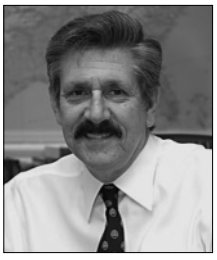

# The Euro versus Currency Competition

BY RICHARD M. EBELING

It is now four years since the euro was introduced as a circulating currency in parts of the European Union. Both Europeans and others are becoming increasingly used to a single money in much of the continent. If the euro remains in use for another five or ten years people may well look back at the multiple European currencies of the twentieth century as some strange archaic arrangement.

Such an attitude would be unfortunate because there are good reasons for considering the imposition of the euro a step backwards from progressive reform and economic liberalization. It is now generally accepted that socialism does not work and that decentralized competitive market decision-making is a far more effective and productive way of arranging economic activities.

In contrast the euro represents an institutional change toward greater monetary central planning. It reduces the ability of ordinary citizens to easily escape from harmful monetary policies by shifting income and wealth into an alternative currency for safekeeping. Yes, there is still the dollar and the yen and the pound. But that does not change the fact that the field of significant competing currencies has been seriously narrowed through the imposition of the euro.

Of course, the euro's advocates emphasize the value of a single money in radically reducing the cost of doing business throughout an increasingly integrated European community. And some EU member nations, wishing once again to compete with the United States in international affairs, view the euro as an important political tool against the dollar.

We need to remind ourselves that central banking is a form of central planning. A central bank possesses monopoly control of the money supply. It determines the quantity of money in circulation and therefore influences the value, or purchasing power, of the monetary unit. It can also influence (at least in the short run) some market rates of interest, which may affect the amount and direction of investment.

Throughout the twentieth century, governments frequently used their central banks to finance budget deficits through money creation—and of course they continue to do so in the 21st century when it serves their purposes. The end-products of such monetary mischief have been prolonged periods of price inflation, which eat away at people's accumulated wealth; distorted market prices resulting in imbalances between savings and investment, and supply and demand; and disincentives for long-term business planning and capital formation.

Why is the euro a less attractive monetary regime than the preceding system of national currencies? About 30 years ago the Austrian economist and Nobel laureate F. A. Hayek delivered a lecture at a conference in Switzerland, later published as *Choice in Currency: A Way to Stop Inflation*. Hayek explained that due to the influence of Keynesian economics over monetary and macroeconomic policy, governments were invariably guided by short-run goals in the service of special-interest groups. The consequence was the constant abuse of the printing press, with its resulting price inflation, to feed the seemingly insatiable demands of those privileged and politically influential groups.

Hayek concluded that some method had to be found to free ordinary citizens from the government's monopoly control of the medium of exchange. The answer, he suggested, is to allow them to use whatever money they choose. Hayek said:

> There could be no more effective check against the abuse of money by the government than if people were free to refuse any money they distrusted and to prefer money in which they had confidence. Nor could there be a stronger inducement to governments to ensure the stability of their money than the knowledge that, so long as they kept the supply below the

*Richard Ebeling (rebeling@fee.org) is the president of FEE.*

demand for it, that demand would tend to grow. Therefore, let us deprive governments (or their monetary authorities) of all power to protect their money against competition: if they can no longer conceal that their money is becoming bad, they will have to restrict the issue.

Make it merely legal and people will be very quick indeed to refuse to use the national currency once it depreciates noticeably, and they will make their dealings in a currency they trust.

The upshot would probably be that the currencies of those countries trusted to pursue a responsible monetary policy would tend to displace gradually those of a less reliable character. The reputation of financial righteousness would become a jealously guarded asset of all issuers of money, since they would know that even the slightest deviation from the path of honesty would reduce the demand for their product.

Hayek's proposal clearly required the abolition of legal-tender and related laws.

It is true that political authorities and central bankers are no longer dominated by the same type of doctrinaire Keynesianism that pervaded the policy landscape 30 years ago. But governments remain today, as much as then, under the sway of a political ideology that insists it is the duty of the state to regulate the market in the service of powerful special-interest groups, to redistribute wealth, and to secure "safety nets" under most aspects of everyday life. The budgets and deficits of many EU countries demonstrate this beyond any doubt.

The euro's monetary central planners still presume to have the wisdom and ability to target rates of price inflation and move interest rates in directions they consider "optimal." I would suggest that just as the central planners in the Soviet Union were not wise or informed enough to successfully plan the supply of shoes and the production of bread, the managers of the European Central Bank (ECB) cannot know what interest rates should be or what target to set for the general level of prices. Interest rates should be set by the market to bring the actual supply of savings into balance with the demand for loans. And both the general level and the relative structure of prices should be determined by those same market forces, based on people's willingness to trade money for goods and goods for money.

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## No Guaranty Against Inflation

The problem with the euro is that there is no certainty that the current or future decision-makers in the ECB will not come under strong pressure someday from member governments to inflate the currency to prevent fiscal crises, to stimulate aggregate demand to reduce unemployment, or to try to spur "growth" through interest-rate manipulations.

In the "old days" before the euro if one of the national central banks undertook such policies, that country's citizens soon saw the rising inflation rate and related differentials between their nation's currency and the money of the surrounding countries. In the euro zone the impact of similar ECB policies will take longer to fully materialize, and the resulting price effects will be open for comparison with only a few remaining leading currencies.

What then is to be done?

The most desirable goal is the eventual denationalization of money, taking away control from government through the establishment of market-based private competitive free banking. But until that day it would be better if countries that are not yet part of the euro zone stayed out and allowed their citizens the choice in currency Hayek advocated.

If achieving the goal of private free banking seems too far into the future, then citizens of the EU nations should challenge their governments to reverse the euro experiment, restore their national currencies, and allow the people of Europe unrestricted choice in currency. If Hayek's proposal for currency competition were enacted, any additional transaction costs related to trading in multiple currencies might well be lower than those connected with the effects of inflation under European-wide monetary central planning.