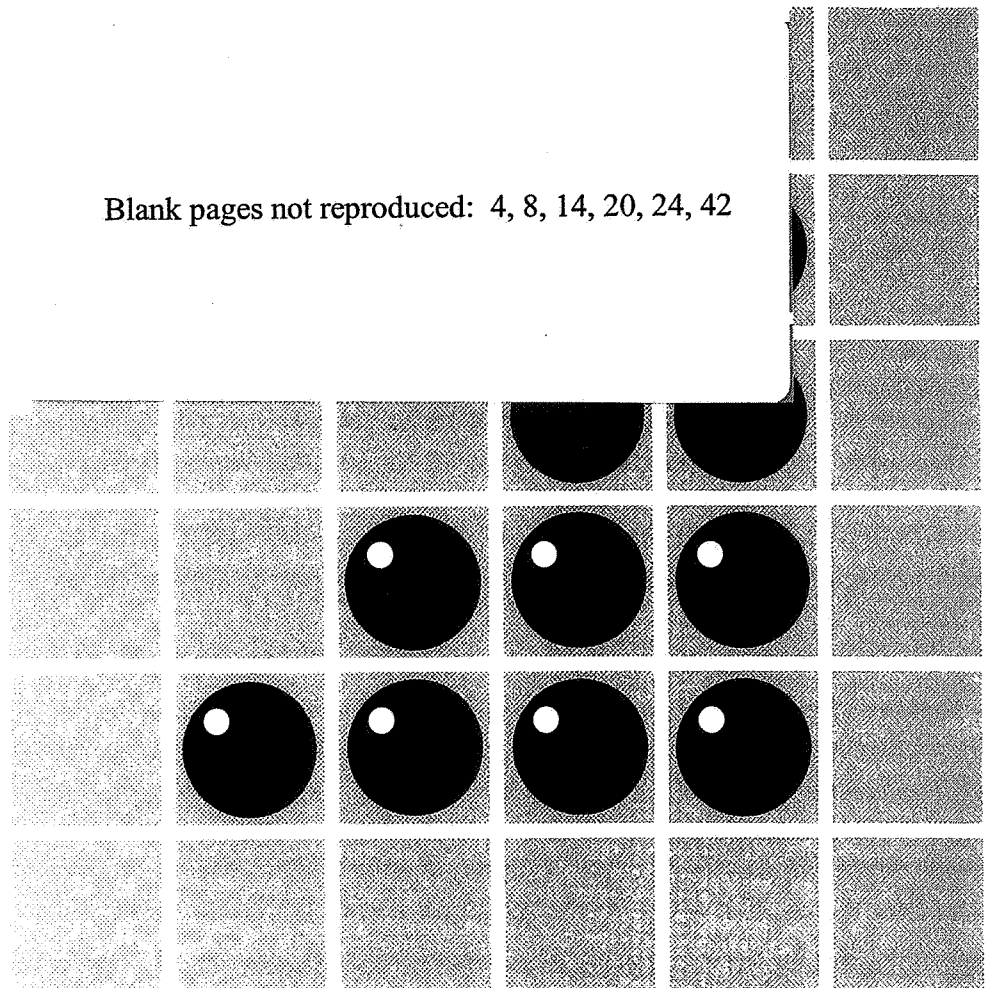


THE ECU

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The ECU

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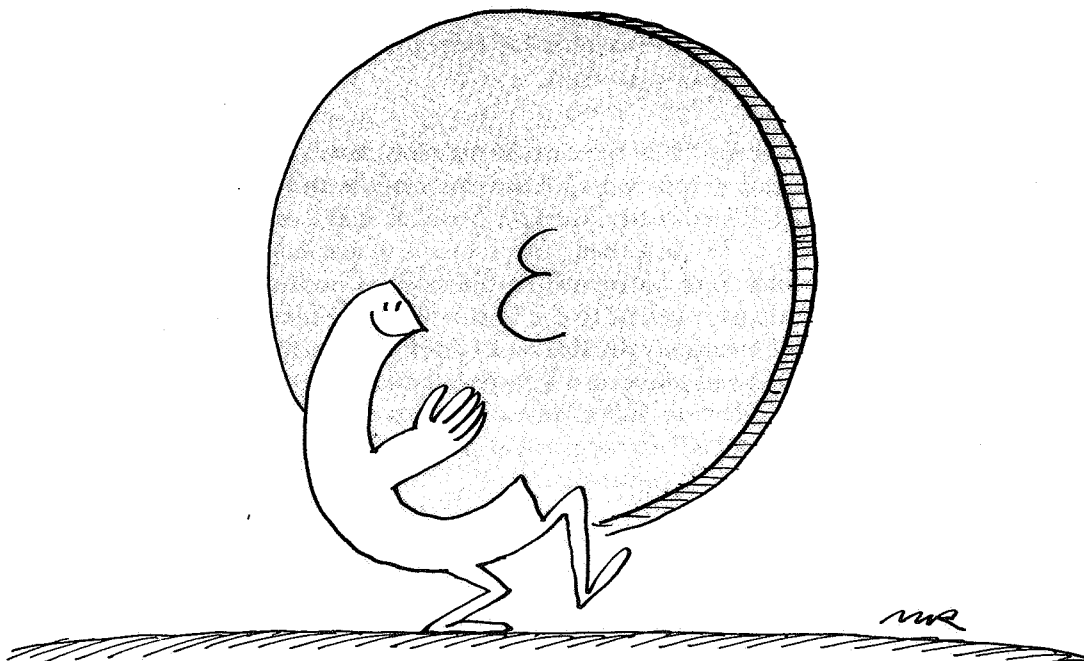
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I. Origin of the ECU



When individuals, companies or countries do business across the boundaries of their national economic territories, they need a common unit of value. A national currency is not necessarily the appropriate standard since its value can be unilaterally fixed, influenced or changed by the monetary authorities of the issuing country. A measure of value is required that not only determines the claims and obligations when a contract is concluded but also serves to preserve future value. Internationally accepted measures of value, such as gold and silver, existed long before the European Communities were founded. The gold franc, for example, which the Universal Postal Union used to settle balances between national postal administrations, was derived from gold.

In the European Community, which initially comprised six, and now has ten, member countries with equal rights but different currencies, a common measure of value was needed that could not simply be one of the national currencies. Such a measure was essential for drawing up the Community budget, for settling claims and obligations and, following the introduction of the common agricultural policy in the early 1960s, for expressing common prices for agricultural products. But a uniform measure of value is not a common currency:

initially, it is only a common yardstick, a unit of account. As such, it cannot be used in note or coin form to make payments. This is done using conventional currencies.

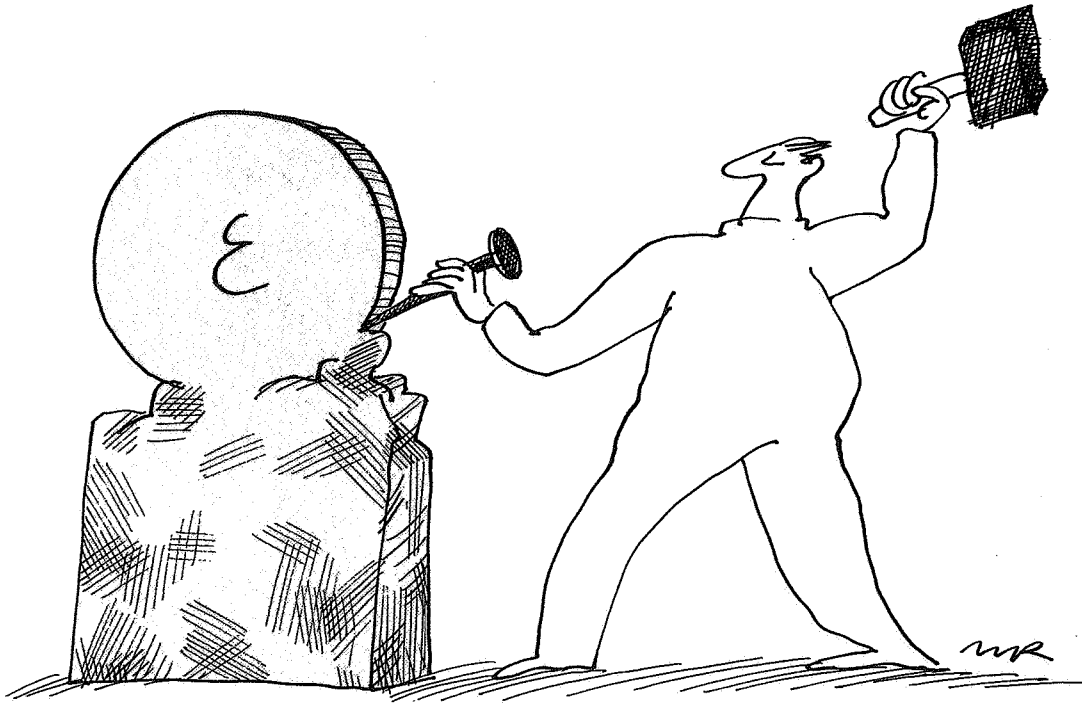
The Community's first unit of account (u. a.) was that used by the European Payments Union (EPU), set up in 1950. Its value was equivalent to the weight in gold of one United States dollar, which at the time still had a fixed relationship to gold and was defined as being worth 0.88867088 gram of fine gold. At the outset, therefore, the Community's unit of account and the dollar were identical in value. But since the end of 1971, they have gone their separate ways. Nowadays, the value of the dollar and that of the ECU, the successor to the unit of account, are determined by widely differing criteria. The parallelism between the dollar and the unit of account was ended by the December 1971 devaluation of the dollar and the March 1973 decision to allow exchange rates to float.

With the disintegration of the system of fixed exchange rates, it was not long before the Community's unit of account began to split as well. Conversion of the unit of account into national currencies was based on the official central rates for Member States' currencies, but these have existed only on paper since 1973. As a result, several units of account came into being in the Community, some of which were based on the old parities notified to the International Monetary Fund while others were geared to the fluctuating daily rates of the currencies concerned. Consequently, the Community decided on 21 April 1975 to follow the example of the International Monetary Fund and to create a European basket-type unit of account made up of specific quantities of the Member States' nine currencies and with an external value that changed daily. At the time, the IMF unit of account, the special drawing right (SDR), consisted of a basket of no fewer than 16 currencies.

The Community's new basket-type unit of account was christened the European unit of account, or EUA. With its introduction in 1975, the foundation was laid for the ECU. When the European Monetary System (EMS) was launched on 13 March 1979, the EUA formula was retained unchanged as the unit of account, but a review clause was incorporated and the EUA renamed the ECU.

The confusion caused during the 1970s by the existence of different units of account was gradually ended. Since April 1979, the ECU has been used as the unit of account for the common agricultural policy. Since 1981, it has replaced the EUA in all the latter's previous fields of application, notably in the Community budget, in relations with the Community's partner countries in Africa, the Caribbean and the Pacific under the Lomé Convention and in the accounts of the European Investment Bank and of the European Coal and Steel Community. The ECU is now the Community's sole unit of account. Different European units of account also came to be used during the 1970s on private money and capital markets, where a growing need was felt for a measure of value that was less volatile than national currencies.

Fortunately, after the EMS had been launched, the ECU clearly carried the day against this multiplicity of units of account. The Community institutions and private business now use only the ECU where balances have to be settled or transactions concluded in units of account. The ECU has put an end to the welter of European units of account that were liable to confuse private users. The singular nature of the ECU has also helped to promote its private use. The EC Commission is planning to secure legal protection for the name 'ECU'.

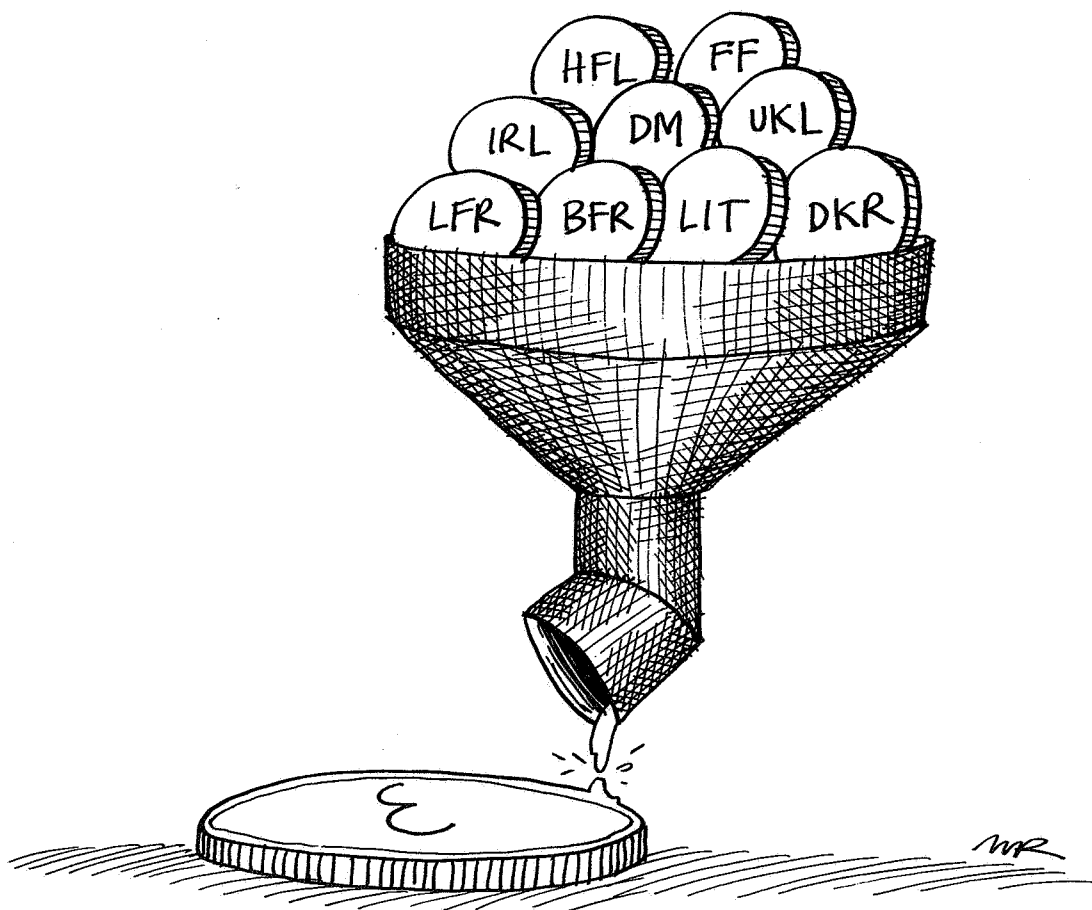


The European Parliament has passed a resolution recommending that a symbol be devised for the ECU. One suggestion is a design based on the Greek epsilon.

The architects of the EMS drew on differing sources in arriving at the name 'ECU'. For the then French President, Valéry Giscard d'Estaing, it was supposed to be reminiscent of the gold coin introduced by Louis IX (also known as Saint Louis) as early as the 13th century and subsequently circulated throughout Europe. The British and German representatives took the name from the initials of 'European currency unit'.

While the ECU as a unit has been given an official name, no designation has yet been found for the one hundredth part of the ECU. This will not pose a problem until such time as the ECU is issued for circulation in coin form or as a postage stamp.

II. Nature of the ECU



The ECU is a basket-type currency. Each Member State of the Community is supposed to have a share in that basket that reflects its economic strength and to have included in it a specified quantity of its currency. The respective shares, or weights, were determined not only by reference to each country's gross domestic product, but also by reference to its participation in the Community's external trade and its quotas under the short-term monetary support system. Through inclusion of all Member States' currencies in the basket, it has been made clear that the ECU is intended to be more than a simple technical unit. Such a unit would more appropriately have been restricted to only a few currencies, making its value easy to calculate at any given moment. And it would probably have been an immutable, closed cur-



The ECU is made up of nine currencies. It is put to a variety of uses in the private sector. One bank has even introduced an ECU savings book.

rency basket. The ECU basket, by contrast, is an open basket designed to receive the currencies of future Member States as well. It is intended to reflect the Community's membership.

Under the Act of Accession of Greece, which joined the Community in 1981, the drachma is to be included in the ECU currency basket by 31 December 1985.

The ECU basket is not an abstract idea but something quite tangible. It is composed of the following real amounts of Member States currencies:

0.828	German mark
0.0885	pound sterling
1.15	French francs
109	Italian lire
0.286	Dutch guilder
3.66	Belgian francs
0.14	Luxembourg franc
0.217	Danish krone
0.00759	Irish pound

Anyone who spends his holidays in other Community countries and brings coins back from each as souvenirs can put together his own ECU basket using the above amounts of the nine currencies. There is a technical problem since not all the currencies have coins of sufficiently small denomination. An amount of 100 ECU can, however, accurately be made up using notes and coins.

Why was it that these specific amounts were chosen in 1974 for the basket making up the then European unit of account (which became the ECU in 1979)? The answer is that the basket was constructed in such a way that, on 28 June 1974, one EUA was worth one special drawing right (SDR) issued by the International Monetary Fund, with the SDR in turn corresponding to the official price of one ounce of fine gold — a price which has since been abandoned.

The national currency value of the ECU on any particular day can easily be calculated on the basis of the basket's composition. The amount of each currency in the basket has to be multiplied by its daily rate against a reference currency such as the dollar. The resulting nine amounts in one currency have then to be added together to give the value of the ECU in terms of that currency. The EEC Commission each day calculates the rate of the ECU in Member States' currencies using the exchange rates recorded at 2.30 p.m.. This produces the official daily rates of the ECU which the Commission publishes in the *Official Journal of the European Communities*. These rates are applied where the ECU is used in the Community's official transactions. Anyone interested can obtain them from the Commission's automatic telex answering service. On 28 February 1984 the official value of one ECU in national currencies was 2.24137 German marks; 0.576966 pound sterling; 6.91143 French francs; 1 394.347 Italian lire; 2.52988 Dutch guilders; 45.8953 Belgian or Luxembourg francs; 8.22697 Danish krone; 0.729244 Irish pound; 86.8384 Greek drachmas.

The official ECU rate calculated by the Commission on the basis of the composition of the ECU basket does not exactly match the ECU quotation on individual foreign exchange markets. On those markets, a rate of the ECU used in private transactions is already being formed

by the interplay of supply and demand, so that slight deviations from the official rate as calculated on the basis of the components are unavoidable. The ECU basket was not fixed in 1974 as an immutable entity. It is an open currency basket whose content can in the course of time be changed by agreement between the Member States.

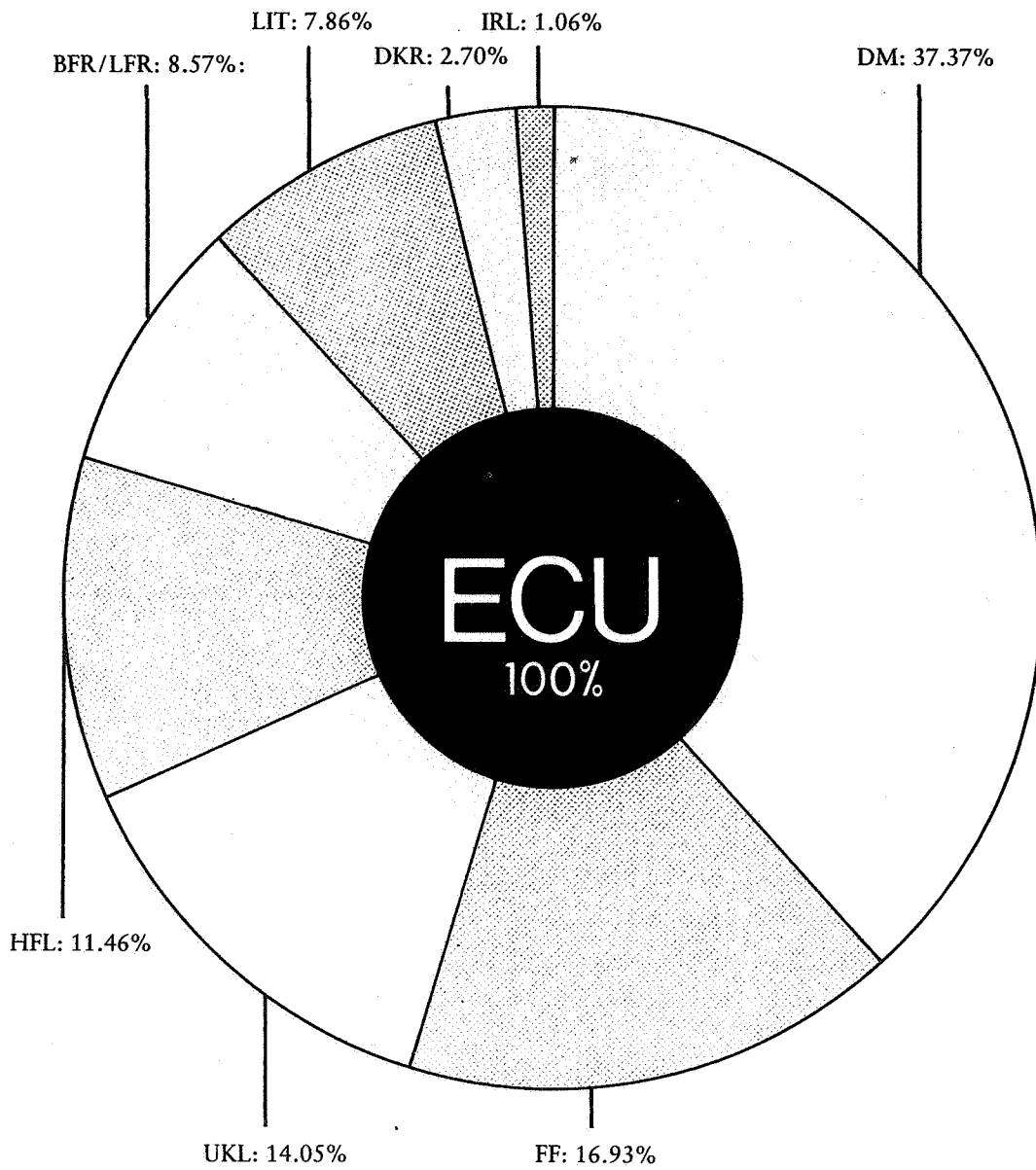
The composition of the basket is normally to be re-examined only every five years. At any other time, a re-examination may be requested by a single Member State if the weight of any currency has changed by 25% or more. Revisions have to be mutually accepted. The value of the ECU basket must not initially undergo any change on the date of revision (modification in composition or inclusion of new currencies) since the continuity of the ECU is to be maintained even though it is an open currency basket. However, a new ECU basket is worth the same as the old one only on the day of the change. Because the currency basket will be made up differently, its value will subsequently deviate.

Unlike the original gold-based unit of account, the ECU has no fixed point of reference, being a basket-type currency. Its value can be expressed only in relation to other currencies such as the dollar, or other units of account such as the IMF's special drawing right.

Since the ECU basket is made up of fixed amounts of Member States' currencies that do not alter when currencies are revalued or devalued, the percentage composition of the basket in terms of the individual currencies changes when an adjustment is made to a participant currency's central rate. If the strong currencies are revalued, the amounts of them found in the basket will not be reduced and the amounts of the weak currencies will not be increased. Accordingly, the value shares of the strong currencies that are revalued must rise while those of the weak currencies that are devalued must fall. Because the composition of the currency basket remains the same, adjustments to central rates thus produce changes in individual currencies' shares in the basket.

Since it was introduced in the Community, the individual currencies' percentage shares in the ECU basket in response to adjustments in central rates is as follows (taking selected dates):

	March 1975	13 March 1979	23 March 1981	21 March 1983	18 May 1983
Belgian and Luxembourg francs	8.2	9.63	9.31	8.57	8.46
Danish krone	3.0	3.06	2.74	2.70	2.67
German mark	27.3	32.98	32.54	37.38	36.93
French franc	19.5	19.83	19.18	16.93	16.73
Irish pound	1.5	1.15	1.11	1.06	1.05
Italian lira	14.0	9.50	8.63	7.86	7.77
Dutch guilder	9.0	10.51	10.17	11.46	11.32
Pound sterling	17.5	13.34	16.32	14.05	15.07
	100	100	100	100	100



The ECU currency basket comprises fixed amounts of the currencies of nine of the ten Member States of the Community. The Greek drachma is not yet included in the basket. The composition of the ECU may be changed by decision of the Community.

III. The function of the ECU in the European Monetary System (EMS)

1. Centre of the EMS

The ECU is the pillar of the European Monetary System (EMS) and the symbol of a zone of monetary stability in Europe. This was made clear in the resolution adopted by the Member States' Heads of State or Government at their meeting in Brussels on 5 December 1978 at which the EMS was launched: 'A European currency unit (ECU) will be at the centre of the EMS'. The EMS was designed to bring about a greater measure of monetary stability in the Community. The Heads of State or Government wanted it to be seen 'as a fundamental component of a more comprehensive strategy aimed at lasting growth with stability, a progressive return to full employment, the harmonization of living standards and the lessening of regional disparities in the Community'. It was 'to have a stabilizing effect on international economic and monetary relations'. The lasting success of the EMS was to be ensured by policies conducive to greater stability at home and abroad for both deficit and surplus countries.

Given these objectives, the ECU has a role to play not only within the EMS but also, in the longer run, within the international monetary system, whose stability it seeks to help reinforce.

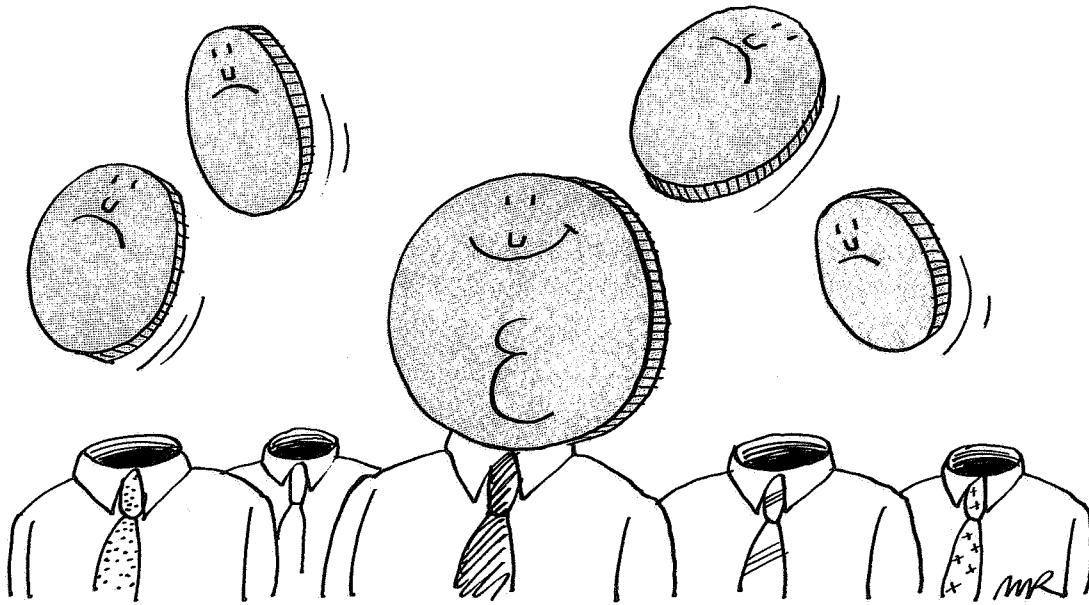
Only if the Community works for greater stability internally can it usefully contribute to a return to increased monetary stability externally, that is to say in the world at large.

Within the EMS, the ECU is supposed to be the expression of the Community's gradually emerging monetary identity. The Heads of State or Government expressly assigned four functions to the ECU; it is to serve as:

- (a) the denominator (*numeraire*) for the exchange-rate mechanism;
- (b) the basis for a divergence indicator;
- (c) the denominator for operations in both the intervention and credit mechanisms;
- (d) a means of settlement between monetary authorities in the Community.

(a) Denominator (*numeraire*)

The first task of the ECU is to act as the denominator for the EMS exchange-rate mechanism. This is much more than a purely technical function for, with the ECU as point of reference, links are set up between the participating currencies. Adjustments to their central rates are no longer at the discretion of the individual countries but must be approved by all of them.



A central rate expressed in ECUs is fixed for each currency in the EMS. These ECU-related central rates are used to establish a grid of bilateral exchange rates. Fluctuation margins of 2.25% (6% for the Italian lira) are allowed on either side of the bilateral exchange rates.

Participation in the EMS exchange-rate mechanism means that each currency's ECU-related central rate is dependent on the rates of the other countries. The ECU-related central rates of two currencies may change even if their bilateral exchange rates are not affected when an adjustment is made within the EMS. Through the ECU, any adjustment to a central rate has therefore become a matter of common interest to all participating Member States which cannot be decided by one government alone. However, when central rates are adjusted the practice is for the margins of revaluation or devaluation to be negotiated on the basis of the bilateral exchange rates and for the new ECU-related central rates to be calculated only as a second step.

(b) Divergence indicator

An economic and monetary policy task has been allotted to the ECU with its second function as the basis for the divergence indicator. This indicator is to act as a sort of early-warning system, identifying any currency that diverges from the average for the other currencies, i.e. the ECU, before the gap grows too large. When a currency crosses its 'threshold of divergence' and activates the early-warning system, there is, according to the rules agreed by the Heads of State or Government on 5 December 1978, 'a presumption that the authorities concerned will correct this situation by adequate measures'. The country concerned is expected to take countermeasures of its choice to prevent its currency from overstepping the permissible margin of fluctuation. In this role, the ECU encourages discipline in national economic and monetary policies.

(c) Denominator

With its third function — that of denominator for operations under the system's intervention and credit mechanisms — the ECU was assigned an important role in ensuring the smooth working of the EMS. Intervention consists in the monetary authorities buying or selling foreign currency against national currency with the aim of influencing their own currency's exchange rate by expanding or reducing supply.

Intervention is necessary in the EMS whenever a currency threatens to exceed its permitted 2.25% margin of fluctuation against another currency (6% in the case of the Italian lira). The central bank of the country with the strong currency buys the weak currency, and the central bank of the country with the weak currency sells the strong currency. If it does not possess sufficient reserves, it borrows the currency required from the other central bank.

Under the intervention mechanism, the central banks are obliged to make available to one another unlimited, very short-term credit facilities to finance the required interventions. These operations are conducted through the European Monetary Cooperation Fund (EMCF) set up in 1970, and are expressed in ECUs. The lending central bank acquires a claim in ECUs while the borrowing central bank incurs an ECU debt for the same amount. For credit balances in ECUs, creditor central banks receive interest in ECUs from the debtor central banks. The interest rate is the weighted average of the official discount rates for currencies in the ECU basket.

Reliance on the ECU as the denominator for the intervention-related currency credit mechanism has ensured that the exchange risk, previously borne by the debtor alone, is shared by the two parties: when the central rates of the currencies in the ECU basket are adjusted, the creditor is liable to receive back less in its own currency than it lent, while the debtor, whose own currency has been devalued, will have to pay back more in its own currency. Settlement in ECUs is thus more than simply a European form of presenting bilateral credit transactions between central banks.

(d) Means of settlement

Its fourth function in the EMS makes the ECU an instrument for settling creditor and debtor balances that have arisen between monetary authorities. Interest payable on ECU-denominated debts is also settled in ECUs. In the initial phase of the EMS, however, use of the ECU for settling balances is subject to a major restriction. The first phase was supposed to last only two years, i.e. until March 1981, but was extended for an unlimited period. A creditor central bank is not required to accept settlement in ECUs of a larger proportion than 50% of its claim on a debtor central bank. For the remaining 50%, it may request settlement in other reserve assets. This is a significant restriction on the use of the ECU, which the Commission would like to see removed on transition to the next phase of the EMS.

2. A reserve currency in the making

The European Council made it clear when it launched its ambitious initiative in December 1978 that in introducing the ECU it wanted not only to create a unit of account but also to lay the foundations for a currency and reserve unit. Since the inception of the EMS, Member States have deposited 20% of their gold reserves and 20% of their dollar reserves with the European Monetary Cooperation Fund (EMCF). In exchange, the EMCF has credited them with ECUs. The dollar portion is valued at the market rate two working days prior to the valuation date. For the gold portion, extreme daily fluctuations in the rate are eliminated by taking a six-monthly average of prices established at the London gold fixing; to avoid any overvaluation, the average price recorded on the two days prior to the deposit is taken if it is lower than the six-monthly average.

By requiring the deposit of gold and dollar reserves as the counterpart to the creation of the ECU, the Community has shown that the ECU is not a source of liquidity additional to existing reserve instruments and created out of nothing, but that the ECUs issued are entirely matched by other, immobilized currency reserves.

The deposit arrangements applicable during the first phase must not, however be confused with definitive transfer of part of Member States' gold and dollar reserves to the EMCF. So far, Member States' deposits with the EMCF of 20% of their gold and dollar reserves have merely been in the form of three-month revolving swaps.

Physically, the gold and dollars remain in the possession of Member States' central banks, which also bear the investment risk and receive interest payable on the dollar portion. The ECUs credited against the original deposit do not therefore yield any interest. Interest on ECU credits or debts becomes receivable or payable only when Member States lend ECUs to one another within the EMCF for intervention purposes.

As a consequence of the deposit arrangement the ECU shows up as such in central bank returns and balance sheets. The International Monetary Fund has made allowance for deposits against ECUs by no longer showing gold reserves deposited with the EMCF among Member States' national gold reserves.

The creation of ECUs against the deposit of dollar and gold reserves has one drawback however: the quantity of ECUs issued is not determined by the Community itself but depends on the gold price and the rate of the dollar. Both are subject to sharp fluctuations on which the Community has no direct influence. The quantity of ECUs created changes every three months for two reasons. First, Member States make quarterly adjustments to the gold and dollar holdings deposited with the EMCF to ensure that these continue to represent 20% of their actual gold and dollar reserves. The change due to such adjustments are normally smaller than the changes arising from the second reason — fluctuations in the gold price and in the rate of the dollar. In the first few years after the establishment of the EMS, the gold price and dollar rate were particularly volatile. Under more permanent arrangements, the quantity of ECUs should not be determined by external factors beyond the Community's control. The EMS has so far been a closed system. Only Member States participate in the system and in the pooling of their foreign-exchange reserves. However, in their resolution of 5 December 1978, the Heads of State or Government already provided for the possibility of participation by

European countries with particularly close economic and financial ties with the Community on the basis of agreements between central banks. The system of depositing foreign-exchange reserves with the EMCF in exchange for ECUs could one day be used to give practical shape to such cooperation.

IV. The ECU and the Community institutions

1. *Budget — customs — statistics*

The ECU is the unit of account used by the Community institutions for drawing up their budgets and by the European Investment Bank for preparing its balance sheet. All Community revenue and expenditure is entered in ECUs in the draft general budget, which is prepared by the Commission and adopted in ECUs by Parliament and the Council under a special budget approval procedure. Generally, exchange-rate changes affect the national currency equivalent of ECU-denominated payments commitments less than if those commitments were expressed in a national currency.

Since 1979, the ECU has also been the sole unit of account for fixing and collecting the specific external customs duties, levies, refunds and other intra-Community payments. Even the tax-free allowances for Community residents travelling between Member States or arriving from a non-member country are first fixed in ECUs and then converted into national currency.

In 1977, the Statistical Office of the European Communities began to use the EUA, which has become the ECU, as its unit of account. As it is still possible for central rates to be adjusted and currencies to fluctuate, some measure of comparability between statistical data is thus ensured. Anyone wishing to convert statistics expressed in ECUs into national currency must use the national currency value of the ECU for the relevant period.

Community grants and loans made to companies for research purposes, for example, are also denominated in ECUs. The same applies to fines imposed on companies for infringing Community provisions, such as the competition rules. The ECU is, therefore, more than simply an internal accounting unit for the Community budget. It is of direct relevance to the individual company and ordinary citizen.

2. *Common agricultural policy*

The ECU plays an important role in the common agricultural policy, being the unit used for expressing common farm prices, which are not only intended to regulate supply and demand but which also largely determine farm incomes. The guaranteed prices paid to farmers in general or for production up to a certain ceiling are thus expressed in terms of a uniform standard. Arrangements have however been made to ensure that adjustments to central rates do not work directly through to the common agricultural policy itself or to farm prices. If modi-

fied central rates against the ECU were applied to agriculture direct, this would signify a fall in farm incomes equal to the size of the revaluation against the ECU in the countries that revalued and a corresponding rise in food prices for consumers in the countries that devalued. Since these effects of revaluations and devaluations are of critical importance for farm incomes and the cost of living, governments endeavour to delay them at least.

This is done through special representative conversion rates, the so-called green rates, which are fixed by the Council. The green rates follow the central rates with a time lag and the gaps between the central rates and the green rates are bridged by 'monetary compensatory amounts'. At the request of Member States wishing to be shielded temporarily from the effects of central rates adjustments on farm and food prices, the Commission may fix new monetary compensatory amounts for imports or exports, or may alter existing ones.

3. European Development Fund and non-member countries

Since April 1975, first the EUA and now the ECU have been the unit of account for the European Development Fund, which was set up under the Lomé Convention, linking the Community with more than 60 African, Caribbean and Pacific countries. Financial aid, credits and loans granted to non-member countries by the Community are also expressed in ECUs.

4. Balance sheet of the European Investment Bank

The European Investment Bank (EIB), the Community's long-term financing arm, was the first Community institution to use the then European unit of account (EUA), the forerunner of the ECU, for drawing up its balance sheet. The decision was taken on 18 March 1975 by its board of governors (i.e. the Member States' finance ministers). The EIB was also the first Community institution to issue public loans in ECUs, thereby contributing to the development of a private capital market in ECUs. The loans it makes to companies may be expressed and disbursed in ECUs if the recipients so wish. Its capital is denominated in ECUs as was the two-fold capital increase in 1981.

5. The ECU and the Community's support mechanisms

Member States which find themselves in temporary balance-of-payments difficulties may apply for credits from the Community's support mechanisms. Under a short-term monetary support facility, three-month credits are available which may be renewed twice. A medium-term financial assistance facility offers credits for a period of between two and five years. The quotas under the short-term facility and the ceilings under the medium-term facility (up to which the individual Member States are required to provide or may expect assistance) are expressed in ECUs.

Under the system of short-term support among central banks, credits are still expressed in the creditor country's currency and not in ECUs, except where they are in the form of a prolongation of an ECU-denominated debt under the very short-term financing facility for currency support within the EMS. Credits under the medium-term facility, by contrast, under which Member States' governments grant assistance to one another, are expressed in ECUs.

While Italy obtained credits from the Community's support mechanisms during the 1970s, no Member State has drawn on the short-term or on the medium-term facility since the EMS was set up.

V. The ECU and its role in private payments

1. Origin of the 'private' ECU

If it were used solely by the Community institutions — as an accounting currency between authorities — the ECU would have only one role. But the ECU as used by the Community institutions soon found its way into private circulation. The Community institutions, with their budget drawn up in ECUs had to manage their ECU-denominated resources. They had an interest in opening ECU accounts with banks, particularly in Brussels and Luxembourg where they are located. Banks in the two cities were willing to set up such accounts for the Community institutions, paving the way for private use of the ECU. The ECU was first introduced into private payments as book money. If conventional national currencies started out as means of payment in note or coin form, the ECU took its first steps as non-physical money. At a time when book money, which is transferred from one account to another by means of payment orders, credit cards or cheques, is coming increasingly to replace risky cash payments, this is without doubt a normal start for a currency unit.

2. The ECU in the service of the individual

It is vital for the future of the ECU as a medium for private payments that it should be generally known and recognized. Once taxi drivers and hotel cashiers begin to accept cheques made out in ECUs just as readily as they now accept cheques made out in national currency, the ECU will have asserted itself regardless of whether official ECU notes and coins have been issued. Means of payment denominated in ECUs, such as cheques or credit cards, will be accepted once people are certain that every bank will honour them in exactly the same way as payment instruments denominated in national currency.

For the ECU to become more widely used, it would be helpful, though not indispensable, if it were issued as a physical payment medium in the form of coins, notes and postage stamps. But as experts on the EEC Monetary Committee have pointed out, a number of legal and practical problems would have to be resolved before ECU notes and coins could be issued. To prepare the legal ground, Member States would have to pass legislation making ECU notes and coins legal tender and hence prescribe their acceptance in payment of debts. This obligation could initially be restricted to limited amounts as long as the ECU was intended to facilitate travel. In addition, the issuing authority would have to undertake to buy back ECUs at a specified rate.

On the practical level, care would have to be taken to ensure that ECU coins did in fact facilitate travel and tourism in the manner intended. Travellers should be able to use them in small

amounts for their day-to-day spending everywhere in the Community without having to change their money into another currency at each frontier, incurring costs and wasting time. For this, ECU notes and coins must actually circulate, that is to say, must not become simply souvenirs or collectors' items, as happens with limited issues of national coins.

The value of the ECU in national currency could correspond to the rounded central rate against the ECU of the currency in question. This would ensure that the rate for ECU notes and coins would not alter as long as the currency's central rate remained unchanged. However, the ECU rate for notes and coins would then differ slightly from the daily rate for ECU-denominated book-entry claims. If there were a limited issue of ECU notes and coins, in small denominations of, say, one ECU to begin with, there would be no great danger of large scale arbitraging to exploit the exchange rate differential. If ECU notes and coins were accurately valued at the daily rate in the same way as ECU-denominated book-entry claims, this might hinder practical use of the ECU since a precondition of acceptance would be knowledge of its rate.

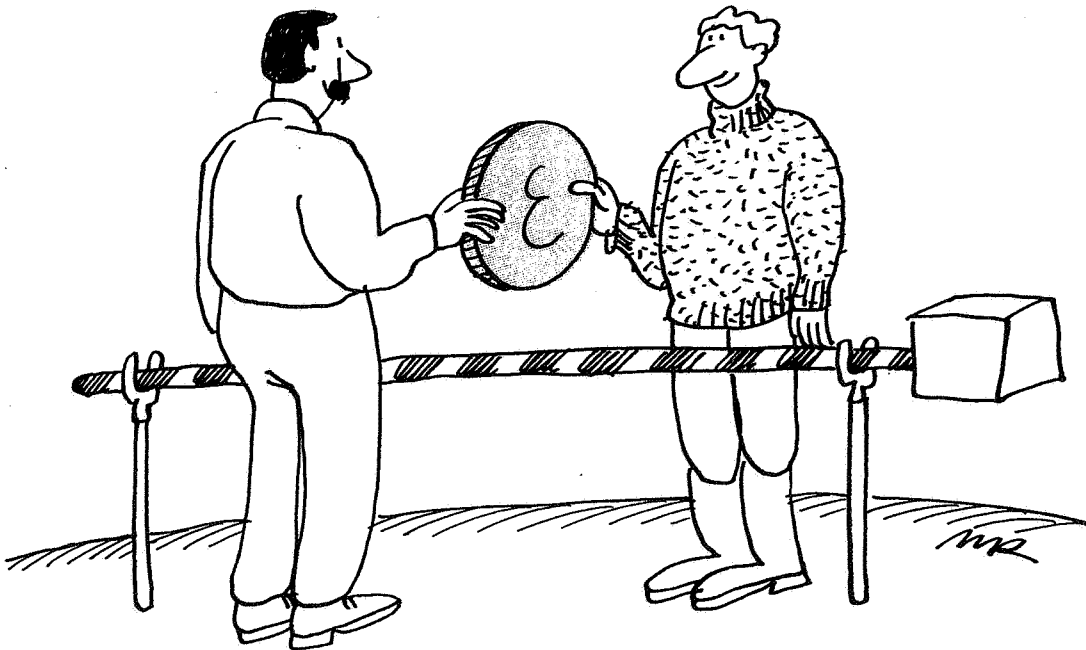
While the issue of ECU notes and coins is still the subject of study, financial institutions already have advanced plans for bringing the ECU into circulation as credit money, for modern forms of payment, thereby making it available to the general public.

Banks in the Community are considering providing tourists with travellers' cheques denominated in ECUs. This might spare a tourist the — pleasant or nasty — surprise that occasionally awaits him at his destination, when he cashes in his dollar-denominated travellers' cheques and discovers that the dollar has moved strongly in his favour or against him. Once ECU-denominated travellers' cheques are issued, it must however be guaranteed that all banks will accept them as readily as they do cheques made out in dollars or other strong currencies. It would detract from the ECU's image if travellers holding ECU-denominated cheques could not swiftly and easily cash them in the country they were visiting.

The issue of postage stamps denominated in ECUs would raise similar legal and practical problems as the issue of coins, but these problems do not appear insurmountable. Tourists travelling in the Community could affix ECU-denominated stamps they brought with them to standard letters and postcards without first having to buy national postage stamps.

3. The official and the private ECU

The private ECU developed in the wake of the official one. But today it leads a life of its own and is legally independent of the official ECU's function as the Community's unit of account. ECU-denominated bank deposits, loans and note or bond issues are governed by private contracts not guaranteed by the Community or national monetary authorities. However, the official definition of the ECU as laid down by the Community institutions also serves as the basis for its private use. This applies not only to the current ECU basket. Financial institutions and companies that issue ECU-denominated securities or conclude contracts in ECUs normally provide that the ECU used is invariably that defined by the Community institutions and ensure that any changes in the composition of the ECU basket are allowed for in the terms of the contract. This not only creates legal certainty but also prevents a proliferation of units of account of the kind that occurred in the 1970s.



Many ECU-denominated contracts also make provision for the highly improbable eventuality that some day there may not be an official ECU. The last official ECU basket would then be used to calculate the daily ECU rate applicable in private contracts. The contracts for certain ECU-denominated issues actually specify who would be responsible for calculating the daily rate of the ECU.

Since the official and private uses of the ECU are quite separate, those investing their money privately or commercially in ECUs should not believe that their investment is free from risk or that it is covered by Community guarantee simply because they conclude an ECU-denominated contract, open an ECU account or subscribe to an ECU-denominated issue. Those investing their savings in ECUs must take just as much care in selecting the bank, company or debtor in which they place their trust as if they had made an investment in conventional currency.

4. The ECU and the money market

The banks that began by opening accounts in ECUs for the Community institutions saw no reason to withhold this facility from other interested parties as long as this was permissible under national law. None the less, in the first few years, ECU accounts were only opened for large customers who found it worthwhile to shoulder the management costs for accounts in a new currency unit. In 1979 and 1980, accounts could be opened only for deposits of 5 million ECU or more. But use of the ECU as a bank deposit currency did not remain the prerogative of large customers for long. The minimum amount needed to open an account was soon reduced to 10 000 ECU in Belgium and Luxembourg, where the market grew fastest because the Community institutions were located there. Nowadays, ECU-denominated current accounts, from which money may be withdrawn at any time, and ECU-denominated deposit accounts,

in which money is lodged for a fixed period, can be opened in a number of Member States in exactly the same way as accounts in national currency with virtually no minimum limit being applied.

In October 1982 a Luxembourg-based bank even began to issue ECU-denominated savings books to its customers. The normal practice however is for banks to advise customers who set aside money for major purchases or simply for a rainy day to invest it in the currency of the country in which they live and where they will eventually need the money. An ECU-denominated investment reduces the possible risk of loss due to exchange-rate movements but it does not eliminate it altogether. It is therefore understandable that the ECU should initially be used more extensively for deposit accounts than for savings accounts or savings books.

The ECU is viewed as a currency unit particularly apt at providing some protection against the exchange risk. Currencies which fluctuate widely are regarded as particularly risky. Being a composite currency unit, the ECU is less exposed to the danger of such fluctuations. It is normally more stable than the relationship between its component currencies, assuming that these include both strong and weak currencies. This is true both in periods when the EMS central rates are changed and in periods when they are not changed. Movements of the individual currencies in the ECU basket are mutually offsetting to some extent and the ECU plays the role of the weighted average. Moreover, the ECU basket comprises amounts of each participating currency so that any one currency will in any case move in line with the ECU to the extent of its share in the basket. Those holding balances or incurring debts in ECUs are not in general seeking to make speculative profits but wish to protect themselves against currency losses from excessive exchange-rate movements. It is precisely for this reason that the ECU is also used as cover for import and export transactions.

Particular sections of the population may have a special need for ECU investments. Among them are frontier workers, who work in a country other than their country of residence, and migrant workers or self employed persons temporarily working outside their home country. These groups may one day have to use their savings in a country other than that in which they earned them. The risk of depreciation facing them in a Community without fixed exchange rates can be reduced through investing in ECUs. The ECU is a cushion which provides them with partial protection against possible losses.

A person who lives in a weak-currency country and invests money in ECUs expects to be better protected against depreciation losses than if he stayed in his own currency. He will however earn a lower rate of interest on his ECU investments. A person who lives in a strong-currency country and invests money in ECUs goes for the higher interest on ECUs. But he may have to accept a depreciation loss against his own currency. In both cases, the ECU affords protection. The investor seeks to steer a middle course as regards both the final value of his investment and the return. He attempts to protect himself against loss but, in so doing, forgoes a potentially higher return, or he goes for a higher return, accepting the possible fall in the value of his investment.

Initially, ECUs accepted by banks had immediately to be split into the nine component currencies whenever a holder of ECU-denominated deposits made drawings on his bank account or closed it. There was virtually no scope for re-employing ECU deposits. Splitting up was complicated and costly. Today, however, there are not only a large number of holders of ECU



accounts but also many ECU users who borrow in ECUs. This means that the banks now transfer ECU deposits as such to ECU users without being obliged to split the ECU up into its component currencies.

In order to minimize the need to split up the ECU, the banks that accept and lend ECUs now deal with one another in ECUs on a daily basis in exactly the same way as they do in national currency or foreign currencies. Some 200 banks actively engaged in ECU business take part in this interbank market on which a bank in need of ECUs borrows them from other banks that can spare them.

In another move to avoid having to split up the ECU into national currencies, a clearing system is to be set up between the major banks doing ECU business and operating on behalf of banks less heavily engaged in the ECU market. A system of this sort will match ECU supply with ECU demand and will restrict the need to split up the ECU to a minimum of the residual balances.

On the markets on which the ECU is traded, an independent exchange rate and an independent interest rate are formed by supply and demand, without a detour through the nine com-

ponent currencies. The ECU is already officially quoted on the Rome, Milan and Copenhagen foreign exchange markets. The Italian central bank reserves the right to make intervention sales or purchases on the ECU market to regulate its rate. The Danish and Irish central banks calculate a rate for the ECU each day. ECU rates established on the exchanges are market rates and hence not fully identical with the official ECU rate calculated by the EC Commission on the basis of the portions of the nine currencies in the basket.

An independent interest rate is also being formed on the ECU money market. Although it must broadly follow movements in the weighted average of the interest rates for the nine component currencies, market forces (i.e. the supply of and the demand for ECUs in circulation on a particular market that have not been split up into national currencies) are already playing an appreciable role in its formation. In this way, independent credit conditions are gradually emerging for the ECU and an autonomous circulation of ECUs is slowly developing.

5. The ECU and the capital market

If banks open ECU accounts for their customers and pay interest on the funds entrusted to them, they must on-lend these funds. Had the banks viewed the ECU simply as an artificial accounting currency and had there been no willing borrowers, the deposits in ECU accounts would necessarily have had to be split up again into their national-currency components. But the ECU offers advantages to borrowers too and takers were soon found for medium-term and longer-term bank credits denominated in ECUs. The volume of ECU credits on the Euro-market amounted to some 200 million ECU in 1981, rising to some 350 million ECU the following year. By the end of 1983, the volume of ECU credits outstanding stood at around 1 500 million ECU.

It is as a loan issue currency, however, that the ECU has made its greatest impact on the capital market, especially the Euromarket, since 1982. For a long time, it appeared as though the international bond market, on which large companies, governments and international and European organizations raise funds, were the preserve of the major currencies. Units of account such as the special drawing right at any rate had never managed to establish themselves permanently on that market. This changed with the appearance of the ECU on the capital market. The beginnings in 1981 were cautious and modest but the following year the ECU had definitely broken into the long-term bond market.

The first ECU-denominated loan was issued on the Euromarket on 21 April 1981 by STET, the Italian public-law telecommunications company, acting through its Luxembourg-based finance company. The European Investment Bank and a Turin-based bank were the next to tap the market. In 1981, the very first year in which the ECU developed into an issuing currency, a company from outside the Community, Hydro Quebec, floated an ECU-denominated loan. A large number of borrowers from other non-member countries have since followed, including the Swedish export credit agency, the Province of Quebec and the finance companies of large US companies and banks. After the European Investment Bank and the Commission, the Council of Europe and the World Bank also raised ECU funds on the Euromarket.

To date, most ECU-denominated issues have carried a fixed interest rate and have been for between six and eight years (ten to fifteen years in exceptional cases). Variable-rate issues have



remained the exception. Like gold earlier, the ECU is also used occasionally as the reference currency for loan issues. In 1981, for instance, the Belgian Government floated a loan tranche that was denominated in Belgian francs and indexed to the ECU. Subscribers were assured of receiving back as many Belgian francs as corresponded to the ECU value if the Belgian franc did not perform as well as the ECU. A Turin-based bank also floated an ECU-indexed issue. Issues floated in ECUs are quoted on the Luxembourg stock exchange. A fledgling secondary market has developed for issues already in circulation, enabling ECU-denominated issues to be dealt in at any time without difficulty even after their initial flotation.

While only five ECU loans totalling 190 million ECU were issued in 1981, the breakthrough came in 1982, when 17 loans worth 1 812 million ECU were floated. The year 1983 saw 21 loans totalling 1 935 million ECU. In 1982, the Italian treasury was the largest borrower with 1 200 million ECU, although only 100 million ECU of this amount was raised on the Euro-market. In 1983, a much larger number of issuers used the ECU even if, in many cases, they only floated loans in the 35 million to 50 million ECU range. The Italian treasury was once again the largest borrower, accounting for 600 million ECU, and the World Bank raised 150 million ECU.

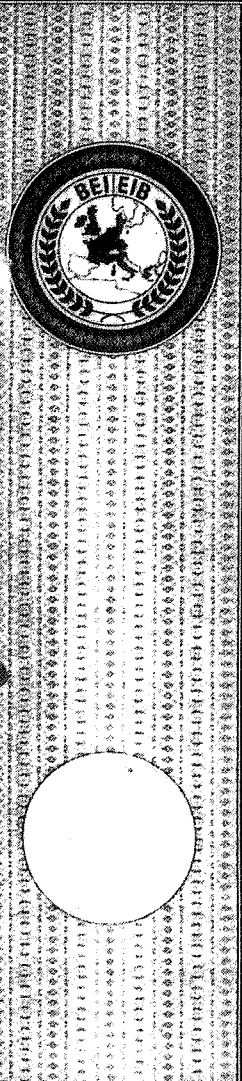
By the end of 1983 — just under three years after the first issue in March 1981 — loans amounting to nearly 3 000 million ECU had been floated on the Euromarket. With 850 million ECU French issuers topped list of borrowers. Italian issuers accounted for 265 million ECU and issuers from non-member countries, especially Canada, the United States, Sweden and Norway, for 485 million ECU. The Community institutions raised some 750 million ECU and other international institutions 240 million ECU.

11th June

13¼ per cent. 1981 - 1989 Bonds

ECUs 1,000

EUROPEAN INVESTMENT BANK



ECUs 40,000,000
13¼ per cent. 1981 - 1989 Bonds

ECUs 1,000

No. 00000

13¼ per cent. 1981 - 1989 BONDS

EUROPEAN INVESTMENT BANK for value received hereby unconditionally promises to pay to the bearer the sum of

One Thousand ECUs

on 11th June, 1989 (or on such earlier date as such principal sum may become payable) together with premium (if any) and to pay interest on such principal sum from 11th June, 1981 at the rate of 13¼ per cent. per annum payable annually in arrears on 11th June in each year commencing on 11th June, 1982 until such principal sum shall have been paid or payment thereon is provided for, subject to and in accordance with the Terms and Conditions endorsed hereon.

IN WITNESS WHEREOF EUROPEAN INVESTMENT BANK has caused this Note to be duly executed by its President and the Manager of its Finance and Treasury Directorate by their facsimile signatures and coupons for the said interest bearing the facsimile signature of the said Manager to be attached hereto.

Dated as of 11th June, 1981.

EUROPEAN INVESTMENT BANK

By


President

By

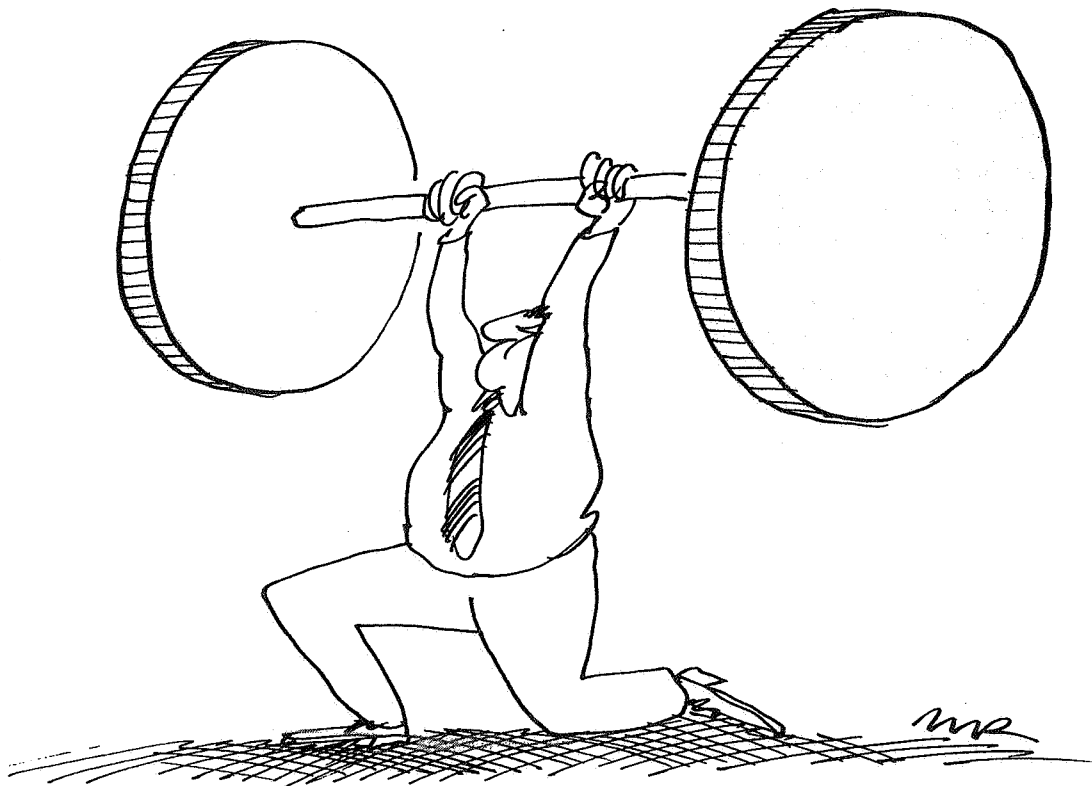

Manager of the Finance and
Treasury Directorate

A typical loan issued by the European Investment Bank (EIB). These loans are well received by the public.

Although the ECU's share of issues on the Euromarket is still modest, it is expanding and has already overtaken the shares taken by most major European currencies. In the first half of 1983, it stood at 3.5%, as against 0.7% in the first half of 1982 and 1.6% in the whole of 1982. In the first half of 1983, the ECU therefore already ranked third among the currencies used for issues on the Euromarket. The dollar came clearly top (around 80%) and the German mark held the second position (10 to 12%). Then came the ECU (3.5%), followed by the Canadian dollar and sterling (each with 2% of the market).

The other important basket-type currency, the special drawing right (SDR), which is the accounting currency of the International Monetary Fund, was very successful on the private capital market in 1981 with five issues totalling 300 million SDR. Initially a large basket comprising 16 currencies, it was simplified in 1981 and is now made up of only five currencies: the dollar with an initial share of 42%, the German mark (19%) and sterling, the French franc and the yen (each with 13%). However, the large share of the dollar, which rose to almost half of the SDR basket as a result of its appreciation, turned out to be a drawback for the use of the SDR as an issuing currency on the bond market. The ECU, on the other hand, has no dollar component and is appreciated by investors looking for an alternative to the dollar.

Users of the ECU have advantages on the capital market that national currencies cannot offer. This applies to both issuers and investors, debtors and creditors. With ECU-denominated issues, chances and risks are spread in accordance with the currency composition of the basket. Companies from weak-currency countries issue loans in ECUs because they would not find any foreign takers for loans denominated in their national currency. In so doing, they are



able to raise capital abroad at a lower interest rate than at home and without incurring an excessively high exchange risk, as would be the case with loans issued in a currency susceptible to revaluation. Investors, especially those in weak-currency countries, can protect themselves against possible exchange-rate losses by purchasing ECU-denominated debt instruments. Investors in countries with a strong currency and a low rate of interest can, by purchasing ECU-denominated paper, earn a higher return on their investments without incurring too large an exchange risk.

6. *The ECU as a trading and balance-sheet currency*

Multinational companies that do most of their business in Europe and are active in several European countries have to decide which currency is best able to provide a reliable view of the financial position of the entire group and of the position and performance of their subsidiaries. Any balance sheet drawn up in a national currency gives a one-sided picture that may change significantly in the event of an exchange-rate adjustment.

It was for this reason that in 1980, the French chemical group Saint-Gobain began to use the ECU as its internal accounting currency — the first company to do so. The fact that the group's internal accounts are drawn up in ECUs does not relieve the parent company in France or its various subsidiaries abroad of the obligation to present their commercial and tax balance-sheets in the currency of the country in which they do business. But by converting transaction and balance-sheet values into a single accounting currency, the group's management obtains a more accurate idea of the overall situation, particularly if much of the group's business is carried on in the countries whose currencies make up the ECU basket.

By using the ECU in its cost accounts, a company can achieve greater transparency of intra-group transfer prices, that is to say, the prices charged on sales from one subsidiary to another within the group. Calculation of internal transfer prices and prices charged to outside customers can be simplified and made more objective. Auditing or supervisory bodies that inspect multinationals' transfer prices might also find ECU-based calculation helpful.

Balance sheets drawn up using the ECU — a mean value of the Community currencies — are probably better suited to the needs of many companies in the Community than balance sheets expressed in dollars or in one of the strong or weak European currencies. In the case of Saint-Gobain, the experiment proved so successful that, since 1982, the group has been recommending that customers settle their bills in ECUs. Other French multinationals such as the Lesieur food group have begun sending ECU invoices to customers in certain countries if this is found acceptable.

A company which can use the ECU not only for costing and balance-sheet purposes but also for making out invoices effectively reduces its risk when importing and especially when exporting. This brings down the cost of exchange risk cover and eases the administrative burden of constantly monitoring various foreign currency positions.

The potential uses of the ECU are far from exhausted. The future of the ECU as an accounting currency for foreign trade and payments has yet to begin, while the European institutions would be at a loss without the ECU as their accounting currency.

7. Restrictions on the use of the ECU

The ECU is the unit of account of the Community institutions and the centre-piece of the European Monetary System. Its use in the Community budget and by the Community institutions, including the European Investment Bank, is governed by Community legislation. By contrast, there are as yet no Community provisions on the use of the ECU between private individuals. Member States are, it is true, required by the EEC Treaty (Article 107) and by virtue of their participation in the European Monetary System to treat their exchange-rate policies as a matter of common concern but they have retained all other aspects of their monetary sovereignty. Accordingly, they are free to admit or not to admit the use of the ECU on their territory, except where it is a matter of official ECU transactions by the Community. Because of this legal situation, private use of the ECU is still subject to many restrictions.

Most Member States have decided to place the ECU on the same footing, *de jure* or *de facto*, as a foreign currency. While it has thus been given currency status it is not treated in the same way as their own national currencies: it ranks as a foreign currency even though the ECU basket is made up of fixed amounts of each national currency.

In the Community countries in which it has foreign-currency status and in which there are still restrictions on the free movement of capital, the ECU is subject to the provisions applicable to all foreign exchange. Thus, residents of Community countries with a weak currency are not normally permitted to open foreign-currency accounts, or they must first obtain authorization; nor may they acquire or hold securities denominated in foreign currency unless this prohibition is lifted or relaxed for specific issues — usually issues floated by the public authorities themselves. If removal of these restrictions on the use of foreign currencies had to await the general liberalization of capital movements, the ECU would probably continue to play only a limited role in the private sector. The EEC Commission's proposal is therefore not only that all Member States accord foreign-currency status to the ECU. It also advocates that transactions in ECU-denominated paper be liberalized and opened up to all Community residents. For residents to have such access to the ECU market, a number of Member States would need to dismantle their exchange restrictions in respect of the ECU.

The ECU does not yet rank as a foreign currency in the Federal Republic of Germany. Contracts and commitments denominated in ECUs are regarded as agreements involving an indexation clause, and these are not generally permitted because of fears that the stability of the German mark might be undermined if other standards of value were used. In Germany, authorization must be sought for every single ECU-denominated agreement concluded between residents and, if authorization is not obtained, such agreements have no force in civil law. This requirement is an impediment to the creation of an ECU money market and prevents the ECU from being used as a currency for bank accounts.

ECU-denominated agreements between residents and non-residents by contrast are not subject to authorization. Consequently, there is nothing to prevent German residents from subscribing to ECU issues floated abroad. But German companies are not allowed to place with residents ECU issues floated on the German capital market.

The restrictions imposed on the ECU under Member States' laws hamper its development. Both the general restrictions on the free movement of capital, which an ECU with foreign-cur-

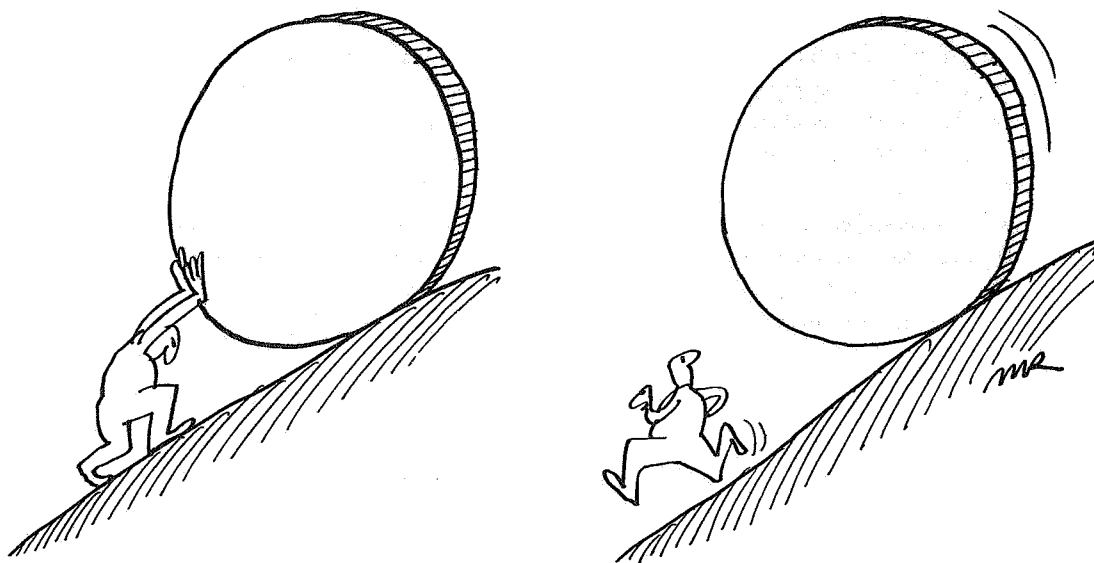
rency status does not escape, and the specific restrictions arising from the failure to recognize the ECU as a foreign currency should be gradually lifted. It should be made possible to use the ECU as a foreign currency throughout the Community, and all obstacles to its future development should be removed. The central banks in the Community should feel jointly responsible with the Community institutions not only for the official ECU but also for the orderly development of the private ECU.

VI. The future of the ECU

In its official role, the ECU performs the practical functions of an accounting currency for the European institutions, for the Community budget and in the European institutions' financial relations with governments and firms. In its private role, it is evolving into a currency unit that will enable firms, workers and private individuals seeking to invest their funds or savings to protect themselves from unforeseen exchange-rate losses. And over and above these practical applications, the ECU holds out the hope that some time in the future there will be a unified European currency.

The name ECU raises great expectations. Private individuals hope that with the ECU they will one day have a currency in their pockets that can be used in any Member State just like their own national currency. Frontier workers and migrant workers who were paid in ECUs would have at least partial protection against the risks of devaluation. Business travellers and tourists hope that the ECU will spare them the inconvenience and cost of having to change money whenever they cross national frontiers. ECU postage stamps, ECU traveller's cheques and ECU coins and small denomination notes could demonstrate that Europe was growing together and that frontiers were no longer the barriers they once were.

Sharp fluctuations in exchange rates which reflect the differing performances of the national economies are seen as one of the reasons that many firms are reluctant to engage in risky busi-



ness abroad. These fluctuations must no doubt bear part of the blame for the reduced propensity to invest and the high level of unemployment.

The ECU should one day relieve firms, especially small and medium-sized ones, of the exchange risk in intra-Community trade and in investment. Large companies are better able to shield themselves against such risks internally since they do business in various countries. For small and medium-sized firms, covering the exchange risk involved in investing, importing and exporting, is an expensive matter.

Large multinationals too will find it easier to do business across frontiers if they draw up their balance sheets and invoices in ECUs. And transfer prices and balance sheets expressed in ECUs would make for greater transparency of multinationals' activities.

The European Monetary System was set up in 1979 with the aim of achieving closer convergence of Member States' economic and monetary policies and, in so doing, eliminating the root causes of the divergent exchange-rate performances. But the objectives of a system that has been conceived not only to secure greater stability within the Community but also to contribute to a steadier movement of exchange rates worldwide cannot be achieved overnight.

The first few years of the EMS admittedly brought some limited progress towards stabilization of the currencies participating in the exchange-rate mechanism. But no headway was made in harmonizing economic policies and narrowing inflation differentials. Now, four years after the EMS was launched, we see the first tangible signs of a reduction in inflation rates.

As the centre-piece of the EMS, the ECU has a major role to play in its future development. Surprisingly, since the EMS was set up the private use of the ECU has made greater progress than official use, even though private use is hindered rather than helped by official regulations. By contrast, the legal framework of the EMS and hence the official use of the ECU have not been developed further. In their Resolution of 5 December 1978, the Member States' Heads of State or Government expressed their strong determination to consolidate the EMS into a final system not later than two years after its introduction. By March 1981, the system was to have resulted in the creation of a European Monetary Fund and full utilization of the ECU as a reserve asset and as means of settlement. It was also to have been based on adequate legislation. Such expansion and legal consolidation of the ECU's role within the EMS would have provided further stimuli to private use of the ECU.

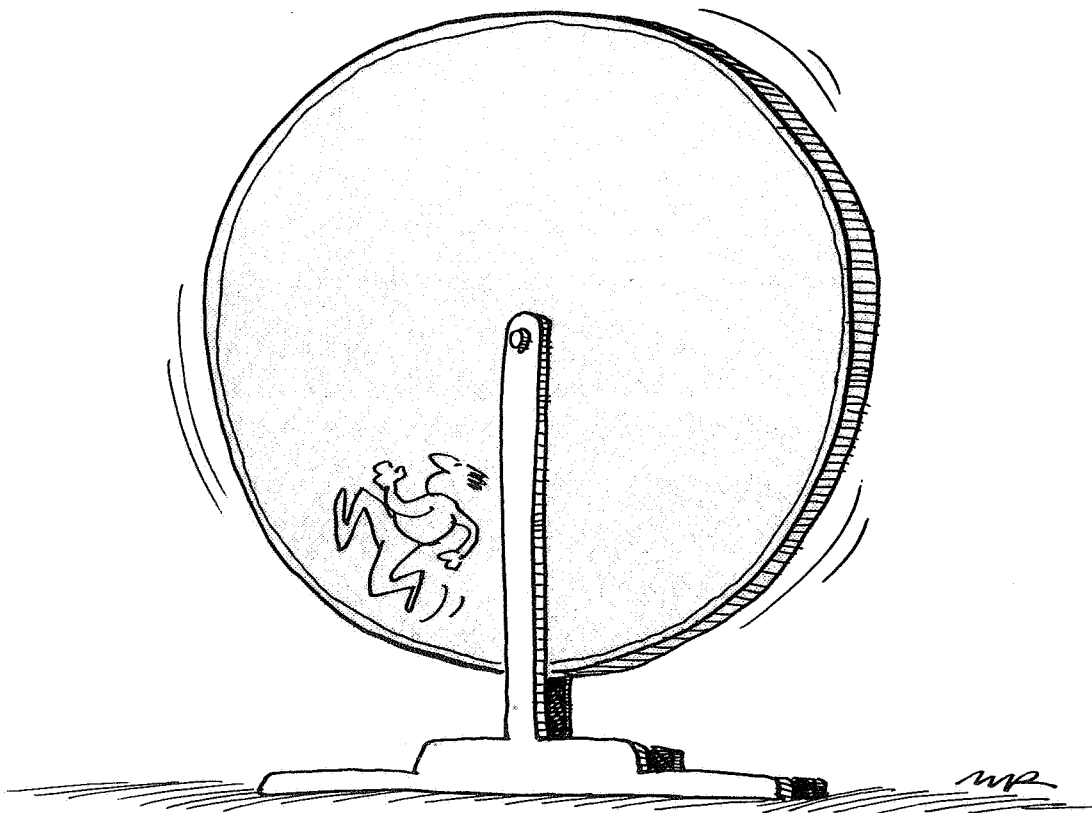
However, the transition to the final system, scheduled for March 1981, has been postponed. The decision to do so was based on the argument that, while the EMS had made for greater stability in the participating currencies' exchange rates, it had not yet brought about a satisfactory degree of economic policy convergence and a corresponding reduction in inflation rates in all the participating countries. Postponing transition to the next phase of the EMS at the same time meant deferring decisions on strengthening the ECU. In May 1983 the Commission therefore reminded Member States' governments that in their Resolution adopted at the European Council meeting in Bremen on 7 July 1978 they had described the ECU as the centre of the European Monetary System. It called on them to lift the restrictions on the ECU before transition to the final phase of the EMS. It urged that the ECU should be accorded foreign-currency status in all Member States but should not be subject to the restrictions applica-

ble in some Member States to other foreign currencies. In addition, transactions in ECU-denominated paper should, according to the Commission, be liberalized and made accessible to all Community residents.

The Commission would also like to see the legal status of the ECU defined and the designation 'ECU' protected so that it is always used in the same way and does not give rise to abuse. There should be only one ECU for both EMS purposes and private business transactions.

High hopes are being pinned on the ECU. As already noted, it bears a name that is derived from a 13th century gold coin. And it is an old custom for gold coins to be regarded as a solid store of value and as a means of payment that is readily accepted everywhere. This maps out an ambitious path for the ECU: if it is to fulfil its task, it must create greater stability and security for the ordinary citizen.

As early as 1970, a group set up under the chairmanship of Pierre Werner, the Luxembourg Prime Minister, to examine ways of achieving economic and monetary union, the objective conceived at the time, formulated four conditions for success: internally, the total and irreversible convertibility of currencies, the elimination of margins of fluctuation of exchange rates, the irrevocable locking of parities and the complete liberalization of capital movements. Ten years later, in 1979, the governments launched the ECU, a designation that aroused great expectations, without any of the preconditions for a common currency spelt out in the Werner report having been met. Member States' currencies are still not fully convertible against one



another in unlimited amounts. The margins of fluctuation between the currencies participating fully and effectively in the system have not been eliminated. They are still 2.25%, or 6% in the case of Italy. Sterling and the Greek drachma, neither of which participates in the exchange-rate mechanism, still have no limits applied to their fluctuation. And the Community is still as far from satisfying the third condition, immutable exchange rates, as it is from complete liberalization of capital movements, the fourth condition. Several Member States place restrictions on the free movement of capital. Since the four preconditions for a European currency have not yet been met, it would be presumptuous to expect the ECU to perform like one already. Excessively bold experiments involving use of the 'ECU' designation should be guarded against. Every step forward must be carefully scrutinized since it would be dangerous to run high risks in the critical field of currencies.

A clear distinction must be made between where we are now and where we want to go. The ECU so far bears only the name, but does not have the stature, of a European currency unit. The spectacular progress made recently in the private use of the ECU in banking and on capital markets should not blind us to this fact. There is still a considerable way to go before we have a European currency. With the creation of the ECU, the first important steps were taken down a long road.

ANNEXES

- 1. Documents**
- 2. Bibliography**

The European Monetary System: documents

Extract from the conclusions of the Presidency of the European Council of 4 and 5 December 1978 in Brussels

European Monetary System

The European Council agreed, on the basis of the preparatory work of the Council (Economics and Finance Ministers) and of the Monetary Committee and the Committee of the Governors of the Central Banks to set up a European Monetary System as from 1 January 1979.

The purpose of the European Monetary System is to establish a greater measure of monetary stability in the Community. It should be seen as a fundamental component of a more comprehensive strategy aimed at lasting growth with stability, a progressive return to full employment, the harmonization of living standards and the lessening of regional disparities in the Community. The European Monetary System will facilitate the convergence of economic development and give fresh impetus to the process of European Union. The Council expects the European Monetary System to have a stabilizing effect on international economic and monetary relations. It will therefore certainly be in the interests of the industrialized and the developing countries alike. (. . .)

Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters

A. The European Monetary System

I. Introduction

1.1 In Bremen we discussed a 'scheme for the creation of closer monetary cooperation leading to a zone of monetary stability in Europe'. We regarded such a zone 'as a highly desirable objective' and envisaged 'a durable and effective scheme'.

1.2 Today, after careful examination of the preparatory work done by the Council and other Community bodies, we are agreed as follows:

A European Monetary System (EMS) will be set up on 1 January 1979.

1.3 We are firmly resolved to ensure the lasting success of the EMS by policies conducive to greater stability at home and abroad for both deficit and surplus countries.

1.4 The following chapters deal primarily with the initial phase of the EMS.

We remain firmly resolved to consolidate, not later than two years after the start of the scheme, into a final system the provisions and procedures thus created. This system will entail the creation of the European Monetary Fund as announced in the conclusions of the European Council meeting at Bremen on 6 and 7 July 1978, as well as the full utilization of the ECU as a reserve asset and a means of settlement. It will be based on adequate legislation at the Community as well as the national level.

2. The ECU and its functions

2.1 A European currency unit (ECU) will be at the centre of the EMS. The value and the composition of the ECU will be identical with the value of the EUA at the outset of the system.

2.2 The ECU will be used:

- (a) as the denominator (*numeraire*) for the exchange rate mechanism;
- (b) as the basis for a divergence indicator;
- (c) as the denominator for operations in both the intervention and the credit mechanisms;
- (d) as a means of settlement between monetary authorities of the European Community.

2.3 The weights of currencies in the ECU will be re-examined and if necessary revised within six months of the entry into force of the system and thereafter every five years or, on request, if the weight of any currency has changed by 25%.

Revisions have to be mutually accepted; they will, by themselves, not modify the external value of the ECU. They will be made in line with underlying economic criteria.

Council Regulation (EEC) No 3180/78 of 18 December 1978 changing the value of the unit of account used by the European Monetary Cooperation Fund¹

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community;

Having regard to Council Regulation (EEC) No 907/73 of 3 April 1973 establishing a European Monetary Cooperation Fund,² and in particular the last paragraph of Article 5 of the Statutes of the Fund;

Having regard to the proposal from the Commission;

Having regard to the opinion of the Monetary Committee;

Having regard to the opinion of the Board of Governors of the European Monetary Cooperation Fund;

¹ OJL 379, 30. 12. 1978, p. 1.

² OJL 89, 5. 4. 1973, p. 2.

Whereas Regulation (EEC) No 907/73, in Article 5 of the Statutes of the Fund, requires the latter's operations in the currencies of the Member States to be expressed in a European monetary unit of account of a value of 0.88867088 gram of fine gold;

Whereas this definition no longer conforms with the rules in force in the international monetary system;

Whereas, apart from cases in which the value of the European Monetary Cooperation Fund unit of account is changed automatically, the last paragraph of the said Article 5 provides that any other changes shall be decided on by the Council, acting unanimously on a proposal from the Commission, after consulting the Monetary Committee and the Board of Governors of the Fund;

Whereas the establishment of a new European Monetary System, which was the subject of the resolution of the European Council meeting in Brussels on 4 and 5 December 1978, provides for the use of an 'ECU' defined as a basket of Member States' currencies,

HAS ADOPTED THIS REGULATION:

Article 1

With effect from 1 January 1979, the Fund's operations shall be expressed in a unit of account known as the ECU which is defined as the sum of the following amounts of the currencies of the Member States:

0.828	German mark,
0.0885	pound sterling,
1.15	French francs,
109	Italian lire,
0.286	Dutch guilder,
3.66	Belgian francs,
0.14	Luxembourg franc,
0.217	Danish krone,
0.00759	Irish pound.

Article 2

The Council, acting unanimously on a proposal from the Commission after consulting the Monetary Committee and the Board of Governors of the Fund, shall determine the conditions under which the composition of the ECU may be changed.

Article 3

This Regulation shall enter into force on 1 January 1979.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 18 December 1978.

For the Council
The President
H. Matthöfer

*Council Regulation (EEC) No 3181/78 of 18 December 1978
relating to the European Monetary System*¹

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof;

Having regard to the proposal from the Commission;

Having regard to the opinion of the European Parliament;²

Having regard to the opinion of the Economic and Social Committee;³

Whereas the European Council meeting in Brussels adopted, on 5 December 1978, a resolution setting out the arrangements related to the establishment of the European Monetary System which will come into effect from 1 January 1979;

Whereas, in this context, and not later than two years after the start of the system, the existing arrangements and institutions would be merged into a European Monetary Fund; whereas, in the meantime, responsibility for administering the new monetary system should be entrusted initially to the European Monetary Cooperation Fund, set up by Regulation (EEC) No 907/73;⁴

Whereas, by Regulation (EEC) No 3180/78, the Council adopted the ECU as the unit of account used by the European Monetary Cooperation Fund;

Whereas, for the system to begin functioning, it is necessary to provide immediately for the creation of a supply of ECUs against part of the central banks' reserves placed with the system, and for those ECUs to be used as a means of settlement within the system;

Whereas, in this context, the introduction of the ECU into the operations of the European Monetary Cooperation Fund and its utilization as a means of settlement are necessary if the objectives pursued by the Community are to be achieved, notably the gradual convergence of Member States' economic policies, the smooth functioning of the common market and the attainment of economic and monetary union; whereas the powers needed to set up the system are not provided for in the Treaty,

HAS ADOPTED THIS REGULATION:

Article 1

The European Monetary Cooperation Fund is hereby empowered to receive monetary reserves from the monetary authorities of the Member States and to issue ECUs against such assets.

Article 2

The Fund and the monetary authorities of the Member States are hereby empowered to use ECUs as a means of settlement and for transactions between those authorities and the Fund.

¹ OJ L 379, 30. 12. 1978, p. 2.

² OJ C 296, 11. 12. 1978, p. 62.

³ Opinion delivered on 29 and 30 November 1978.

⁴ OJ L 89, 5. 4. 1973, p. 2.

Article 3

The Board of Governors of the Fund shall take the administrative measures necessary for the implementation of Articles 1 and 2.

Article 4

This Regulation shall enter into force on 1 January 1979.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 18 December 1978.

For the Council
The President
H. Matthöfer

Communication ¹ on the calculation ² of the equivalents of the ECU and of the European unit of account published by the Commission

1. Definition of the ECU and the European unit of account (EUA)

The ECU, as defined in Council Regulation (EEC) No 3180/78 of 18 December 1978 ³ and the EUA, as defined in Article 10 of the Financial Regulation of 21 December 1977 ⁴ are composed of the same amounts of national currencies.

These amounts are as follows:

0.828	German mark,
1.15	French francs,
0.0885	pound sterling,
109	Italian lire,
0.286	Dutch florin,
3.66	Belgian francs,
0.140	Luxembourg franc,
0.217	Danish krone,
0.00759	Irish pound.

The equivalent of the ECU and EUA in any currency is equal to the sum of the equivalents of these amounts in that currency.

¹ This new communication annuls and replaces the previous communication (OJ C 225, 22. 9. 1978).

² From 28 December 1978.

³ OJ L 379, 30. 12. 1978, p. 1.

⁴ OJ L 356, 31. 12. 1977.

2. Exchange rates used for calculating the ECU's and EUA's equivalents

The central bank in each Member State communicates a representative market exchange rate for its currency against the United States dollar. The dollar has been chosen as giving the most representative rate in all financial centres. The rates are taken from the exchange markets at 2.30 p.m. They are communicated by the National Bank of Belgium to the Commission, which uses them to calculate an ECU/EUA equivalent first in dollars and then in the currencies of the Member States. If an exchange market is closed, the central banks agree on a representative exchange rate for the currency against the dollar which is communicated to the Commission.

Example: Calculation of equivalents for 1 December 1978

National currency amount of the ECU and EUA definition	1 December 1978 exchange rate against the USD	Equivalent in dollars of national currency amount	Equivalent in national currency of total USD amount
(a)	(b)	(c) = (a) : (b)	(d) USD total x (b)
0.828 DM	1.9358	0.4277301	2.51689
1.15 FF	4.4495	0.2584560	5.78516
0.0885 UKL ¹	1.9364	0.1713714	0.671443
109 LIT	853.00	0.1277842	1 109.06
0.286 HFL	2.1035	0.1359638	2.73494
3.66 BFR	30.6675	0.1193445	39.8734
0.140 LFR	30.6675	0.0045650	39.8734
0.217 DKR	5.3885	0.0402709	7.00604
0.00759 IRL ¹	1.9364	0.0146972	0.671443

Total of dollar amounts 1.3001831

¹ The dollar exchange rate from London and Dublin is the number of dollars per currency unit rather than the number of currency units per dollar. Column (c) is therefore found for each of these two currencies by multiplying the value in column (a) by that in column (b); and column (d) by dividing the dollar equivalent of the ECU and EUA (c) by the rate in column (b).

The Commission also calculates an equivalent of the ECU and EUA for other currencies using for each its market rate against the dollar at 2.30 p.m.

3. Publication of the currency equivalents of the ECU and EUA

The daily equivalents in the different currencies calculated by the Commission are published correct to six significant figures in the 'C' edition of the Official Journal of the European Communities.

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This brochure explains the history and significance of the ECU in a manner easily understood by the general reader.

Kommissionen for de Europæiske Fællesskaber
Kommission der Europäischen Gemeinschaften
Επιτροπή των Ευρωπαϊκών Κοινοτήτων
Commission of the European Communities
Commission des Communautés européennes
Commissione delle Comunità europee
Commissie van de Europese Gemeenschappen

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European documentation
Documentation européenne
Documentazione europea
Europese documentatie**

ADDENDUM

THE ECU

On 24 September 1984 the Community Finance Ministers decided that, with effect from 17 September 1984, all Community currencies would be included in the ECU 'basket' in the following amounts:

0.719	German mark (32%)	3.71	Belgian francs (8.2%)
0.0878	Pound sterling (15%)	0.14	Luxembourg franc (0.3%)
1.31	French francs (19%)	0.219	Danish krone (2.7%)
140	Italian lire (10.2%)	0.00871	Irish pound (1.2%)
0.256	Dutch guilder (10.1%)	1.15	Greek drachmas (1.3%)

The decision was taken after this brochure went to press.