

COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

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THE ECU, THE COMMON CURRENCY AND THE MONETARY UNION

I. Issues and options

1. The following terminology may be used to facilitate the discussion concerning the common currency and the ECU:

A common currency describes a currency which is used in the Community and is not the national currency of either a member state or a third country. Two types of a well-defined common currency can be distinguished:

- a parallel currency, which is a common currency that is created independently of, and in addition to, national currencies. It circulates in parallel to national currencies and competes with them;
- a single currency is a common currency that has replaced all existing national currencies as a result of an institutional decision (rather than a market process).

A common currency may, however, also be understood to cover the use of a common numeraire (as the private ECUs today) or a common reserve instrument as a means of implementing a common monetary policy.

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2. The issue of the currency in a monetary union revolves around two interrelated questions:

- (a) What is the need for, and role of, a common currency in the process leading to monetary union?
- (b) What should be the future role of the ECU?

3. A common currency in the process leading to monetary union. Various views may be held on this problem. One is that no common currency needs to be foreseen in order to have a monetary union, because the irrevocable locking of parities, full mobility of capital, and the pursuit of a single monetary policy suffice for the creation of a monetary union, i.e. a single currency area. Alternatively, the view may be held that ultimately the move to a single currency is necessary in order to reap the full benefit of monetary union. According to this view, only with one single currency will there be a convenient numeraire for the transactions of private economic agents and will uncertainties and transaction costs be substantially reduced. It may also be observed that no monetary union has ever existed without a common currency, and that the credibility of the "irrevocable locking" would be at danger with the continued existence of many different currencies.

4. The role of the ECU. Proposals concerning the ECU obviously depend to a significant extent on the views about the need for a common currency. However, it should be taken into account that the ECU already exists, that it occupies a place in private markets, that it has raised a certain amount of expectations concerning its future role in the process towards monetary union and that it carries a symbolic value to which political leaders may attach importance. To many observers it seems natural to see the ECU's role growing with the progress towards monetary union and to become the Community's single currency. Others may consider that setting

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up arrangements concerning a common currency is premature, and that only the promotion of convergence and monetary stability is necessary.

5. There are three options for the future role of the ECU, which are not necessarily mutually exclusive.

6. Firstly, the ECU remains a basket of Community currencies and serves as a common numeraire. Following this option, all possible impediments to its voluntary use in private financial and commercial transactions will be removed, but no particular official action would be taken to promote the use of the ECU; no new institution would be required to "look after the ECU", but the monetary effects of its spreading use would have to be monitored.

7. Secondly, the official ECU (which could remain a basket) is used as a common reserve instrument to manage a common monetary policy. In this case the ECU would become the reserve money of the European system of central banks. This approach has been suggested in Governor Ciampi's paper. This expanded use of the official ECU would not necessitate a linkage between the official and the private ECU, with the latter evolving in accordance with the first option.

8. Thirdly, as has been suggested by some academic economists, the ECU could be made a parallel currency. It would be issued by a central institution and permitted to circulate freely throughout the Community as a means of payment, store of value and unit of account. The ECU would be an additional - thirteenth - currency of the Community, it would have to be defined in its own right (so-called abstract ECU) and it would form part of the exchange rate arrangements. Its acceptance and use by private market participants would essentially depend on its quality as money.

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II. Propositions relating to the ECU

9. Four possible propositions are stated in the following, in order to spell out their interpretation and possible implications.

10. "A parallel currency approach is neither a useful nor a desirable way to establish a monetary union". In accordance with this approach the ECU would be created independently of, and in addition to, national currencies, thus circulating in parallel with them and competing with them. The idea of those who advocate this approach is that the ECU would eventually "crowd out" national currencies, thus establishing a monetary union "in a painless way". The critics of this approach reject it on two grounds. Firstly, it would not contribute to solving the problem of co-ordinating national monetary policies; on the contrary, it would add a thirteenth player to an already difficult co-ordination exercise. Secondly, it could undermine a monetary policy oriented towards price stability, because it would add a source of money creation that is difficult to link to the needs of economic activity.

Concrete implications of this proposition are that before the final stage:

- the ECU should remain a basket;
- no independent monetary policy would be set up for the ECU;
- no link needs to be established between the private and the official ECU circuits.

11. "An 'imprimatur' is given to the ECU as the future single currency of the Community". A single currency, while not strictly necessary for the creation of a monetary union,

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may be seen - for economic as well as psychological and political reasons - as the natural and desirable further development of the monetary union. However, the decisive step before the Community can consider the adoption of a single currency is the irrevocable locking of exchange rates (and when this step will be reached might depend much more on an effective co-ordination of policies than a growing use of the ECU). Once exchange rates are permanently fixed the ECU will become a very close substitute for any national currency.

Concrete implications of this proposition are that:

- there should be no discontinuity between the present ECU and the future single currency, i.e. that any debt contracted in ECU before the introduction of the single currency would be payable at face value in ECU if, at maturity, the transition to the single currency has been made.

12. "All impediments to the voluntary use of the ECU as a common numeraire by private economic agents would have to be removed". Barring official action discriminating in favour of the ECU (which would result in undesirable financial market distortions) and excluding a link between the official and the private ECU, there are, broadly speaking, two types of measures: direct encouragement (e.g. increased borrowing in ECUs by public sector authorities; larger exchange market interventions in ECU; "greater official support" to the ECU clearing system) and indirect encouragement (e.g. removal of restrictions on the private use of the ECU by giving it in each member country the status of a foreign or national currency; demonstration effects through increasing operations in official ECUs within the EMS and by enlarging the group of "third" holders).

Concrete implications of this proposition are that:

- as a numeraire, the ECU would have equal, but not privileged, status compared to the national currency denomination; therefore

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- the ECU would be added as a unit of account wherever national legislation specifies the use of a numeraire.

13. "The official ECU could play a role in the conduct of a common monetary policy in an advanced stage of monetary union". Governor Ciampi presented a scheme in which the official ECU would be used as a reserve instrument in order to manage a common monetary policy in the Community. This scheme represents one, but not necessarily the only, way to give operational meaning to the concept of a single monetary policy. In considering whether there are other operational schemes for a common monetary policy, it has to be taken into account that the ECU should not become a parallel currency (i.e. the official ECU must remain an asset used only within the circle of central banks) and the fact that the official ECU performs already now a number of functions in central bank operations.