CANADA AS A 13TH RESERVE DISTRICT?
FEDERALISM AND THE GOVERNANCE OF
NORTH AMERICAN MONETARY UNION

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ABSTRACT: If Canada was to join a North American monetary union, what kind of influence might it have over monetary policymaking within the union? Some NAMU supporters suggest that Canada could become the 13th reserve district within the US Federal Reserve system, and that its influence would then be similar to that of European countries which have joined the euro-zone and its new European Central Bank (ECB). This article highlights how the US Fed’s more centralized federal structure, as well as the quasi-private nature of the Reserve Banks, would in fact complicate Canada’s efforts to obtain the same influence that individual European countries have had within the ECB. The article also notes that the question of Canadian representation within the Fed brings to the surface a longstanding debate within Canada about the lack of federalism within the Bank of Canada. NAMU supporters from some provinces of Canada, notably Quebec, have been less concerned about Canada’s influence within the Fed because their provincial governments already have no say in Canadian monetary policymaking. In these ways, the NAMU debate raises important governance issues relating to not just the federal structure of US Fed but also the lack of formal regional representation in Canada’s existing system of monetary policymaking.
In 1999, a high profile debate broke out in Canada about the idea of joining a monetary union with the United States (and possibly Mexico). Since that time, supporters and opponents have devoted much attention to the economic arguments for and against a “North American monetary union” (NAMU). Equally important, however, has been the political question relating to the governance of such a union. Opponents of NAMU have argued that the United States would inevitably dominate such a union because of the asymmetries of power in the region. They suggest that Canada would be unable to convince the US to follow the European model of creating a new supranational currency and central bank in which the participant countries had an equal voice. Instead, the common currency for North America would become the US dollar, and Canada would have little influence over monetary policy in the region (e.g. Laidler and Poschmann 2000; Robson and Laidler 2002).

This argument about the likely political architecture of NAMU has been a powerful one in influencing the debate in Canada. Even prominent analysts who support NAMU on economic grounds have been swayed by this point to oppose the idea (e.g. Fortin 2000, Buiter 1999). For this reason, many supporters of NAMU have tried to address this concern directly. One line of argument, put forward by Grubel (1999), is that people should not underestimate the willingness of the US to endorse a new supranational North American currency and central bank in which Canada is granted a significant voice. The more prominent argument, however, has been the one advanced by Thomas Courchene and Richard Harris. They point out that the federal nature of the US central bank parallels that of the new European central bank. If Canada was able to join the US dollar zone as a new 13th Federal Reserve district, they ask whether its situation would in
fact as different as critics suggest from that of individual European countries. Harris (2000: 95) makes the case in the following way:

An important issue relating to NAMU that remains a stumbling block for many Canadians is that the governance of North American monetary policy would reside in the hands of the US Federal Reserve. While this would surely be the NAMU reality, it does not differ that much from the reality facing any single country within the Euro zone. Consider the currency choices facing Canada and Britain….In Canada’s case, this means sharing a voting membership on a North American Federal Reserve with the 12 existing US Federal Reserve banks and the Mexican central bank. In Britain’s case, this means joining the Euro with a similarly small voting share – one of twelve votes.¹

In this article, I explore the argument that the federal character of the US central bank could make a North American monetary union based on the US dollar more politically palatable to Canadians. In the first two sections, I point out at the federal character of both the US central bank and the new European central bank are more complicated than Courchene and Harris’ discussion implies. An examination of decision-making in these two bodies highlights how Canada’s position as a 13th Reserve district would be considerably different than the position of individual European countries within the Euro zone. I also discuss how the ECB may not be a very good model to follow for those seeking to create an accountable central bank. The third section then highlights how the Canadian debate on this topic raises an equally important question of how Canada’s monetary preferences are determined. In contrast to the US, Canada’s central bank lacks a federal decision-making structure in which the various regions of the country have a formal voice. I show how this feature of the Bank of Canada has long been controversial,
and has become so again today in the context of the NAMU debate where it is used by
NAMU supporters to question the significance of the argument that Canada may have
little input into Fed decision-making. In this way, I suggest that both the federalism of the
US central bank and the lack of federalism in the Bank of Canada are playing an
interesting and important role in influencing Canada’s NAMU debate.

Before launching into these arguments, I must mention an important caveat. This
paper is not designed to provide a comprehensive analysis of the politics of Canada’s
NAMU debate. Instead, I am focusing exclusively on the specific issue of how decision-
making structures in both the US Fed and the Bank of Canada are swaying the debate.² I
also make little effort to analyze possible US views towards the various governance
questions I address below in this paper. This is undoubtedly a serious limitation since
supporters of NAMU base much of their analysis on an assumption that the US will be
interested in negotiating the provisions they outline, whereas opponents tend to be
skeptical about this assumption. Because of space constraints, however, I have left
detailed analysis of this issue out of this paper and I refer readers to other work on this

**CANADA AND THE FED: WHAT ROLE FOR A 13 TH RESERVE DISTRICT?**

Let us begin with Courchene and Harris’ argument. They are certainly correct that
the federal character of the US central bank makes the political architecture of North
American monetary union easier to imagine. The US central bank is, after all, called the
“Federal Reserve” because it is made up of twelve Reserve Banks, each representing a
district of US territory whose headquarters are in the following cities: Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Given this structure, it certainly seems plausible that Canada could simply become a 13th district. And the attraction of this scenario is that it would enable Canada to have a voice in US central bank – which would be renamed North American Federal Reserve under their plan - since district banks have a formal role in the policymaking of the Fed. But how much voice would Canada have in the Federal Reserve in its role as 13th reserve district? The question is in fact difficult to answer definitively because the nature of the Fed’s federalism is more complicated than Harris and Courchene imply.

The key decision-making body in the Federal Reserve is the Federal Open Market Committee (FOMC) which meets every 4-6 weeks and controls the Fed’s all-important open market operations as well as its foreign exchange operations. The Committee does indeed have twelve voting members. But only five of these votes are allocated to the presidents of Reserve Banks, while the remaining seven are assigned to the members of the Board of Governors of the Federal Reserve System who have been appointed by the US President to fourteen year terms (and confirmed by the US Senate). The allocation of the five Reserve Bank votes is also done in an interesting manner; the president of the Federal Reserve Bank of New York (FRBNY) has a permanent vote (and is also the vice-chair of the FOMC), while the other four votes are shared on a rotational basis among the presidents of the remaining eleven Reserve Banks (although all the presidents can attend all meetings)
As a result, if the Bank of Canada became the 13th Reserve Bank – as perhaps the Federal Reserve Bank of Ottawa (Culpepper 2001) or even Toronto (Pastor 2001: 114) - it would not be guaranteed the kind of voting share that Courchene and Harris suggest unless it secured the same permanent vote that the FRBNY has. If this proved politically impossible, it would have to lobby hard for the best placing within the rotational system involving the other Reserve Banks. At the moment, the Reserve Banks are placed in four groups, each of which runs their own system of rotation: 1) Boston, Philadelphia and Richmond, 2) Cleveland and Chicago, 3) Atlanta, Dallas and St. Louis, and 4) Minneapolis, Kansas City, and San Francisco. Obviously, the second group would be the best to join because Banks in that group have a chance to vote more often. But one could certainly anticipate resistance from those same Banks since Canada’s entry would dilute their influence.

There is a further problem. The Reserve Banks are not structured in a way that is designed to represent the broad “public” interest of the districts they represent. Each of the Reserve Banks is privately-owned by commercial banks that exist within the district. The election of their boards reflects this; six of the nine board members are elected by these private banks. Three of these six are supposed to be chosen by the banks to represent the public (and they may not be linked to private banks as officers, directors or employees), but in practice these “Class B” directors (as opposed to the three “Class A” directors that represent private bank interests directly) tend to be dominated by officials of large manufacturing firms.⁵ One consequence is that the voting patterns of Reserve Bank presidents – who are elected by this board - within the FOMC tend to be more conservative (i.e. they express stronger support for tight monetary policy) than the

At the same time, even this skewed form of regional voice is diluted by the fact that the remaining three members of the Reserve Bank boards – who are also supposed to represent the public (and once again can have no link to private banks, even as shareholders in this case) - are chosen by the federal Board of Governors. The federal Board of Governors also designates one of the directors it chose as the chair, and another director as the deputy chair of the board of the Reserve Bank. Perhaps most important is the fact that, once the nine-member board of the district Reserve Bank has selected a President to represent it on the FOMC (for a five-year term), the federal Board of Governors also must give its consent to the person chosen. The result is described by Woolley (1984: 49-50): “since the [federal] Board, and especially the chairman, exercises a virtual veto over selection of district bank presidents, it is believed the district bank presidents are individuals who reflect the preferences of the Board - or perhaps of the chairman. In the eyes of some Federal Reserve officials, the presidents are essentially employees of the Board” (see also Havrilesky 1995: 294). The power of the local board of the Reserve Bank is also restricted by the fact that, once selected, Reserve Bank presidents are not bound by the preferences of their board when casting votes in the FOMC.

If Canada formed a 13th district represented by a Reserve Bank of this kind, this Bank would hardly act as a representative of the Canadian public interest. Instead, it would be beholden to an odd combination of the preferences of Canadian private banks and the views of the US-appointed members of federal Board of Governors. Needless to
say, this would be a sharp break from current practice. The Bank of Canada is presently a publicly-owned institution whose Governor and board members are all chosen by the Canada’s Minister of Finance. Moreover, none of its Board members is allowed to have any connection to private banks. If the Bank of Canada was to act as representative of Canada’s interests within the FOMC, it would need to preserve this public character. Whether this kind of arrangement could be negotiated as part of Canada’s entry into NAMU is an open question. A concession to Canada along these lines might be welcomed by those Americans who have long sought to reform the Reserve Banks to make them more accountable to the public. For the same reason, it might be resisted by others who fear that the structure of the Reserve Banks can not be altered without upsetting the delicate political balance on which the Fed was founded. Perhaps a messy compromise might emerge in which Canadian banks play the same role as their US counterparts in selecting six of the nine board members, while the Canadian government is given the role of choosing the remaining three and also of approving the selection of Bank president (instead of the US-controlled Board of Governors).

Decision-making within the Federal Reserve thus represents a rather odd form of federalism. Power is concentrated in the Washington-based Board of Governors which has a majority voting block on the FOMC and also plays a role in the appointment of the Reserve Bank presidents and their boards. And to the extent that the Reserve Banks express regional preferences, the views of local private banks play the dominant role. This unique decision-making model is not a product of any formal constitutional federalism, but rather of a political compromise at the time of the Fed’s birth in 1913. At that time, a broad consensus had emerged on the need for some kind of national central
bank. But policymakers remained very sensitive to longstanding fears in US politics about such a bank becoming controlled either by New York bankers or by politicians in Washington. The distinct structure of the Fed was proposed as a solution. The federal structure of regional banks supervised by a Washington-based governing board was designed to address the fear that New York bankers might dominate the new central bank, while the private ownership of these banks reassured those who feared Washington’s control (e.g. Woolley 1984: 36).

But there remained strong disagreements between the New York banking community and many Republican politicians on the one hand, and some key Democrats allied with smaller banks and agricultural interests from the West, mid-West and South on the other. The former preferred a small number of reserve banks and federal governing board with few political representatives. The latter called for a large number of reserve banks (some people wanted as many as 50) and very little role for private interests on the federal governing board. When Woodrow Wilson was elected president, his sympathies were with this latter group and he endorsed a governing board that was entirely politically appointed. At the same time, he accepted the idea of a smaller number of Reserve Banks than some of his supporters were demanding. The 1913 Federal Reserve Act allowed for between eight and twelve such banks, and twelve were soon created by a committee after receiving submissions from 37 cities which wanted to house these banks.

The issue of where final authority rested in the Fed – with the privately-owned Reserve Banks or the politically-appointed federal Board – was unfortunately not outlined clearly in 1913 and it remained very contentious for the first twenty years of the central bank’s existence (e.g. Woolley 1984: 41-4; Havrilesky 1995: 86-105, Wheelock
It was not resolved until the Banking Act of 1935. In the wake of the Great Depression, Roosevelt’s New Dealers made clear their goal of asserting greater centralized political control over the financial sector, a goal that included an attack on the power of the privately-owned Reserve Banks of the Fed. Roosevelt initially wanted to eliminate their decision-making role altogether from the FOMC, but he agreed to a compromise which set up the current configuration of the FOMC with Board members having a majority share of the vote vis-à-vis the Reserve Bank presidents. Two other changes reinforced this shift of power decisively to the Federal Reserve Board (which was now renamed the “Board of Governors of the Federal Reserve System”): 1) Reserve Banks could no longer authorize OMO without the FOMC’s approval, and 2) the Board would now approve the selection of heads of the Reserve Banks (now called “presidents” instead of “Governors”) as well as their budgets (and Bank presidents could no longer be instructed by the boards of their Banks to vote according to the latter’s preferences). It was also at this time that the specific rotation system for the Reserve Banks was established that is still in place today (although the FRBNY did not receive a permanent vote until an amendment in 1942). These changes had the effect not only of asserting greater public control over the Fed but also of centralizing decision-making in Washington.

If the Bank of Canada was to join the Federal Reserve as a 13th Reserve Bank, then, it would be joining an institution whose history has left it with decision-making rules that are quite complicated. To be guaranteed a vote on the FOMC, Canada might lobby hard to receive the unique status for the Bank of Canada that the FRBNY has obtained. At the same time, Canada would also need to maintain some degree of control
over the process by which the head of the Bank and its board was selected. Since both of
these demands might be difficult to obtain, Canadian negotiators would likely also press
for an alternative mechanism for guaranteeing Canada a permanent vote on the FOMC:
obtaining a Canadian representative on the Board of Governors. Since the US President
nominates the existing seven members of the Board, Canada would likely press for a
Canadian representative to be appointed by the Canadian government. Canadian
negotiators could try to justify this demand on the grounds that the Fed’s Board of
Governors is supposed to be somewhat diverse in regional terms.8

This demand might be particularly important for Canadian negotiators because the
Board – rather than the Reserve Banks – is where power has been concentrated in the Fed
since the mid-1930s. The Board controls the budgets of the Reserve Banks and sets the
salaries of their officers. It also has ultimate power over such things as the setting of
discount rates and reserve requirements (although their contemporary significance is not
large).9 Canadian negotiators would also likely press for some say over the selection of
the Chair of the Fed (this person is currently chosen by the US President with Senate
confirmation). The Chair is a powerful figure, playing a leading role in FOMC meetings
and also strongly influencing the allocation of resources within the board. Individual
Board members, for example, find themselves quite dependent on the Chair because they
are allocated no staff of their own except for one research assistant (Havrilesky 1995: 4,
290). If it was not possible for Canada to play a role in the selection of the Fed’s chair,
Canadian negotiators could perhaps press for a vice-chair role on the FOMC to parallel
that held by the FRBNY.
Ironically, then, the existence of the regional Reserve Banks themselves may be less significant to the question of Canada’s voice within the Fed than Courchene and Harris suggest. To be sure, their existence would at least guarantee a Canadian voice of some kind. It would also provide a mechanism for ensuring that attention would be given to Canadian monetary conditions because the FOMC receives a “Beige book” in advance of their meetings which summarizes economic conditions in each of the existing Reserve Districts.  

Each Reserve Bank board also selects one person – usually a prominent banker - to serve on the Federal Advisory Council which meets four times a year to make non-binding recommendations to the Board. But the role of the head of a Canadian Reserve Bank might ultimately be less significant in projecting Canadian preferences within the Fed than a Canadian representative on the Board and/or a Canadian role in selecting the Fed’s Chair.

**COMPARING TO THE EUROPEAN CONTEXT**

How does Canada’s potential position within a North American Federal Reserve compare to that of European countries within the European Central Bank (ECB)? Courchene and Harris suggest that it would be similar. Here again, however, the situation is more complicated than they suggest. To begin with, there are a number of reasons why member countries of the euro-zone have greater influence within the ECB than Canada can anticipate within the Fed:

• The head of each national central bank within the ECB has been guaranteed one vote on the key decision-making body, the Governing Council. There has been, in other words,
no system of rotation among these representatives of the kind that Reserve Banks participate in within the FOMC of the US Fed. The central banks of small countries also have exactly the same voting share as large ones.\textsuperscript{11}  
• The national central banks hold a majority voting share on the ECB’s Governing Council instead of the minority share held by the Reserve Banks in the FOMC. The Governing Council is made up of the national central banks plus an Executive Committee (which roughly parallels the Fed’s Board of Governors). But the latter has only six members (the President, the vice-President, and four others), a number easily outnumbered by the national central bank representatives.  
• The selection of the Executive Committee (each member of which serves non-renewable eight year terms) is done by unanimous approval of the national governments participating in the euro-zone. This gives the governments of even small European countries a veto power, a much more influential role than Canada is likely to be able to obtain with respect to the selection of the Fed’s Board of Governors and its Chair.  
• Unlike the Fed’s Board of Governors, the ECB’s Executive Committee has no say over the selection over the heads of national central bank. Each national government controls completely the selection process of the head of its central bank.  

In these ways, the ECB represents a much more decentralized federal structure - which gives more power to the “regions” of the common currency zone - than the Fed. There is one further reason why individual European countries have more say in the ECB than Canada would likely have in a NAMU. The ECB must report to, and consult with, a number of pan-European institutions, in which each country has a voice. The European Parliament, for example, must be consulted about the selection of the ECB’s president
and its executive council (although it is not empowered to reject nominations). It also receives the ECB’s annual report and can ask its President or executive committee members to appear before its relevant committees. In addition, the ECB president reports to the European Council and European Commission (Dyson 2000). In North America, there are no equivalents of these kinds of pan-regional bodies for a North American Federal Reserve could report to or consult with. This reduces the opportunity for Canada to express its preferences. For example, the Chair of the US Fed has since 1977 been mandated to report semi-annually to the US Congress, but could s/he also be forced to report to the Canadian Parliament? Some, such as Laidler (1999), Buiter (1999) and even Courchene (1999c: 313), are skeptical, and conclude that only the Canadian representative(s) in the Fed would likely play this role. These kinds of difficulties lead many critics of NAMU to argue that the common central bank would lack legitimacy and could only function credibly on a sustainable basis if regional political institutions were created (e.g. Chriszt 2000: 37; Buiter 1999; Fortin 2000).

It is important, however, not to overstate the “voice” of individual European countries within the ECB. One reason is that national central banks are mandated not to consider their specific country’s interests when participating in the ECB’s decision-making. This mandate is reinforced by the fact that, in contrast to the practices of the Fed, the votes and debates in the Governing Council are kept confidential; national governments are, thus, unaware of how their country’s central bank head is voting (Pringle and Turner 1999; Dyson 2000:239). These provisions were explicitly designed to force ECB directors to adopt a pan-European perspective. Indeed, Dyson (2000: 33) notes that even the seating arrangements in the Governing Council are designed to serve this
goal; “its members sit in alphabetical order, by name not by country, and mixing national governors with executive board members in order to avoid any grouping in hostile blocks.”

Also important is the fact that the ECB has been established in a manner that makes it relatively unaccountable to elected officials across Europe (e.g. Verdun and Christiansen 2000; Taylor 2000). As we have seen, national governments certainly influence the Bank through their control of the selection of the Bank’s executive council and the Governors of the national central banks. But once appointed to their long terms in office, these central bankers are relatively autonomous from elected officials. I have already noted that the ECB engages in some reporting and consultative activities vis-à-vis the European Council, the European Parliament, and the European Commission. But ultimately, the Bank’s autonomy is very strongly protected in a legal sense. Article 107 of the Maastricht Treaty states: “neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions” from outside bodies. The Maastricht Treaty also states famously that the Bank must make “price stability” the bank’s central goal. This mandate was, of course, agreed at the time by national governments. But because it was set out in this international treaty, it is now very difficult for future governments to alter. It can not, for example, be changed simply by a vote of the European Council of Ministers or the European Parliament. Many analysts argue that this weak accountability to elected officials is a fatal flaw in the ECB’s design. The comments of Pringle and Turner (1999: 240-1) are typical:

The biggest threat to the euro and the ECB arises not out of any faults with the ‘internal’ design of the system but with the absence of a mechanism for political
accountability….No central bank can operate in the long term in an environment that is not in tune with the public interest….there is no accepted mechanism for ensuring its continued political legitimacy.

These features of the ECB make it much less accountable to elected officials than the US Fed and the Bank of Canada within their respective domestic political settings. The latter are both creatures of a legislative body (i.e. the US Congress and the Canadian Parliament) which can at any moment change their mandate. In the case of the Bank of Canada, the Canadian government has even set out specific “inflation targets” for the Bank to follow since the early 1990s. The 1967 revisions to the Bank of Canada Act also make clear that ultimate responsibility for monetary policy rests with the government, and the Bank of Canada’s Governor is required to consult regularly with the federal Minister of Finance for this reason. In the event of a conflict between the Governor and the federal government, the Minister has also been empowered since 1967 to issue a public directive to the Governor (although this has never been done and it would carry high political risks for the government).\textsuperscript{13} The Fed is not guided by any specific “inflation targets” set by Congress or the President, and this kind of “directive” power does not exist. But it too consults regularly with elected officials and it is keenly aware of its potential vulnerability to changes in its mandate (e.g. Morris 2000).

In sum, then, individual countries have more voice within the ECB than Canada would likely have within a North American Fed. But even this European institution is hardly a model to follow since it is seen by many to suffer from a serious “accountability deficit”. Indeed, many of those who are critical of NAMU on this basis are also critics of the ECB for the same reason (e.g. Laidler and Poschmann 2000). It is worth recalling,
however, that the weak political accountability of the ECB is seen by some as a virtue in Europe. Indeed, many supporters of EMU have backed the project precisely because it promises to insulate monetary management from political influence to a greater extent than before. Joining the euro-zone has been seen as a way to “lock in” an approach to monetary policy that prioritized price stability. For some, this goal stemmed from their commitment to the “neoliberal” idea that price stability should be the prime objective of monetary policy. For others, it reflected a more pragmatic desire for monetary “credibility” in the face of increasingly powerful global financial markets which were undermining national monetary sovereignty anyway. The fact that a large political constituency supported these views across Europe helped to generate some of the support for the euro project. And from this perspective, the ECB will in fact be perceived as legitimate as long as it fulfills its technocratic task of preserving price stability (Dyson 2000: 216-9).

The same goals drive some of the supporters of NAMU in Canada. Grubel, for example, explains his support for NAMU partly on the grounds that it would help to insulate monetary policy from political interference by Canadian politicians: “I would like to have an institution that protects me against the future, when another generation of economists is rediscovering Keynesianism, or whatever threats there might be in the future” (Canada 1999: 62). He also hopes that a future North American Fed would be guided by the same price stability mandate as the ECB. Courchene and Harris (2000: 15) also predict that the North American Fed might have this kind of mandate, and they try to dispel fears about the NAMU being unaccountable to Canadians on the grounds that the provision of price stability should increasingly seen as an uncontroversial supranational
“public good” (e.g. author 2003; Harris 2000: 95). In addition, they argue that Canadians must recognize how national sovereignty in monetary affairs is increasingly becoming a thing of the past. In addition to pointing to the growing power of global financial markets, they highlight the growing use of the US dollar by the private sector within Canada. In a context of creeping informal “dollarization”, they argue that obtaining even a small voice within the Federal Reserve would be better than the alternative of being left with no voice in a de facto dollarized economy (e.g. Courchene 1999c).¹⁴

If there is a large support for these views, the debate about an “accountability deficit” may be less politically controversial in Canada than some NAMU critics suggest. The chief of the Bank of Canada’s international section, James Powell, hinted at this point in an internal memo about NAMU (obtained under the Access to Information laws): “[Common North American political institutions] might be preferable in order for the North American Monetary Authority to be accountable to some degree to Canadians. However, this may not be important to people” (quoted in Toulin and Bellavance 2001, my emphasis). As Dyson (2000) suggests, what is really at stake is two competing visions of legitimacy. Supporters of the ECB and NAMU are suggesting that these regional central banks can be sustained by a kind of relatively narrow “technocratic conception of legitimacy” (Dyson 2000:244). Their critics have a broader “Lockean” concept of legitimacy which emphasizes how these central banks can only function credibly on a sustainable basis if they are supported by ongoing democratic accountability and consent.

**MONETARY DECISION-MAKING WITHIN CANADA**
There is one further reason why arguments about the weak Canadian voice with a future North American Fed may resonate less strongly in Canada than critics of NAMU hope. Some regions within Canada already complain about their existing lack of influence within Canadian monetary policymaking. This is because the Bank of Canada does not share the US central bank’s federal structure. Instead, it has a long history of highly centralized decision-making that gives no formal role to regional voices across the country. In this context, fears about an “accountability deficit” in NAMU are received less sympathetically in some parts of Canada since they are seen simply to replicate a longstanding deficit of this kind already present within the Bank of Canada.

Critics of the lack of regional voice within the Bank of Canada often contrast its decision-making structures with those of the Fed. The Bank of Canada has a unitary structure instead of a federal system of Reserve Banks. Even on its twelve member Board of Directors, there is no formal system of regional representation. All Board members are appointed by the federal government, with no role given to the provinces in this process. Although Board members are supposed to be selected to represent a variety of occupations, there is not even a formal requirement for regional diversity. In practice, the federal government has embraced an informal regional arrangement; two Board members are always from Quebec and Ontario, while each of the others is from one of the remaining provinces (no members are from the territories). But the significance of this informal regional representation is undermined by the fact that Board has historically played a minimal role in influencing the Bank’s policymaking. Its members hold part-time positions that are not well paid, and they receive only three year terms (Laidler 1991). Power has instead – until very recently (see below) – been highly concentrated in
the position of the Governor of the Bank. Although the Board does formally select the Governor, the government’s approval is required; in practice, the government plays the key role in this selection process.16

The lack of regional input in Bank of Canada policymaking is somewhat odd given that Canada is a federal state. Many other federal states, such as Germany, Switzerland and the US (although not others such as Australia), have central banks that embrace federal decision-making processes (Coleman 1991). The situation is particularly unusual in Canada because of the enormous regional economic diversity of the country. This diversity ensures that different regions of the country often have quite distinct monetary and exchange rate preferences. Indeed, in his seminal 1961 article on “optimum currency areas”, the Nobel prize-winning economist Robert Mundell famously suggested for this reason that Canada might be better divided into at least two distinct regional currency zones.

Not surprisingly, the lack of regional voice in the Bank of Canada’s decision-making structures has long been a controversial issue in Canadian politics. When a 1933 Royal Commission recommended the establishment of the Bank of Canada, a Quebec member of the five-person Commission – Beaudry Leman – dissented, noting that more careful attention should be given to the constitutional complexities of establishing such a Bank in a country with a federal political system. Mindful no doubt of the fact that the Quebec government opposed the Bank’s creation,17 he added:

Regardless of the constitutional aspects of the question, if a central bank is to be a co-ordinating agency in this country, it would seem indispensable to ascertain beforehand that such an institution would be assured of the goodwill and co-
operation of each and every ones of the Provinces of Canada. Before a central bank can hope to speak with one voice on behalf of Canada, it would seem desirable that it should have authority to express the views not only of the Dominion Government but also those of all the Provinces. (Royal Commission 1933a: 96).

Despite Leman’s views, the Commission did not recommend a federal decision-making structure for the Bank. The approach was not defended in the Commission’s report, and some have explained it on the grounds that the Bank of England officials who dominated the Commission simply used their own bank as a model for that of Canada (e.g. Coleman 1991: 732). It is certainly true that the British chair of the Commission – Lord Macmillan – showed a preference in the hearings for a centralized model.18 It also no doubt reflected the view of the government and the Commission that the Bank should be a privately-owned bank that was insulated from sectional political pressures (Stokes 1939:159).19 Also important may have been the fact that regional voices from the Maritimes and the Western provinces did not appear to lobby strongly for a federal decision-making structure. Although attacks against the financial dominance of the country by central Canadian interests were certainly voiced by many in these regions during the 1930s, I have been unable to find calls for a federal structure for the Bank of Canada in the Commission’s extensive hearings. By contrast, the fear of New York financial domination in other regions of the US played a central role in strengthening the case for a federally structured central bank in that country. Particularly important in demanding the decentralized Reserve system were banks in US regions such as the mid-West who hoped this system could preserve their existing central role in various regional financial systems (e.g. Livingston 1986: ch.7-8). In Canada, by contrast, the banking
system had long been much more centralized on a national basis via branch banking; as a result, there was no parallel to the regional bank lobby that existed in the US at the time of the Fed’s creation.

After Leman’s critique, the issue of the lack of regional representation in the Bank of Canada arose again in the 1960s. During the 1962 hearings held by the next Royal Commission into banking issues, the issue was raised this time by the Ontario government. That government demanded that provincial governments be allowed to nominate directors to the Bank of Canada’s board who would then formally represent them (Royal Commission 1962a: 7120-5, 7140). By the late 1960s, the Quebec sovereigntist movement was gaining in strength and it also demanded a new decision-making model for the Bank of Canada. If a monetary union was to be preserved with the rest of Canada after Quebec separation, the leaders of the sovereigntist movement asserted that Quebec must receive substantial representation within the Bank of Canada. They maintained this view throughout the 1970s and into the 1980 referendum campaign.

The Bank of Canada’s decision-making model became controversial once again during the early 1990s when the Bank’s rigid anti-inflation policy induced a severe recession in Canada. The Bank was subject to enormous public criticism at the time, and one line of criticism was that the Bank’s policy had been designed primarily to contain inflationary pressures in Southern Ontario at the expense of growth in other regions of the country. The legitimacy crisis experienced by the Bank in this period was reinforced by the fact that this criticism was heard in a period of constitutional crisis in the country when Westerners and many in Quebec were demanding a major restructuring of the
Canadian federation. In this context, many proposals were put forward to force the Bank to listen more to regional perspectives (see Laidler 1991, Clarke 1996, Crow 2002: 16-22). Even the federal government included a number of reforms of this kind in its September 1991 constitutional proposals. These reforms included measures to require: 1) the Bank of Canada Governor to meet with federal and provincial finance ministers on a regular basis, 2) the federal government to consult with provincial governments when appointing Bank of Canada board directors, 3) the Bank of Canada Governor’s appointment to be ratified by the Senate (which itself was to be reformed by giving provinces more say in the appointments to the body), and 4) the creation of regional consultation panels, chaired by Bank directors, whose membership would be chosen in consultation with provincial and territorial governments.\(^{22}\)

These proposals were soon dropped from the agenda for constitutional reform, but a House of Commons subcommittee took up the task of analyzing as many as eight different models of governance for the Bank. Although the committee ultimately endorsed the status quo in its 1992 report, the Bank itself soon undertook some reforms to address the criticisms. In 1994, it endorsed the idea of decentralizing authority away from the Governor by establishing a new six member Governing Council which included the Governor, the Senior Deputy Governor and four deputy Governors selected by the Board (but not with any formal regional representative criteria in mind). Three years later, the Bank created five regional offices. The Governor explained the rationale: because Canada is such a large country with so many diverse economic regions, it is important that the Bank maintain contacts with the public that are country-wide and that involved two-way communication. We need to hear first-hand what is
happening to the economy and every corner of Canada. That is why, in 1997, we set up five regional offices, including one here in Halifax for the Atlantic region. Our representatives are in frequent contact with various local associations, businesses, community groups, government officials, colleges, and universities to give and receive information into exchange views on the economy and monetary policy.

(Thiessen 2000:2)

The debate about NAMU, then, has come not long after an historical moment when criticism of the Bank’s insensitivity to regional perspectives reached a peak. Although the Bank has been trying to respond by decentralizing its decision-making, the memory of the early 1990s controversies remains strong in many parts of the country. This is clear in some of the arguments of NAMU supporters. Quebec sovereigntists, in particular, have argued that NAMU would enable Quebec to avoid the experience of early 1990s. In Marceau’s (1999) words, "if the past is any indication of the future the American pro-employment monetary policy might be more advantageous for our economy than an anti-inflationary Canadian monetary policy designed to reflect the prerogatives of Ontario." In response to arguments that the adoption of the US dollar would leave Quebec with little influence over US monetary policy-making, some Quebec sovereigntists argue that the Quebec government already has had little say in the operations of the Bank of Canada (e.g. Marceau 1999).

Many Quebec sovereigntists are in fact quite unique among NAMU supporters in arguing that they would support the adoption of the US dollar even if Quebec and Canada have no say in the Federal Reserve. This might seem an odd position for a group whose political project is devoted to the achievement of “sovereignty”. But it reflects their long-
standing goal of addressing Quebec voters’ fears that independence might be accompanied by severe monetary instability (Helleiner forthcoming). In the 1970s and 1980s, Quebec sovereigntist leaders addressed this fear by promising that a sovereign Quebec would maintain the Canadian dollar as its currency. They initially hoped to share decision-making power within the Bank of Canada, but in the lead-up to the 1995 referendum some key sovereigntists (including Premier Jacques Parizeau) argued that Quebec would be prepared to adopt the Canadian dollar even unilaterally in the event that Canada refused to negotiate the terms of a monetary union. At the time, this position perplexed many observers since it would leave Quebec without voice in the management of the Canadian dollar. But it reflected the importance of the issue of “monetary confidence” for the sovereigntist movement. Interestingly, Parizeau also defended it by critiquing the centralized nature of decision-making in the Bank of Canada: "a lot of people argue we wouldn't have any control over the monetary policy of the currency we employ. And that's perfectly correct. But, as far as I'm concerned, Quebec doesn't have any control over the policies of the Bank of Canada right now. So what have we got to lose?" (Quoted in the Canadian Press 1992).

It was a short step from this position to endorse NAMU with or without a formal voice in the US Fed. Indeed, if the unilateral use of the Canadian dollar was designed to calm Quebec fears of monetary instability, the more recent idea of endorsing a North American monetary union might be even more effective for this purpose. An independent Quebec that adopted the US dollar would be better insulated from currency instability because of the US dollar’s wide use. Quebec would also be less vulnerable to Canadian pressure if it no longer relied on the use of the Canadian dollar (Parizeau 1999: 8). If
NAMU were not yet in place, Parizeau has noted that the threat to adopt the US dollar might also provide Quebec with considerable bargaining power in negotiations with Canada (Bueckert 2000). Thus, while analysts elsewhere in the country view the prospect of Canada unilaterally adopting the US dollar as a “quasi-colonial” (Laidler and Poschmann 2000: 18) scenario, this situation looks somewhat different from the perspective of many Quebec sovereigntists.

Although unilateral dollarization might be acceptable to some Quebec sovereigntists, they certainly would prefer a voice with the Fed. But what kind of a voice would this be? They presumably would not want to be simply represented by a Canadian voice selected by the federal government in Ottawa. Instead, might they demand a separate Reserve District for Quebec? If such a demand was put forward, it might lead other regions of Canada to make a similar request. Nystrom (2002: 1), for example, predicts that Canada might be divided into four Reserve districts: “one reserve bank for central Canada, another one for each of Western and eastern Canada and one bank for Québec”. This scenario would, however, raise an obvious constitutional complication; the federal government retains exclusive power over issues relating to currency. Since it would also complicate the voting structure on the FOMC and might give Canadians much more clout, the US would also be likely to resist it strongly.

An alternative decision-making model might be to retain a single Reserve Bank for Canada but create a number of regional branches within it. Most of the existing US Reserve Banks have such branches, each with their own Boards of Directors. These directors, however, are selected in a centralized manner by both the respective Reserve Bank directors and the federal Board of Governors (Havrilesky 1995: 2). This method of
representation would obviously not be very attractive to Quebec sovereigntists or other regional voices in Canada.

Whatever the specific proposals, the creation of a North American monetary union would certainly provide a political opening to those who have long critiqued the Bank of Canada’s centralized decision-making model. In this way, the NAMU debate really raises two levels of architectural questions simultaneously for Canadians. One is the set of questions about Canada’s role within the federal nature of decision-making within the US Fed that have been raised by Courchene and Harris. The other equally important set of questions concern regional representation within Canada’s monetary decision-making processes.

CONCLUSION

It is clear that the governance structure of NAMU could take many different forms. Each distinct form has advantages and disadvantages that could swing the broader Canadian political debate on monetary union in one direction or another. Indeed, many who remain undecided in the NAMU debate have made it clear that the question of governance may become the decisive one in helping them choose a side in the broader NAMU debate. In particular, they remain concerned about the question of whether Canada would be able to gain any significant influence within a monetary union that would most likely be based on the US dollar.

As we have seen, key supporters of NAMU have attempted to address this concern by highlighting both the federal nature of the US central bank and the lack of
federalism in the Canadian central bank. The significance of the former, they have argued, is that Canada’s role as a 13th Reserve district of the Fed would not be terribly different than that of individual countries within the ECB. At the same time, the latter has also been invoked in some parts of the country, most notably Quebec, as a reminder that the Canadian central bank is already not as accountable to regional interests as they wish.

With respect to the first argument, I have shown how both the Federal Reserve and the ECB have more complicated decision-making rules than this argument implies. The Fed’s more centralized federal structure, as well as the quasi-private nature of the Reserve Banks, would complicate Canada’s efforts to obtain the same influence as individual European countries in the ECB. I have also noted that the ECB itself should not be held up as a model since many Europeans worry that it suffers from an “accountability deficit” vis-à-vis European voters as a whole. This feature of the ECB is already raising questions about its political future, and it has generated a broader debate about the means by which central banks are legitimized in democratic societies.

That broader debate in Europe relates to the second argument invoked by some NAMU supporters about the accountability of the Bank of Canada to regional interests within the country. As I have shown, the absence of formal regional input into the Bank of Canada has been a significant political issue at various times in Canada’s history, most notably in the early 1990s when there was a widespread sense that the Bank was suffering a serious legitimacy crisis. There is no doubt that NAMU supporters in Quebec have been able to build upon that crisis to generate support for their cause. Indeed, in internal memos that came to light in 2001, Bank of Canada officials identified the need to improve the Bank’s image in the province, which had suffered during the early 1990s, if
they were to successfully counter sovereigntist arguments in favour of NAMU (Toulin and Bellavance 2001). To respond to regional critiques from Quebec and elsewhere, I have noted how the Bank began to decentralize decision-making as early as 1994. If the NAMU debate intensifies, the pressure to accelerate reforms of this kind may grow.

What does this analysis tell us about the prospects for NAMU? As noted in the introduction, I have not attempted to analyze the broader political alignments in Canada for and against NAMU. I have also made little effort to examine how NAMU is viewed from the US side of the debate. But the paper’s analysis does help us to understand how governance questions may influence the NAMU debate in Canada. It highlights that NAMU supporters in Canada will remain vulnerable to the criticism that Canada may have only a very limited voice within NAMU, despite Courchene and Harris’ attempt to address this issue. At the same time, the political salience of this criticism is sometimes weakened by the limited formal representation of regional perspectives within the Bank of Canada. In this way, it is apparent that the NAMU debate will continue to raise issues not just about architecture of a North American central bank but also about Canada’s existing system of monetary policymaking.
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See also Courchene (1998: 324), Courchene and Harris (2000: 15). For a similar argument, see Marceau (1999).

For a broader analysis of the politics of the Canadian debate on NAMU, see Helleiner (2004).

Under their proposal, Canada would also keep seigniorage revenue as well as maintain its existing clearing system and its own national financial regulatory system. They also suggest Canada’s currency could also retain distinctive national symbols while bearing the mark of the North American central bank.

This paper is not the first to develop this line of criticism. See especially Laidler (1999: 331), Laidler and Poschmann (2000), and Robson and Laidler (2002) for brief analyses of this issue.

Former bankers are also prominent (Woolley 1984: 78). For the election process, private banks are divided into three groups according to the size of their capital. Each group elects (on a one bank, one vote principle) one of the “Class A” directors (the three that represent the banks) and one of the “Class B” directors (the three that represent the public).

In the early 1990s, for example, the chair of the House Banking Committee, Henry Gonzales, sponsored a bill to have the US President (confirmed by Senate) appoint all Reserve Bank presidents and to have six of the nine directors (instead of three presently) of each Reserve bank be chosen to represent a cross-section of the population inclusive of small business, labor, consumer and community organizations, and women and minorities. His bill also called for a study of the appropriateness of the boundaries of
existing reserve district and of the requirement that private banks purchase the stock of, and receive dividends from, the Reserve Banks (e.g. Havrilesky et al 1993).

7 His one concession to the New York banks was the creation of a banker-controlled federal advisory council that could make recommendations to the Fed Board. This council still exists.

8 Board members must be chosen with due regard to “a fair representation of the different commercial, industrial, and geographical divisions of the country” (Amtenbrink 1999: 141-2). There is also a requirement that seven Governors must come from different Reserve districts, although this requirement does not guarantee that all districts will be represented. It is simply designed to prevent one region of the country from being overrepresented (Havrilesky 1995: 4). Gruben et al (2003: 297) suggest that Mexico and Canada might be represented on the FOMC twice by having a representative on the Board of Governors and by making the heads of the Canadian and Mexican central banks voting members.

9 With respect to discount rate changes, the boards of directors of each of the 12 Reserve banks make a recommendation to federal Board of Governors about discount rate changes every two weeks. The Board is not, however, bound by these recommendations. The current focus of monetary policy in both Canada and the US is on the day-to-day interest rate: the “overnight rate” in Canada and the “Federal Funds” rate in the US.

10 But the significance of this should not be overstated, as two recent authors recently noted: “in these [FOMC] meetings, regional information is studied more as an aid to filling out the national picture, as opposed to being a concern, per se, for the FOMC. In addition, the FOMC’s historically strong leadership, as exemplified by Paul Volker in the
past and Alan Greenspan currently, favors a national approach to policy making. Tilting
the FOMC even more toward the national perspective are the financial and political
systems shared by all regions. In the end, the FOMC mainly focuses on aggregate
economic conditions." (Carlino and DeFina 2000: 64).

11 This is, however, about to change. The European Union has been engaged in a lively
debate about how decision-making rules within the ECB will need to be altered as the
number of potential euro-zone countries rises dramatically with the incorporation of
Eastern European countries within the EU. In March 2003, the EU Council of Ministers
approved a new system of voting within the ECB which included the following elements:
1) the Governing Council would never exceed twenty one voting members, of which six
members would still be the Executive Committee, 2) the remaining fifteen voting
members would be national central bank governors selected on a system of rotation from
groups of countries that are organized according to countries’ economic and financial
significance within the euro area. The way that the proposed groupings are organized
would have the effect of giving larger countries a vote more often within the system of
rotation than smaller countries. But Courchene and Harris’ argument was made before
these changes began to be discussed. I have therefore evaluated their argument on the
basis of the original ECB voting rules.

12 The one area where the Council of Ministers has a little more influence is exchange
rate policy. The Council can provide guidelines to the ECB about the “general
orientations” of exchange rate policy as long as these do not interfere with the goal of
maintaining price stability.
These lines of authority were endorsed once again in 1992 report accepted by all the major federal political parties at the time and justified in the following way: “in the democratic society, a public policy instrument as powerful as monetary policy cannot be entirely removed from the political process…the elected government must remain ultimately accountable for the monetary policy followed” (quoted in Laidler and Robson 1993:127).

Critics of Courchene and Harris’ argument have shown that there is in fact little evidence to support their view that informal dollarization is increasing dramatically within the Canadian economy (e.g. Laidler and Poschmann 2000; Robson and Laidler 2002).

Interestingly, even this arrangement was not a product of a formal political arrangement. Instead, it was devised by the Canadian Chamber of Commerce in 1935 when it presented the first slate of candidates for election by what were then the private shareholders of the Bank. The initial Bank of Canada act required that the elected directors represent varied occupations in the following manner: two from primary industries, two from commerce and manufacturing, and three from other occupations (Stokes 1939: 194). But as 12,000 people became shareholders of the Bank in 1934, it quickly became apparent that the election of these directors would be very complicated. The government initially encouraged trade and vocational associations to sponsor candidates, but the Canadian Chamber of Commerce soon submitted a slate of nominees that were all elected during the first vote in January 1935. In creating this slate, the Chamber devised guidelines that mixed occupational and regional criteria in the following ways: the two people representing primary industry would come from the
Maritimes and the Prairies; Ontario and Quebec would be represented by one commercial and one miscellaneous occupation each; and British Columbia would receive the last miscellaneous occupation slot. This set of guidelines was adopted, although it produced a controversy within the business community because it excluded mining and forestry interests in Ontario from representation (Stokes 1939: 205-6; Watts 1993: 24; Babab and Mulroney 1995: 19-20). When the government created additional directors on assuming majority ownership of the Bank in 1936, it assigned these to the provinces not yet represented to receive a director. The model of every province being represented by at least one director – and Quebec and Ontario receiving two – has remained since this time.

16 When the Bank was first created as a privately-owned institution, a veto power was granted to the Cabinet-appointed Governor over the decisions of the privately-elected board of directors. This measure was included as a concession to the Parliamentary opposition who wanted the Bank to be more accountable to the public. When the Bank became publicly-controlled in 1936, the government gave itself the power to disallow the Governor’s veto and the veto power was then withdrawn in 1967 (Watts 1993: 21).

17 The Government of Quebec opposed the creation of the Bank partly on the grounds that the existing monetary system of the country was not in need of reform. But it also worried that the Bank would be politically controlled. More specifically, it suggested that the Bank might give special favours to provinces which supported the federal government. (Royal Commission 1933b: 2254-60)

18 See for example Royal Commission (1933b: 2270-1).

19 The Bank was initially created as a privately-owned institution whose Governor was appointed by Cabinet but whose board of directors was elected by the private
shareholders. When a new Liberal government came to power, it bought out a majority of the shares in 1936 and then nationalized the Bank entirely in 1938 (Stokes 1939:222-237).

The Commission also interviewed an official from the US Fed about its decision-making processes and that official made the case that the Reserve Banks help to provide regional input and to legitimate the Fed across the country (Royal Commission 1962b: 3909).

In the late 1960s, Levesque initially proposed a five year experiment in which an independent Quebec would share a currency union with the rest of Canada. The joint currency would, he suggested, be managed by a central bank with a joint Board of Directors which included the deputy ministers of finance of both countries as non-voting members. The top positions of the bank would be distributed proportionately between the two countries, and the positions of Governor and Deputy Governor would alternate between officials from the two countries (Levesque 1968: 45). By the time of the Parti Québécois’ 1979 White Paper Quebec-Canada: a New Deal, the PQ was proposing that the leadership of a common central bank with the rest of Canada would be "shared alternately by a governor named by each government; the number of seats allocated to each party on the Board of Directors will be proportional to the relative size of each economy" (quoted in Globe and Mail 1979). In the event of disagreement between the representatives of the two countries within the monetary authority, a newly created “community Council” – involving Cabinet ministers from both countries – would have the power to give guidelines to the authority. (Leslie 1979: 17)

The government also proposed some reforms unrelated to the issue of regional representation such as changing the Bank’s charter to make price stability its primary
goal, and replacing ad hoc appearances of Bank officials before Parliament with semi-
annual ones. Proposals put forward by other observers at the time included measures: to
make board members full-time positions with longer terms; to give provincial
governments direct representation on the board; to allow provincial legislatures a role in
questioning Bank directors; and to create “regional” deputy Governors;

23 See also PQ (1994: 57-58).