

The European Monetary Union: Lessons of Historical Experience

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Is it useful to go back to the events which characterised the three monetary unions established in the XIX century? Can it help us at all to understand better the difficulties which have paved the road from Maastricht to European Monetary Union (EMU) and which may still prove serious enough to derail the European monetary train before it reaches its final destination?

Prima facie, little similarity exists between the EMU and its XIX century predecessors. This is not only because the countries involved in the EMU are much more numerous, at last at this stage, than those which were members of XIX monetary unions, like the Latin, the German, the Scandinavian. But especially because the monetary unions of the XIX century were essentially currency unions, linking together what were still pre-eminently metallic monetary systems. XIX century monetary systems, in fact, even if their banknote and bank deposit components kept growing at remarkable rates, were still dominated by metallic currencies. The break from the previous three millennia of monetary experience was still far from being complete.

Coins were made of gold, silver, and copper. They were not made of pure metals, as all three monetary metals were too soft in their pure form to serve the purpose of circulation. Coins were thus made of alloys, meant to make them tougher, to reduce wear and tear and discourage clipping, and to satisfy the fiscal desires of the governments which issued them. Even gold coins often had a fiduciary nature, as their face value was superior to their intrinsic value plus minting costs.

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This distance between face value and intrinsic value makes the XIX century currency systems more similar in nature to those of today at least as long as we restrict ourselves to considering only the fiscal nature of a monetary system, and skip its banking nature altogether.

It is exactly the prevalence of the banking nature of today's monetary systems which reduces the value of the historical exercise we could conduct. But any reader of today's newspaper articles dealing with problems relating to EMU gets the distinct impression that the banking nature of the contemporary European monetary union is either very small or even non-existent, such is the concentration of interest on the fiscal power of governments on national monetary systems. Milton Friedman, about thirty years ago, re-introduced the notion that automatic deficit monetization is the most unjust fiscal instrument in the hands of governments, because there ought to be no taxation without representation. His pleading was so powerful that it conquered the center of the stage in contemporary economic policy debates. When what was initially conceived as a joint European float, the EMS, began to be regarded, in the mid-Eighties, as the first step towards the monetary unification of Europe, the Friedman argument was extended to open economies, linked together by fixed exchange rates and large capital flows. It occurred to several economic and political observers that a country could, by having a public deficit and monetising it, free ride on the fiscal virtue of its partners in a monetary union. Its citizens would enjoy the goods and services produced by other partners by paying with their country's currency, inflated by the monetization of public deficits. As a result, either the union would be unfair to the virtuous partners or, which was more likely, it would soon break up, as the virtuous members refused to further finance the spendthrift ones.

XIX century currency unions started for reasons very similar to those which have induced the birth of the EMS: to create a lake of monetary stability in the very perturbed ocean of the international monetary system. In our time, it was the havoc caused by deep dollar oscillations in the 1970s and 1980s after the Bretton Woods adjustable pegging system had been dissolved by US authorities in August 1971. In the XIX century it was the gyrations of gold and silver prices induced by great mining discoveries of the two precious metals in the New and Newest continent. Governments of adjoining countries tried to get together and reduce the impact gold and silver price oscillations were having on the metallic monetary systems and as a

consequence on general price levels and economic activity in those countries. But, in addition, both in the second half of the last century and in the last quarter of the present one, currency unions were governments' attempts to come to terms with a drastically and rapidly increasing level of international and European economic integration, in both cases due to a transport and communications revolution and to a long peace.

The historical exercise is rendered more interesting by the occurrence of German unification in both centuries. It was in each case followed by an important change in the monetary stance of the just unified country. Unification had thus political, economic, and monetary repercussions on the rest of the world, particularly on the rest of Europe, that can only be called momentous.

I think, therefore, that a good case exists for evoking from the past the shadows of previous currency unions. We must, of course, renounce the view that history cannot be functional to policy-making and that historical comparisons can only fulfill the desire for intellectual entertainment.

1. The Latin Monetary Union

The national and international monetary problems of the greatest part of the XIX century are a consequence of the oscillation of the gold-silver market price, which was the result of waves of new mining discoveries in new countries, like the United States, Australia, South Africa. Periodically one of the precious metals would become more relatively abundant as new mines came into production, and countries had to decide, often in emergency conditions, what to do with the existing Mint Pars. Should they keep them at the old values, thus inducing arbitrage and the variation in their money supply's composition which followed it? Or should they bow to the market, and let the Mint Pars float with Market Prices?

The two countries which exercised political economic and financial leadership in Europe in the XIX century, France and Britain, took opposite policy stances, which shaped XIX century international monetary history. As early as 1717 Britain has decided (by default) to let the price of silver float freely, by choosing a monometallic Gold

Standard. In 1785 France decided to fix the parity between gold and silver at 15½, and managed, with great recourse to active currency management, to stick to it until the First World War.

The *Latin Monetary Union* (LMU) can be said to be an indirect outcome of the Napoleonic Empire and the direct outcome of the monetary havoc induced by the discovery of gold in California in 1849. The Napoleonic conquest of Europe brought in its train a homogeneous currency system, based on the French decimal system and the fixed ratio of 15½ to 1 between gold and silver, in all the lands which it reached. After the dissolution of the Empire, not all countries that had been part of it went back to their old systems. Several decided to keep the French system which had been maintained also by the French Restoration Government. Financial integration, reached during the Napoleonic Empire, was preserved in the former Imperial territories, especially because French economic and financial hegemony remained, and even increased; the French economy was much bigger than those of its neighbours and was still able to absorb imports from them and provide them with financial services (intermediating between short-term and long-term capital).

When the Californian gold flood swamped Europe, the countries under French economic and financial hegemony reacted to it in a scattered way. They lowered the intrinsic content of their divisionary coins to prevent them from being exported, but each chose a different silver title. Arbitrage thus started in a very big way, threatening to seriously undermine the financial integration existing between France and its neighbours.

Even the full-title anchor of the system, the five-franc silver coin, gradually disappeared from circulation, to the consternation of governments but also of the Banque de France, whose reserves it constituted. It must be kept in mind that the Banque de France did not have a legal obligation to convert its notes into one metal upon request, but was free to choose between gold and silver. When it wanted to discourage redemption, it offered to convert notes into silver, which, because of its low intrinsic value, rendered large conversions very cumbersome. The Banque also saw the disappearance of its silver reserve as an economic evil since, because of gold's greater "portability", it was compelled to keep a much larger reserve in order to achieve its own desired precautionary reserve level. People demanded conversion into gold coin much more frequently than into silver coin.

The rate of substitution between bank notes and gold coin was much higher. Gold was a much better substitute for bank notes than silver was.

The *de facto* reduction of the French monetary system to a monometallic Gold Standard did not please the French Haute Banque either, and in particular the House of Rothschild, as it meant for them the drying up of a very considerable source of profits, through gold-silver arbitrage.

The gold flood, which induced the heterogeneous lowering of the intrinsic value of divisionary coins in the various countries which had enjoyed financial integration with France, and the disappearance of full-bodied silver coins, prompted in 1865 a call for concerted international action from Belgium, which was accepted by France, Italy, Switzerland and Greece. On November 20, 1865 an international monetary Conference was convened in Paris, the first of a series which followed in 1867, 1874, 1875, 1876, 1878, 1879, 1885 and 1893. On December 23, 1865 the convened countries signed the First Convention of the Latin Monetary Union. It was an international treaty, which was transformed into laws passed by each national parliament.

The first aim of the Latin Monetary Convention was to re-establish the intercirculation of divisionary coin, by fixing a uniform title at 835/1000 fine silver. The new title was the same as the one adopted by the Kingdom of Italy which had already minted 100 million of divisionary coin. France proceeded to mint 16 million only. Thus Italian coins began to circulate immediately in France and Belgium, and would be the cause of much bitterness among the three countries when the price of silver began to sink in the 1870s and 1880s. The Italians had not been particularly prescient in their choice of silver content. It was the English divisionary coin's silver content they had adopted.

The LMU Convention also fixed a ceiling of 6 francs per inhabitant to the issue of divisionary coin by each participating state. Divisionary coin had to be accepted in private transactions of up to 50 francs, while participating states had to accept back any quantity of their own divisionary (subsidiary) coin presented by their respective nationals.

There was also a clause allowing for periodic recycling of subsidiary coins back to their countries of origin, with a lower limit of 100 francs per transaction. This was supposed to prevent the accumu-

lation of foreign subsidiary coin in particular countries. In reality it did not prove very effective.

As to full bodied coins, the Convention established complete uniformity among the participating countries. Each of them would issue gold and silver coins of equal weight and fineness; the gold-silver ratio was fixed at 15½ to 1. This was more or less imposed by France on its reluctant partners who would have preferred a mono-metallic standard. But France alone had a central bank with a reserve strong enough to stabilize the whole area's monetary system, and Banque de France's monetary management rested, as we have seen, on its right to redeem its own notes in either gold or silver.

On the wind of the LMU Convention, French foreign economic policy hoped to sail towards a more universal monetary unification, which would adopt the French decimal coinage system and possibly the double standard. A conference was called in Paris in 1867, in which 20 countries took part, but did not come to any practical agreement. Meanwhile, the worth of the LMU had to be tried under the severe circumstances of Italy's Declaration of Inconvertibility in May 1866, a consequence of the Austro-Prussian-Italian War and of the Overend, Gurney financial crisis. The war meant that there was a rapprochement of Austria to the LMU, as a result of the dissolution of the Austro-Prussian Monetary Union. But it was a rather formal affair, as Austria, too, was on an inconvertible standard, with no serious consequences. The inconvertibility of the Italian lira, on the other hand, caused a great outflow of Italian coins toward neighbouring LMU countries.

The squabbles over Italian subsidiary coins which emigrated to neighbouring countries were destined to last until Italy returned to convertibility in the early 1880s. They were going to flare up again when Italy experienced another financial crisis in 1893, the lira became inconvertible again, and a great part of Italy's silver currency emigrated to LMU countries. The Italians were then compelled, in order to get their full-bodied coins back, to take back even the subsidiary coins which had been allowed to circulate freely in the Union and had ended up in the coffers of the Banque de France because of the fall in the price of silver. A study of the LMU is instructive because its existence was marked by widely changing world economic and financial conditions, but also by widely fluctuating political relations among its members. The relations between Italy and France, in particular, which had been very friendly under the

Second Empire, became strained in the late 1870s with the Tunis Problem and worsened to the point of open economic warfare in the 1880s, after Italy joined the Triple Alliance with Austria and Germany. A further rapprochement occurred in the late 1890s and lasted until the first world war. The question of Italian coins which had emigrated to France and Belgium has thus to be seen in the light of these wider political problems.

Ironically, it was immediately after the LMU Treaty had been signed, largely under the influence of an increase of silver prices, that silver began what proved to be an incredible, and dramatic, secular decline. The LMU's basic philosophy of bimetallism was thus called into question as soon as it was established.

One of the most trying influences on the stability of the LMU was certainly the decision by the New Prussian Empire to adopt the Gold Standard, with a gold currency, after the defeat of the French at Sedan. With the war indemnity paid by France the German established their Gold Standard Reserve. The aftermath of victory, however, proved to be highly unstable for the German economy and society, and the Gold Standard was widely blamed for the instability. Chancellor Bismarck declared that he would have Germany pay the indemnity, had he known how much trouble it would cause.

The French financial *élite* were also able to lay an ingenious trap to the German government, when it started selling its silver to equip the country with a gold circulation. France promptly declared an end to the free minting of silver, the price of silver collapsed, and the German government encountered a huge loss when they sold their silver. The sales were soon stopped, as Bismarck declared his disenchantment with the whole idea of free trade and the Gold Standard, and Germany kept a substantial silver circulation for a long time.

Subsequently an additional treaty was signed on 31 January 1874, to limit the free minting of silver. Further limitations were agreed upon in 1875 and 1876. Finally in 1878, by diplomatic agreement between the governments, the free minting of silver was altogether suspended (Italy was exceptionally allowed to mint 9 million in 5-franc pieces).

As we have already indicated, the LMU had to deal with the problem issuing from Italian inconvertibility, which lasted from 1866 to 1882. Such was the imbalance in the Italian government accounts and the speculation on the Italian exchange rate and government bonds (widely held in France) that the discount against the Italian

paper currency reached even 20% and the quotations of Italian bonds went as low as 30. Under such circumstances it is easy to understand why most of the Italian metallic money supply ended up in Belgium and France. The Banque de France, which was formally a private institution, decided in 1873 to refuse any more Italian coins in payment: Italian divisionary coins had flooded neighbouring countries' circulation, in spite of the limit of 50 francs established by the LMU Convention of 1865. Most of the following meetings of the LMU were absorbed, as a consequence, by bitter discussions on how to limit the consequences of Italy's inconvertible paper money issues of other LMU countries.

In 1878 Italy decided to repatriate its divisionary coins and asked the other member countries to exclude it from the application of the 1865 Convention for what concerned intercirculation. This suspension of the Convention was supposed to last until Italy would re-establish convertibility. But the repatriation of Italian coin could not possibly take place in one go. To get out of the impasse France undertook the centralisation of the retrieval of Italian coin. It would pay cash against Italian coin presented by the other states within a year. It would then give back the coin to Italy in four years. Italy in turn undertook to replace its paper money by the divisionary coin it would get back from France, taking the paper money out of circulation, and pledging not to issue new paper money.

Having signed this agreement, however, the Italian cabinet could not get it ratified by parliament, and resigned. Negotiations resumed, until an agreement was reached that was slightly less demanding from Italy, especially because the clause according to which Italy undertook to take paper money out of circulation upon receipt of its own divisionary coin was eliminated, as it seemed to violate the monetary sovereignty of Italy. It was, however, replaced by another one, according to which Italy and France would keep Italian coin in the vaults until the equivalent amount of paper money had been cancelled by Italy. Other minor improvements were obtained by Italy and the agreement was accepted by the Italian parliament.

When Italy decided, at the end of the 1870s, to return to convertibility, and to do so by borrowing 640 million French francs from foreign banks to be able to replace its paper circulation, the main worry of the Italian government was to avoid a flood of silver into its money supply. A huge involuntary reserve of 1,200 million in silver was held by the Banque de France. This had managed to

stabilize the silver price which would have otherwise fallen much lower. It could be expected that, if the Banque de France experienced a heavy gold outflow because of the Italian loan, it would elect to redeem its notes in silver 5-franc coins. And this would increase the devaluation of silver. The Italian government thus resolved to borrow 400 million in gold, and the rest (240 million) in silver, knowing that most of it would go to pay for the Italian subsidiary coinage returned by France. The "gold clause" of the Italian loan in practice excluded Paris from the operation. The gold reserve of the Banque de France stood at only 600 million, against a silver reserve of more than 1,200 million. Asked by the "lead bank" to effect the transfer to Italy, the Banque de France would have been compelled to do it in silver. The Italian government thus chose to borrow in London, where it was sure it would be paid in gold. As it happened, 488 million in gold were received, and 156 million in silver, of the latter only 38 million entered Italy, the rest being paid to France to retire the Italian subsidiary coin frozen there by the agreement of 1879. The Italian government also ruled that customs duties be paid in gold. But this constituted too grave a violation of the LMU agreement, and the directive was scrapped by parliament. The Convertibility Bill did, however, contain an article which allowed Italy to keep its 5- and 10-lira paper notes in circulation, for an amount exactly matching the 300 million of Italian full bodied silver 5-lira coins which were in other LMU countries' monetary circulations.

After the elaborate and successful attempt by the Italian government to elude all possibilities to end up as a silver dumping ground, the French resolved to go to the next Renewal Negotiations with one strategy: that of inserting into the Treaty a liquidation clause, which would oblige the Union members to take back, at the termination of the LMU, all their own coins which were in foreign hands, in exchange for either gold or bills of exchange.

Quite apart from the political relations between France and Italy, the problem of the Italian silver coins constituted a problem between the Banque de France and the French government. The Bank was a private institution (of a peculiar kind, admittedly, as the Governor was appointed by the government), and it considered its holding of foreign silver coin to have been imposed upon it by the policies of the French government.

The Liquidation Clause was aimed at Italy but also at Belgium which had issued, proportionally to its own domestic circulation,

more silver coins than any other LMU country. After complex negotiations which saw even the withdrawal of Belgium, the three other states signed an agreement on the Liquidation Clause, which accepted the French view according to which each country would, in case of liquidation, take back all its coins at face value. After the 1885 renewal, the LMU was tacitly renewed for 25 more years. There was, as we have said above, another inconvertibility episode concerning Italy in 1893, and again Italy asked for its divisionary coin not to be accepted by the Public Treasuries of the other LMU countries. After a few years, however, Italian monetary affairs improved radically again.

The continuous fall in the price of silver further reinforced the Union until 1914, as the three main countries had carried on issuing silver coins at 15½ to 1, when their actual value had become much lower. It was not to be expected that the three main countries would propose the liquidation of the LMU, as that would imply taking back one's own respective silver and divisionary coin at face value.

Was the LMU a success? Undoubtedly, in spite of difficult problems, convertibility crises, wars and strained political relations among its members, and above all in spite of the vertiginous fall of the price of silver, the LMU experienced a success *de durée*. It lasted longer than the international Gold Standard. And the member countries, even at the height of political crisis as during the Franco-Italian economic war of the 1880s, used the LMU to try to score points but also to come to agreement. Free intercirculation of coins continued and even the problems arising from the clash between excess issue of paper currency and free circulation of coins were absorbed.

Overall, it must be said that the LMU lasted so long because France wanted it to. It was prepared to absorb Belgian and Italian silver coin and Italian divisionary coin at par. It was prepared to let the Banque de France operate as a lender of last resort for the other countries' central banks. The Banque de France also contributed to smoothing the gold-silver parity by amassing an enormous stock of silver which it knew very well it could not sell to anyone (without a huge capital loss). The Banque de France acted as a buffer shock between the Gold Standard and the bimetallic halves of the international financial system.

Because of French behaviour, the LMU was able to absorb the excess supply of Italian money induced by Italian budget deficits leading to inconvertible paper currency issues. In the last 20 years of

the Union, before the end of the first world war, however, Italy switched completely to a Gold-Exchange Standard, as currency consisted mainly of non-exportable state and bank notes. Metallic reserves were held exclusively by the banks of issue. The main source of problems was thus eliminated from the LMU, also because Italian finances and external accounts improved very substantially from 1896.

2. The German monetary unions

At the beginning of the XIX century, Germany was still divided into many small states, each of them guarding its own monetary independence. In 1914 there were only two German monetary areas, the Austro-Hungarian and the German Empires. But from 1857 to 1866 there had been complete monetary unification of the German world, which was brought to dissolution by the Austro-Prussian war of 1866 and never achieved again until 1938.

German monetary unification can be said to have begun on 15 August 1837, when six German states, Bavaria, Württemberg, Baden, Hesse, Nassau and Frankfurt first signed two monetary Conventions which adopted the florin as unit of account and basis for their monetary system. They also agreed on minting conditions, and on the issue and circulation of divisionary coin. On 27 March 1845 a further Convention was signed, which organised the withdrawal of old local coins and the issue of a two-florin piece. Two more countries had meanwhile joined the Union, Saxe-Meiningen and Schwarzburg-Rudolstadt.

In 1838 the German Monetary Union was divided into two halves. The first included the North German States and adopted the thaler as currency; the second included the Southern States, and adopted the florin. A special Treaty regulated monetary relations between the two halves, by fixing a rate of exchange between florin and thaler (1 thaler = 1¾ florin). The Treaty also fixed the title and weight of coins. All states agreed in addition to issue a Convention coin, of two thalers or 3½ florins, which was issued proportionally to each state's population (a predecessor of LMU's rule of issue) and had legal course in all states of the Union. Finally, the states agreed to restrict the issue of divisionary coin.

The Union was based on silver. States were however left free to coin their own gold coins without standardization. An important part of German territory was left out of this first Union: Hamburg, Bremen, Lübeck, Löwenburg, Schleswig-Holstein. And there were still 31 banks of issue at work in Germany. The first Monetary Union did however manage to bring monetary order to the smaller states, which had hitherto been very lax in their issuing policies.

In 1857 a great step forward was made, by the signing of the Monetary Union Treaty between Austria and the Monetary Union States. The 1857 Treaty saw Austria capitulate to Prussia on the question of the standard, as it abandoned the idea of leaving the inconvertible paper standard on which it was to adopt the Gold Standard. She accepted instead silver, which had been, as we have seen, the standard of the German Union. A fixed rate of exchange was established among Austrian and German currencies. But there was no freedom of circulation of either full-bodied or, *a fortiori*, subsidiary coin. Only the Currency Union coins were free to circulate in the Union together with all Prussian coins. Gold coins were free to circulate, but their value was given only by their weight, like any other commodity.

Moreover all signing members agreed to stop inconvertible paper currency issues and to withdraw all existing inconvertible notes from circulation by the end of 1858. This was particularly important, as Austria had been on an inconvertible paper standard since 1761. Austria did promptly execute the change of notes with silver coins. But, just after the deadline for the change expired in April 1859, she went to war against Sardinia and France and once again had to declare the inconvertibility of its currency. As was the case with Italy in the LMU, all coins, full bodied and subsidiary, emigrated in following years from Austria to the other states of the German Monetary Union. After the battle of Sadowa, the German Monetary Union and the Austro-German Union were dissolved by a Bismarck decree. The formal dissolution of the Union occurred on 13 June 1867 by a Treaty signed in Berlin.

The Union thalers which the Austrians had coined while they had been members continued, however, to circulate in Germany for many years, and Austria had no obligation to repatriate them, because the Union Dissolution Treaty had given each former member a completely clean slate. The paradox ensued, when Germany adopted the Gold Standard, of a foreign currency which was allowed to

circulate in Germany, at face value in spite of the fall of silver prices. In 1892 the Austrians, just before starting their monetary reform which demonetised silver thalers, agreed to buy back one third of them at their original exchange rate. The rest were withdrawn from circulation by the German government, and the latter absorbed the loss of about 10 million marks. The Agreement crowned ten years of drastically improved relations between Austria and Germany. The problems of the Austrian coins, in the German Union, issuing from the war of 1866 are the exact equivalent of those of the Italian coins in the Latin Union, which were also determined by the 1866 war.

In modern terms, these two episodes can be compared to the European Monetary System going onto the second and third stages *without* a binding rule about money supply and Budget Deficit Monetization. It must be said, however, that France, because of strong foreign policy motives, was led to absorb both Italian and Belgian coins for a very long time without dissolving the LMU, which was its own creature.

3. The Scandinavian Monetary Union

Rather like the countries which would have formed the LMU, the Scandinavian countries had enjoyed very similar currency systems before 1873, based on silver and with coins of an almost equal weight and title. Very wide intercirculation existed, and the central banks of the three countries accepted each other's coins.

After the LMU Treaty had been signed, Sweden made preparations to join it, by coining a gold piece equal to the LMU 10-franc coin. A Royal Commission was appointed to report on the adoption of an international standard, and it came out, in 1870, in favour of adopting a standard almost equal to that of the LMU.

All this was, however, to change, because of the political and monetary consequences of the French defeat at Sedan. Like Austria, which in 1867 had made overtures to the LMU, Sweden became converted to the reality of German economic and political power. Scandinavian independence, however, and Swedish neutrality induced the Scandinavian countries to move towards the formation of their own currency union. This was achieved at the end of 1872, by a Treaty signed by Sweden, Denmark and Norway. But the Norwegian

parliament refused to approve it, only to agree to it in October 1873.

The Scandinavian Monetary Union (SMU) was based, like Germany, on gold. A common unit was adopted, which was the crown, in weight and title equal to an old Swedish coin, the Riksdaler. All coins could freely circulate with unlimited legal value, in the three countries. Divisionary coin was also free to circulate; the three countries agreed to periodic coin repatriation, to avoid excess issue. But the problem never arose. An important clause of the Agreement bound each country not to reach a monetary agreement with another power without the consent of the other two.

Another interesting feature of the SMU was the *de facto* freedom of circulation of bank notes that it achieved. All bank notes being freely convertible, the Scandinavian public soon elected to use them rather than metallic coins, and the coins all ended up in the Scandinavian banks' vaults.

The SMU was made even more complete by the unification of the three countries' legislation on Bills of Exchange, and by starting a Scandinavian clearing system in 1885. The three central banks opened current accounts with one another, on which cheques could be drawn, each time advising the drawee, and never doing it for speculative reasons. The clearing was effected every three months, and the Clearing Agreement could be terminated by simple notification, with a 3-month delay.

The Clearing Agreement was subsequently inserted into the Statutes of the three central banks and they were allowed to consider the amounts held in the current accounts as reserves for their bank notes. In this fashion gold transfers were reduced to an absolute minimum.

As was noted by contemporary observers, the SMU was the most successful of all European currency unions because the exchange rates of the three countries remained fixed. There were no reasons for export of coins, as had happened to Italian and Greek coins in the LMU and to Austrian coins in the German Monetary Union. And exchange rates could remain stable because the three countries remained largely outside great international financial flows and were not troubled by military, political and social problems. The situation of their public finances was therefore sound (with the exception of Denmark, which did not, however, monetise her deficit). Homogeneous countries could easily achieve virtual economic and monetary union.