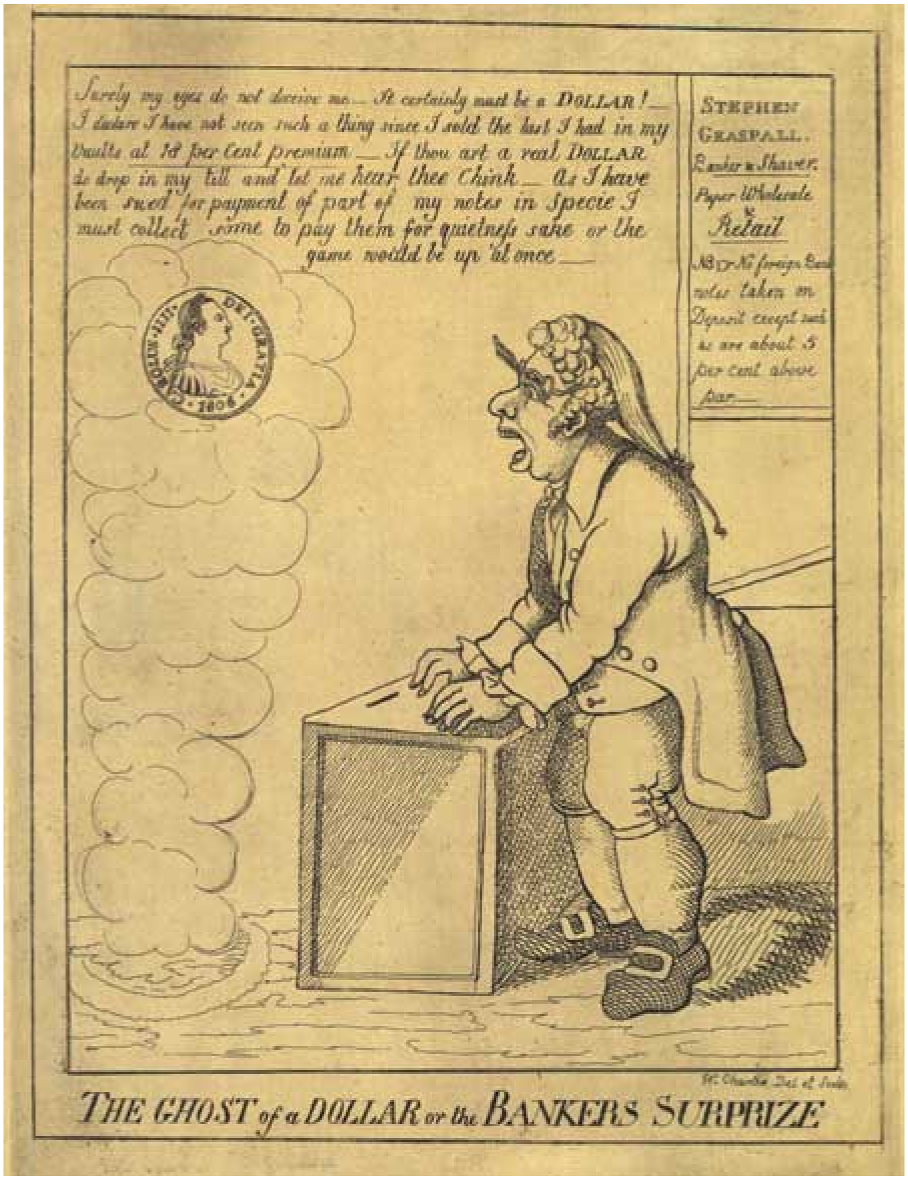
[Currency Unions Past and Present]



Units of account, constitutions, and media of exchange

To be one or not to be one? That is the question currently confronting Europeans as they decide whether or not to adopt a supranational constitution. Over two hundred years ago, North Americans faced the same question. The big difference between the American and European experiences is that the Americans united politically before they created a monetary union and integrated economically. The Europeans integrated economically and formed a monetary union before attempting to unify politically. To appreciate this fundamental difference, we need to take a broad view of the political and economic histories of both continents.

Like Europe today, North America in 1750 was divided into numerous polities. Thousands of native tribes controlled the great bulk of the continent, though imperial powers had made limited gains. The Russian empire laid claim to the far northwest; the French empire, to the northeast; the Spanish empire, to the south and west; and the British Empire clung tenaciously to a foothold in the east. Small though it was, the British portion was further subdivided into thirteen colonies, some controlled by the Crown and others, like Pennsylvania, by proprietors.

Over the next century and a half, the new natives—the ones of European extraction—by degrees forced the European empires and the original natives to relinquish control of the continent. The vast bulk of the land fell under the control of three new empires: the Canadian in the north, the American in the center, and the Mexican in the south. The extreme south of the continent, sometimes called Central America, remained fragmented, probably because the American empire wished it so.

In retrospect, the formation of those three empires appears to have been well neigh inevitable. But the present distorts historical reality. The formation of an American empire (which I call the United States despite the fact that the Mexican empire also dubs itself the United States . . . of Mexico) was not foreordained. Because they stretched for over one thousand miles from north to south, the British colonies were quite dissimilar economically. The far north, which was taken from the French during the French and Indian War, was a frigid source of furs. The far south, by contrast, grew semitropical crops like rice and indigo. Even the large temperate zone in between was far from homogenous, some areas being more suitable to fruits and vegetables, others to wheat, and still others to tobacco. Natural-resource endowments varied too. New York was blessed with a fine port and a highly navigable river. New England sported many fast rivers suitable for powering mills but not for moving commodities. Pennsylvania had rich farmlands and iron and coal deposits. Virginia boasted fine soil and numerous navigable waterways.

Dr. Benjamin Franklin, frontispiece, engraved by P.R. Maverick. Taken from The Works of the Late Dr. Benjamin Franklin: Consisting of His Life; Written by Himself Together with Essays Humorous, Moral, & Literary, chiefly in the manner of the ‘Spectator,’ by Benjamin Franklin, 1794. Courtesy of the American Antiquarian Society.

Cultural differences abounded as well. In the far north, most people spoke French; in the far south, many spoke a pidgin language composed of bits of English and sundry African tongues. Many New Yorkers still spoke Dutch, and Pennsylvania had so many German speakers that the legislature ordered the laws promulgated in both German and English. Welsh reigned in some regions. Among English speakers, ethnic and religious differences dominated. Quakers, Anglicans, Presbyterians, Congregationalists, and sundry smaller sects vied for power and patronage, as did members of at least four different British ethnic groups. The differences between a Scots-Irishman and an East Anglian may seem trivial to us today, but they were quite profound then, extending from dialects to ways of thinking about wealth, family, marriage, and education.

It must also be noted that not all of those asked to join the United States agreed to do so. Despite much prodding from the United States, the denizens of the far north set off to create an empire of their own. The French in Quebec were just too different to assimilate, and to this day they threaten to fracture the Canadian empire. Moreover, the Great Lakes and St. Lawrence River formed a natural boundary between the two empires for almost half their westward extent. Most of the rest of its empire America purchased with money and blood, not by inducing others to join it.

With this view of things, it is difficult to imagine that the American empire ever formed at all. If the unification of the United States was not foreordained by religion, language, culture, politics, or ethnicity, why did the polities from Georgia to Massachusetts join in union in 1788? Why did they stay together (at least until 1861)? And strive to grow? For the same reason that many Europeans today want to unify—efficiency. By combining politically, the independent states economized on their defense and foreign policy costs, created an enormous zone for the free trade of goods and people, and forged a monetary union. Lincoln may have exaggerated when he claimed that “divided we fall,” but he had the direction right. Californians are richer today than they would have been had they not united politically and economically with the citizens of Maine, Florida, Washington, and all points in between.

But of course history does not so much repeat itself as rhyme. Europe’s path differs from that taken by the United States, which joined first politically, then soon after monetarily, and only slowly economically. A loose sort of political union emerged out of the Revolution, but the national government remained extremely weak. Congress could not directly tax the citizenry but instead went hat-in-hand to the several states for table scraps. It emitted paper money—the infamous Continental dollars—but so too did the states. The union was so weak that the states laid tariffs on each other’s produce.

The ratification of the Constitution in 1788 considerably strengthened America's political union. The national government gained the power to tax citizens directly and to enact tariffs. States lost the right to lay tariffs on goods imported from other states and also the power to emit legal tender paper money. With passage of the Mint Act in 1792, the United States established a bona fide monetary union by defining a uniform unit of account, the dollar, in terms of both gold and silver (to be precise, 371.25 grains of pure silver or 416 grains of standard silver or 24.75 grains of pure gold or 27 grains of standard gold).

"The Ghost of a Dollar or the Bankers Surprise" by William Charles, 1813. Courtesy of the American Antiquarian Society (Visual Art Collection).

Confusion arises, even among scholars, because many Americans in the nineteenth century complained about the lack of a common form of cash. Those complaints were justified but were directed at the various media of exchange, or cash instruments, then in circulation. Before the gold (and silver) strikes in California, the U.S. Mint never came close to producing enough gold and silver coins to satisfy the demand for money, so most payments were made with foreign coins, bank notes, checks, and small chits issued by storekeepers, toll bridges, and the like and not with U.S. silver dollars or gold eagles (ten dollar coins). Because only the foreign coins and the handful of U.S. coins in circulation were a legal tender and then only at rates closely corresponding to their actual metal content, the different varieties of cash, though inconvenient, did not constitute different monies but merely different ways to pay. After 1792, the U.S. dollar unit of account, to wit a known quantity (see above) and fineness of gold or silver, was the means by which all Americans reckoned value in both current and credit transactions.

Additional confusion arises because some Americans after 1792 continued to keep their account books in colonial pounds, shilling, and pence. They continued simply because they were accustomed to doing so. But the conversion rates between the colonial currencies and the dollar were essentially fixed by the mint and foreign coin rating acts, so the use of colonial pounds was merely nominal. The fact that Joe Farmer might have put seven shillings, six pence Pennsylvania currency instead of one dollar in his account book was of no economic consequence because by law 7s. 6d. was equal to $1 and vice versa. An analogous case today occurs in places like Ithaca, New York, where “community money” circulates. Each Ithaca “Hour” is by law equal to ten dollars. Whether Ithacans keep their accounts in Hours or dollars doesn’t matter because there is no exchange rate between the two, only an invariable conversion rate. Just as an inch is an inch whether measured using the English or the metric system, a dollar is a dollar whether it is called a dollar or a tenth Hour or 8s. York money or 7s. 6d. Pennsylvania currency.

The dollar provided Americans with a common numeraire, a uniform way of expressing economic value. Combined with the large internal free-trade zone created by the Constitution, the United States slowly grew more economically integrated. Colonists had easily slipped from one colony to another, and some limited regional trading took place. Only over the course of the nineteenth century, though, did a truly national economy, with a high degree of regional specialization, emerge. By the twentieth century, most goods and many services were made for the national market, as opposed to the international or merely local markets.

The Europeans have taken a somewhat different approach to unification. They first enjoined some economic unification by forming a common market. But they kept immigration barriers relatively high. They next created a monetary union. Like the U.S. monetary union, the European monetary union concentrated first on establishing a common unit of account, the euro, and only later introduced a common medium of exchange, euro-denominated notes and coins. In Europe, however, the euro was merely a unit of account for just a few years. In the United States, the dollar was mainly a unit of account for over a century. Most importantly, Europeans moved toward political unification only recently, and so far they have botched it badly.

I hesitate to say that the Europeans have gotten things backwards by starting with free trade, then forming a monetary union, and only then attempting political unification. But European policymakers do need to realize that political unification is not the inevitable result of monetary union. Europe has had monetary unions before, including the Latin and Scandinavian monetary unions, none of which led to political unification. Instead of hoping that economic pressures will force a political compromise, policymakers should study the formation of the Canadian and American empires closely. What prevailed in those cases was the creation of a frame of government that safeguarded citizens’ rights to liberty and property and, just as importantly, ensured a good degree of local autonomy.

The Cobler Giving Her Money for the Fair from The Adventures of the Industrious Cobler, his Scolding Wife: and their Affectionate Daughter, text & illustrations, presumably by William Charles, Cf. Weiss, and Harry B. William Charles, Philadelphia, 1814. Courtesy of the American Antiquarian Society.

The European constitution currently under consideration may be too long, too vague in some places, and too specific in others to be ratified. Just ask the French and the Dutch.

Failure this time around would not necessarily be a bad thing. The United States needed two attempts to get it right, and Canada too needed time and experience. Moreover, the European monetary union can continue to function without political unification, especially if the flow of human and financial capital between members is further liberalized.

Continuation of the monetary union and common market to a large degree mitigates the risk of war by raising its expected costs and reducing the likelihood that a rebel could prove victorious. Again the American experience is instructive. The rebellious Southern states abandoned the currency union and free trade zone along with their seats in Congress in 1861 and paid dearly for it. Losing access to the euro and to the free-trade zone is a huge barrier to armed conflict, even bigger I daresay than the geographical dispersion of McDonald’s. And as long as European countries can refrain from shooting at each other, all should be well, even if it takes another year, decade, or century for political unification to come.

Further Reading:

For more about ethnicity in colonial America, see David Hackett Fischer, *Albion’s Seed: Four British Folkways in America* (Oxford, 1989). The best survey of the colonial American economy is still John J. McCusker and Russell Menard, *The Economy of British America, 1607-1789* (Chapel Hill, N.C., 1985). Recent general treatments of the early U.S. financial and monetary systems include Robert E. Wright, *The First Wall Street* (Chicago, 2005) and Robert E. Wright and David J. Cowen, *Financial Founding Fathers* (Chicago, 2006). Technical discussions of the early U.S. monetary union include Ron Michener and Robert E. Wright, “State ‘Currencies’ and the Transition to the U.S. Dollar: Clarifying Some Confusions,” *American Economic Review* (June 2005), 682-703 and Ron Michener and Robert E. Wright, “Development of the U.S. Monetary Union,” *Financial History Review* (forthcoming). On the Latin Monetary Union, see Henry Willis, *A History of the Latin Monetary Union* (Chicago, 1901). On the history of monetary unions more generally, a good place to start is John Chown, *A History of Monetary Unions* (New York, 2003). The McDonald’s hypothesis is discussed in Thomas Friedman, *The Lexus and the Olive Tree* (New York, 1999).

This article originally appeared in issue 6.3 (April, 2006).

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