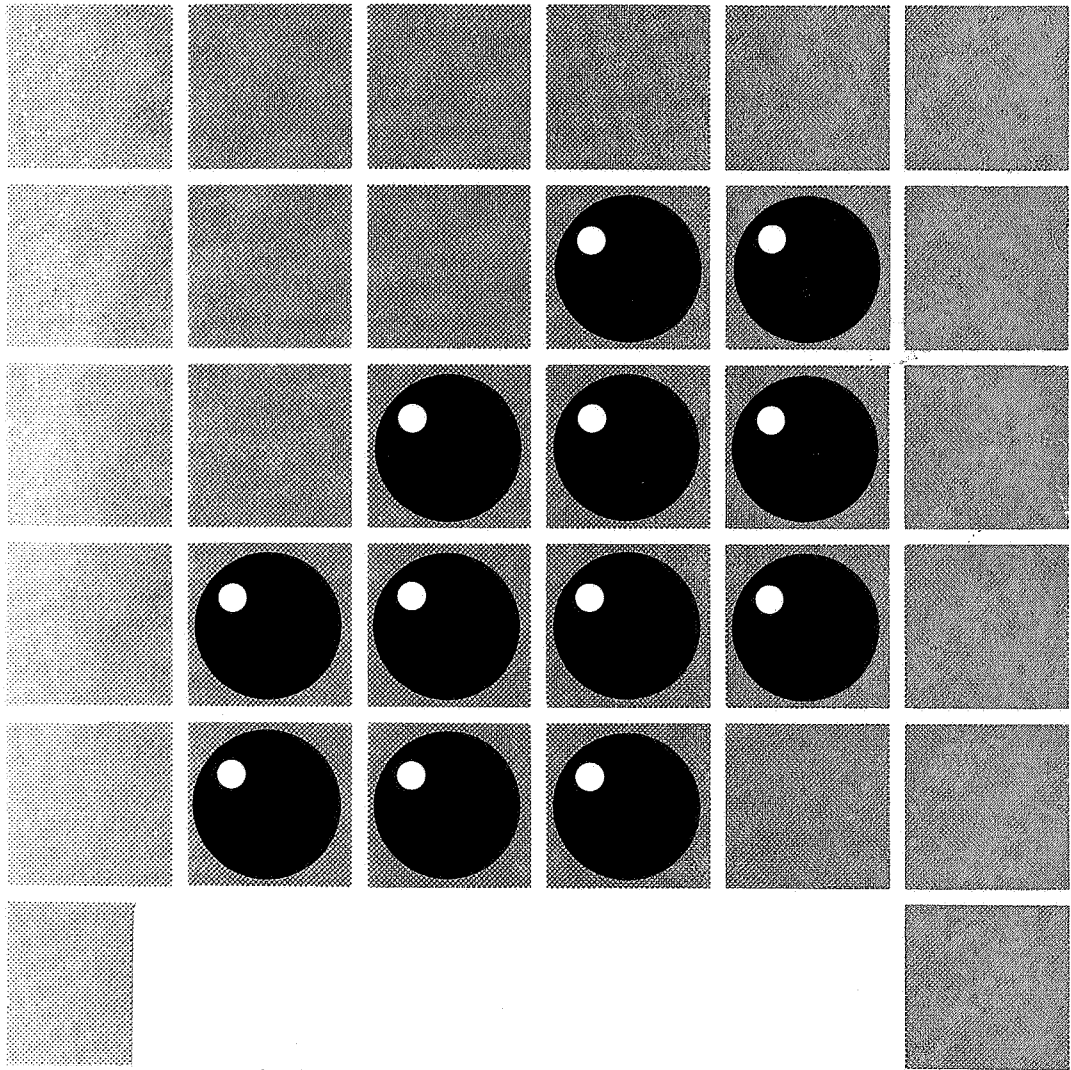


THE ECU



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The ECU

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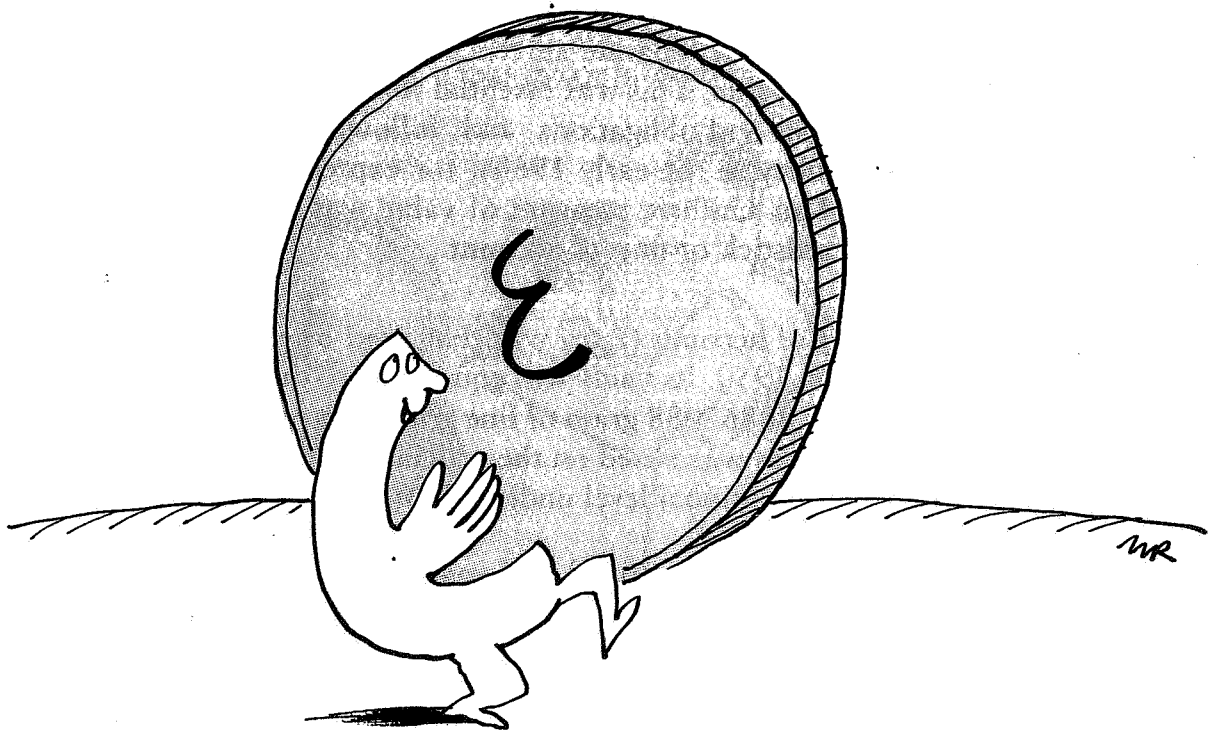
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A. Introduction

1. *Origin of the ECU*



The ECU started life as a unit of account used only for budgetary purposes. It now serves increasingly as money within the Community, not only for official purposes by the European Community institutions that created it, but also, on an even greater and increasing scale by companies, banks and private individuals.

Such growth in the private use of the ECU (European currency unit) in so short a period of time has been possible only because national currencies alone cannot meet all the needs of increasing cross-frontier trade and capital movements within the Community and worldwide. A generally accepted form of money is also required to reduce and spread more evenly the risks associated with the use of national currencies in cross-frontier transactions.

The growing use in international trade and on the financial markets of a unit of account initially needed by the Community institutions for their own internal accounting purposes required the background of a strong European Community and of the European Monetary System (EMS), established in 1979. Only the unit of account of a Community determined to ensure cohesion and a stable economy could have transcended the narrow framework of its official use and have been taken up by the private sector, which was looking for a currency unit for cross-frontier transactions. The ECU is being used today in two separate circuits: there is the official ECU used by the monetary authorities and the private ECU used by business and the population at large, both being identical in definition.

The European Community originally comprised six Member States, and since 1986 has 12 — all with equal rights but separate currencies. Since its foundation, it required a common measure of value. This 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. This uniform measure of value was not a common currency, merely a common yardstick or unit of account.

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 — 0.88867088 gram of fine gold. Conversion of the unit of account into national currencies was based on the official central rates for Member States' currencies fixed at international level under the Bretton Woods agreement.

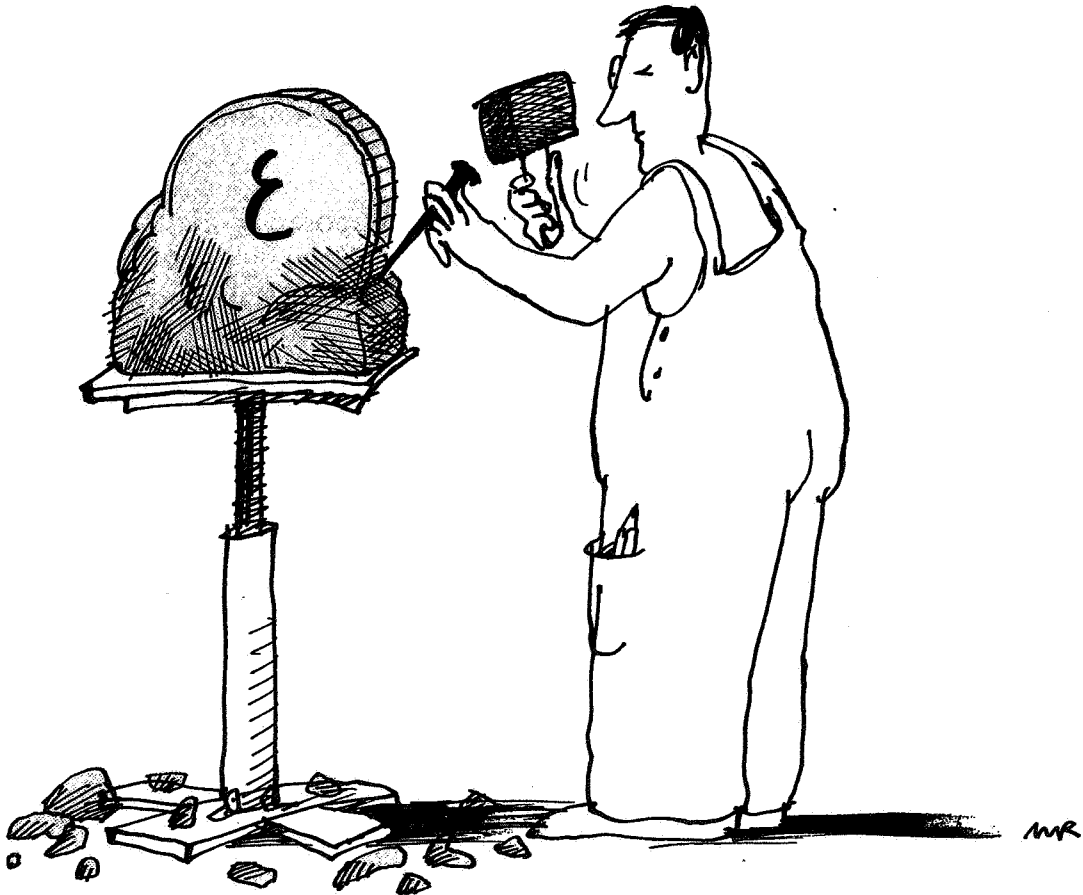
With the disintegration of the system of fixed exchange rates, it was not long before the Community's unit of account began to split as well. As a result, several units of account came into being in the Community, some of which were based on the old and less and less applicable parities, while others were geared to the fluctuating daily rates of the currencies concerned.

On 21 April 1975, the Community decided to follow the example of the International Monetary Fund and to create a European unit of account made up of specific quantities of the then nine Member States' currencies. At the time, the IMF unit of account, the special drawing right (SDR), consisted of agreed quantities of 16 currencies in a common basket.

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, but a review clause was incorporated and the EUA renamed the ECU.

Since 1981, the ECU has replaced the EUA in all its other 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, in the accounts of the European Investment Bank and for the European Coal and Steel Community. The ECU is now the Community's sole unit of account. This has put an end to the confusion caused during the 1970s by the existence of different units 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 emerged at the head of this multiplicity of units of account. The Community institutions and private business now use only the ECU, putting an end to a situation liable to confuse private users.



There is an essential difference between the ECU and the units of account used previously: the latter were used simply for denominating assets or liabilities that had ultimately to be settled in a national currency. The ECU, by contrast, is used not only as a denominator but also as a means of payment. In other words, it performs the function of a genuine currency in international transactions.

2. Nature of the ECU

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) in the thirteenth century and subsequently circulated throughout Europe. The British and German representatives took the name from the initials of 'European currency unit'.

The ECU is defined as a basket-type currency made up of specific amounts of Member States' currencies. Precise rules have been laid down for re-examining and changing the composition of the basket.

Initially, the basket comprised the currencies of the nine Member States that made up the Community after the first enlargement in 1973. On 17 September 1984, four and a half years after Greece joined the Community, the drachma was included in the currency basket at the periodic five-yearly re-examination of its composition. Following Spain and Portugal's accession to the Community in 1986, the escudo and peseta could be included in the basket at the next re-examination, due to take place in the autumn of 1989.

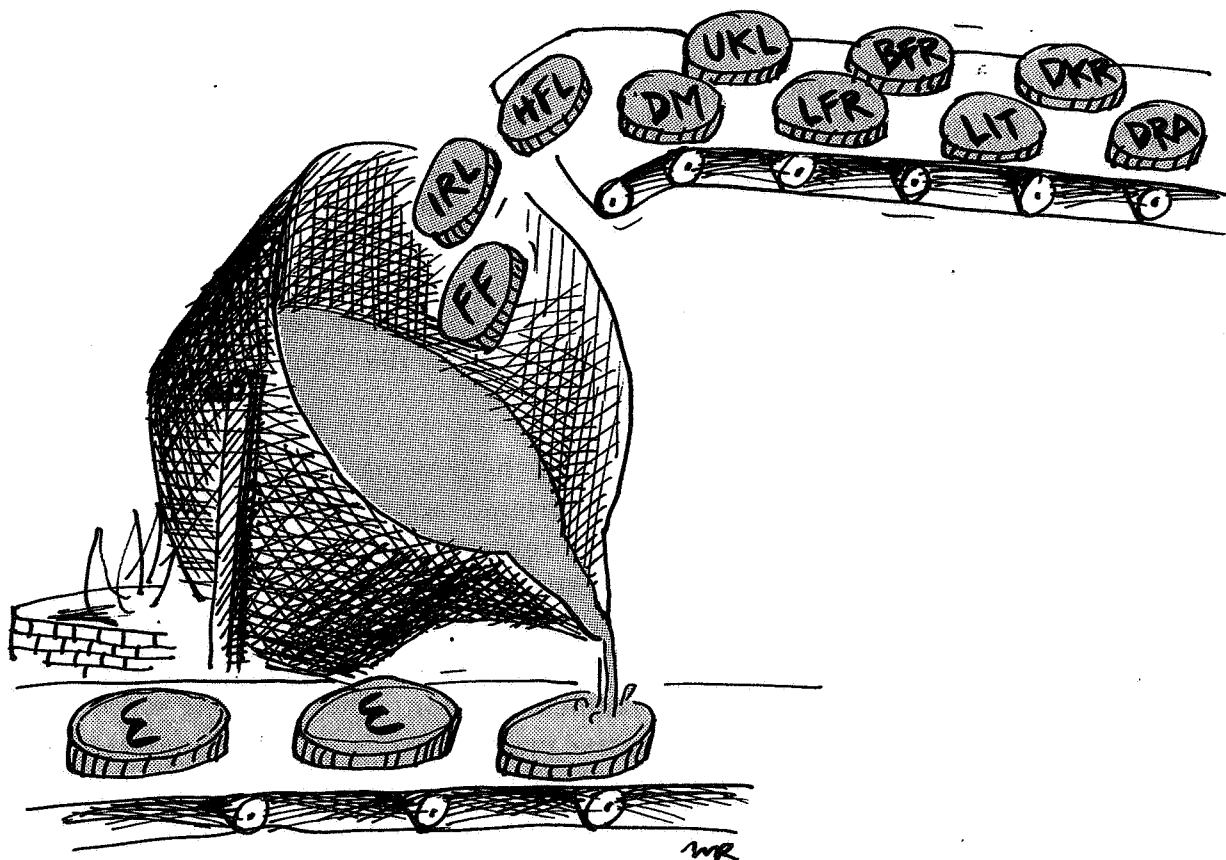
The ECU basket is not an abstract idea, since it is composed of actual amounts of Member States' currencies. Anyone who has spent holidays in the 10 Community countries whose currencies are included in the ECU basket and has brought coins back from each as souvenirs can put together his own ECU basket using the prescribed amounts of each currency. The only technical problem is that not all the currencies have coins of sufficiently small denomination.

The first column in the table below shows the composition of the basket of the European unit of account (EUA) and the subsequent ECU as it applied from 1975 to 17 September 1984, when the drachma was included. The second column shows the composition of the new basket made up of 10 currencies.

Composition of the ECU basket

	Up to 17 September 1984	Since 17 September 1984
German mark	0.828	0.719
Pound sterling	0.0885	0.0878
French franc	1.15	1.31
Italian lira	109	140
Dutch guilder	0.286	0.256
Belgian franc	3.66	3.71
Luxembourg franc	0.14	0.14
Danish krone	0.217	0.219
Irish pound	0.00759	0.00871
Greek drachma	—	1.15

The value of the ECU in each of the national currencies that make it up, can be easily calculated. For example, the value of the ECU in Italian lire is equal to the amount of lire in the ECU, i.e. 140, plus the sum of the other components of the basket converted into lire at the daily exchange rate of the lire against those currencies. The EC 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* ('C' edition).¹ These rates are applied where the ECU is used in the Community's official transactions.



On 3 February 1987 the value of 1 ECU in the currencies of the Member States and selected non-member countries was as follows (rounded off): 2.06 German marks, 2.32 Dutch guilders, 0.751 pound sterling, 0.777 Irish pound, 7.8 Danish kroner, 6.87 French francs, 1467 Italian lire, 42.67 Belgian and Luxembourg francs on the regulated market for commercial transactions and 43.27 Belgian and Luxembourg francs on the free market for financial transactions, 151.09 Greek drachmas, 145.8 Spanish pesetas, 160.4 Portuguese escudos, 1.147 United States dollars, 1.74 Swiss

¹ Anyone interested can obtain the rates from the Commission's automatic telex answering service by calling telex No Brussels 23789 and typing the code 'cccc'.

francs, 7.40 Swedish kronor, 7.96 Norwegian kroner, 1.529 Canadian dollars, 14.49 Austrian schillings, 5.18 Finnish markkaa, 174.65 Japanese yen, 1.72 Australian dollars and 2.11 New Zealand dollars.

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. The official rate is a snapshot (taken at 2.30 p. m.). Since rates are constantly changing on the foreign exchange markets, slight deviations from the official rate as calculated on the basis of the components are unavoidable.

Provision is made for two basic occasions on which the composition of the ECU can be revised:

Firstly, it is stipulated that the composition of the ECU is to be re-examined every five years, or on request if the weight of any of the currencies making up the ECU has changed by 25% or more. The weight means the relationship between the number of units of a currency in the ECU on the one hand and the value of the ECU in that currency on the other. The purpose of the re-examination is to establish whether there is still sufficient consistency between the broader economic importance of a country and the weight of its currency within the ECU. Any decision to revise the composition of the ECU must be taken unanimously by the Council of Ministers of the European Community.

A revision can never be undertaken arbitrarily; the new weights are established by reference to objective economic criteria. The original weights and those established at the 1984 re-examination were based on the relative share of the individual Member States in the Community's gross domestic product and in intra-Community trade; account was also taken of the quotas applied under the short-term monetary support arrangements. However, the new weights are not simply calculated arithmetically, but are laid down by a Council decision. They must lie within the percentage range determined by the objective criteria. So as to avoid any interruption in the continuity of ECU rates, the new composition must be calculated in such a way that on the day of the changeover the value of the ECU in its new composition and the value calculated for the old basket are the same.

The second occasion for changing the composition of the ECU is the inclusion of the currency of a new Member State. Given its current definition, the ECU is intended to include the currencies of all the Member States. The procedures for including new currencies form one of the elements of each accession negotiation.

A joint declaration annexed to the Accession Treaty of Spain and Portugal stated that the peseta and the escudo could be included at the next five-year review of the weighting of the currencies within the ECU in September 1989, but that any decision would have to take account of the need 'to ensure a stable development of the functions and uses of the ECU'.

