

The ECU, the common currency and the monetary union

I. Issues and options

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

A common currency describes a currency which is used throughout the Community and is not the national currency of either a member state or a third country. Two types of 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 with 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 as signifying the use of a common numeraire (as in the case of the private ECU today) or a common reserve instrument as a means of implementing a common monetary policy.

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. Varying views may be held on this question. One is that no common currency is needed in order to achieve 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 such a union, i.e. a single

currency area. Alternatively, it may be argued that ultimately the move to a single currency is necessary in order to reap the full benefits of monetary union. According to this view, only a single currency can provide a convenient numeraire for the transactions of private economic agents and substantially reduced uncertainties and transaction costs. It can also be pointed out that no monetary union has ever existed without a common currency, and that the credibility of the "irrevocable locking" would be at risk if many different currencies continued to exist.

4. The role of the ECU. Any proposals concerning the role of the ECU obviously depend very much on the views held regarding the need for a common currency. However, it should be borne in mind that the ECU already exists, that it holds a place in private markets, that certain expectations have been raised 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 that the ECU's role should grow with progress towards monetary union and that it should become the Community's single currency. Others may consider that it is premature to formalise arrangements for a common currency, and that all that is needed is to promote convergence and monetary stability.

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

6. Firstly, the ECU would remain a basket of Community currencies and serve as a common numeraire. All possible impediments to its voluntary use in private financial and commercial transactions would be removed, but no particular official action would be taken to promote it; no new institution would be required to manage the ECU, but the monetary effects of its growing use would have to be monitored.

7. Secondly, the official ECU (which could remain a basket) would be used as a common reserve instrument in managing 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. The expanded use of the official ECU in this way would not require a

link between the official and the private ECU, and the latter would evolve 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 - Community currency, 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 depend essentially on its quality as money.

II. Propositions relating to the ECU

9. Four possible propositions are stated and examined below:

10. "A parallel currency approach is neither a useful nor a desirable way of establishing a monetary union." Under the parallel currency approach the ECU would be created independently of, and in addition to, national currencies, circulating in parallel with them and competing with them. The idea of its advocates is that the ECU would "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 in an orderly manner 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.

Some concrete implications of this proposition are that before the final stage:

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

11. "An "imprimatur" should be 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, might - for economic as well as psychological and political reasons - be seen as the natural and desirable further development of such a union. However, before the Community could consider adopting a single currency exchange rates would have to be irrevocably locked (the timing of which might depend much more on the effective co-ordination of policies than on growing use of the ECU). Once exchange rates are permanently fixed the ECU will become a very close substitute for any national currency.

One concrete implication of this proposition is that:

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

12. "All impediments to the voluntary use of the ECU as a common numeraire and a means of settlement 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 measure: direct encouragement (e.g. increased borrowing in ECUs by public sector entities; larger exchange market interventions in ECU; some official support for the ECU clearing system) and indirect encouragement (e.g. removal of restrictions on the private use of the ECU by giving it the status of a foreign or national currency in each member country; demonstration effects through increasing operations in official ECUs within the EMS and by enlarging the group of Other Holders).

Some concrete implications of this proposition are that:

- as a numeraire the ECU would have equal, but not privileged, status vis-à-vis the national currency denomination; therefore
- the ECU would be an additional 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." Gov. Ciampi presented a scheme in which the official ECU would be used as a reserve instrument in managing a common monetary policy in the Community. This scheme represents one, but not necessarily the only, way of giving 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 borne in mind 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 that the official ECU already performs a number of functions in central bank operations.

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