep. From the maritimes to the Pacific, Canadians are far from consensus regarding the future of their national money, the much belittled “loonie.”

But what about opinion south of the longest unguarded border in the world? Largely lost in the din of debate among Canadians is the perspective of the United States, Canada’s putative partner. America’s interest in NAMU is rarely addressed in any systematic manner. This is surely a critical omission. Even if Canadians could unite in favor of currency union as a policy goal, a vital imperative would remain – namely, the need to gain support from Washington. How would Americans view a monetary initiative from Ottawa? Would the prospect of NAMU be greeted with open arms or with hostility? As a practical matter, a common currency would be impossible without the concurrence, or at least the compliance, of the United States.

This essay explores the NAMU issue specifically from a U.S. point of view, addressing both economic and political aspects. The big question is: What does the United States have to gain? The short answer, which will disappoint many Canadians, is: Not much. The U.S. greenback, as the world’s leading international currency, already generates considerable benefits for Americans. That is the starting point from which analysis must proceed. As compared with the status quo of America’s de facto market dominance, a formal monetary union with Canada, though not without advantages, would threaten more risks and losses for the United States than gains. Moreover, this negative assessment holds true no matter what form NAMU might take – whether modeled on Europe’s euro, substituting an entirely new North American money for the continent’s two existing dollars; or if instead it were simply to replace the Canada’s loonie with the greenback, a “dollarization” model. Either way, under present circumstances, the idea can be expected to elicit little interest among Americans and even less encouragement.

Are there any conceivable circumstances that might alter this conclusion? Certainly it is possible to imagine future developments that could dispose Americans more favorably toward NAMU. None, however, is a contingency to which we can reasonably attach a high degree of probability in the near term. In fact, dispassionate analysis suggests that for a great monetary power like the United States, under normal circumstances, national interest is better served by avoiding the constraints and responsibilities that would accompany a formal monetary union. So long as the benefits of de facto market dominance can be effectively sustained, little is gained by formalizing the informal.

## I. The Status Quo

To suggest that NAMU offers little gain to the United States might seem, at first glance, counterintuitive and perhaps even naive. Any arrangement between the two countries would clearly be dominated by the much larger and wealthier American side. Canada, in effect, would become a monetary dependency; and as Jonathan Kirshner has remarked, “monetary dependence can create a sphere of influence [that] can provide considerable political benefits for core states” (1995: 8, 17). Monetary dependence may be exploited, Kirshner astutely notes, in four ways: (1)

enforcement – manipulation of standing rules or threats of sanctions; (2) expulsion – suspension or termination of privileges; (3) extraction – use of the relationship to appropriate real resources; and (4) entrapment – transformation of a dependent state’s interests. Why should the United States not want to avail itself of all these considerable advantages?

The answer lies in the status quo, which already generates significant economic and political advantages for the American side. The U.S. dollar today functions as the only truly global currency – a national money used for international purposes in virtually every corner of the world. America’s interest in NAMU must be compared with that stark reality.

### *The dollar’s market leadership*

Broadly speaking, currencies may be employed outside their country of origin for either of two purposes – for transactions either between nations or within foreign states. The former is conventionally referred to as international currency use or currency internationalization; the latter goes under the label currency substitution and can be referred to as foreign-domestic use. Both types of use reflecting the accelerating competition that exists today among national currencies – a process I have described elsewhere (Cohen 1998, 2004) as the *detritorialization* of money.

For each of these two purposes, the U.S. dollar is employed on a very broad basis. Indeed, the greenback is indisputably the market leader among world monies, perched at the peak of what I call the Currency Pyramid (Cohen 1998, 2004). Its only serious rivals to the title of Top Currency are two Patrician Currencies, the euro and, more distantly, the yen. Canada’s loonie, by contrast, along with a few other familiar names like the pound sterling and Swiss franc, is located in the next rank down – the rank of Elite Currencies, which qualify for some international use but are of insufficient weight to carry much direct influence beyond their own national frontiers.

The clearest signal of the greenback’s leadership in *international* currency use is sent by the global foreign-exchange market where, according to the Bank for International Settlements (2002), the dollar is the most favored vehicle for currency trading worldwide, appearing on one side or the other of some 90 percent of all transactions in 2001 (the latest year for which data are available). The euro, in distant second place, appeared in just 38 percent of transactions – higher than the share of its popular predecessor, the deutsche mark (DM), which had appeared in 30 percent of transactions in 1998, but lower than that of all euro’s constituent currencies taken together that same year (53 percent). The yen was even further behind with only 23 percent.<sup>1</sup>

The greenback is also the most favored vehicle for the invoicing of international trade, where it has been estimated to account for nearly half of all world exports (Hartmann 1998), more than double America’s share of global trade. The DM’s share of invoicing in its last years, prior to its replacement by the euro, was fifteen percent, roughly equivalent to Germany’s proportion of world exports. Preliminary evidence from the European Central Bank, the ECB (2003), suggests that the euro’s share may have increased modestly since its introduction in 1999, but mainly for Europe’s trade with the outside world rather than in exchanges between third countries. The yen’s share of global invoicing was just five percent, significantly less than Japan’s proportion of world exports. Likewise, the dollar dominates in global financial markets, even after the arrival of the euro. According to the ECB (2003), the euro has cut into the

greenback's share of the bond market, now accounting for some 30 percent of all international issues as against 45 percent for the dollar and less than ten percent for the yen. But in global banking outside Europe the dollar still dominates, with a share of 63 percent of cross-border loans as compared with just 8 percent for the euro and 12 percent for the yen (ECB 2003).

The clearest signal of the greenback's leadership in *foreign-domestic* use is sent by the swift increase in the currency's physical circulation outside the borders of the United States, mostly in the form of \$100 bills. Authoritative studies by the U.S. Treasury (2000) and Federal Reserve (Judson and Porter 2001) put the value of all notes in circulation abroad at between 50 and 70 percent of the total outstanding stock -- equivalent at the turn of the century to roughly \$275 billion to \$375 billion in all. Estimates also suggest that as much as three-quarters of the annual increase of U.S. notes now goes directly abroad, up from less than one-half in the 1980s and under one-third in the 1970s. By the end of the 1990s, as much as 90 percent of all \$100 notes issued by the Federal Reserve were going directly abroad to satisfy foreign demand. Appetite for the greenback appears to be far greater than for either the euro or the yen.

### *Advantages for the United States*

Not surprisingly, all this international use of the dollar appears to translate into considerable advantages for the United States, both economic and political. Four distinct gains may be cited.

Most familiar is the potential for seigniorage. Expanded cross-border circulation of a country's money generates the equivalent of a subsidized or interest-free loan from abroad -- an implicit transfer that represents a real-resource gain for the economy as a whole. Consider just the circulation of Federal Reserve notes, which are a form of non-interest bearing liability. Updating earlier estimates by Jeffrey Frankel (1995) and Alan Blinder (1996), current interest savings from foreign circulation of the greenback may be conservatively calculated at some \$16-22 billion a year. To this may be added a saving of interest payments on U.S. government securities, which are uniquely attractive to foreign holders because of their greater liquidity. Portes and Rey (1998: 309) call this an "often neglected source of seigniorage to the issuer of the international currency." In their words (1998: 309): "This international currency effect reduces the real yields that the United States government has to pay" -- a "liquidity discount" that they suggest could amount to at least \$5-10 billion a year. Put these numbers together and, paraphrasing former Republican Senator Everett Dirksen's celebrated remark about the Federal budget, we are beginning to talk about real money.

A second gain is the increased flexibility of macroeconomic policy that is afforded by the privilege of being able to rely on one's own money to help finance foreign deficits. Expanded cross-border circulation reduces the real cost of adjustment to unanticipated payments shocks by internalizing through credit what otherwise would be external transactions requiring scarce foreign exchange. In effect, it reduces the need to worry about the balance of payments in formulating and implementing domestic policy. Who can remember the last time Washington decision makers actively incorporated concern for our large current deficits or exchange rate in debating the course of monetary and fiscal policy?

Third, more psychological in nature, is the gain of status and prestige that goes with market dominance. Money, as I have written elsewhere (Cohen 1998, 2004), has long played a

key symbolic role for governments, useful – like flags, anthems, and postage stamps -- as a means to cultivate a unique sense of national identity. But that critical role is eroded to the extent that a local currency is displaced by a more popular foreign money, especially a money like the greenback that is so widely used on a daily basis. Foreign publics are constantly reminded of America's elevated rank in the community of nations. "Great powers have great currencies," Robert Mundell once wrote (1993: 10). In effect, the dollar has become a potent symbol of American primacy – an example of what has come to be called "soft power," the ability to exercise influence by shaping beliefs, perceptions, and identities. Though obviously difficult to quantify, the role of reputation in international affairs should not be underestimated.

Finally, there is the gain of "hard" political power that derives from the monetary dependence of others. On the one hand, an issuing country is better insulated from outside influence in the domestic arena. On the other hand, it is also better positioned to pursue foreign objectives without constraint or even to exercise a degree of coercion internationally. Money, after all, is simply command over real resources. If another country can be denied access to the means needed to purchase vital goods and services, it is clearly vulnerable in political terms. Its dependence, to recall Kirshner's terminology (1995), can be exploited via enforcement, expulsion, extraction, or entrapment. The dollar's widespread use puts all these possibilities in the hands of Washington policymakers.

Admittedly there can be limits to these benefits, particularly if they are abused. At present, the United States is running a current-account deficit in excess of \$500 billion a year. To many, this appears to be an over-exploitation of privilege that could eventually jeopardize the advantages of market leadership. As America's external liabilities rapidly accumulate, increasing supply relative to demand, foreigners might naturally be expected to worry about the risk of future depreciation or even restrictions on the usability of their holdings. As a result, Washington's autonomy could eventually be constrained, to a degree, by a need to discourage sudden or substantial conversions through the exchange market. Both seigniorage income, on a net basis, and macroeconomic flexibility would be reduced if a sustained increase of interest rates is required to preserve the dollar's market share. And all of this could be exacerbated even more if the rising level of anti-Americanism evident around the globe today, provoked by the present Administration's unilateralist foreign policies, were to induce additional switching from the greenback to politically more acceptable currencies like the euro. At time of writing, however, there was still little sign of any serious threat to the dollar's past dominance.<sup>2</sup> Even admitting the possibility of limits, there seems little doubt that presently the United States still derives considerable advantages, as numerous sources acknowledge (e.g., Portes and Rey 1998: 308-310).

The question is: Given these already considerable advantages, what would be added by NAMU?

## **II. The Amero Model**

Consider first the version of NAMU promoted by the likes of economists Thomas Courchene, Herbert Grubel, and Richard Harris.<sup>3</sup> Modeled on Europe's Economic and Monetary Union (EMU), this version calls for a full sharing of monetary sovereignty between the United States and Canada, replacing both the greenback and the loonie with a wholly new joint

currency, which Grubel (1999) would label the amero.<sup>4</sup> Call this the amero model.

Clearly, the amero model would not be without benefit for the United States. Most important would be the prospect of reduced transactions costs as compared with a geography of two separate national currencies. Savings on commercial exchanges between the United States and Canada could be realized because there would no longer be a need to incur the expenses of currency conversion or hedging. The usefulness of money would thus be enhanced for all its basic functions: medium of exchange, unit of account, and store of value. And these savings, in turn, could generate significant increases in trade volumes and, ultimately, incomes per capita.

The magnitude of these potential gains, however, should not be exaggerated. Analysis suggests that in relative terms benefits for Americans would be rather small. According to one source (Robson and Laidler 2002), annual savings on U.S.-Canadian currency transactions would amount to less than \$3 billion annually. Moreover, since in practice much of the business that Americans do with Canada is *already* conducted in their own money, it would be not Americans but Canadians -- with up to 90 percent of their exports going to the United States -- who would benefit most from the anticipated efficiency gain. Likewise, estimates by Jeffrey Frankel and Andrew Rose (2002) suggest that monetary union, by eliminating a "home bias" in international trade, can be expected to increase trade volume by as much as a factor of three. For Canadians, with exports to the United States already accounting for upwards of 40 percent of gross domestic product (GDP), income per capita could increase by as much as a third over a twenty-year period (Frankel and Rose 2002: 457). For Americans, by contrast, with their much more closed economy, income gains would be little more than negligible.

On the other hand, the amero model could bring with it real losses and risks for the United States as compared with the status quo. All the advantages presently derived from the greenback's Top-Currency standing -- seigniorage, macroeconomic flexibility, prestige, and political power -- could be significantly compromised.

### *Seigniorage*

For advocates of NAMU, seigniorage is a non-issue. True, the amero model would presume creation of a joint monetary institution much like the European Central Bank (ECB). A North American Central Bank (NACB), as Grubel would call it,<sup>5</sup> would subsume if not replace the Federal Reserve System as well as the Bank of Canada (BOC). Hence seigniorage revenues presently earned by the Federal Reserve and BOC would now go to the NACB. (These revenues are derived from the difference between the central banks' interest-free liabilities -- cash in circulation-- and the interest they receive on their counterpart assets.) For Canada, this might mean a diversion of some C\$2-2.4 billion annually (Grubel 1999: 16; Robson and Laidler 2002: 12). However, as EMU has demonstrated, arrangements can be easily negotiated to assure that all seigniorage earned by the NACB would be returned equitably to the partner countries. In Europe, net profits of the ECB are distributed in proportion to the shareholdings of each member of the European System of Central Banks. No doubt, advocates confidently assert, some similar formula could be agreed for NAMU as well. Courchene and Harris (2003: 313) dismiss the subject in a single sentence.

But this approach neglects the critical *international* dimension of seigniorage -- the net resource transfer that America currently enjoys as a result of the greenback's widespread foreign

circulation. An amero, we may assume, is no less likely to be used around the world than today's U.S. dollar. Hence the magnitude of the interest-free loan from abroad would most probably remain sizable. But whereas at present Americans are the exclusive beneficiaries of this advantage, now the gain would have to be shared with Canadians, who currently earn nothing like the same benefit from their much less widely used loonie. Canadians, in effect, would free ride on the inherited popularity of the greenback, enjoying a windfall gain at America's expense. The loss to the United States might not be "real money," but it could be cause for considerable resentment.

### *Macroeconomic flexibility*

Even more serious could be a loss of flexibility of macroeconomic policy in Washington. With the amero model, U.S. monetary policy would be directly affected, owing to the limited convergence of the American and Canadian economies. Fiscal policy could be constrained, too, depending on the nature of any budgetary provisions that might be incorporated into NAMU.

The challenge to monetary policy could be particularly severe. To be sure, the two neighbors are not entirely divergent in aggregate terms. How could they be, given their close integration through trade and direct investment? Inflation and employment rates in Canada tend to be acutely sensitive to developments below the border, and business cycles have long been highly synchronized. Yet not even the most ardent of NAMU's advocates would suggest that at the microeconomic level, the pair come anywhere near to approximating what might be described as an optimum currency area. Quite the opposite, in fact, as many specialists have noted.<sup>6</sup> As compared with the United States, Canada remains disproportionately dependent on its farming and extractive sectors, which still account for as much as a third of all Canadian exports. For all the synchronization of business cycles, the underlying structures of the two economies remain strikingly divergent, with their terms of trade tending to move in reverse directions in response to frequent fluctuations of commodity prices. Asymmetric shocks, acting in combination with wage and price stickiness, could cause considerable instability on both sides of the border in the absence of a flexible exchange rate between the greenback and the loonie.

Designing a single monetary policy for two such divergent economies would not be impossible, of course. Both the Federal Reserve and Bank of Canada are thoroughly experienced at the kinds of compromises that are required to address the often conflicting needs of different regions of their continent-wide countries. Similar adjustments could be managed by the NACB, too. But for Americans this would represent a distinct sacrifice, since now Canadian interests and preferences would have to be factored into the monetary policy intended for the United States. Autonomy would be lost as compared with the status quo.

Obviously, Americans would not be alone in this. Formally, Canadians would lose autonomy, too. Subordination of national policy independence is simply the price to be paid for a sharing of monetary sovereignty. But for Canada the price in practical terms would be relatively low since, de facto, autonomy is already severely constrained by the looming presence of the United States next door. Canadians are long accustomed to adjusting their monetary policies to the vagaries of the American economy, twenty times the size of their own. Indeed, for Canada there would now be a net gain, insofar as Canadians would gain a seat at the table where North American monetary policy is made. Few observers expect that in a joint monetary



institution, Canada would have a voice equal to that of the United States. More likely, most analysts agree, would be an arrangement making the Bank of Canada the equivalent of a thirteenth district bank within an expanded Federal Reserve System (Helleiner 2003). But even that much voice would enable Canada to speak with more authority than it can at present.

For Americans, by contrast, the sacrifice of policy flexibility would be a novel and, for many, unwelcome prospect. As John McCallum (2000:2), a NAMU foe, accurately observes, “the European Union model, in which independent states share decision-making and sovereignty, is alien to American thinking and American history.” Americans, as Canadians well know, much prefer to act on their own. In the words of another respected source (Clarkson 2000: 155-156): “American politicians’ tenacious determination to retain every possible speck of national sovereignty would make it very hard to sell the idea that Canada... should be granted membership in a continentalized Federal Reserve Board.”

The sacrifice for Americans could also extend to *fiscal* policy, depending on how closely the European model is followed. In EMU, currency union incorporates formal constraints on national fiscal policy as well via the controversial Stability and Growth Pact (SGP). In accordance with the Maastricht Treaty of 1992, the SGP mandates a medium-term objective of fiscal balance in all participating economies as well as, in principle, a strict cap on annual budget deficits of just three percent of gross domestic product. The rationale for these fiscal restraints is clear. It is to prevent potentially profligate policymakers from tapping into the EMU’s broader pool of savings to finance large spending programs at the expense of partner countries. But the effective impact of these restraints is equally clear. They make it far more difficult for elected officials to use budgetary policy for contracyclical purposes at home. Even in the best of times, most governments tend to run deficits of some magnitude. Little room is left, therefore, for participating states to raise public spending or cut taxes when needed to promote output and jobs (unless, like France and Germany today, they are prepared to flout the rules). Indeed, under a strict reading of the SGP, officials might be obligated to act in a *pro*-cyclical manner, tightening policy even when the economy slows in order to maintain momentum toward the goal of budget balance.

Incorporation of similar restraints into NAMU would be anathema to Americans. Not all Americans approve of the fiscal profligacy of the country’s present Administration, which has produced some of the biggest budget deficits in U.S. history. Proposals for a cap on the growth of public debt, up to and including a constitutional amendment, have frequently been mooted and are widely popular. But it is one thing for Americans themselves to set a limit on their government’s room for maneuver, and quite another to do it by international treaty. This too would be a hard sell to politicians determined to retain every speck of national sovereignty.

### ***Prestige***

In the psychological realm of soft power, the amero model could jeopardize the prestige that the United States currently derives from the market dominance of its dollar. The greenback, in effect, has become something akin to a registered trademark, a global symbol not unlike the Nike “swoosh” or the three-pointed star of a Mercedes. As economist Robert Aliber quips (2002: 16), “the dollar and Coca-Cola are both brand names.” The risk is that replacement of the greenback by an untested new brand, the amero, might weaken perceptions of American primacy

around the world.

The importance of brand-name competition in international relations should not be discounted. In fact, in today's rapidly globalizing world economy, state branding increasingly is becoming a key imperative of foreign policy. As one source observes (van Ham 2001: 3-4): "Globalization and the media revolution have made each state more aware of itself, its image, its reputation, and its attitude – in short, its brand.... Smart states are building their brands around reputations and attitudes in the same way smart companies do." And nowhere is the rise of the "brand state" more evident than in the realm of money, owing to the acceleration of competition among national currencies. Deterritorialization deprives governments of the monopoly control they once claimed over monetary management, forcing them to compete actively to preserve or promote market share for their currency – effectively, to "sell" their money. In practical terms, this means that they must now do all they can to invest in their money's reputation. "To out-perform rivals," notes a prominent commentator (Shelton 1994: 231), "a money producer would have to offer the public a better brand of money than the competitors."<sup>7</sup>

Today, of course, there is no more respected brand of money than the U.S. dollar – the world's Top Currency. Could an amero fare as well? Americans might legitimately be concerned. Reputations cannot be established overnight, after all. It might well take some time for the unfamiliar amero to become as universally popular as the comfortable old greenback. Moreover, even assuming success, the symbolic benefit for the United States would be diluted, since the new currency would not be directly identified with the United States alone but rather with some ambiguous new entity labeled "North America." Unlike EMU, NAMU is not promoted as a possible precursor of a political union. But without political union the amero has no single state for which to be a distinctive brand. The United States would lose the close one-for-one association that is currently seen between the prestige of its money and its status as a great power.

### ***Political power***

Finally, there could be adverse implications for America's hard political power in world affairs. As the sole issuer of the world's most desired currency, Washington today is happily placed, if it wishes, to exploit the monetary dependence of others. With the amero model, by contrast, coercion could be exercised only with the assent of Ottawa, which might not always be easy to obtain.

Would Washington ever dare to use the leverage provided by the greenback? The answer is obvious: Of course. A case in point is provided by Panama, which since its independence in 1903 has always used the U.S. dollar as its main legal tender. Although a national currency, the balboa, notionally exists, only a negligible amount of balboa coins actually circulates in practice. The bulk of local money supply, including all paper notes and most bank deposits, is accounted for by the dollar. In economic terms, observers rightly have mostly praise for Panama's currency dependence (e.g., Goldfajn and Olivares 2001). Though reliance on the dollar has by no means induced a high degree of fiscal discipline, it has succeeded in creating an environment of monetary stability, helping both to suppress inflation – a bane of most of Panama's hemispheric neighbors – and to establish the country as an important offshore financial center. In political terms, however, Panama has been especially vulnerable in its relations with Washington, as

Panamanians learned in 1998 when the administration of President Ronald Reagan initiated a campaign to force Manuel Noriega, the country's de facto leader, from power. Panamanian assets in U.S. banks were frozen, and all payments and dollar transfers to Panama were prohibited, effectively demonetizing the economy. The effect on the economy was devastating despite rushed efforts by the Panamanian authorities to create a substitute currency, mainly by issuing checks in standardized denominations that they hoped recipients would then treat as cash. Over the course of the year, domestic output fell by a fifth, undoubtedly hastening Noriega's eventual downfall in 1999.

Though extreme, the Panama case aptly illustrates the potency of the money weapon currently available to U.S. policymakers. Implicitly, it suggests as well how much more difficult it would be for Washington to throw its weight around if the greenback were to be replaced by an amero. Can anyone imagine the Canadian government, well known for its preference for diplomacy over naked force, agreeing to this kind of overt arm-twisting? America's money weapon would be critically blunted, if not wholly neutralized.

### III. The Dollarization Model

Given these potential disadvantages from a U.S. point of view, it is hardly surprising that the amero model might hold little appeal for Americans. In fact, opposition south of the common border is prodigious. In a 2002 survey of U.S. public opinion, an overwhelming 84 percent of respondents rejected the notion of a new joint currency for North America (Robson and Laidler 2002: 25). As McCallum (2000: 2) writes, the United States "is obviously light years away from...contemplating a move to a supranational, euro-style currency." Most NAMU advocates ruefully concur. "The biggest obstacle," concedes Grubel (1999: 39), "will be indifference in the United States."

What, then, of the dollarization model – straightforward replacement of the loonie with the greenback? Though dismissed by most NAMU advocates as a distinctly second-best alternative, dollarization would have one appealing merit from a Canadian point of view. In principle, this version of monetary union could be implemented unilaterally, in contrast to the amero model that would require formal negotiation with Washington. Canada could simply adopt America's dollar on its own, much as did Ecuador in 2000 and El Salvador in 2001. BOC reserve holdings of U.S. Treasury obligations would be liquidated to acquire the greenback notes and coins needed to replace Canadian cash in circulation, and the U.S. dollar would officially supplant the loonie as the country's sole legal tender.

In reality, however, this is a merit that exists *only* in principle. As a practical matter, it is difficult to imagine Ottawa taking such a radical step without at least tacit approval from Washington. Canada is no remote banana republic, puny enough to dollarize without noticeable impact on America's monetary system. Quite the reverse, in fact. Canada boasts one of the largest and wealthiest economies in the world, and is right next door to boot. Washington's imprimatur – informal if not formal – would doubtless be regarded by both sides as essential for moving forward. So the question remains: Would Washington approve?

U.S. concurrence, or at least compliance, is certainly conceivable – but unlikely. Little enthusiasm exists among Americans for adoption of the greenback by other governments; a bill designed to promote formal dollarization, introduced in 1999, went nowhere in the Congress.<sup>8</sup>

Elsewhere I have suggested that dollarization in Latin America is not in the national interest of the United States (Cohen 2002a, 2002b). Here I would argue that the same is true of dollarization by Canada. As compared with the amero model, dollarization threatens fewer losses and risks for the United States. But as compared with the status quo there would still be more disadvantage than advantage, suggesting no less opposition from the U.S. side.

### *Advantages*

From the U.S. point of view, the key benefit of the amero model – reduced transactions costs – would be fully duplicated by the dollarization alternative. A single currency produces efficiency gains whether it is called the amero or the greenback. That would certainly be an advantage as compared with the present geography of two separate national currencies. It is also the only assured advantage of the dollarization model.

Some would add a second possible advantage for the United States – expanded seigniorage earnings. With an amero issued and managed by a joint central bank, there would be no question of Canada's right to share in the net profits of currency issue. The only question would be the details of the formula to guide distributions. With dollarization, however, all seigniorage revenues would in principle accrue automatically to the United States. The BOC would lose the interest previously earned on its liquidated reserve assets – a pure windfall profit for the U.S. Treasury -- and henceforth it would be the Federal Reserve, not the BOC, that benefits from the difference between the interest earned on its assets and the interest-free liabilities in circulation as cash in Canada. America's gain would be at the direct expense of its Canadian partner.

As a practical matter, of course, the prospect of a rich windfall for Washington seems dubious. No matter how eager they might be for some form of NAMU, Canadians are unlikely to accept such an unequal – not to say exploitative -- bargain. If they are to give up their monetary sovereignty, Canada's policymakers can be expected to insist on compensation for at least part of their lost seigniorage revenues. Otherwise, dollarization simply will not happen.

Historically, there is ample precedent for incorporating some form of seigniorage sharing into a regional currency agreement. In southern Africa, for example, where under the terms of the so-called Common Monetary Area (CMA) South Africa's rand circulates as legal tender in two partner countries, Lesotho and Namibia, the South African government makes annual payments according to an agreed formula to compensate both neighbors for seigniorage revenues foregone. NAMU advocates confidently assume that something similar would be possible between Washington and Canada in the event of dollarization by Ottawa.<sup>9</sup> But then, of course, there would be no gain for the United States beyond reduced transactions costs to make the model more appealing than the status quo.

### *Neutral effects*

In two respects, the dollarization model would be more or less neutral as compared with the status quo. Unlike the euro model, dollarization by Canada would threaten neither the soft nor the hard power that the United States currently derives from the greenback's market dominance. At the psychological level, America would continue to enjoy all the prestige

presently accorded its famous brand of money. No effort would have to be invested in building up the reputation of an untried new alternative. Likewise, at the level of hard-nosed politics, America's money weapon would remain as potent as ever. No assent from Ottawa would be needed should Washington wish to make use of the leverage provided by the greenback to promote foreign objectives.

Conceivably, the symbolic role of the greenback might actually be enhanced. Few people were shocked when Ecuador and El Salvador opted to become, in effect, monetary dependencies of the United States. These small, poor economies had long been seen as part of an informal American empire. Canada, by contrast, has always placed a high premium on sustaining its distinctiveness and independence as a political community. A voluntary surrender of monetary sovereignty by America's touchy northern neighbor might well reinforce popular perceptions of U.S. primacy. But given the already widespread recognition of the dollar as a global symbol, any positive impact would, most likely, be marginal at best.

On the other hand, it is conceivable as well that the symbolic role of the dollar could turn negative, to the detriment of U.S. interests. Reputation can prove a two-edged sword, depending on circumstances. What in prosperous times might be accepted as benign, even natural, could become a focal point for hostility in the event of recession or crisis. Formal dollarization creates a convenient target for protest. When the greenback was adopted in Ecuador, demonstrators marched in the streets denouncing what they feared would be the "dollarization of poverty." It is not difficult to imagine at some point similar emotions erupting in Canada, blaming the greenback – and thus Washington – for failures of economic management at home. It is even possible to imagine the occasional politician in Canada, concerned about re-election, deliberately fomenting popular protests as a way of diverting attention from his or her own policy errors. Prestige for the United States could come at a high price, creating an easy target for grievances.

### *Disadvantage*

Even worse, from the U.S. point of view, Canadian grievances could translate into demands for policy accommodations by Washington, compromising U.S. macroeconomic flexibility. For most Americans, that risk alone would be enough to make the dollarization model a non-starter. A prospective threat to policy autonomy at the macroeconomic level would decisively outweigh the attraction of efficiency gains at the microeconomic level.

Formally, of course, dollarization would require no substantive concessions from Washington. A country that dollarizes technically cedes all authority over monetary management to the Federal Reserve, voluntarily surrendering control of its own money supply and exchange rate. In effect, the country becomes a currency dependency, a client of the United States. Washington is under no legal obligation to assure that the dollarizer's specific circumstances will be taken into account when monetary decisions are made; nor must access be granted to the Federal Reserve's lender-of-last resort facilities should the dollarizer's banks get into difficulty. Indeed, U.S. officials have gone out of their way to deny that American policy or institutions would be adjusted in any way to accommodate the interests of nations that choose to adopt the greenback. Certainly no commitments were made to either Ecuador or El Salvador when they decided to dollarize.

It bears repeating, however, that Canada is no Ecuador or El Salvador. In reality, it

would be difficult for the United States to ignore adverse developments in the economy of its largest trading partner. Washington might make no explicit commitments to Ottawa. But implicit in any Canadian decision to dollarize would surely be an expectation of special consideration -- a kind of contingent claim on neighborly good will. At a minimum, the Federal Reserve might be expected to take Canada's specific priorities and fragilities into account when setting policy goals, or to open its discount window to Canadian financial institutions in time of need. More radically, Ottawa might even presume a right to indirect or even direct representation on the Federal Reserve Board or Federal Open-Market Committee. Legalities notwithstanding, obligations would be assumed, introducing a potentially serious constraint on U.S. policymaking. To say the least, such a development would be unwelcome to most Americans.

#### **IV. Alternative Circumstances?**

On balance, therefore, apart from a saving of transactions costs, there seems little in present circumstances to recommend NAMU to the United States, whatever form it might take. As compared with the status quo, the amero model would compromise all the substantial benefits that Americans presently enjoy as a result of the greenback's global popularity; and even with the dollarization model, there would be more disadvantage than advantage. The obstacle of U.S. indifference will be extremely difficult to overcome.

Are there any foreseeable circumstances that might alter this conclusion? Four possible scenarios come to mind. None, however, appears especially probable.

First, it is possible that a winning coalition of domestic interest groups in the United States might be mobilized to overcome popular resistance. Certainly there are key sectors that, because of their heavy involvement in cross-border activity, could be expected to profit materially from a monetary union between the two countries. Among others, these would include U.S. banks and other financial intermediaries as well as export and import interests and portfolio investors. And so certainly an incentive exists for such constituencies to get together to campaign on behalf of NAMU in some form, perhaps in coalition with like-minded Canadian interests. But would the incentive be great enough to overcome inherent collective-action problems among such groups? Until now, lobbying in Washington on the issue has been most conspicuous by its absence, suggesting little practical appeal. As a practical matter, prospective gains seem too marginal or uncertain to motivate a serious political initiative. Even Grubel (1999: 24) admits that the idea of NAMU "will have little support from American interest groups."

Second is the possibility of a grave deterioration of economic conditions on one side of the border or the other -- a risk of downturn so painful that it might drive the two countries, in effect, to huddle together for protection. In Canada, for instance, misdirected policies or a reinvigorated Quebec independence movement could threaten prolonged recession or financial collapse. On the U.S. side, runaway current-account deficits might severely erode confidence in the greenback, raising the specter of a sudden exchange-rate crash. In circumstances like these, a monetary union could begin to look far more attractive to Americans than it does now, offering the equivalent of a lifeboat in a storm. But as with all weather developments, the challenge is in the forecast. How serious are the risks? Though such contingencies are not implausible, few

observers see any reason to raise high-level storm warnings for the near term. Economic conditions would have to get a lot worse than anyone now anticipates to dent America's present indifference to NAMU.

Third, there is the euro, which many observers foresee as a future Top Currency rivaling the U.S. dollar. A serious challenge from Europe's new currency, eroding the advantages presently derived from the greenback's market leadership, could greatly alter America's calculus of interest in NAMU. This *deus ex machina* is repeatedly invoked by NAMU advocates. Grubel, for example (2003: 331-332), writes that the euro represents "a real threat to the current status and power of the U.S. dollar and the benefits U.S. citizens derive from it.... The United States should consider that the creation of a North American monetary union will reduce the size of these losses." Likewise, Courchene and Harris (1999: 23) speculate hopefully that because of the rise of the euro, "the Americans may well wish to expand the reach of the dollar area." In reality, however, there is less here than meets the eye. As I have argued elsewhere (Cohen 2003b), the euro's putative challenge to the dollar is actually much less serious than suggested. Europe's new currency, I contend, is fated to remain a distant second to the greenback. Hence little pressure will come from across the Atlantic to alter Washington's views on NAMU.

Finally, it is not inconceivable that a broader movement might develop toward full-scale political integration between Canada and the United States, *à la* the European Union. The two North American neighbors are already closely linked by a dense network of economic and social linkages, formally institutionalized in the North American Free Trade Agreement and a variety of other pacts and treaties. Although monetary union is not promoted as a possible precursor of a political union, it could certainly be sold as ancillary to one. Opposition to NAMU would surely be softened if the idea were packaged as part of a projected United States of North America. But there is little sign at present that the American public, let alone Canada, might be prepared to think along such ambitious lines. Indeed, given the conflicted histories of the two countries, this may be safely assumed to be the least probable scenario of all.

## V. Conclusion

In short, Canadians may debate the pros and cons of NAMU all they like. But they can expect little support, let alone encouragement, from the U.S. side of the border. For Americans, the status quo is preferable. Circumstances can be envisioned that might alter U.S. attitudes, but their probability is limited at best.

The general point is clear. So long as a monetary power, such as the United States today, can expect to enjoy the substantial benefits of de facto market dominance, there is little to be gained, and possibly much to lose, from formalizing the informal. Only if those benefits are seriously threatened – say, by economic crisis or the emergence of a serious rival – would the option of de jure union take on more appeal. As adolescent boys like to joke about marriage: Why buy the cow when you can have the milk for free?

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**NOTES**

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1. Because each foreign-exchange transaction involves two currencies, the total of shares sums to 200 percent rather than 100 percent.
  2. One reason for the dollar's continued dominance is undoubtedly the incumbency advantage that the currency enjoys as a result of network externalities. For more on such inertias in international currency use, see Cohen 2004: ch. 1.
  3. See e.g., Courchene 1999; Courchene and Harris 2000a, 2000b, 2003; Grubel 1999, 2000, 2003; Harris 2003.
  4. An earlier proposal to call a joint U.S.-Canadian money the "North American dollar" (von Furstenberg and Fratianni 1996) attracted little favor.
  5. See Grubel 1999, 2000, 2003. Buiter (1999) suggests the name NAMUFed.
  6. See e.g., Laidler 1999; Arora and Jeanne 2001.
  7. The argument in this paragraph is spelled out in more detail in Cohen 1998 and 2004.
  8. For more on the dollarization debate in the United States, see Cohen 2004: ch. 3.
  9. See e.g., Grubel 1999: 27.