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In Defence of Sterling

A critique of the proposed European Single Currency

Professor Tim Congdon

Many people believe that amalgamating the currencies of Europe into one would be a relatively simple step, like the decimalisation of Britain's currency or the metrication of weights and measures. They do not think that it would involve a fundamental change in our relationship with Europe and, in particular, they deny that it would erode our independence as a nation. The British Government itself has now sided with this view. It has let other members of the European Community know that it regards as unhelpful Mrs Thatcher's concern, expressed so forcefully in her final months as Prime Minister, that a move to a single European currency would entail a significant loss of sovereignty. Mr Major and his successors at the Treasury apparently want to drop all references to the emotive word 'sovereignty'.

The purpose of this article is to argue that the official British view is wrong. It will claim that the definition of a 'money' or a 'currency' is inseparably connected with the definition of a nation. A move to a single currency would end the identity of Britain, and also of every other member of the European Community, as a distinct nation state. Mrs Thatcher was correct to say that our sovereignty — our very existence as an independent nation — is at stake.

Our starting point has to be historical, as the nature of our present monetary arrangements is best understood by an account of their development. Originally precious metals were the only kind of money circulating in Britain, a fact testified to by the name of our currency (the 'pound sterling' was, of course, a pound of sterling silver). However, in the 17th and 18th centuries the situation changed radically. It became recognised that the selection of a single precious metal, gold, as the standard would overcome the inconveniences caused by the changing price of gold and silver. Even more importantly, people became prepared to accept paper promises to pay gold — such as notes and bills of exchange — as substitutes for gold itself.

The realisation that the functions of money could be performed as effectively by paper as by precious metal conferred enormous benefits. For example, it dispensed with the need to mine new metals or to import them from abroad, but is also created new and difficult problems of financial organisation. The various assets that were used as money could serve this role only if there was general confidence that they would all retain their stated face value. In other words, people had to believe that a paper pound note would always be worth as much as a gold sovereign. The trouble was that the paper itself was almost worthless. In the end notes had value only because of their convertibility into precious metal.

As paper increasingly supplanted gold, this problem became ever more pressing. Issuers of notes included small country banks, which often went bankrupt in the commercial crises of the early 19th century, and their notes would be redeemed in gold at only a fraction of their face values. The answer was for Parliament to decide, in a

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sequence of Bank Charter Acts, that a particular kind of paper – the pound notes issued by the Bank of England – were legal tender. The equivalence of these notes to gold was therefore guaranteed by law. Since the link with gold was severed by Britain's departure from the gold standard in 1931, the legal tender laws have been the basis for the validity of our paper currency. It is no exaggeration to say that pound notes have value as pound notes only because they possess legal tender status. Their value derives, in the final analysis, from government fiat.

Paper money is very different from gold or silver. Whereas the production of new precious metals was costly, involving the employment of labour and capital, the production of paper money was virtually costless. Paper money had value by law, but it cost almost nothing to make. Our legislators understood many decades ago that it would be wrong for this difference between value and cost of production (so called 'seigniorage') to go to private agents. Instead, since the state confers value on paper money by legislation, it has the right to appropriate the resulting seigniorage for public ends. The right to issue paper money is akin to the right to raise taxes. By specific legislative enactment, the profits of the Bank of England's note issue were assigned to the state. They still are today.

The evolution of these arrangements has been discussed in the British context, but very similar stories could be told about other countries. Our account provides the rationale for certain repetitive features of the modern nation state. All over the world nation states have one law and one government. The government entrusts the right to issue legal-tender money to a single central bank and this money is the only valid legal tender in the nation concerned. Countries have one money for much the reason that the have one law, one army and one police force.

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Because they have legal backing, the central bank's note liabilities are always worth their stated face value. In this respect there is a sharp contrast with the deposit liabilities of private banks, since private banks can make losses and go out of business. A cheque written against a bank deposit is not legal tender and, as is well known, everyone has a perfect right to refuse to take a cheque in payment. Banks, which are fully aware of their own vulnerability, are therefore not prepared to accumulate debts against each other to an indefinite degree. Instead they clear debts between themselves in central bank money. The normal institutional device is for banks to adjust their balances at the central bank depending on the outcome of a daily cheque clearing. As a result, central bank balances are the operational fulcrum of monetary policy in virtually all industrial countries and in many developing countries too. It follows that the distinction between the legal-tender, default-free char-

acter of its note liabilities and the greater riskiness of commercial bank deposits explains the central power's power to implement monetary policy. Central banks are able to conduct monetary policy because their liabilities are legal tender, whereas those of privately owned commercial banks are not. Without the notion of legal tender 'monetary policy' would be a conceptual incoherence.

The repetitiveness of these features in every significant nation state is not an accident, but is to be explained by three simple functional objectives – the need to be confident that money is always worth its stated value; the advantage in any single political unit of standardising on a single monetary standard; and the propriety of keeping the gains from seigniorage out of private hands.

In summary, the right to issue currency is an integral part of the fiscal powers of the state and is basic to any government's ability to govern.

Now all of this may seem, on reflection, rather obvious. We have merely been describing a number of institutional arrangements which accord with everyday observation and experience. Strangely, however, our view – in which the legal framework is seen as essential to the acceptance of a currency as such – has been denied by the Treasury. In the Winter issue of its *Bulletin*, the Treasury claimed that legal tender "is a specialised legal concept with little practical significance". This must be one of the most fantastic statements ever to have been made by a British government department.

On the contrary, our argument shows that a new European currency will not be 'money' unless it is made legal tender across the different nation states. But, then, by whose laws is it to be legal tender? Is the enforcement of the legal-tender status to remain with the British Government or is it to pass to a new pan-European government? Which government is to receive seigniorage? Is it to be the individual governments or, again, a new pan-European government?

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The questions may seem hypothetical and rather remote from the current political debate, but they are not. At present, officials from the finance ministries of Europe are meeting to discuss plans for Economic and Monetary Union. They are running into trouble. They cannot agree on basic questions such as whether national governments or a new European central bank should control foreign exchange reserves, which

countries should the right to borrow from the central bank, how the profits of the central bank should be distributed and a host of other practical issues. The disagreement on these matters arises because they impinge on the most fundamental right of any government, to control resources within its own borders.

Parliament's right to levy taxes gave it the upper hand over the Crown in our constitutional development. If it now readily concedes the power to issue currency to a European body it will be surrendering an important part of its fiscal prerogative. Our sovereignty will have been reduced, in the most basic sense that we the British will be less able to govern ourselves. If we want to remain a free and independent nation in the next century, we must resist the introduction of a single European currency in the 1990s.

Professor Tim Congdon is Managing Director of Lombard Street Research Ltd, the research subsidiary of Gerrard & National. He is one of the City of London's leading financial commentators and a regular columnist in *The Spectator* and *The Daily Telegraph*. He is the author of several works on macroeconomic issues, the most recent of which is *Monetarism Lost: and why it must be regained* (1989).

Oxfam – The Abuse of Charitable Status

This 42-page dossier documents Oxfam's systematic abuse of its charitable status for political ends and was the IFF's submission to the Charity Commission's inquiry into Oxfam. In May 1991 the inquiry found Oxfam guilty of political activity illegal under its charitable trusts, vindicating the IFF's campaign.

"[The IFF] has become the most visible opponent of Third World charities...Its criticisms of Oxfam and Christian Aid have won the backing of 12 Tory MPs, many of whom agree with its plan to strip the Charity Commission of its investigative powers and set up an Ombudsman to deal with public complaints."

The Independent, **14 March 1991**

Copies of *Oxfam – The Abuse of Charitable Status* are available priced £10 each from:

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