# Coda: Currency Wars

DAVID A. ANDELMAN

At noon on August 10, 1978, I arrived at the frontier between Austria and Czechoslovakia in my rickety old Opel sedan that was *The New York Times* bureau car. I'd driven up from Belgrade, where I was then based, covering an Eastern Europe thoroughly in the grip of communism. Now, when I arrived at the frontier, I steeled myself. I was about to pass through what Winston Churchill had 32 years earlier dubbed the Iron Curtain, separating East from West. These were difficult times. Communism and capitalism were very much at each others' throats, and there was no more extreme a contrast than in some of these heavily-fortified border points where the favored few could

cross in both directions, provided they had all the right papers. Indeed, I had my American passport, my Czechoslovak visa, a fistful of dollars, my notebooks, and some background material, from which I had carefully expunged any Czech contacts and sliced off the letterhead of Radio Free Europe Research, the virulently anti-communist, American-backed propaganda source, that would likely have landed me in hot water with the ever-vigilant border police.

I had also prudently resisted the momentary temptation to buy a fistful of black market Czechoslovak koruna in Vienna. I could have made a considerable amount of money. The official exchange rate at the time was 35 koruna to the dollar. In Vienna, though, that number soared to at least 140 to the dollar—a four-fold profit. But as my car inched toward the frontier I recognized that I'd avoided what could have been a horrendously embarrassing, not to say outright dangerous, series of consequences. For the border patrol was pulling out selected cars, apparently at random, to search them. And when I say search, I mean removing the seats, unscrewing and dismantling all interior door panels, and putting the car up on a lift. They weren't fooling around. Indeed, they were looking every place I would have secreted my black market koruna. And that's exactly what they were seeking.

## SETTING VALUES

Across Eastern Europe at the time, governments were taking similar measures, largely in vain, to put a stake through the heart of black market currency trading that was making a mockery of what they sought to portray as the communist economic miracle. Still, there are lots of reasons black markets develop and are difficult—if not impossible—to eradicate, especially in the case of centrally planned economies where the Soviets preferred to operate in their satellite protectorates.

"In general, a black-market may be expected to develop when restrictions are imposed on commodity provision," economists Alan E.H. Speight of the University of Wales and David G. McMillan of St. Andrews observed in the *Journal of International Money and Finance*. "With a pegged official exchange rate and controls on dealings in foreign currencies, an excess demand for foreign exchange and overvaluation of the exchange rate may be expected to arise, with the available supply of foreign currency being rationed at the official price when official reserves are unable to satisfy the excess demand." Or arriving visitors could simply bring in more supply that black marketers would happily gobble up at an elevated price.

Then, as now, currencies are the heart and soul of society and the governments that rule them. Last year in these columns, I sought to describe how various branches of government intersect with the lives of people. But there is one outside factor that I did not explore at the time—currencies. Nothing can undermine the viability of a government more profoundly than a currency whose value is plummeting. Moreover, the efforts of a government to cope with such currency crises, whether of their own making or provoked by outside forces, can prove dramatically unsettling. Removing from a government the ability to change the course of its currency can change the economic forces and drive deep wedges between various social and political elements,

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widening already profound gulfs between rich and poor—the franchised and the disenfranchised. And, as much of Europe has seen in recent years, as it has endeavored to stabilize the value of its pan-national currency, economic imbalances can cause intense political turmoil.

Seminal moments in modern political history had their roots in money and debt. In Thailand, at the peak of the 1997 crisis over the value of the Thai baht, the government decided to allow the currency to float, all but uncontrollably, when it simply did not have enough hard currency to defend the baht on international markets. The Russian ruble crisis a year later was even more catastrophic, particularly in its political fallout. President Boris Yeltsin survived barely months after the crisis began to wane, paving the way for Vladimir Putin's arrival on the still fragile Russian scene. These currency-based crises still define international responses to both nations and loom large in the political memory of their people today.

Forty years ago, when there were fundamentally two different global economic systems, the challenge was even greater. In Eastern Europe, Russia, and China—all centrally-planned economies where rulers controlled every aspect of production, output, pricing, and wages, the value of a currency was pegged to some artificial exchange rate that clearly bore little relationship to the real value of any of these currencies. Not surprisingly, a black market all but immediately sprang up—clandestinely within the country, quite openly and boldly outside. The black market rate of the koruna was the one I could have obtained by simply walking into any major bank in Vienna, on the "free" side of the Iron Curtain and changing the international currency of choice—the dollar—for all but worthless Czechoslovak paper. Of course, the only way to use those koruna was to smuggle them into the country—a process that was fraught with danger. Had I walked up to the counter in the Intercontinental Prague Hotel and sought to pay my bill with a stack of koruna instead of a dollar-denominated credit card, I would instantly have called quite unwanted attention to myself. Still, koruna, even then, were useful to many Czechs (at least those not authorized to have direct contact with capitalist interlopers like myself), for any variety of souvenirs, restaurant meals, and other casual expenses. At four-to-one, Prague would have become one of the most affordable cities on the planet. Well, at least one of several as it happens.

RUSSIA, WHICH RAN THE ECONOMIES OF ITS SATELLITES WITH AN IRON FIST THROUGH THE EAST EUROPEAN COMMON MARKET KNOWN AS COMECON, HAD LITTLE INTEREST IN FREEING UP SCARCE HARD CURRENCY.

For each of the East European capitals had its own all but worthless currency—the Polish zloty, the Hungarian forint, the Romanian leu, not to mention the Russian ruble. Of all these currencies, though, the zloty was the most compelling domestic and international story. Poland, then and now, was anxious to assume a leadership role on both sides of Europe. Dominant geographically, it was and is a nation rich in natural resources, the most populous nation by far in Eastern Europe—twice the size of Romania and Czechoslovakia, four times the size of Hungary—but it was still desperately short of the kinds of equipment and machine tools that would allow its factories to compete in the West. And Russia, which ran the economies of its satellites with an iron fist through the East European common market known as COMECON, had little interest in freeing up scarce hard currency for any of its satellites that might have allowed them to modernize. So some, like Poland, effectively mortgaged their birthright, taking out loans with a host of western banks, collateralized with coal mines and other natural resources. Then they tried to turn that hard currency into products they could sell.

Which is where I entered the picture in the late 1970s. One of the products that Poland discovered to be quite marketable was golf carts. Not that they had any vast experience with such capitalist frivolities in their own country. But they did know how to make them. It seems that making a golf cart is not dissimilar to making a jet plane, or at least the fuselage—the same metal-bending and welding technology. Poland had a factory that had been languishing since the Russians took back the manufacturing of its own jet fighters to the motherland. So the Poles retooled a bit and began pumping out golf carts. The question became how to price them. Since the inputs—from steel to workers' wages—were all denominated in zlotys, they could be converted at just about any price the government desired. There was the tourist rate of 31.5 to the dollar, any of a host of business rates of exchange ranging from five to 50 zlotys per dollar or the black market rate that was approaching 140 to the dollar. It was, after all, effectively a worthless currency everywhere but inside Poland, whose value was determined not on any international exchange, but by fiat. Not surprisingly, the rate the government settled on was a price that, even after shipping costs to America, still vastly undercut the price any U.S. golf cart maker could match. So the Polish variety sold like hotcakes, up to the moment the American manufacturers got together and filed an unfair trade complaint with the U.S. government.

> "THE GREEKS SIMPLY WANTED TO CONTINUE TO DANCE AND SING IN THE SUNSHINE," GROUSED ONE GREEK BUSINESSWOMAN.

The final resolution involved finding a comparable capitalist economy with a currency freely convertible to dollars at daily market rates that could then be used to "price" the value of Polish labor and raw materials. Poland proposed Spain, Italy, or Finland. The American mediator, Deputy Assistant Treasury Secretary Peter D. Ehrenhaft, chose Spain. And the golf carts wound up being priced at $10 apiece more than the Poles had been charging, but below the price of any American model. So the Poles wound up selling tens of thousands, their stunningly clever marketers recognizing that such technology would be invaluable far beyond golf courses—indeed as far afield as airports, amusement parks, even the American presidential retreat at Camp David where a Polish cart was photographed as the setting for a seminal conversation between Israeli President Menachem Begin and his Defense Minister Ezer Weizman.


JERRY WONG

## A POTPOURRI

At least 180 currencies are in use in the 193 member countries of the United Nations. Much of Europe, of course, has given up their own currencies in favor of a common currency—the Euro—and a gaggle of other nations had been knocking eagerly on the door to join the Euro system. Then along came the economic crises in Greece, followed by Spain, Italy, Iceland, and several others waiting in the wings as the world held its breath. Technically, these were not actually currency crises, but rather sovereign debt crises. Still, as a member of the Euro bloc, the inability of Greece to finance its operations going forward, and fears that even more substantial economies might do the same, sent shivers throughout Europe, across the Atlantic, and as far as China and Japan.

For if one member of the Euro bloc were to pass through the looking glass to real or functional bankruptcy, that would effectively call into question the viability of every other nation that priced its debt, not to mention the entire economy, in that common currency—the Euro.

All this suggests one of the many problems of the concept of common currencies. On the one hand, such a model can be quite positive. The European Commission lists six such advantages for the Euro:

- More choice and stable prices for consumers and citizens
- Greater security and more opportunities for businesses and markets
- Improved economic stability and growth
- More integrated financial markets

- A stronger presence for the EU in the global economy
- A tangible sign of a European identity

There are even more advantages that transcend these immediate benefits, which also remove the need to change money every time you cross into another country. A common currency in a common market as vast as Europe also removes the need for most corporations to hedge their risks against fluctuations in multiple currencies of nations where they do most of their business. Of course, each of these countries must manage to keep its economy—especially its labor market, inflation, economic growth, service and consumer sectors—healthy and growing. On the government level, as the EU points out, the most important advantage is that the Euro "allows every member government to plan for the future." Provided, of course, planning is wise and to the benefit not only of that individual government but Europe as a whole. Clearly, some of the outlying governments were not able to see beyond their own particular needs. "The Greeks simply wanted to continue to dance and sing in the sunshine," groused one Greek businesswoman, who left the country decades before the arrival of the Euro. The result was the accumulation of mountains of national debt, much of it denominated in Euros, that its slim industrial production and anemic exports were ill equipped to service. Eventually, that mountain had to collapse—putting in jeopardy not only Greece, but large swaths of Europe, whose member states were also issuing Euro-denominated bonds that required a solid foundation.

At the same time, marginally more manageable mountains of debt were being accumulated by even larger European economies, especially Italy and Spain. It seemed to some of the least profligate peoples of Europe—particularly the Germans—that their industries and banking sector were being forced, at knifepoint, to subsidize the excesses of southern Europe. The price of failure would be an all but cataclysmic collapse of one of the world's most widely-used currencies—the Euro. The price of success was lower interest rates and a more potent single trading block for German consumers and businesses. All in all, a decent tradeoff, the Germans finally decided.

Nevertheless, the travails of southern Europe do also suggest a host of reasons why a common currency can be questionable when good times turn sour. First, and foremost, a common currency suggests several critical prerequisites—a common labor market with roughly equivalent levels of employment (or unemployment), and by extension, true portability of labor across the entire currency union with equivalent rates of economic expansion (or contraction). If sudden pockets of deep depression and high unemployment develop that cannot be filled by importation of labor from surplus areas, serious dislocations can result. Linguistic, social, and cultural barriers exist in Europe that are all but insurmountable compared with, for example, the United States, where a single currency and labor market is manageable across even more time zones and theoretically as diverse cultural differences as in Europe, but where a common language and historical context removes many of the barriers that exist in Europe's common market. Even the removal of national frontiers in Europe and the ability of any European to work in any European nation has failed to lift many other barriers that remain as insurmountable as when there was a multiplicity of currencies.

Not surprisingly, Britain—which chose not to adopt the Euro, though it remains a member of the European Community—has been rather quietly pleased by the discomfiture of its fellows on the continent that did choose a common, and increasingly fraught, currency. It has also managed to avoid many of the imbroglios that have pitted Germany's iron-willed Chancellor Angela Merkel against France's feckless president François Hollande. And then there are the "fringe" countries, eight of whom—Lithuania, Rumania, Bulgaria, Poland, Czech Republic, Hungary, Sweden and Croatia—are waiting, several of them with some considerable skepticism, to join. A few are reluctant to adopt the fiscal straight jacket that is required of new members; others are anxious about tying their fortunes to neighbors whose economic fortunes remain somewhat problematic.

BY THE TIME I ARRIVED IN BUCHAREST, KENT KING-SIZE SOFT PACKS WERE EFFECTIVELY THE ONLY ACCEPTABLE CURRENCY.

## TRANSNATIONALITY

All of these questions raise deep concerns over just how transnational currencies could, or for that matter should, function. Certainly there are a few "reserve currencies" that are effectively trans-national currencies in their own right due to the power and reach of the nations that back them. The dollar is, of course, the premier such reserve currency. But during America's fiscal emergency, beginning in 2008, there was considerable skepticism over how realistic—indeed how toxic—it might be to have the world's finances based on a currency whose own foundations could be so easily compromised. But then, of course, the world's central bankers, not to mention investors and others who trade every day in this very currency, began to reflect what the alternative might be.

Europe and the United States are not the only regions where there are real or potential common currencies. So far, none seem to be working very much better. Africa has contemplated eventually moving toward a pan-national currency regime. And there is already a basis for this—the CFA franc, used by 14 African nations and guaranteed by the French treasury. Named for the *Communauté Financière Africaine* (African Financial Community), the community includes 12 former French colonies in Africa, one Portuguese (Guinea-Bissau), and one Spanish (Equatorial Guinea)—all now independent and most of marginal financial health. None of the major African powerhouses—Nigeria, Kenya, South Africa—is a member or likely to join in the foreseeable future. The member states have a joint GDP of \$166.6 billion, or per capita annual income of barely \$1,129, compared with \$34,751 in the Euro zone. At the time the Euro zone was created, in 1998, European leaders agreed that the CFA arrangement, through the French treasury, could continue since it was unlikely to have any "material effect" on the Euro zone—first because of the scale, and second because there was no real or implied obligation of the new European Central Bank to guarantee the CFA franc or the economies or obligations of any of its member states.

So what's the value? Membership in the CFA does have the advantage of maintaining at least some tenuous ties to the developed world through France and by extension to the European Union. For companies doing business in Africa, there are the prospects of a reasonably stable exchange rate across 14 markets—in short many of the same advantages as prevail in the Euro zone. But any effort to bring into such an arrangement any economy far larger, more complex, and potentially more unstable could carry enormous risks that clearly the French treasury would, especially in these fragile times for that nation's own economy, be ill prepared to bear.

Which is not to say that there are not other regions that might benefit from forming some common currency. The Middle East's Gulf region is one that has captured attention at certain moments in the past. The Gulf Cooperation Council (GCC) is a group of six countries bordering the Persian Gulf—Bahrain, Kuwait, Omar, Qatar, Saudi Arabia, and the United Arab Emirates. Founded in 1981, at least in part as a political and economic response to the European Union and the growing power of Iran in the region, it took the countries 28 years to launch a Monetary Council as a first step toward a common currency. It's moved little further. Not long after its formation, when I visited Saudi Arabia, several senior Saudi officials admitted to me that the real motivation behind a single currency would be to tie neighboring Gulf states even more closely to Saudi Arabia—effectively cementing Sunni hegemony along the Gulf.

Indeed, currency and politics are closely tied. A weak currency means, for the most part, a weak economy—weak purchasing power for consumers, inevitably higher interest rates and, at least in democracies, the defeat of the party in power that has led to these catastrophic, real-world, pocketbook failures.

WHEN CONVENTIONAL CURRENCY SYSTEMS APPEAR TO BREAK DOWN, UNCONVENTIONAL SYSTEMS QUICKLY EMERGE TO FILL THE GAP.

### KENT KING-SIZE

If there was any doubt that communism was doomed, there was ample evidence in flawed currency systems like Romania's all but worthless leu. Black market money-changers frequented the environs of the Intercontinental Bucharest, the only hotel where any foreigner with any means would ever consider spending time in the 1970s, yet no self-respecting Romanian with western contacts would ever consider taking leu in exchange for goods or services.

It was pretty much illegal for any Romanian to possess any hard currency. Indeed, when the Romanian secret police decided they wanted to entrap me in order to find an excuse to throw me out of the country, their first, pathetic efforts at compromising me consisted of flinging "money changers" at me as I stepped outside the door of the hotel. And when I demurred, they began raising the temptation by offering as much as ten times the going black market rate. Finally, exasperated by this nonsense, I asked one hapless spook, "Do you think I am an idiot? Go back and tell your colonel he needs to do way better than that." But what Romanians could and would take—no, actually insisted on taking—for services rendered (or even services demanded) was cigarettes. But not just any random smokes—Kents. And not just any Kents, but Kent King-Size soft packs. By the time I arrived in Bucharest, they were effectively the only acceptable currency whatsoever. A pack would get you a ride in a taxi. A couple of packs and your driver might even wait for you at your destination. Need a tune-up and oil change on your car?

Probably a carton. A few days in the hospital, a carton or two. I never spotted anyone actually breaking open a pack and smoking a single one of these precious commodities. It would be like someone lighting a cigar with a hundred dollar bill.

Of course, in other countries, there were other brands. In Czechoslovakia, for instance, it was Marlboros. The symbol of decadence, or at least of privilege and access, was to flaunt the act of smoking a Marlboro in public. As it happens, I discovered that I was being tailed, not very adeptly, by a young couple who had StB (state security) written all over their trench coats. And it was always the same couple. I noticed that she smoked Marlboros, so on my next visit, I brought along a carton. Sure enough, there she was exiting her car with her fellow officer. It was summer, so the window was rolled down. I led them down the sidewalk, then turned back toward their car and, as I passed her driver's door, casually tossed the carton of Marlboros on her seat and kept on walking. A few paces later, I looked back. They were in a heated discussion. Her companion was red-faced and furious, and she was shaking her head vigorously, in great fear for her immediate future. They'd both have a lot to explain. Incidentally, I never saw either of them again.

## CRYPTO-CURRENCIES & BEYOND

Of course, through the years there have been a host of other crypto-currencies. Bitcoin is especially fashionable today, as at various times were various currency baskets, like the one OPEC was considering some five years ago to value oil. Always quoted in U.S. dollars, this came into question in the wake of some sharp fluctuations in the value of the currency issued by the single largest OPEC consumer, but certainly a non-member. The new basket OPEC was considering consisted of the Japanese yen, Chinese yuan, Euro, gold, and a new, unified currency of the GCC nations. It was said to be en route by 2019. While the GCC couldn't agree on how to implement its part of the deal, the price of gold soared, peaked, and faded, while the Euro seemed at various times over the past year to be itself poised on a high ledge.

When conventional currency systems appear to break down, unconventional systems quickly emerge to fill the gap—hence the arrival of Bitcoin to replace the relatively slow and easily hacked debit and credit card systems. But what happens when these new crypto systems begin to fail? None is backed by a central bank, nor by the full faith and credit of a government.

The problem is that devices such as Bitcoin are built on a series of computer algorithms and on a foundation of trust in the electronic systems that created them, the good name of their creators, and even the extent of their acceptance in the real world of hard currencies. When one or another of them breaks down, so does the value of the crypto-currency. This happened with Bitcoin in late January and early February, when a succession of issues ranging from government probes into the use of Bitcoins for illicit activities arose, to rejection by a host of central banks from Norway to China, to a series of computer glitches in the large Bitcoin exchange, Mt. Gox. The response was a devaluing of Bitcoin—slashing its value in half within a week. If this ever occurred to any national currency, it would represent a catastrophe approaching biblical proportions.

Long before Bitcoin ever arrived, of course, there was *hawala*. Though not a currency, per se, this institution served as a response to an immediate need. Millions of people, many who had never seen each other, nor ever would, needed a viable and reliable system of exchange—of valuing their output, their work, their intelligence and creativity. Such a network is at once the single most critical lubricant of an economic system and glue that holds society together. And it is the single most vital method of tying nations and people together across the globe. There is likely no more immediate evidence of that than the *hawala* network. Meaning "transfer" in Arabic, this system dates back to the early Middle Ages, when there was no other means of transferring value along the vast trade routes that began in Europe and stretched across the Middle East, following the route of Marco Polo from Venice to the court of Kublai Khan. Also known as Informal Value Transfer Systems (IVTS) or Alternative Remittance Systems, they are used to transfer funds across borders via multiple currencies—without a single piece of paper, species, or coin ever crossing a single frontier. The first step involves a person seeking to transfer funds walking into a *hawaladar*'s office, tent, or stall, informing the banker how much the customer wants to transfer and where. The funds are handed over, and a code is provided. At the other end, the recipient, armed with the code, receives the funds from the local *hawaladar*. Not a single document has been created in the entire process. There is no paper trail, no record of the transaction—just good faith inherent in the system. If the transaction goes awry, the person at fault could well pay with his life.

It is also a perfect system of money laundering—indeed a system of currency that runs parallel to the official system of wire transfers and bank drafts that are all too easily monitored by government and law enforcement. *Hawala* and its clones drive officialdom crazy. Not surprisingly, Bitcoins and a host of IVTS are similarly anathema. But each has come to life because of some failing—or some missed opportunity—in the conventional systems of currencies and money.

Rather than bay at the moon or send in law enforcement, why not simply try to fix the system whose failings have given rise to these less than palatable alternatives? If the issue is liquidity, make the system more liquid. If it's transparency, improve the transparency. Frankly, currency transactions can never be too transparent. The failures of the Euro, the vast contortions to bring economies into closer proximity in terms of growth, inflation, employment, and a host of other metrics simply to make a unified currency palatable or workable, to perpetuate a system that was artificially derived in the first place, may in the long run be unworkable and unnecessary. Readers of this space have perhaps come to appreciate my belief that artificially constructed nations combining a host of elements with sharply differing cultures, languages, histories, and sensibilities will never work well for any of those involved. So Yugoslavia, Czechoslovakia, the Soviet Union, perhaps even Iraq eventually, have all broken apart or are in the process of doing so. Meaning, eventually it will be time to halt the creation of pan-national currencies across equally diverse economies and nations.

In the end, currencies that respond directly to the needs and will of their people will best serve those who spend them every day. After all, how pleased are the Brits to have held onto their pound sterling? ●