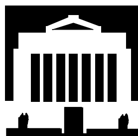

BANK OF CANADA

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Bank of Canada Governor
Addresses Canadian Club of Ottawa

OTTAWA -- Bank of Canada Governor Gordon Thiessen today reviewed the economic implications of the European currency union and its lessons for Canada. Mr. Thiessen's remarks came in a speech to the Canadian Club of Ottawa.

Calling the launch of the euro as the new common currency of 11 European countries "an economic event of historic proportions," Mr. Thiessen described the relatively smooth transition to the euro as "a major political, administrative, and technical feat."

Mr. Thiessen said an understanding of European monetary union had to begin with the profound political impetus towards economic integration in the years immediately following World War II. He noted that "had this been a strictly economic initiative, it might not have materialized."

The main economic benefits of the common currency are eliminating the costs of converting currencies and removing the risk of exchange rate fluctuations. The main cost is that countries can no longer pursue an independent monetary policy and can "no longer benefit from having their national currency operate as a buffer in the event of an economic shock."

"The economic case for a common currency in Europe," said Governor Thiessen, "rests on a judgment that buffering differential shocks in the partner countries will be a less important consideration than the benefits from lower transaction costs and the greater economic certainty because of reduced currency risk. This presumes that the economic structures of these countries are sufficiently alike that any shocks will be felt by all of them at roughly the same time and to a similar degree."

Turning to the implications of the euro for Canada, the Governor said the direct effects will be limited since Euroland accounts for just 4 per cent of Canadian exports and 7 per cent of Canadian imports.

However, the launch of the new euro has piqued public interest in Canada about a North American monetary union. Mr. Thiessen noted the decline in the external

value of the Canadian dollar over the past year “has, no doubt, heightened interest in the issue.”

Mr. Thiessen underlined that, for several reasons, “the euro is not a blueprint for a North American monetary union.” He noted that in North America, “there are no parallels to the profound political forces” underlying the move to greater integration in Europe.

Mr. Thiessen said a monetary union in North America would not be like that in Europe where there are three large partners and eight other medium- and smaller-size participants. He said any North American monetary arrangement would “likely mean that Canada would have to adopt the U.S. currency.”

Mr. Thiessen added that, for Canada, the major problem with a single North American currency is that Canada would be giving up the buffer that a flexible exchange rate offers in dealing with economic shocks that affect us differently from the United States.

“An important contrast between Canada and the United States is the distinctly different impact that fluctuations in the world prices of primary commodities have on our two economies,” Mr. Thiessen said. The decline in world commodity prices over the past two years has meant that Canada is relatively less well off.

“That is reality,” said Mr. Thiessen, “and we have to adjust to it, whether we are on a floating or fixed exchange rate or even in a currency union.” If the exchange rate is not allowed to move, then ”the adjustment would have to take place primarily through declines in prices and wages and the movement of labour and capital. And if those did not readily occur, the adjustment would take longer and cost more in terms of losses in output and employment.”

The Governor concluded that there is a tendency in Canada to blame movements in the Canadian dollar that reflect economic shocks as “the cause of our problems. In fact, these currency movements are a consequence, not a cause. Exchange rate flexibility has served us well over time. Why would we want to give it up?”