

# EUROPEAN COMMUNITY

**BACKGROUND INFORMATION**

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BACKGROUND NOTE

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## A NEW EUROPEAN UNIT OF ACCOUNT

A new unit of account (UA), composed of a "basket" of the nine European Community member countries' currencies, will be used to express the amounts of EC aid, channeled through the European Development Fund (EDF), to the 46 developing countries which have signed the Lome trade-and-aid Convention with the Community. This UA will also be used for accounting purposes by the European Investment Bank (EIB), which grants development and reconversion loans to EC members and associates. According to the Council's decision last March 18, the use of this UA should gradually be extended to other Community activities.

Ever since the Community's foundation, every activity and common policy which has to be expressed in monetary terms has run into problems caused by the diversity of currencies and the autonomy of national monetary policies. A solution to this problem has been sought in the creation of a UA which is distinct from the currencies to which it is related, while at the same time being closely linked to them. This Community UA was originally based on gold. Its weight of 0.8867088 grams was equal to the "old" gold weight of the US dollar and converted into national currencies by using the officially declared "par" value. In this system, when a currency was devalued or revalued by declaring a new gold parity to the International Monetary Fund (IMF), the counter value in that currency for sums expressed in units of account increased or decreased automatically.

Recent international monetary developments ended the post-war Bretton Woods international monetary system and led to the introduction of central rates, and subsequently, to generalized floating. While the conversion rates of UAs into national currencies generally continued to be based on officially declared parities which no longer had a close relationship to the exchange market rates, the management of the UA became more and more difficult.

It is worth recalling in this respect that the Community is now using the UA technique in 16 different areas of Community activities, the main ones being the Community budget, the common agricultural policy, the European Coal and Steel Community's lending activities, and the European Investment Bank.

### The Community's New Approach

In a monetary world of floating exchange rates where the dollar itself was no longer a stable reference, many different solutions based on baskets of several currencies have been tried. After the launching in 1973 of several loans by the European Investment Bank based on a new type of UA -- the so-called EURCO which represented the nine EC currencies -- a new method of determining the transaction value of the special drawing rights (SDR) was introduced by the IMF on July 1, 1974. This method was based on a basket of the 16 main IMF currencies.

In its March 18 decision, the EC Council decided not to take the SDR-basket for the following reasons:

- To choose the SDR-basket would mean using for intra-Community transactions a UA in which Community currencies account for only 45 per cent whereas non-Community currencies represent 55 per cent, of which the dollar alone accounts for 33 per cent. It would hardly be conceivable for intra-Community conversion rates to be altered solely because the yen or the US dollar changed in value.
- The Community's economic scope seems to be large and homogeneous enough to allow these countries to form a genuinely autonomous basket of their currencies, reflecting the monetary developments in this area. In fact, it seems normal that the Community would want to have control over a UA which applies to intra-Community or Community-related transactions.
- It is hoped that the gradual application of this UA, even though at the moment it represents mainly an accounting device and by no means a payments currency, will help to pave the way for the European Community's own monetary identity.

How the New Unit of Account Works

The Commission calculates the value of the unit of account daily.

For convenience, the initial value was fixed at US \$1.20635, the value of the SDR on June 28, 1974. Since July 1, 1974, when the SDR basket took effect, the rate quotations have not coincided.

Within the UA basket, the nine currencies were initially weighted according to a formula mainly based on the gross national product (GNP) and foreign trade capacities of the member states. This method produced a UA whose value, in each constituent currency, is equal to the sum of the following amounts of national currencies valued at their daily market exchange rate:

|                  |         |
|------------------|---------|
| Deutsch mark     | 0.828   |
| Pound sterling   | 0.0885  |
| French franc     | 1.15    |
| Italian lira     | 109.00  |
| Dutch guilder    | 0.286   |
| Belgian franc    | 3.66    |
| Luxembourg franc | 0.14    |
| Danish kroner    | 0.217   |
| Irish pound      | 0.00759 |