# PERSPEKTYWY INTEGRACJI EKONOMICZNEJ I WALUTOWEJ W GOSPODARCE ŚWIATOWEJ. Dokąd zmierza strefa euro?

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# PARALLEL CURRENCIES AND THE FUTURE OF THE EUROZONE

**Abstract**

This paper refers to the problem of parallel currencies. It was motivated by a relatively common tendency to compel the binary choice between two currencies (e.g. between euro and a national currency), while introduction of parallel currencies allows to achieve a greater number of outcomes. The paper presents some theoretical concepts of parallel currencies with reference to current problems of the eurozone.

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## Introduction

Euro is a political construction, embodying the idea of unity of European society and strength of European economy. Probably, this origin made the common currency subject to all-or-nothing decisions forcing countries first to resign completely from their national currencies (even if the Eurozone has never constituted an optimal currency area) and now to pay a high price for maintaining euro or to bear costs of leaving the euro area.

The concept of introduction of parallel currencies has rarely entered a wider discussion, despite the fact that such suggestions were presented both before the introduction of euro and after the onset of the sovereign debt crisis. It seems that introduction of euro several years ago was as premature as some recent propositions to dissolve the eurozone. In both cases (perhaps for a transitional period) countries could have been encouraged to issue currencies circulating concurrently with euro according to the needs of the real sphere.

The aim of this paper is to present some theoretical concepts referring to parallel currencies and to make an attempt to relate them to the current problems of the euro area. Many problems of European monetary integration were anticipated before the creation of the Eurozone. However, in that time many solutions were also proposed, such as introduction of parallel currencies.

This paper is divided into two parts discussing the problems of circulation of parallel currencies in the prevailing system of fiat money and a situation when parallel currencies are based on different standards. The final section concludes.

## Parallel currencies within the system of fiat money

A new wave of interest in parallel currencies was aroused in March 2012 when the President of the National Bank of Poland, Marek Belka, proposed to introduce (as a temporary solution) a dual currency system in Greece with domestic currency used for internal purposes. For instance, Greeks would keep their savings in the euro but get their salaries in a new domestic currency [FTD, 2012].

Two months later, Deutsche Bank economist, Thomas Mayer [2012], stated that a parallel currency may be a way to deal with Greek debt, because it would be possible for Greece to devalue the currency without formally leaving EMU and to regain international competitiveness (Mayer coined the name Geuro for a parallel currency stemming from IOUs issued by the government suffering from the shortage of euro cash).

It is also worth noting that in February 2012 an Estonian political scientist (and a proponent of introduction of parallel currencies in the most indebted countries), Viljar Veebel [2012], referred to the experience of Estonia where parallel currencies (RUB, USD, DEM) were circulating before adoption of Estonian currency (EEK) in

1992. Although parallel currencies and high inflation led to redistribution of income and wealth, Estonia became a competitive and export-oriented economy attractive to foreign investors.

Propositions to use euro (or “basket ecu”) as a secondary currency were also discussed much earlier, mostly following the publication of the Delors Report [e.g. Chown, Wood, 1989]. Some authors pointed out that different currencies might circulate in different sectors of the economy [Gros, 1989, p. 223].

All these suggestions have been often criticized as being impractical and expensive [Fry, 1991, p. 492], which justified use of parallel currencies for a transitional period only. In fact, there might also be a problem concerning the dissent between the society and the government. When parallel currencies circulate, government does not have the possibility to impose an inflation tax on domestic currency, as it would imply currency substitution. Therefore, a parallel debt (issuing bonds denominated in foreign currencies) has been a much more popular solution, especially for countries with weaker currencies [Basevi, Pecchi, Piga, 2005, p. 6].

Currently, there is a risk that introduction of a parallel currency (e.g. in Greece) may have no impact on prices of goods and services but will make the euro crowded out the country via trade deficits. In the extreme case, there will be no euros in domestic circulation, especially when economic agents anticipate such a scenario and in advance shift domestic deposits to the banks from other countries of eurozone [Eichengreen, 2010, p. 12-13].

Nevertheless, when agents have heterogeneous preferences it may be socially beneficial to have multiple national currencies, because they enhance the differentiation in the production structure and a more efficient allocation of resources. In such an interpretation a successful implementation of common currency would depend on the scale of consumers’ indifference towards the origin of goods being bought [Kocherlakota, Krueger, 1999].

In general, a parallel currency can be an indicator of probability of success of monetary union provided that individual agents and markets rather than politicians decide on the scale of use of both currencies.

In the Greek case, a parallel currency may indicate whether it is beneficial to stay in the EMU in a longer perspective or to abandon the euro. However, in this situation it is the government that is expected to play a crucial role in introducing the domestic currency, providing for its convertibility and deciding on the proportions of its supply against the euro. Issuing domestic currency will make the fiscal discipline easier to maintain, may promote regaining competitiveness and exporting as well as reducing the costs of servicing foreign debt (unless there are no euros available in the fiscal system). An overissue of domestic currency can make the whole operation irreversible, though.

**Parallel currencies based on different standards of money**

At the beginning of 1991 European Community was no longer united on the shape of monetary union. Most of the proposals advocated a single currency administrated by the European Central Bank or competition of national currencies (sometimes suggesting to use ECU as a parallel currency in both approaches). Officially, only a managed paper standard was assumed, despite the fact that alternative monetary standards were also debated (e.g. a commodity-basket monetary standard or a rule-based paper standard) [Fry, 1991, p. 481-483]. Perhaps the real reason for rejecting a commodity standard was an implicit assumption that price stability would not be the sole objective of any central bank in the European Union [Fry, 1991, p. 497].

As various monetary systems lead to different economic outcomes, there may exist a combination of them that is more beneficial for the society than a homogeneous (e.g. fiat money) system [Douthwaite, 2006, p. 10]. In particular, if optimal realization of all functions of money requires different conditions, one cannot exclude that circulation of a single type of money may favour a limited number of agents or groups at the expense of the rest of the society.

If one instrument serves for two opposing applications, it cannot perform both functions at one time. A coin cannot be spent and saved. A means of circulation by definition should facilitate exchange and thus circulate faster and faster – losing its purchasing power. On the other hand, hoarded money is expected to maintain its purchasing power over a longer period of time. Therefore, omnipresence of such phenomena like inflation undermines the validity of circulation of one but multi-purpose currency.

Accordingly, a multi-currency system could consist of: an international currency (a unit of account and a reserve currency that could be related to a scarce resource), national and regional exchange currencies (allowed to lose gradually their purchasing power), user-controlled exchange currencies (e.g. backed by an hour of service) and separate store-of-value currencies or other special purpose currencies [Douthwaite, 2006, p. 52-74].

Such diversity of standards, scales and functions may not only prevent a perfect substitution of currencies (and related risks), but also provide a long-term financial stability. Even if there would be a certain loss in terms of efficiency, greater transaction costs may constitute an important source of stability of the system. On average, positive effects resulting from a common currency are observed by the most mobile and wealthy agents, while the rest may need stability provided by a more complex system.

Finally, it is worth signalling that in response to the crisis many alternative currencies networks are growing in Greece (e.g. TEM in Volos) or other countries that are supplementing rather than replacing the euro. This can be interpreted either as a confirmation of a relative unavailability of the euro as a means of circulation or as a spontaneous tendency to create a more complex and stable monetary order.

## Concluding remarks

Some argue that competitiveness in Greek economy could be restored by decreasing nominal wages (denominated in euro). However, such a solution is associated not only with social resistance, but also with deflationary tendencies. In turn, deflation increases uncertainty and makes economic agents search for alternative transaction chains. If the euro is characterized by a relatively high yield, more assets that are its close substitutes (with similar information and transfer costs but lower yield) will be used. Thus, introduction of supplementary monies will increase the available stock of real balances [Brunner, Meltzer, 1971, p. 801]. So, the proposal to cut wages may result in emergence of private money as a parallel currency. If the government introduces its currency first, it may conduct necessary fiscal and structural reforms more easily.

The success of implementation of a parallel currency in Greece may be significantly limited or complicated e.g. by political risk, confidence crisis, individual preferences, flows of speculative capital, the scale of external imbalances, and proposals by financial institutions such as IMF.

The aim of the paper was not to suggest that parallel currencies are always the best solution for such countries like Greece, but to promote seeking of alternative solutions for existing problems. For example, it seems that creating banking union in Europe, just like the introduction of Eurobonds, could be very costly in terms of social welfare. The explanation can be based on an analogy that several small portions of poison may immunize an organism while one big portion will lead to its death. Therefore, concentration of debt (be it government debt or banking debt) may result in a collapse of an economic system.

In order to avoid such a destabilization it is also essential to stress that what the European societies need is a guarantee that irrespective of the course of events in many countries euro will remain euro (that savings in euro will not be by force converted into weaker currencies). To some extent this would stop the tendency to withdraw savings from banks – one of the problems lying behind the concept of banking union.

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