UC SANTA BARBARA

THE Current

April 29, 1998
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New Book Explores the Realities of Currency Competition

Most of the world's governments have lost monopoly control of the money used within their borders, calling into question both the traditional notion of sovereignty and whether contemporary leaders are in fact fully accountable to those they govern.

Welcome to the new world of de-territorialized currency, in which governance is shared between national governments that issue currency and the private individuals and corporations that use it. According to Benjamin J. Cohen, the Louis G. Lancaster Professor of International Political Economy at UC Santa Barbara, this hybrid form of governance is rapidly re-configuring the world's political landscape.

"Increasingly, we are witnessing cross-border currency competition whereby the currency of one country is used as an alternative to the domestic currency of another country. A vivid example is the widespread use of the U.S. dollar as an alternative to local currencies in Latin America. In these cases the currencies in effect compete, a phenomenon that is altering the distribution of power in monetary relations," said Cohen, author of a perceptive new book on the subject, "The Geography of Money" (Cornell University Press, 1998).

According to Cohen, the growing use of currencies outside their country of origin has resulted in the steady transfer of monetary authority from governments to private traders whose buying and selling on the international market determine currency values.

"The private market agents who are most influential are those who have the means to make large-scale choices between currencies. These people aren't loyal to any one government or currency. It's a question of wealth and access to alternative currencies. Some of the most powerful private market agents are wealthy people in Third World countries," said Cohen.

Governments, then, are no longer free to set domestic policy independent of world currency trends. States must now make a concerted effort to preserve market share for their currency by avoiding inflationary policies that might otherwise threaten its value or usefulness in trading.

This deflationary bias in the world economy translates into suppressed social spending, which in turn engenders greater unemployment and wage restraint. At the same time, however, the public has less input regarding policy-making.

"Governments are no longer accountable to any kind of electorate. When a country like Mexico has a crisis, the people choosing to leave the Mexican peso for the dollar may not even be Mexicans, yet those people have an increasing influence on what the Mexican government can do," Cohen said.

"This loss of accountability taken together with the obvious inequity inherent in wealth corresponding to influence raises serious questions about legitimacy. In politics one talks about legitimacy, the notion that those who govern have a legitimate right to do so. We have had a transformation in the form of governance, but is this new form legitimate in the same way that indisputably sovereign governments were?"

The dangers are no less significant for countries whose currencies are used elsewhere. While these nations do gain power relative to governments whose currencies compete with foreign money, they must also closely monitor investor confidence---the loss of which could hamper efforts to self-manage monetary affairs.

For instance, if traders were to lose confidence in the dollar, it could prompt a broad sell-off on the international market, weakening the dollar's value and perhaps forcing the U.S. government to raise interest rates.

According to Cohen, the general message for all governments is the same: They must pursue policies that are consistent with market preferences and that discourage capital flight.

"These are the realities of the modern world. The only way that governments could regain control over money in a way comparable to that of the past would be to create a single world money, which would eliminate currency competition. Of course, this is politically unrealistic. Look how difficult it has been for the European Union to create a common currency," he said.

"Governments could also try to halt the use of foreign currency within their borders, but such an approach would be very costly. It would require imposing restrictive controls on the transfer of money and other high-cost measures. It's not impossible, but it's extremely unlikely by virtue of the fact that it would be very expensive and would limit a government's ability to conduct international trade."

Currency competition is not particularly new; until the 19th century, in fact, it was quite common. In the 1800s, nationalist fervor swept much of the world and most currencies were territorialized. In a sense, governments are returning to the kind of monetary system that existed for most of human history, according to Cohen.

He said the future could bring a direct threat to government authority over currency in the form private electronic money used through the Internet as an alternative to state-issued bills and coins. Even so, Cohen doesn't subscribe to the extreme globalist view that wholesale decay of the world's borders and nations is inevitable.

"We are nowhere near a situation in which governments are irrelevant. They are still the principal issuers of money, meaning that they continue to dominate the supply side of the currency market. On the demand side are private market actors who make choices between the currencies provided by governments The only way governments could lose authority completely would be if they faced competition not only on the demand side but also on the supply side of the market, that is to say if private monies became a serious alternative to state-issued currency," he said.

"The Geography of Money" marks a milestone in political thought. It is the first book to posit and then compare divergent spatial models of monetary organization: the traditional but increasingly obsolete territorial model where the boundaries of a currency correspond to the territorial frontiers of the state that issues it; and the newer model based on transactional networks that function independently of conventional sovereign borders.

Cohen is the author of numerous books, including "Organizing the World's Money: The Political Economy of International Monetary Relations" (Basic Books, 1977) and "In Whose Interest? International Banking and American Foreign Policy" (Yale University Press, 1986). Prior to joining the UCSB faculty in 1991, he was the William L. Clayton Professor of International Economic Affairs at Tufts University's Fletcher School of Law and Diplomacy.

Cohen will discuss and sign copies of "The Geography of Money" at 4 p.m. May 7 in the Interdisciplinary Humanities Center's McCune Conference Room at UCSB.
