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Morrison Bonpasse, Single Global Currency Association, Newcastle, Maine, USA 4 July 2007

ABSTRACT

As globalization continues, businesses are increasingly importing and exporting from countries with different currencies. To conduct that business, they (whether one or both parties) must pay fees for exchanging one currency for another and they must determine the exchange rate for a particular time. If the transaction is to be conducted over time, they may purchase currency instruments to hedge against currency fluctuation. All of these tasks add up to an average of about 5% of revenue for international businesses. As an increasing number of international businesses understand that these expensive tasks are unnecessary for trade conducted within a monetary union, these businesses are likely candidates to lead the effort to implement a Single Global Currency, to be managed by a Global Central Bank within a Global Monetary Union. In short, a "3-G" world. It's common cents.

Keywords: Currency Crisis, euro, European Central Bank, European Monetary Union, Exchange Rates, Foreign Exchange, Global Central Bank, Global Monetary Union, Hedge, Monetary Union, Single Global Currency.

1. INTRODUCTION

For approximately 2,500 years, the world has lived with multiple currencies and we have coped with the differences in valuations of goods and services by different currencies, and with their unpredictable fluctuations. The valuation discrepancies and the fluctuations are expensive, but have been assumed to be a necessary part of living and working in an increasingly globalized, but still multicurrency world. The only way to eliminate those fluctuations over the long term is to reduce the number of currencies to one, within a Global Monetary Union. While monetary unions have been tried many times, it was in the 20th century that their prospects for long term success were assured when central banks became an integral part of every monetary union and when member country currencies were replaced by the currency of the monetary union.

Led by the example of the European Monetary Union, countries around the world are exploring the creation and expansion of monetary unions. However, the largest benefits of monetary union will come only with the establishment of a Global Monetary Union where there are zero transaction costs for foreign exchange trading within the 13 member monetary union, and zero fluctuations of values of goods and services due to currency changes.

Long dismissed as utopian, a Global Monetary Union is the inevitable conclusion of the ongoing trend toward a smaller number of currencies. The questions remaining are how long the implementation process will take and how much additional cost, risk and loss will be borne during that process?

2. LITERATURE REVIEW

Among the articles about the Single Global Currency are Richard Cooper's Fall 1984 article in *Foreign Affairs*, "A Monetary System for the Future" (Cooper, 1984) which was updated by his 2006 article with Michael Bordo, "Proposal for a Common Currency among Rich Democracies." (Bordo, Cooper, 2006). The leading proponent of a Single Global Currency is Robert Mundell, beginning with his 1961 article, "A Theory of Optimum Currency Areas." (Mundell, 1961). In 2005, he wrote, "The Case for a World Currency," (Mundell, 2005) but that fell short of calling for the replacement of existing currencies with a Single Global Currency, available to all the people in the world in one Global Monetary Union.

The only book in the world entirely devoted to the Single Global Currency is *The Single Global Currency - Common Cents for the World*, by the author of this article. (Bonpasse, 2006, 2007) The book describes the several routes to that goal, including international monetary conferences and the creation of new regional monetary unions and the expansion of existing monetary unions.

3. THE EXISTING MULTICURRENCY SYSTEM AND ITS COSTS.

Every trading day, the equivalent of \$2.5 trillion is exchanged on the foreign exchange markets around the world. Much of that money is needed to enable businesses to conduct their operations for their global customers who use different currencies. This multicurrency system is costly in several ways, beginning with transaction costs.

Transaction costs are the fees charged to trade currencies, which go to pay the wages of the traders and all the corporate and informal infrastructures which support them, and the purchases and maintenance of the

computers and all the associated costs of buying and selling complex securities. These costs are often invisible as they are bundled into transactions, and they must be calculated and extracted from the total costs.

In general, credit card companies charge 1 percent for consumer foreign exchange transactions and many banks add another 1 percent. PayPal, now a division of E-Bay, "adds a 2.5 percent spread above" the Interbank rate, and it also charges 1 percent "cross-border fees" which may include foreign exchange charges.

Foreign exchange trading at border crossings is the most expensive. The European Council's 1990 study, One Market, One Money, cited a 1988 Belgian experiment which involved a hypothetical person traveling through 10 European Community countries and converting all his/her cash at each border. Beginning with 40,000 Belgian francs, the traveler ended the hypothetical journey with 21,300 Belgian francs, showing a cost of 47 percent, for an average of 4.7 percent cost for each transaction. (Emerson, et al. 1992, pp. 65-66). If a similar traveler had traveled in 2006 from Belgium with €40,000 to all of the 146 other currency areas, with each charging 4.7 percent for currency exchanges on average, his or her funds would have diminished to less than €1,000 by the 78th currency, and dropped to €35.45 by the 146th. These high transaction cost hypotheticals were for cash, and the foreign exchange transaction charge percentages decline dramatically for large, non-cash transactions. Nonetheless, even small charges still add up. If the border exchanges charged only 2 percent, the worldwide "€40,000" traveler would have returned with only €2,094.

In studies prepared during the run-up to the introduction of the euro, it was estimated that foreign exchange transaction costs were approximately .3 percent (.003) of the value of the currency being traded. (Jayaraman, 2004). Applying that percentage to the daily \$2.5 trillion traded, the daily worldwide transactions cost would be \$7.5 billion. Using a 260 trading day year, the annual cost to the world would be \$1.95 trillion per year.

Since the European Commission studies were done fifteen years ago, the automation of the currency markets has continued and the percentage costs of trading have dropped. To be conservative about the current transaction costs, this article assumes that the average transaction cost is .062 percent, (.00062) of the value of the transactions, and thus one-fifth of the .3 percent level previously determined in the 1990 European Commission study. This estimate includes the initial foreign exchange trading costs as well as all the charges and markups to customers at various levels, and it's applied only to the total for "traditional" foreign exchange transactions, and does not include the dollar volume for derivatives or over-the-counter transactions. At the .062 percent rate, the annual worldwide transaction costs for foreign exchange trading are estimated to be \$403 billion, which are rounded to \$400 billion here.

Another such cost is the administrative burden of requiring some parties to contracts to designate the a foreign currency as the contract's currency. The European Commission's One Market, One Money study estimated that there would be a .05 percent GDP benefit to the European Community member countries when corporations and others engaging in international contracts could denominate their obligations in their home currency rather than in a foreign currency, such as the dollar. (Emerson, et al, 1992, p. 25).

Another way to summarize the total cost of transactions is to express them as a percentage of GDP. "Focusing only on the transaction costs that are incurred in the Canadian foreign exchange market," John Murray found those costs to be \$3.0 billion (CAD) annually, or .4 percent of GDP. (Murray, 1999).

The One Market, One Money study found that "Overall, transaction costs can be conservatively estimated to amount to around 1/2 percent of GDP...." (Emerson, et al, 1992, p. 64). In 1996, the IFO Institute of Munich found that "foreign exchange management costs within the EU amounted to almost 1 percent of the EU12 GDP in 1995," and explained that more up-to-date data accounted for the increased estimate. (European Commission, 1997).

Although trade and international financial transactions accounted for a larger percentage of the GDP for European countries than for others in 1990, the world has globalized significantly since then, so that the 1 percent estimate can be fairly applied to the rest of the world. Hugo Mendizabal found that the savings to the EMU from the elimination of the foreign exchange costs of intra-EMU transactions could be as much as .69 percent of EMU GDP, which accounted for one-half of members' international trade foreign exchange transactions. (Mendizabal, 2002). For all transactions, including those with non-EMU countries, the percentage would be 1.38 percent.

If those percentages were conservatively adjusted downward to .95 percent, and assumed to include all transaction costs at all levels, and applied to the world's estimated 2005 GDP of \$42.2 trillion, that would bring the annual cost of transactions to \$400 billion.

Thus, using either method, whether by calculating from each transaction or from summing up total costs and expressing as a percentage of GDP, the annual total transaction costs of worldwide foreign exchange operations are estimated conservatively here to be \$400 billion. Again, it is noted that these estimates are for the total transaction costs, and not only those incurred at the currency trading desk.

The \$400 billion estimate here is intended to be conservative, and more research is welcomed to better determine the actual cost of worldwide foreign exchange transactions. Each international corporation might determine its own costs imposed by the multicurrency system.

4. THE MULTICURRENCY SYSTEM AND INTERNATIONAL CORPORATIONS

International corporations make investments and sell products and services around the world and must constantly be on the alert for currency risk. They have to price their products and services in the currencies of their customers and always be alert that the exchange rates will not eliminate their profits. In addition to paying a percentage on all their foreign exchange transactions, international corporations have to cope with the fluctuations of foreign exchange values, in two areas: reporting and worldwide allocation of resources.

Using the pound sterling as its home currency, the U.K.-based Reuters reported in 1999 that it "has significant costs denominated in foreign currencies with a different mix from revenue. Reuters profits are, therefore, exposed to currency fluctuations." The Annual Report continued, "...the impact of an additional unilateral 1 percent strengthening of sterling would have been a reduction of approximately £10 million on operating profits." (Reuters, 1999). Thus, a 1 percent increase in value of the pound from \$1.7000 to \$1.7171 will mean an increase in Reuters profits by £10 million, and a similar drop would bring a decrease. Does this make cents?

It's estimated that Nissan Motor gains about \$440 million in profits for each 1 percent drop in value of the yen against the US dollar. For Toyota, the gain would be about \$1.2 billion. (Sapsford and Shirouzu, 2006). The reverse would also be true, but do these possible shifts make cents? Why should the fortunes of these companies be so subject to the whims of currency values over which the corporations have no control?

Honda stated in its 2004 Annual Report that it "generates a substantial portion of its revenues in currencies other than the Yen. Honda's results of operations would be adversely affected by an appreciation of the Yen against other currencies, in particular the US dollar." (Honda, 2004)

In 2003 Nestle, the world's largest food company, headquartered in Zurich, announced that its profits for the first half of 2003 fell by half from the year previous, hurt by a strong Swiss franc. (Langley, 2003) For some corporations, the effect is larger than Nestle's lost profit opportunities. Also in 2003, Nintendo estimated a loss of 3 billion yen (\$27 million, computed at 111.11 yen to the dollar), which was its first loss since its shares were first listed in 1962. The primary reason for the loss was its booking of a 40 billion yen loss (\$360 million) due to foreign exchange fluctuations. The problem was that Nintendo had approximately \$5 billion in cash deposits in the United States, and a 7.2 percent drop in the value of the dollar relative to the yen caused the loss. (WSJ clip, 2003). Does this make cents?

Of course, these reports of harm were likely balanced for other corporations by the increase in profits due to currency translation, except that in the annual reports of those corporations, the credit for such profits was not as likely to be allocated to currency translation. Sometimes, such windfalls are reported. In 2002 Avon Products hedged against the devaluation of Latin American currencies; but when that devaluation didn't occur, the appreciation of Avon's holdings contributed to its profits. (Reuters clip, 2002). The problem is not so much profits and losses as it is uncertainty and risk--each an anathema to corporations. In a standard text, Corporate Risk- Strategies and Management, currency risk is featured in seven of its thirty chapters. (Brown and Chew, 1999). All international corporations have people and departments to manage the foreign exchange risk. Joachim Herr is the head of risk management at BMW International where he has approximately five people trading currencies with the goal of making "sure that the fluctuations of a currency do not impact our operating business, which is producing and selling cars... What we see ourselves as is hedgers...we have long-term strategic hedging, where we do very long, deep analysis on currency movements, and we have short-term technical hedging, where we decide how to cover the remaining open risk in the coming months...." For each country where BMW operates, there is a Treasurer who is responsible for local currency exposure, and Herr estimates that such foreign exchange work takes about 10 percent of such treasurers' time. (Rosenstreich, 1992 pp. 109-114). Such expenditures of cash and time are unnecessary and obsolete.

Richard Cooper noted that one of the widest fluctuations in currency values, the 70 percent increase of the yen to the US dollar between 1995 and 1998, may have thrown many otherwise healthy firms into bankruptcy. Further, he surmises that the prolonged nature of the late 1990s--2000s recession in Japan was partly caused by Japanese firms investing in other currency areas in order to hedge against losses in yen due to currency fluctuations. (Cooper, 2000).

Many international corporations do more on the foreign exchange markets than hedge to control currency risk. One article noted, "Currency speculation has always had a vast influence on systems of flexible exchange rates. A large variety of empirical, experimental, computational, and theoretical investigations deal with this topic. But what determines the speculative decision of a firm? Why do non-financial firms speculate [in the currency markets]? How do they deal with exchange rate uncertainty?" (Kaiser and Kube, 2005). For many

banks, trading currencies for their customers represents a sizable portion of revenue. The European Commission 1990 report found that such trading represented 5 percent of European banks' revenues. (Emerson, et al. 1992, p. 64). The Bank of America trades approximately \$100 billion per day, according to Steve Nutland, Director of North American trading. Of the foreign exchange markets generally, he stated, "many people believe Forex is a necessary evil. On the institutional/hedge fund side of the business, many view it as the largest casino in the world. I like to see it that somewhere in between the two lies the truth." (Rosenstreich, 2005, pp. 114-23). Whether a casino or necessary evil, the foreign exchange markets are an expensive and vestigial holdover from an obsolete system.

As part of its trading business and in order to protect its own international operations, the Bank of America "manages interest rate and foreign currency exchange rate sensitivity predominantly through the use of derivatives. Fair value hedges are used to limit the Corporation's exposure to total changes in the fair value of its fixed interest-earning assets or interest-bearing liabilities that are due to interest rate or foreign exchange volatility. Cash flow hedges are used to minimize the variability in cash flows of interest-earning assets or interest-bearing liabilities or forecasted transactions caused by interest rate or foreign exchange fluctuation." (Bank of America, 2004). Scotiabank is a leading Canadian Bank, and does extensive business in the United States, Mexico, South America and the Caribbean. Its 2005 Annual Report financial results depended in substantial part on a critical change over which it had no control: the Canadian dollar "strengthened" in relationship to the US dollar by 8 percent, from .7586 to .8217 per US dollar. (Scotiabank, 2005). Scotiabank reported a net income of \$3.184 billion (CAD), which was \$292 million (CAD) greater than the year before. However, it also noted a negative effect of \$145 million (CAD) due to currency translation, meaning that without the currency translation, net income would have risen by that additional amount. The oft-repeated phrase in the report is, "Before the impact of foreign currency translation...." The effect is summarized, "In the absence of hedging activity, a one percent increase(decrease) in the Canadian dollar against all the currencies in which we operate, decreases(increases) our earnings by approximately \$23 million (CAD) before tax. A similar change in the Canadian dollar would decrease (increase) the foreign currency translation account in shareholders' equity by approximately \$81 million (CAD)." (Scotiabank, 2005). To illustrate, a 1 percent increase in the value of the Canadian dollar from \$.87000 to \$.87870 or \$.88 would decrease Scotiabank's profits by \$23 million (CAD) and decrease shareholders' equity by \$81 million (CAD).

5. THE COST OF LOW ASSET VALUES DUE TO CURRENCY RISK.

When calculating the value of an asset, an investor or owner must determine the likelihood of getting a real return on that investment; and such return will be adversely affected in inverse proportion to currency risk.

When the value of an asset is artificially low, compared to similar assets in other situations or places, the difference in value can be said to be a cost or opportunity cost. That is, owners of such undervalued assets are losing the opportunity to use that asset for other purposes that might be available if valuation were not artificially deflated by currency risk.

One down-to-earth illustration of the effect of high exchange risk on asset values is the status of the home mortgage market around the world. The issue in the United States or Europe is not whether there are mortgages available, but whether they are for ten, fifteen, twenty, or thirty years and whether they have a fixed rate or an adjustable rate, to be moved up or down with the linked prime rate. In some parts of the world, mortgages are not available because of the high long term currency risk. When mortgages are unavailable, demand for homes is crippled, leading to low prices which are a small fraction of their equivalent value in a similar city and neighborhood in the United States or Europe. For example, using Argentina with its high currency risk as an example, a three-bedroom home in London might be worth €490,000, but the same home in Buenos Aires might be worth about €70,000.

Similarly, the values of financial assets in the less developed, or high currency risk or sovereign risk, world, are undervalued because of that currency risk, i.e. the risk that a currency might severely inflate or collapse. Due to currency risk, the ability to earn reliable interest on an asset far into the future is in doubt, and therefore potential lenders are unwilling to lend. Financial assets such as stocks and bonds are also undervalued due to the uncertainty of future return.

The IMF Global Financial Stability Report estimates that the total value of the world's financial assets in 2005 was \$144 trillion. (IMF, 2006). If all currency risk were lowered to the same level as the developed world, it's estimated here that an additional \$36 trillion would be added. Hence that amount could be called a cost of the existing multicurrency foreign exchange system.

6. A SINGLE GLOBAL CURRENCY.

Moving the world to a Single Global Currency, managed by a Global Central Bank within a Global Monetary Union will eliminate these costs and risks. As former U.S. Federal Reserve Chair, Paul Volcker, has said, "A

global economy requires a global currency." While the precise design of the structure of the union and central bank await negotiations among the stakeholders at future international monetary conferences, it seems likely that the Global Central Bank will be similar to the European Central Bank and the central banks of other monetary unions.

The easiest savings to understand with a Global Central Bank will come from the elimination of transaction costs. Willem Buiter, a supporter of the euro, wrote that "The transaction cost saving advantages of a common currency are familiar.... The usefulness to me of a medium of exchange is increasing in the number of other economic agents likely to accept it in exchange for goods, services and securities. By eliminating the need for the exchange of one currency for another, monetary union saves real resources." (Buiter, 1999).

The other benefits, such as the increases in asset values in countries where currency risk was high, will occur slowly and throughout the implementation period of the Single Global Currency.

7. HOW TO GET THERE FROM HERE.

The Economist magazine predicted in 1988 the implementation in 2018 of a global currency, which it called the "Phoenix". (Economist, 1988). That date is now only 11 years away. Richard Cooper's 1984 proposal for a common currency among the industrialized democracies anticipated implementation by 2009, only two years away. What takes time is the work required for the establishment of the goal and the date for implementation. By comparison, actual implementation will take little time. Once the euro was given its current name in 1995, it only took four more years to introduce the currency to the banks and financial institutions of the European Monetary Union.

The 21st century began with 159 currencies among 189 U.N. members. By 2005, the number of currencies had declined to 147. (Single Global Currency Assn. 2007). At that rate of 12 every five years, the journey to 1 will take 62 years until 2067, the 200th anniversary of the 1867 Paris International Monetary Conference. The number declined to 146 in 2007, with the adoption by Slovenia of the euro, and will decline to 144 in 2008 with the addition of Malta and Cyprus to the euro. If the political decisions were made by just a few major countries to proceed with the project, the implementation could be accomplished in less than five years. Bryan Taylor wrote in 1998, "Once the transition to a single currency for Europe and the United States was made, the transition to a single currency for the entire world could come with a speed that might surprise many. The world might easily move from having almost 200 currencies today to having one within a decade, and twenty-five years from now, historians would wonder why it took so long to eliminate the Babel of currencies which existed in the twentieth century." (Taylor, 1998).

Paul De Grauwe and Jacques Melitz wrote of the shift of view during the runup to the euro, "However, at some point monetary union began to be seen as something inevitable, as something that was written in the stars. At that point, professional opinion largely rallied in its favor. There can be no doubt that the mere existence of European Monetary Union has changed economists' outlook about monetary union." (DeGrauwe and Melitz, 2005, page 2).

There are several routes to the Single Global Currency, including the enlargement of existing monetary unions and the creation of new unions. Small countries can "ize", as in dollarize or euroize, their currencies by adopting a more stable currency as their own. Ecuador and El Salvador took this step in 2000 and 2001, respectively. A Single Global Currency Institute can be established to fully research the issues, including a comprehensive study of the costs and benefits of a Single Global Currency. International conferences can be convened to begin planning and among the identified early tasks could be a worldwide nomination and voting process to determine the name of the Single Global Currency. That process would contribute popular support to the Single Global Currency.

At the business level, corporations can research for themselves the extent to which they would benefit from a Single Global Currency. For the very few corporations who derive substantial revenue from the existing system, such research would include planning for the transitioning of some of its work to other fields. Corporations can contribute to the Single Global Currency Association and/or form their own association in support of that goal, following the example of European corporations and their associations which supported the planning for the euro and its implementation.

Guidliemo Carchedi explained the lobbying efforts for the euro in some detail in his book, For Another Europe, "Perhaps the most influential of all these groups is the European Roundtable of Industrialists (ERT), which was founded in 1983 by Umberto Agnelli of Fiat, Wisse Dekker of Philips and Pehr Gyllenhammer of Volvo. The ERT has dramatically increased contacts among European corporations. Its members are forty-five 'captains of industry', that is, the Chief Executive Officers of the most important European oligopolies, also called transnational corporations, which in 1997 had a combined turnover of ECU 5501m and three million employees world-wide. The ERT has some ten working groups covering major areas of interest (e.g. competition, education)...

This new alliance between the European Commission and the ERT played a crucial role during preparations for the Internal Market. In 1985, ERT chairman Wisse Dekker launched his proposal and timetable for the removal of all obstacles to trade within the European Economic Community. The European Commission was easily convinced. This pressure from industrial leaders for unification of European markets was precisely the momentum towards further European integration that the Commission was seeking.... Alongside the ERT, there is also the Union of Industrial and Employers' Confederation of Europe (UNICE). While the ERT influences the general criteria informing European legislation, UNICE reacts to specific pieces of legislation and makes sure that they are tailored to business's interests...

In the autumn of 1993 the ERT prepared its report 'Beating the Crisis'. In December 1993, the Delors 'White Paper on Growth, Competitiveness and Employment' was released. The two reports were prepared in close co-operation between the ERT and the Commission and 'are strikingly uniform in their calls for deregulation, flexible labour markets and transport infrastructure investments'... As early as 1985, the ERT had argued that the Internal Market must be completed with a single currency. The EMU continued to be a leading ERT demand in its 1991 report Reshaping Europe. This report also presented a timetable for EMU implementation which bears remarkable similarity to the one incorporated in the Maastricht Treaty a few months later. However, the main work preparing the ground for the EMU was not done by the ERT, but rather by (one of its off-springs) the Association for the Monetary Union of Europe (AMUE). The AMUE was founded in 1987 by five transnational corporations, each of which was also represented in the ERT. The AMUE enjoys the same privileged access to high decision-making bodies as the ERT and its co-operation with European oligopolies and the EU is close. The Commission not only provides financial support to the AMUE but also frequently consults it on monetary questions. The AMUE also has close contacts with the European Central Bank." (Carchedi, 2001).

The ERT and AMUE model could be useful for international corporations as they join together in support of the Single Global Currency. If corporations were to contribute as little as \$100,000 annually for the next 17 years, until 2024, to the Single Global Currency Assn., and if the association's use of that \$1.7 million accelerates the implementation date of the Single Global Currency by only one year, the world will save approximately \$400 billion and promote the increase of world wealth by many \$trillion. For the sake of mathematical simplicity, the benefit from the acceleration by one year could be set conservatively at \$1.7 trillion, for a return on the investment of 100 million%. Such a return is staggering and makes a lot of cents.

In Switzerland, the Chief Economist of the Swiss National Bank, Ulrich Kohili, noted in a 2003 speech lauding the European Monetary Union, that there was pressure in his country from industry and the unions to join the euro because the strong Swiss Franc was hurting exports, especially to the Eurozone. Even though he urged continued Swiss abstinence from the EMU, his speech showed that maintaining a national currency, even for a country with a sterling reputation for prudent banking, has its costs. (Kohili, 2003).

For the campaign for the Single Global Currency, worldwide business and trade organizations, such as the International Chamber of Commerce, will need to be mobilized. The publication of research articles in business association and academic publications will help generate momentum for the 3-G world. In 1996, the American Chamber of Commerce in Belgium published in its AmCham magazine, "The Case for a Single Global Currency" by Brian Warburton. (Warburton, 1996). Even for corporations whose self-interest would appear to be damaged by a common currency, there is often a silver lining. At a recent annual meeting of the Directors of HSBC Malta, the Maltese subsidiary of the international HSBC bank, CEO Shaun Wallis was asked about the effect of the upcoming implementation of the euro, and he replied, "Yes, we will have lower foreign exchange profits, that's true. But the introduction of the common currency will create more trading opportunities. It will provide stability because 60% of Malta's trade is done within European Union borders." (Carabott, 2006). Finally, corporations do not all have to be "international" in order to support the implementation of a Single Global Currency. In Ecuador in 2000, the Chamber of Commerce supported the dollarization in order to achieve financial stability and not necessarily because of its perspective on globalized trade.

8. CONCLUSION.

Implementing the Single Global Currency will bring considerable benefit to almost everyone in the world and business can play a substantial role in moving the world in that direction. The years 2024, 2034 or even 2044 are not so far away that business cannot begin researching, planning and organizing now.

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