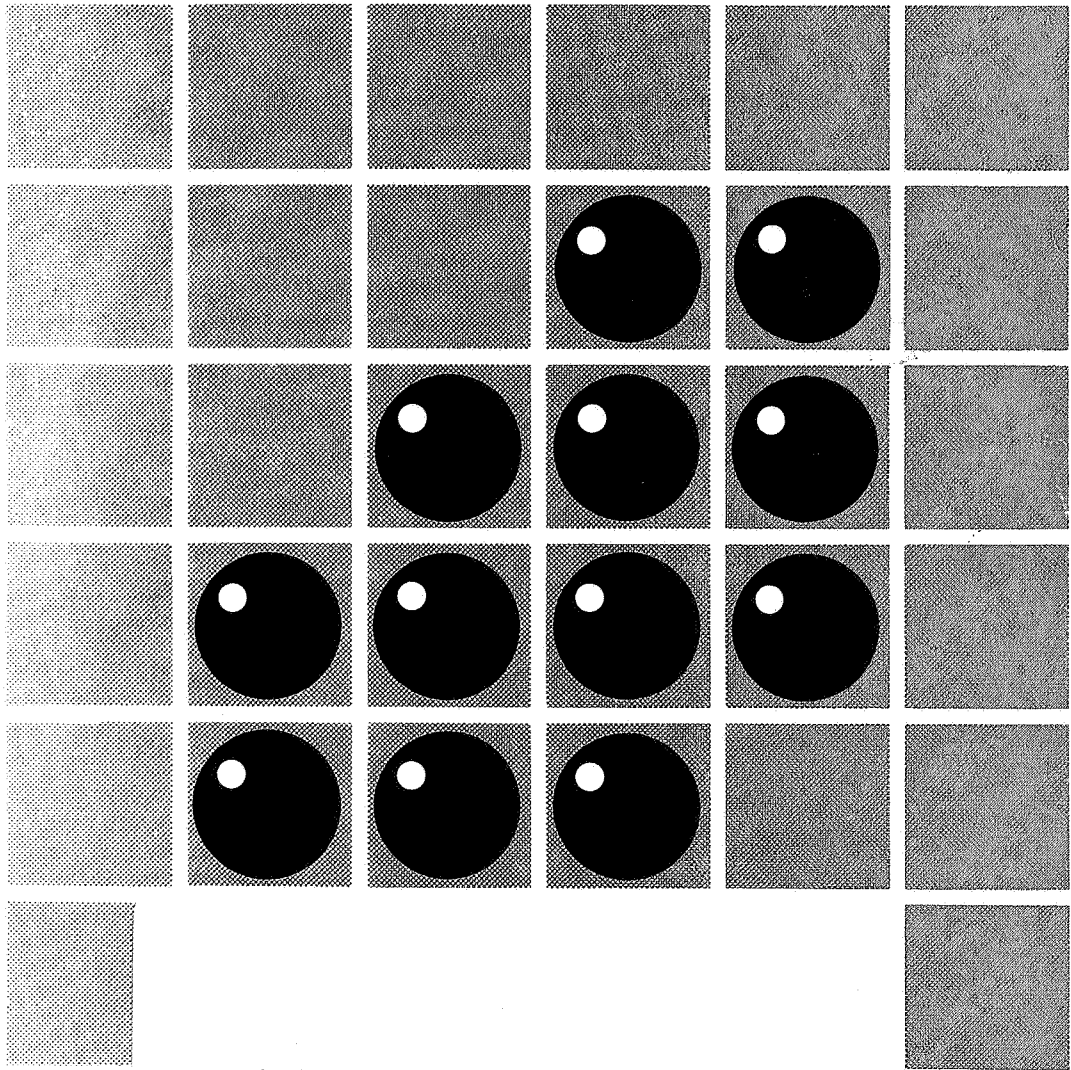


# THE ECU

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# **The ECU**

*Second edition*

**Manuscript completed in June 1987**

This publication is also available in the following languages:

ES	ISBN 92-825-7422-9	EI ECU
DA	ISBN 92-825-7418-0	ECU'en
DE	ISBN 92-825-7419-9	Der ECU
GR	ISBN 92-825-7420-2	To ECU
FR	ISBN 92-825-7423-7	L'Écu
IT	ISBN 92-825-7424-5	L'ECU
NL	ISBN 92-825-7425-3	De Ecu
PT	ISBN 92-825-7426-1	O ECU

Cataloguing data can be found at the end of this publication.

Luxembourg: Office for Official Publications of the European Communities, 1987

ISBN 92-825-7421-0

Catalogue number: CB-NC-87-005-EN-C

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*Printed in the FR of Germany*

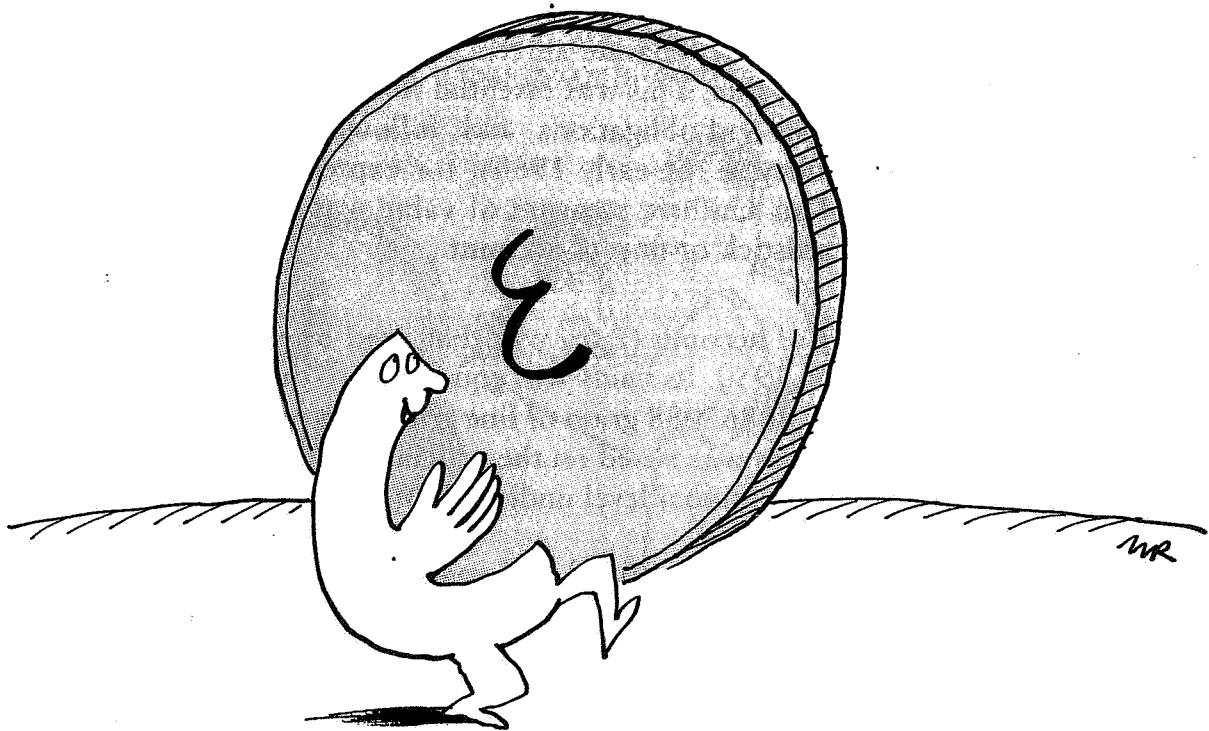
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## A. Introduction

### 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.

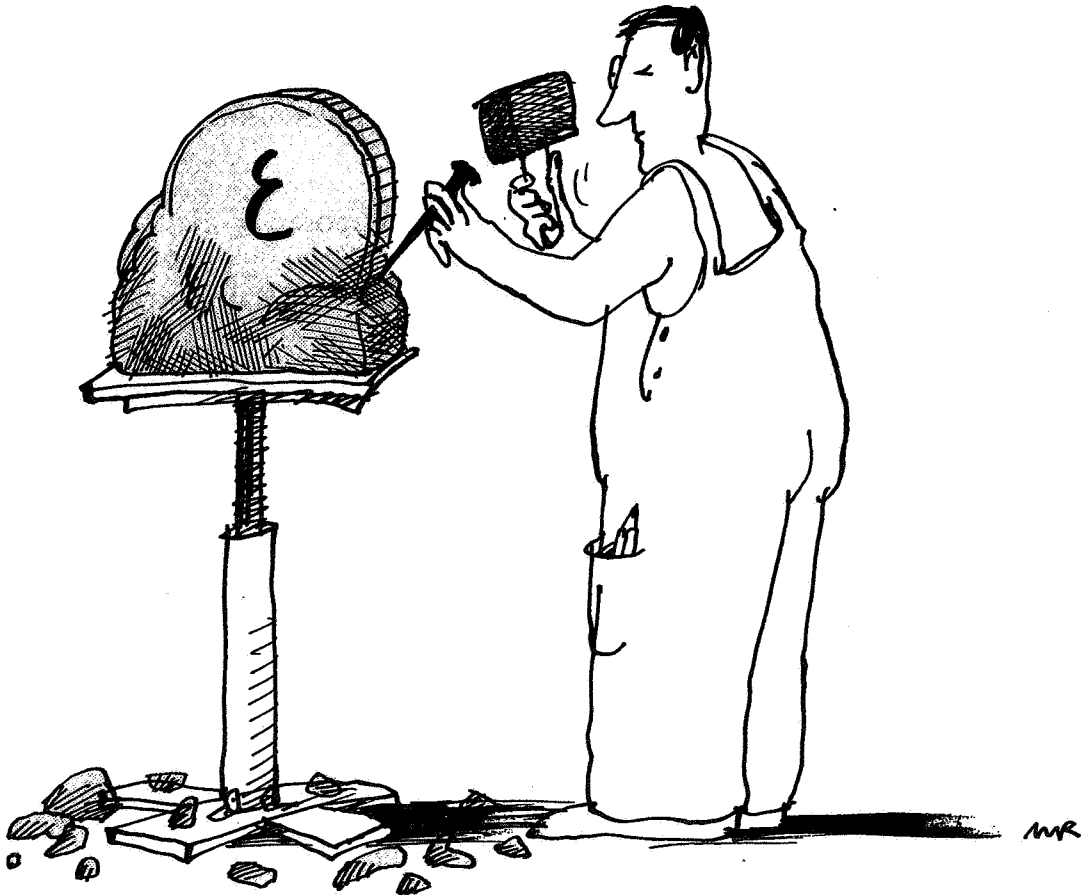
With the disintegration of the system of fixed exchange rates, it was not long before the Community's unit of account began to split as well. As a result, several units of account came into being in the Community, some of which were based on the old and less and less applicable parities, while others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

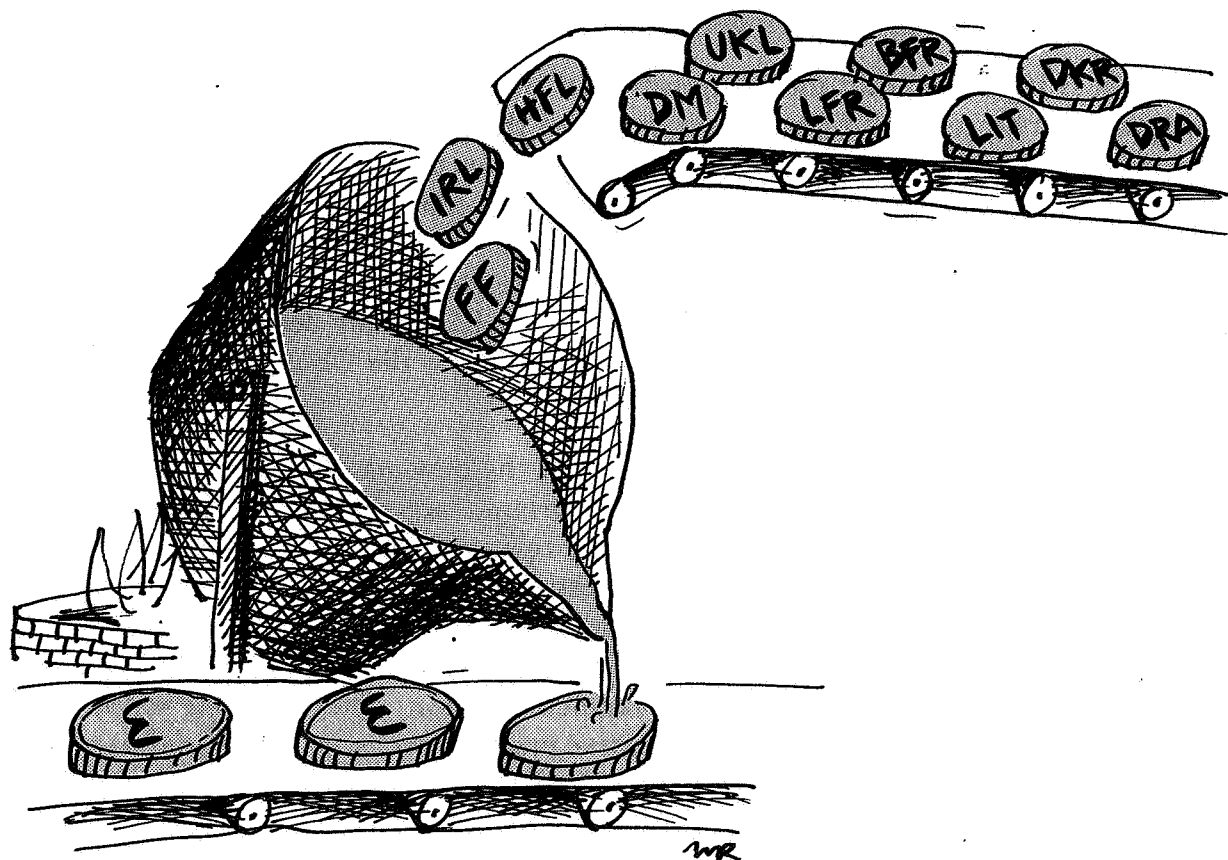
The ECU basket is not an abstract idea, since it is composed of actual amounts of Member States' currencies. Anyone who has spent holidays in the 10 Community countries whose currencies are included in the ECU basket and has brought coins back from each as souvenirs can put together his own ECU basket 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).<sup>1</sup> 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

<sup>1</sup> 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.

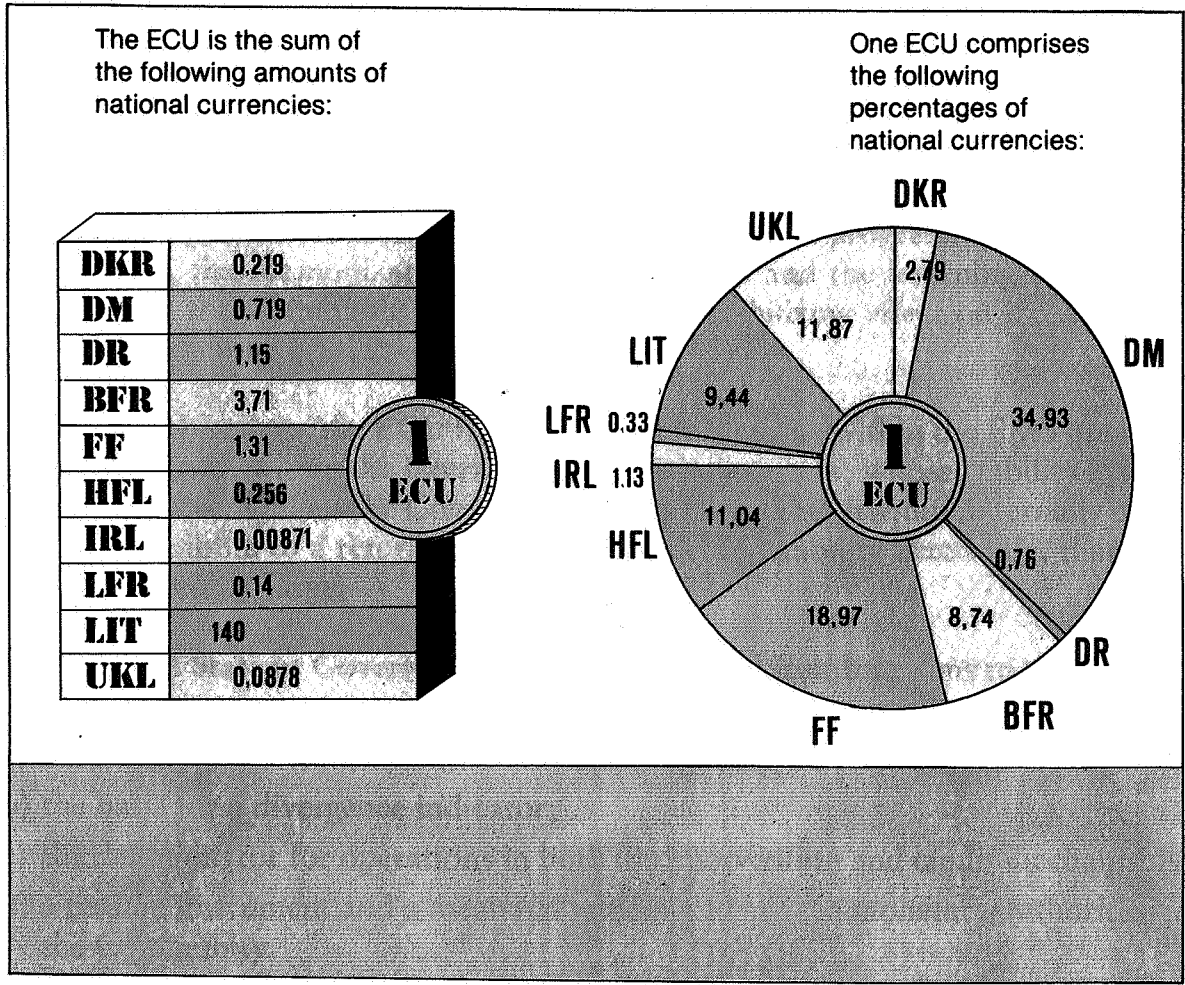
A revision can never be undertaken arbitrarily; the new weights are established by reference to objective economic criteria. The original weights and those established at the 1984 re-examination were based on the relative share of the individual Member States in the Community's gross domestic product 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'.

So far, the composition of the ECU has been revised only once, at the first five-year review in September 1984.

The revision was carried out because the weights of the individual currencies in the ECU basket had changed to such an extent between 1975 and 1984 that they no longer reflected the actual economic strength of the countries and their share in intra-Community trade. In particular, the shares of the Italian lira and the French franc had fallen too sharply, while the shares of the German mark and Dutch guilder had risen disproportionately. The re-examination of the shares of the nine currencies in the basket was carried out simultaneously with the inclusion of the Greek drachma in the currency basket as laid down in the Accession Treaty.



The modification took place smoothly. It had been expected on the financial markets and had gradually come to be reflected weeks in advance in the ECU interest rate, so that there were virtually no changes in interest rates on the day it was carried out.

The table below shows how the individual currencies' percentage shares in the value of the ECU basket since its introduction have moved in response to adjustments to central rates and the revision of the basket on 17 September 1984 (taking selected dates).

**Shares of the currencies in the ECU basket**

	March 1975	13 March 1979	23 March 1981	21 March 1983	17 Sept. 1984	21 July 1985	7 April 1986	15 Jan. 1987
BFR/LFR	8.2	9.5	9.3	8.57	8.57	8.59	8.81	9.07
DKR	3.0	3.0	2.8	2.70	2.69	2.69	2.77	2.79
DM	27.3	33.0	32.5	37.38	32.07	32.12	33.62	34.93
DR	—	—	—	—	1.31	1.14	0.85	0,76
FF	19.5	19.8	19.2	16.93	19.06	19.09	18.81	18.97
HFL	9.0	10.5	10.2	11.46	10.13	10.15	10.63	11.04
IRL	1.5	1.1	1.1	1.06	1.2	1.2	1.22	1.13
LIT	14.0	9.5	8.6	7.86	9.98	9.21	9.36	9.44
UKL	17.5	13.6	16.3	14.05	14.98	15.81	13.93	11.87

## **B. The function of the ECU in the European Monetary System (EMS)**

### *1. Centre of the EMS*

The ECU is a 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'.

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.

The Heads of State or Government expressly assigned four functions to the ECU; it is to serve as:

- (a) the denominator (*numéraire*) 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 reserve instrument and a means of settlement between monetary authorities in the Community.

#### **(a) Denominator (*numéraire*)**

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.

Participating in the EMS exchange-rate mechanism means that each currency's ECU-related central rate is dependent on the rates of the countries. 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 Member States' requests for 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, a 'presumption' that the country concerned will take appropriate measures to prevent its currency from overstepping the permissible margin of fluctuation. In this role, the ECU was supposed to encourage discipline in national economic and monetary policies.

However, the hopes placed in the ECU as a divergence indicator have only been partially fulfilled.

#### **(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. 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 1973 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. The interest applicable is also expressed in ECUs.

The use of 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.

**(d) A reserve currency in the making and a payment instrument**

The European Council made it clear when it launched its 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, EMS participants 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.

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. The deposit arrangements themselves are renewed every two years.

Physically, the gold and dollars remain 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 becomes receivable only when Member States use their ECU credits for payment purposes.

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.

As a consequence of the deposit arrangement the ECU shows up 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. For this reason, the total number of ECUs has increased from 27 000 million at the inception of the EMS, to 45 000 million in 1985.

In future, the amount of ECUs should not be determined by external factors largely beyond the Community's control.

Another drawback to the system is the limited use that can be made of the ECU as a reserve instrument. It can only be used for settlement of 50% of the debts arising from very short-term financing as outlined in Chapter B 1(c) above.

## *2. Improvements in the functions of the ECU*

In mid-1985, the Community central banks agreed to the first improvements in the functioning of the ECU.

They agreed to:

- (i) relax the rule whereby the amount a debtor central bank could settle in ECUs was limited to 50% of the claim being settled. The 50% acceptability limit for the settlement of claims in ECUs no longer applies if the central bank accepting ECUs is itself a net debtor in ECUs;
- (ii) raise the rate of interest on the ECU. Previously, the interest rate paid on net ECU credit balances was calculated from the weighted average of Member States' official discount rates. Now, the rate of interest on the ECU reflects market rates more closely since it is now calculated on the basis of the weighted average of representative money market rates in the Member States. The changeover to a more closely market-related interest rate increases the attractiveness of the ECU as a reserve currency;

- (iii) introduce a new mobilization mechanism which enables EMS central banks requiring intervention funds to mobilize through the European Monetary Cooperation Fund their net ECU creditor positions and a proportion of the ECUs allocated to them by the Fund in return for the deposit of 20% of their gold and dollar reserves. The mobilization takes place in dollars at the other central banks in proportion to their outstanding ECU/dollar swaps with the Fund. The dollars thus obtained may be exchanged for EMS currencies with the agreement of the central banks of the relevant currencies. The mobilization transactions are for three months, renewable for a further three months, and bear interest at the market rate. This system allows central banks to acquire dollars or Community currencies temporarily against ECUs for intramarginal interventions, i.e. before intervention thresholds are reached. Intramarginal interventions are intended to prevent market rates from drifting down as far as the intervention threshold and hence to ensure that rates remain more stable.

### *3. ECUs for central banks of non-Community countries*

Since 12 November 1985, the official ECU may be held and used as a reserve currency by non-Community central banks as well as by the central banks of the Member States. Although the EMS is a closed system in which only the Member States participate, the Resolution of the Heads of State or Government of 5 December 1978 provided that European countries with particularly close economic and financial ties with the Community may participate.

Central banks of non-Community countries and international monetary institutions may now upon application be granted the status of 'other holders' by the Board of Governors of the European Monetary Cooperation Fund. The central banks and monetary institutions can then temporarily acquire from Community central banks existing reserve ECUs through sales with right of repurchase and through swaps.

### *4. Outlook*

The package of measures put into effect by the Community central bank governors on 1 July 1985 and the widening of the ECU circuit to include 'other holders' were the first steps to be taken to strengthen the official ECU since the inception of the EMS in 1979.

A second positive response followed at the end of 1985. An intergovernmental conference on the revision of the EEC Treaty convened by the European Council of

**Heads of State or Government in 1985 proposed that the EMS and the ECU should be enshrined in the Treaty itself. The conference decided to include a new Article 102 A in the Treaty. The new article establishes a direct link between Member States' efforts to ensure economic and monetary policy convergence and the experience acquired in cooperation within the framework of the EMS and in developing the ECU. The new EEC Treaty makes it clear that the EMS and the ECU are instruments for the progressive realization of economic and monetary union.**

**The future will show whether the central banks and the governments of the Member States are prepared to follow up these initial steps with others.**

## **C. The use of the ECU by the European Community institutions**

### *1. Budget — customs — statistics*

The ECU is the unit of account used by the Community institutions for drawing up their budgets. 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.

The Statistical Office of the European Communities also uses the ECU as its unit of account to ensure comparability between statistical data. Since the beginning of 1987, the Statistical Office has published a special brochure giving the main statistics relating to the EMS and the various uses of the ECU.

Community grants and loans made to companies for research purposes, for example, are also denominated and disbursed in ECUs. The same applies to fines imposed on companies for infringing Community provisions, such as the competition rules. The Commission is also using the ECU to an increasing extent for certain types of expenditure, such as the payment of interpreters, refunding the expenses of candidates participating in recruitment competitions and the reimbursement of experts' expenses. 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 system of uniform agricultural prices under the common agricultural policy also relies on the ECU. Prices are first set in ECUs and then converted into the various national currencies. However, the smooth functioning of the system does presuppose stable exchange rates between the national currencies, since, if a currency is re-valued (or devalued) against the ECU, agricultural prices in that currency will fall (or rise) accordingly.

So as to avoid such price fluctuations, the prices fixed in ECUs are converted into national currency not on the basis of ECU exchange rates, but using special 'green rates'. However, since cross-frontier agricultural trade is carried out at the exchange rates actually determined on the foreign exchange markets, a system of border charges and subsidies ('monetary compensatory amounts') was introduced to make up the difference between the market rate and the green rate and so avoid distortions of trade.

The role of the ECU in the common agricultural policy is therefore slightly more complex than in the other spheres of Community activity since its conditions of use deviate from those governing the market.

## *3. European Development Fund and non-member countries*

The ECU is used by the European Development Fund, which was set up under the Lomé Convention, linking the Community with over 60 African, Caribbean and Pacific countries. The Lomé Convention is renegotiated every five years. The most recent Lomé Convention, covering the period from 1986 to 1990, provides for a total volume of 8 500 million ECU. All the Fund's revenue and expenditure is expressed in ECUs. Member States' contributions, which used to be payable only in national currencies, may now be made in ECUs. An increasing proportion of the Fund's payments to projects it assists and finances is made in ECUs.

## *4. The European Investment Bank*

The European Investment Bank (EIB), the Community's long-term financing arm, was the first Community institution to issue public loans in ECUs, thereby con-

ECU 1.000

No. 0.000.0 0

# Banque Européenne d'Investissement

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(B.A.L.O. du 28 février 1985)

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La présente obligation dont les conditions figurent au verso, est l'une des deux cents mille (200.000) obligations au nominal de mille (1.000) ECU chacune représentatives de l'emprunt obligataire d'un montant de deux cents millions d'ECU (ECU 200.000.000) émis le 15 février 1985 par la Banque Européenne d'Investissement (l'"Emprunteur") et qui fait l'objet d'un contrat de service financier du 5 février 1985 entre l'Emprunteur et la Banque Nationale de Paris (Luxembourg) S.A. en qualité d'Agent Financier.

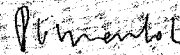
L'Emprunteur s'engage à payer au porteur de la présente obligation, le 15 février 1995 ou à toute date antérieure à laquelle le montant en principal mentionné ci-après pourrait devenir exigible conformément aux conditions figurant au verso, la somme en principal de mille ECU (ECU 1.000), ainsi que l'intérêt de cette somme en principal à compter du 15 février 1985 au taux annuel de 9 1/4 % payable le 15 février de chaque année, le tout conformément aux conditions figurant au verso.

Emis le 15 février 1985

**BANQUE EUROPEENNE D'INVESTISSEMENT**



Le Président



Le Directeur des Finances  
et de la Trésorerie

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

tributing to the development of a private capital market in ECUs. In 1986, such loans in ECUs accounted for almost 8% of long-term liabilities, the Bank's most important source of financing. The proportion of the Bank's financial resources denominated in ECUs is increasing every year.

The EIB also makes available loans expressed and disbursed in ECUs. The proportion of the Bank's total outstanding loans accounted for by such ECU loans stood at almost 9% in 1986.

The EIB in addition acts as an agent for the Community in a number of ECU loan operations financed or subsidized from the Community budget or the European Development Fund. These involve mainly loans from the New Community Instrument (NCI) and loans to African, Caribbean and Pacific countries or the Mediterranean countries.

The ECU has become an important component of the EIB's cash management. The Bank secures a proportion of its liquid assets through ECU-denominated money-market paper.

### *5. The ECU and the Community's support mechanisms*

ECUs may be used by the central banks of the countries participating in the European Monetary System to settle part of the debts arising from compulsory interventions in support of their respective currencies under the exchange rate mechanism. In addition, any central bank in need of funds for intervention (in dollars or Community currencies) can borrow against ECUs at other central banks.

There are also Community credit mechanisms in which the ECU plays a role. These support mechanisms may be drawn upon by Member States which find themselves in temporary balance-of payments difficulties.

Under a short-term monetary support facility, three-months 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.

Member States have so far made little use of these support mechanisms.

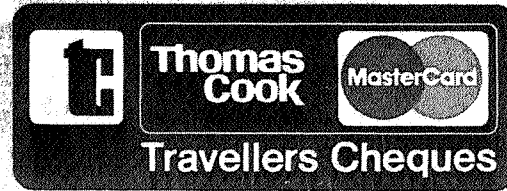
On the other hand, the Community has since 1975 been able to use its creditworthiness to raise finance in each agreed currency on the terms applying on the international capital market. It can on-lend the funds to Member States which are in balance-of-payments difficulties. At present, balance-of-payments loans of up to 8 000 million ECU may be raised and on-lent. However, no debtor country may claim more than 50% of this amount.

The loan is decided by the Council and tied to a programme designed to improve the balance-of-payments situation. This programme is monitored by the Commission in conjunction with the Monetary Committee. Several Member States have taken advantages of this credit facility in the past few years, most notably Greece, which borrowed 1 750 million ECU. In addition to loans floated in conventional currencies, sizeable ECU borrowings, each worth more than 350 million ECU, were made.



# ECU

European  
Currency Units



### Denominations

ECU 50

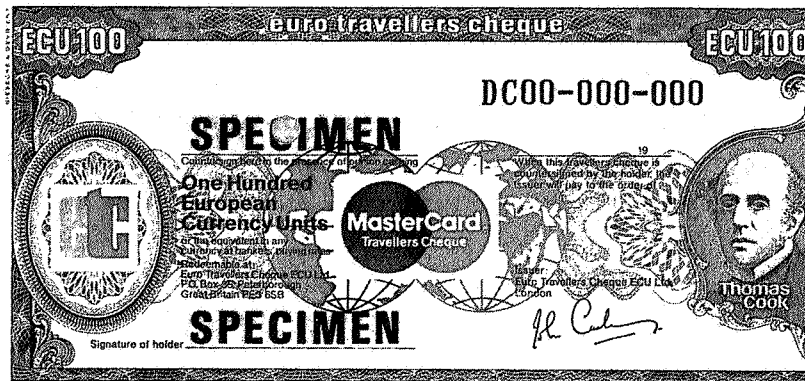
ECU100

*Photo used*

### Cheque Centre

Euro Travellers Cheque ECU Ltd.  
P.O. Box 36  
Peterborough  
Great Britain PE3 6SB

Telex: ENGLAND PETERBOROUGH 32581  
Cable: COOKCHEQUE PETERBOROUGH ENGLAND  
Telephone: (+44 733) 63200



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Please, no writing or stamping in this space

### Reimbursement

Encashed ECU travellers cheques should be sent for reimbursement to Euro Travellers Cheque ECU Ltd. at the above address using standard remittance documentation, which should include the number of cheques and their denominations.



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**A growing number of banks issue ECU travellers cheques (denominations of 50 and 100 ECU)**  
**The cheques provide security against theft, for example, and ensure great stability of value. The photos show two specimen ECU travellers cheques.**

## D. The private use of the ECU

### 1. *Origin*

The development of the private ECU markets began in 1979 when a number of Belgian banks opened ECU-denominated sight and time deposit accounts for the Community institutions at the latter's request. This enabled the Commission to simplify its cash management and to transfer ECU-denominated financial contributions and interest subsidies to the European Investment Bank (EIB) directly in ECUs.

The EIB for its part began to use the ECU resources it received for loans within and outside the Community. The range of non-banks involved in ECU transactions grew, and with it the ECU-related services provided by commercial banks for their customers.

The EIB was able to invest its liquid ECU assets with Italian banks specializing in foreign trade financing, which saw in the ECU an attractive alternative to the currencies — mainly the dollar and the German mark — which they had previously been using.

Interaction of these various factors gave rise to an interbank market for ECU deposits and loans and to foreign exchange dealings in ECUs. However, these markets began to show significant growth only after five of the most active banks had set up an ECU clearing system in 1982. This system, known as MESA, greatly simplified the settlement of ECU transfers between banks and meant that, for a large proportion of transactions, it was no longer necessary to break the ECU down into its component parts.

The infrastructure provided by the ECU banking market created the necessary basis for the development of the ECU bond market and at the same time derived new impetus from it. In March 1981, the Luxembourg holding company SOFTE issued the first ECU bond loan and thereby started a market whose growth was to be particularly impressive over the next few years.

## *2. The reasons for the development of the ECU market*

The ECU could not have achieved the success described in greater detail below if the monetary authorities in the Member States had not created the legal and institutional framework within which ECU transactions could be carried out.

The Banca d'Italia was the first Community central bank to come to terms with the ECU. Under Italian foreign exchange regulations, foreign currency assets raised abroad by Italian firms with a State guarantee must be surrendered for lire to the central bank. This rule had in principle to be applied to the ECU loans granted by the EIB, provided that the ECU could be regarded as a foreign currency. Otherwise Italian firms would have been prevented from borrowing in ECUs. The ECU was in fact legally recognized as a foreign currency in Italy.

The ECU has been placed on the same footing as other foreign currencies in all other Community countries, either explicitly or in the way it is treated in practice. In addition, a number of countries have relaxed their foreign exchange controls so as to allow commercial banks to carry out in their respective currencies the covering transactions associated with ECU transactions.

Three other factors which explain the success of the ECU have thus come into play:

- (i) advantages specific to the ECU and deriving from its structure as a basket currency and from the operation of the EMS;
- (ii) the active promotion of the ECU markets by commercial banks, which recognized the potential attraction of the ECU as a Eurocurrency;
- (iii) support by the Community institutions for the private uses of the ECU.

### **(a) The advantages specific to the ECU**

Using the ECU offers businesses and individuals in the Community a whole range of advantages all deriving from the fact that:

- (i) the ECU, as a basket of Member States' currencies,<sup>1</sup> combines their respective characteristics into an average. Thus, interest rates on ECU deposits are roughly equal to the average of the interest rates on the individual currencies in the basket, and the ECU exchange rate against a Community currency reflects the relations of all the Community currencies to one another;
- (ii) the EMS exchange rate mechanism keeps the fluctuations of the participating currencies against one another within relatively narrow limits.

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<sup>1</sup> The Portuguese escudo and the Spanish peseta are not yet included in the ECU basket.

The interplay between these two factors explains the stability of the ECU *vis-à-vis* the Community currencies. Such stability increases in proportion to the weight of a Community currency in the ECU basket. The exchange rate movement between the ECU and individual Community currencies can therefore generally be predicted with a smaller probability of error than the exchange rate movements of the Community currencies against one another. The convergence of economic and monetary policies in the Community, which was given a decisive boost by the EMS, has helped to ensure that any changes required in central rates have been relatively infrequent and relatively small-scale. Convergence has thus further improved the stability of the ECU.



The small exchange-rate risk attaching to ECU-denominated financial instruments has to be weighed by potential investors or borrowers against the interest yield or interest costs in ECUs. Since ECU interest rates, being averages, are higher than interest rates in the low-interest-rate countries in the Community and lower than in the high-interest-rate countries, ECU investors tend to come from the first group of countries and ECU borrowers from the second. All in all, ECU financial instruments offer wary Europeans an interesting mix of exchange-rate risk and interest-rate advantage compared with instruments denominated in the relevant national currency.

As far as businesses and trade are concerned, using the ECU offers advantages in situations where:

- (i) expenditure is incurred and/or revenue received in a variety of Community currencies. Replacing such payment flows by payments in ECUs enables firms to simplify their cash management considerably;
- (ii) in intra-Community trade, an exporter and importer agree to invoice in a third currency. The exchange-rate risk for both partners is reduced if the invoice is made out in ECUs instead of, say, dollars. Another argument applies to trade with non-Community countries. Invoicing in ECUs is almost as good as invoicing in Member States' currencies; but it has the advantage of avoiding use of several different currencies. As a result, administration is simplified and exchange-rate risks reduced.



*ECU savings book and credit card.*

### **(b) The role of the banks**

Some banks in the Community, particularly in Belgium and Luxembourg, were quick to see the potential benefits to their customers of using the ECU. In their advertising and their advice to customers they provided information on how the ECU basket currency worked and on their own ECU products.

From the banks' point of view, the ECU has a number of other advantages that make ECU business attractive. In the first place, the ECU is a Eurocurrency whose various types of use are not restricted by the monetary authorities of any 'home country'. The banks can therefore tailor their ECU products more easily and more flexibly to their customers' requirements than they can in the case of other currencies.

In ECU banking business, moreover, there are no competitive advantages based on national ties. In contrast to German banks, for example, which have a locational advantage in Euro-DM business, all banks have in principle the same opportunities in ECU business for acquiring expertise and an established clientele.

As the Community's basket currency, the ECU has a broader base than most of the Member States' currencies taken individually. ECU business also allows banks from smaller Member States whose currencies are of lesser international significance, or banks from countries which restrict the international use of their currencies, to play a more active role on international financial markets.

### **(c) The role of the Community institutions**

The Community institutions support the growth of the ECU markets directly when they themselves are active on those markets and indirectly through their constant contacts with the banks involved in ECU business and through their information policy generally. The use of the ECU by Community institutions was described more fully above.

An example of the cooperation with banks is the ECU Banking Association set up in March 1986. The ECU Banking Association has its origin in a small group of European commercial banks that was formed in 1982 at the Commission's instigation to look into ways of establishing a viable multilateral clearing system for ECU transactions. Such a clearing system was developed in close cooperation between the ECU Banking Association, the Bank for International Settlements (the central banks' bank) and the Society for Worldwide International Financial Telecommunication (SWIFT) and replaced the original MESA clearing system on 1 October 1986.

Another example concerns the definition of the ECU in private circulation. Here, the Commission has endeavoured to ensure that in private contracts too, the definition of the ECU used always corresponds to that of the 'official ECU'. The identity of definition of the 'official ECU' and the 'private ECU' permits dealing in a single ECU and avoids fragmentation of the ECU market, whether the contracts were signed before or after the 1984 revision of the ECU.

The following sections sum up the present position regarding use of the ECU.

### *3. Current use of the ECU*

#### **(a) The foreign exchange market**

The ECU has secured a firm position for itself in foreign exchange dealings between banks in the Community countries. According to rough estimates, a total of some 10 000 million ECU is dealt in every day. The spreads between buying and selling rates for ECUs are about the same as those for the national currencies most widely dealt in.



MR

The ECU's ability to reduce exchange-rate risk is used by banks for their own purposes in foreign exchange dealings. Where open positions exist in two currencies whose exchange-rate relationship is subject to sharp fluctuations (for example, the German mark and the dollar) or reflects strains within the EMS (for example, between the German mark and the French franc), less risky ECU/DM positions can be created through ECU/dollar or ECU/FF deals.

The ECU is dealt in on the foreign exchange markets of most member countries and is also officially quoted on the majority of them. In many cases, the inclusion of the ECU in the official fixing meant that it had first to be legally recognized as equivalent to other foreign currencies.

Foreign exchange dealings in ECUs are not confined to Community banks but are also engaged in by banks in other European countries and in the United States and the Far and Near East, so that the ECU is in fact traded round the clock. After the close of European markets, when rates are no longer available for the smaller currencies in the basket, ECU rates are calculated essentially by reference to the rates of the leading currencies, i.e. the German mark, the French franc, the pound sterling and the Italian lira.

#### (b) The banking market

Because of the ECU's basket structure, banks' assets and liabilities on the market for ECU loans and deposits may differ from one another without the banks having to bear any exchange-rate risk. Banks can protect themselves by means of hedging transactions in the individual basket currencies, provided they take account of the proportions prescribed by the composition of the basket. If, for example, the flow of ECU-denominated assets exceeds the flow of ECU liabilities, banks will finance the difference by means of additional liabilities in Community currencies, taking their shares in the ECU basket as the basis (Table 1 in the Annex).

With banks able to obtain cover in the currencies making up the basket, the banking market has another important feature: interest rates for ECU deposits and loans deviate only within relatively narrow limits from a 'theoretical' value represented by the weighted average of the interest rates on the individual basket currencies. If the differences were any greater, it would be possible for some banks to offer their customers more favourable terms for ECU transactions than other banks and to obtain funds in the basket currencies to finance their business.

Initially, non-banks' deposits on the ECU banking market were higher than their lending. During the past few years, however, the imbalance has been reversed, with loans to non-banks exceeding their deposits. Institutional factors may have contributed to this imbalance. These include exchange market restrictions in Italy,



which encourage the use of the ECU to finance foreign trade, foreign exchange regulations in Italy and France prohibiting the holding of foreign exchange balances, and the Bundesbank's interpretation of the German Currency Law, making it difficult for German financial institutions to conclude ECU transactions with their customers. However, even if there were no distorting institutional factors, it is unlikely that banks' ECU assets and liabilities would automatically balance.

The extent of the imbalance on the ECU banking market does not depend on the total volume of outstanding deposits and loans: at the end of June 1984, loans to non-banks, totalling 7 800 million ECU, exceeded deposits from non-banks by 5 700 million ECU. By the end of December in the same year, loans had risen to 11 100 million ECU and the imbalance had increased to 8 400 million ECU. A year later, when claims on non-banks stood at 13 900 million ECU, the imbalance was down to 6 600 million ECU.

This situation arose mainly because, from 1985, non-banks in the hard-currency countries, the Netherlands and Germany, had begun to exploit the advantages of ECU deposits. As a result, deposits rose sharply with Dutch banks and with Belgian and Luxembourg banks, to which the German banks passed on their customers' demand.

The main ECU borrowers are non-banks in France and particularly in Italy. The geographical distribution of non-banks as depositors and borrowers on the ECU banking market thus corresponds to the expected pattern indicated above: the bulk of investors are to be found in the low-interest-rate countries in the Community, and the bulk of borrowers in the high-interest-rate countries.

In interbank dealings, in addition to banks which themselves have substantial non-bank customer business, commercial banks from the United Kingdom are also prominent, accounting for a good 20% of all interbank claims and liabilities.

### **(c) The bond market**

ECU bonds have become a prominent feature of the Euromarkets. On the primary market, ECU bonds have risen in the six years since 1981 to account for over 4% of the market. In terms of size, the ECU bond market is thus roughly equivalent to the market for Eurobonds denominated in yen or sterling (Table 2 in the Annex).

The growth of the ECU bond market is remarkable not only in terms of the volume of issues placed, but also as regards the structure of issuers and investors. Whereas up to mid-1985 most of the bond loans were issued by public borrowers and State-run public corporations from the Member States and by international organizations,

the terms determined by market forces on the secondary market are now the main influence.

Surveys conducted by banks have shown that ECU loans can provide a sensible addition to European investors' investment portfolios by improving the risk properties of the portfolios without adversely affecting overall yield. A portfolio that includes ECU securities can as a rule be improved only marginally by the inclusion of loans denominated in other currencies. For private investors, therefore, ECU loans offer a simple means of diversifying the exchange-rate risk of their financial assets; for institutional investors, they are, together with securities denominated in other currencies, one of the components from which they make up their portfolios using formulas of varying complexity.

For non-Europeans, ECU loans widen the scope for investment and borrowing on the European financial markets. The basket nature of the ECU means that ECU loans can provide non-Europeans too with an effective instrument for reducing exchange-rate risk. The dollar's sharp fluctuations against the European currencies create balance-sheet problems for American multinationals with commitments in several Community countries if, for example, the dollar equivalent of investments in Europe drops as a result of a rising dollar. The composition of the ECU reflects the distribution of the European exchange-rate risk with sufficient precision in many cases, and ECU loans are a low-cost means of protecting balance sheets against the effects of the dollar's volatility.

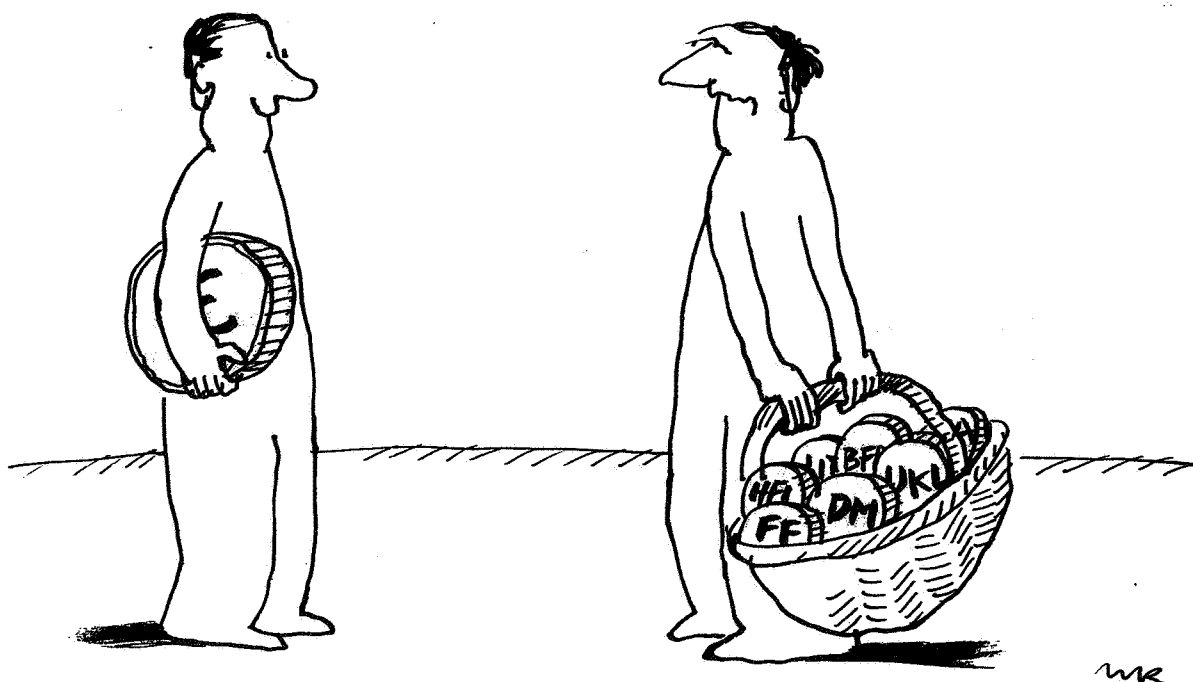
#### **(d) ECU futures and options**

The needs of non-European firms to protect themselves against the fluctuations of their own currency against the European currency bloc can also be met by ECU futures and options. Under an ECU futures contract, the buyer (or seller) has the right and the obligation to buy (or sell) at a specified future date a fixed amount of ECUs at a price agreed when the contract was concluded. Under an ECU options contract, the buyer has the right, but not the obligation, to buy (call) or sell (put) a fixed amount of ECUs at a specified future date.

ECU options have been traded on the Philadelphia Stock Exchange since February 1986, while ECU futures have been traded on the Financial Instrument Exchange forming part of the New York Cotton Exchange and on the Chicago Mercantile Exchange since January 1986.

Dealings in ECU options and futures have been slow to get off the ground. Although European operators are familiar with the ECU concept, they are making little use of the new options and futures instruments, while the ECU is something of an unknown quantity to American market participants. So as to stimulate its market, the

Chicago Mercantile Exchange introduced a special incentive system in May 1986, resulting in a surge in the number of futures contracts traded in Chicago. In comparison with contracts denominated in other currencies, however, the market for ECU options and futures remains relatively insignificant.



#### (e) The ECU in foreign trade

Though examples of the use of the ECU in foreign trade are still relatively small in number, they are extremely varied. The ECU is used, for instance, for the granting of trade credits, as a denominator in the internal clearing transactions of multinational firms, as an instrument for pricing, as an invoicing currency and as a means of payment in import/export transactions.

The use of the ECU in financing foreign trade in Italy has already been mentioned. The interest which the Soviet Union is showing in the ECU as a financing instrument in foreign trade is also worth noting. The ECU has been chosen as an export financing instrument in agreements between the Soviet Union on the one hand and Italy, France and Sweden on the other. A key factor here was the low ECU interest rates compared with the currencies of the relevant countries. Since 1985, a reference interest rate (commercial interest reference rate — CIRRR) has been set for the ECU as for other currencies under the OECD's export credit agreement. The CIRRR can be used by export credit institutions in the participating countries in granting ECU credits.

The best known example to date of a multinational company using the ECU is the Saint-Gobain group, whose French parent company coordinates 50 French firms and 55 firms abroad, 80% of which are located in EMS countries. The ECU has been used by the parent company for internal accounting purposes since 1980. In addition, transfer prices between firms within the group are expressed in ECUs and in part also paid in ECUs.

The European Organization for the Safety of Air Navigation (Eurocontrol), to which the six founder members of the Community and the United Kingdom belong and which Spain is to join, has also decided to use the ECU from 1989 instead of the dollar as the unit of account and payment for its system of route charges for air traffic control.

The use of the ECU as an invoicing currency and means of payment is being promoted by multinational companies and institutions whose own accounting systems are based on the ECU, and by Italian and French importers of products from the low-interest-rate countries in the Community such as Germany and the Netherlands. The use of the ECU as an invoicing currency and means of payment instead of the German mark or Dutch guilder results in lower exchange cover costs because of the smaller interest rate differential compared with the Italian lira or French franc.

Considerable legal and practical difficulties stand in the way of using the ECU as a means of payment in the form of notes and coins. However, there are already surrogate means of payment denominated in ECUs, namely ECU traveller's cheques, ECU-denominated Eurocheques and credit cards linked to ECU accounts, and the 50 ECU gold and 5 ECU silver coins minted by the Belgian Government.

#### **(f) Monetary authorities as participants on the ECU market**

The governments of Denmark, Ireland and Italy have issued ECU loans on the Eurocapital market and, in the case of Italy, also on the domestic capital market. The funds thus raised are surrendered to the relevant central banks against national currency. The central banks can then either hold the ECUs in their reserves or exchange them on the foreign exchange markets against other reserve instruments.

Some Community central banks have also begun to use the ECU as an intervention instrument, i.e. in purchases or sales of their own currency, when they want to influence its exchange rates. Foreign exchange market purchases or sales of an EMS currency against ECUs have much the same effect as interventions in all the basket currencies simultaneously, i.e. they leave the exchange rate relationships between the other basket currencies broadly unchanged. They are in this sense more similar to dollar interventions than to interventions in a single EMS currency, which in-

fluence not only the currency of the intervening central bank, but also the intervention currency itself in its relationship to the other EMS currencies.

The holders of ECU securities on the money and bond market also include a number of central banks from non-Community countries in Europe, South America and the Far East. The amounts invested are at present still small. However, they may be seen as evidence of there being a need for the monetary diversification of official reserves, and of the ECU being considered as one of the possible alternatives.

## E. The role of the ECU as seen by the Commission

In February 1986, at the Luxembourg Conference of representatives of the governments of the Member States, economic and monetary union was recognized in the preamble to the revised Treaties (Single European Act) as the long-term goal of integration in the Community. The revised Treaty text relates the EMS and the ECU directly to economic and monetary union.

In other words, the EMS in its present form is a stage on the road — no doubt still a long one — to economic and monetary union. The economic and monetary integration process can be assisted by the further development of the EMS and of the ECU, which the Brussels Resolution describes as being 'at the centre of the EMS'.

It is difficult to envisage the ECU progressively assuming the role of a common single currency that would be created by the achievement of economic and monetary union, without surmounting significant institutional and monetary obstacles.

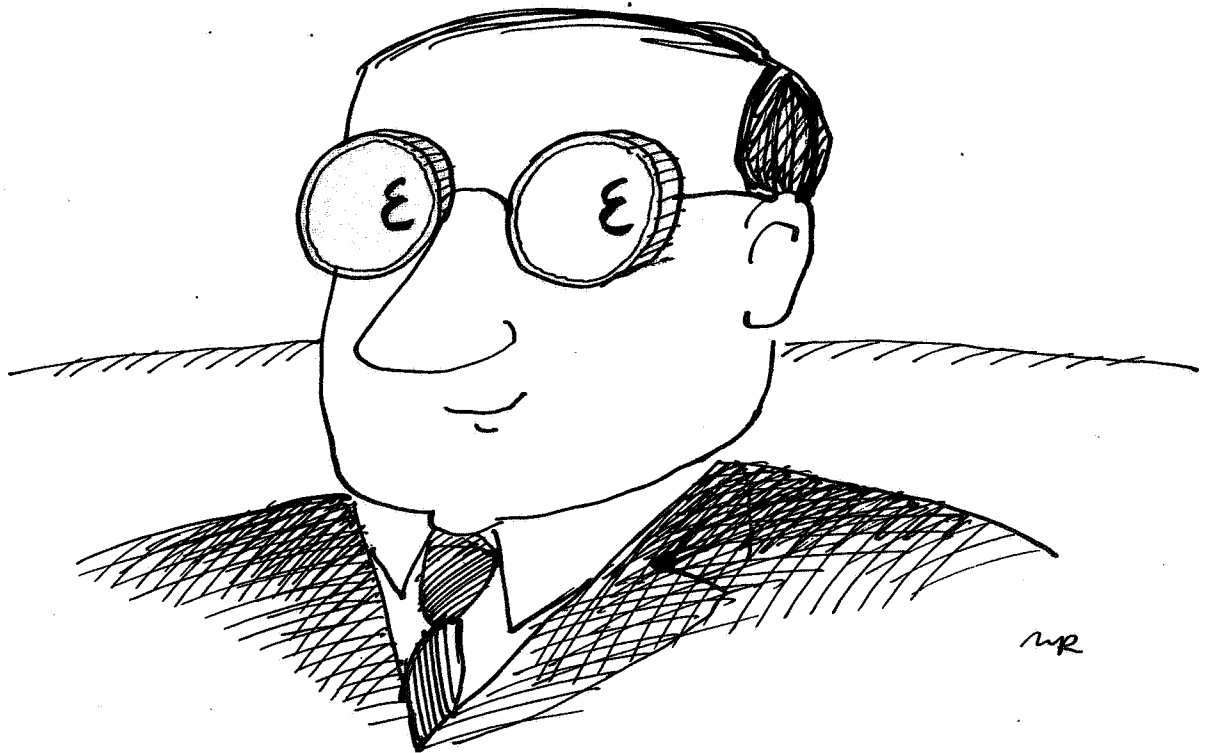
The ECU cannot become legal tender as a parallel currency alongside national currencies without amendments to the relevant legislation in the Member States. The general amendment of such legislation seems conceivable only as part of a great 'institutional leap' in Member States' relations with one another and with the Community as a whole.

Any genuine future European currency cannot be based on a basket of Member States' currencies, but will like any other currency, have to be issued and managed by a European monetary institution, i.e. a central bank.

These constraints do not diminish the contribution which the ECU can make to the integration process as:

- (i) a symbolic European currency;
- (ii) an international currency for Community operators;
- (iii) an expression of the Community in the international monetary system;
- (iv) a catalyst of monetary policy coordination within the Community.

The growing importance of the ECU on the private markets has helped to ensure that economic and monetary union has become a matter of public awareness and



that discussion of it has been taken up again in the relevant bodies. The many private initiatives involving the ECU, publications and political statements are evidence of this.

There is scope for the ECU to play a more practical role in the completion of the Community's internal market by 1992, notably in the field of financial services. When, for example, long-term financial products such as life insurance or mortgage loans may be provided by credit institutions across frontiers in any Community country, the problem of the contract currency and of the exchange-rate risk will arise. The ECU enables the insurer and the insured person to partly offset the exchange-rate risk in a way that is acceptable to both. Its use also allows insurance companies to simplify cross-frontier transactions of this type significantly and hence to reduce the costs. The ECU thus increases the probability of insurance companies actually supplying their services to non-residents as well as to residents. It accordingly performs a role as an instrument of integration.

It is up to governments and central banks to develop further and strengthen the EMS and the ECU. However, it would be wrong to expect progress in using the ECU as a European monetary unit to come solely from official initiatives. In using the ECU the private sector has the means of showing that it needs a currency unit accepted across national boundaries, while individual citizens can express their wish for a European currency and continued integration towards economic and monetary union.

The population evidently expects political and economic leaders to do more than stand idly by while the ECU imposes itself of its own accord on the financial and trade markets as a generalized means of payment, but to encourage and promote the development of the ECU into a European payment medium alongside national currencies. Along with the achievement of a large and unrestricted internal market must go progress in strengthening the EMS and the ECU.

High hopes are now being pinned on the ECU.

In an opinion poll carried out for the Commission in the six original Member States and the United Kingdom, 59% of respondents were in favour of a currency that could be used freely in all the European countries alongside national currencies. Only 18% were against such a currency, while 23% did not know or had no particular view on the matter. The majority of those polled saw the ECU as a means of strengthening the European economy and as a symbol of European unification.

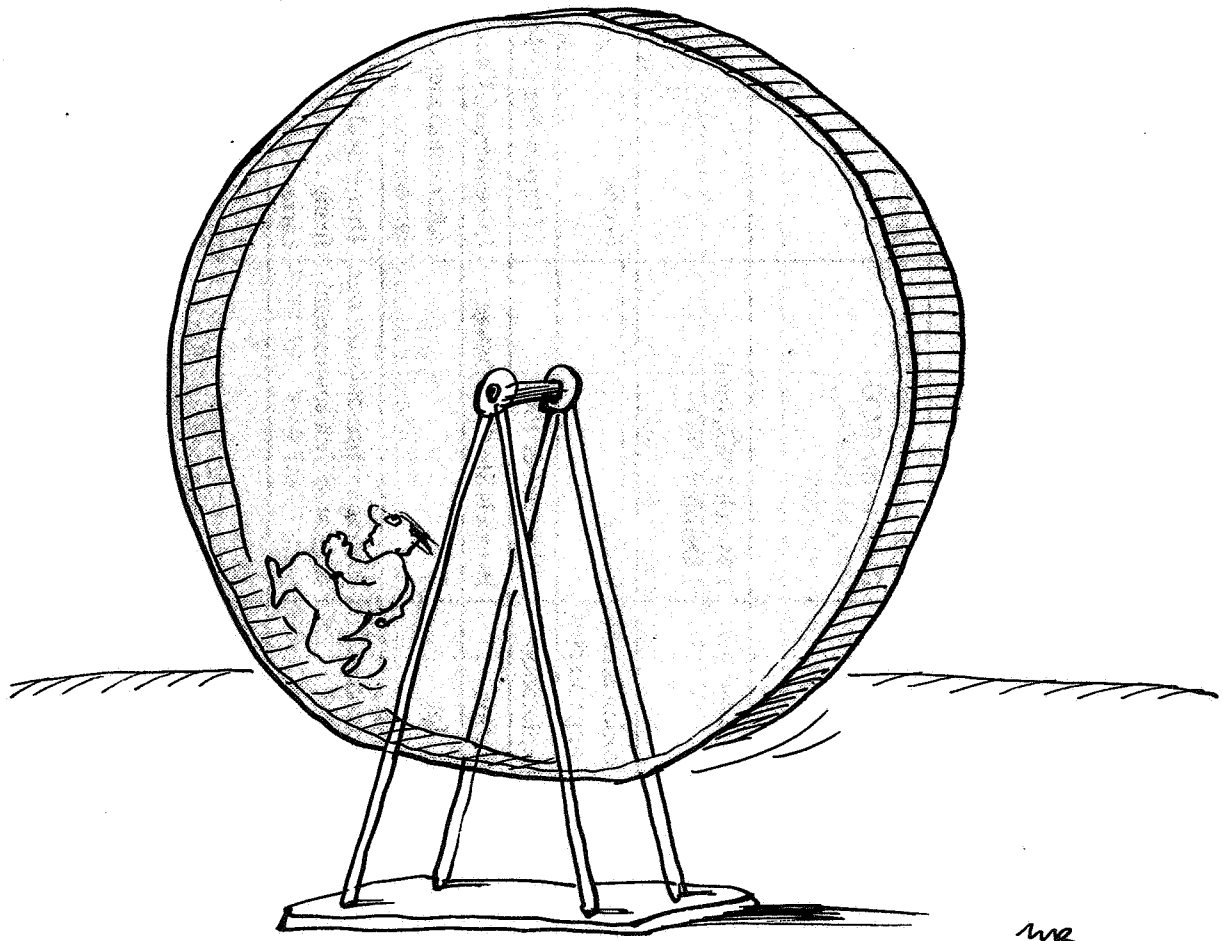




TABLE 1  
The ECU and its status on the foreign exchange markets of the countries whose currencies make up the basket

	Belgium/Luxembourg	Denmark	Federal Republic of Germany	Greece
1. Status granted to the ECU	Classed as a currency	Treated as a currency	Authorized in the same way as a currency	Treated as a currency
2. Official instrument granting this status	Application of the IBLC Rules to the ECU	Implicit recognition	(a) Decision by the Central Bank Council of the Bundesbank (b) Mitteilungen No 1010/87	<i>De facto</i> , but Bank of Greece instrument amends exchange control to give non-resident banks access to the drachma
3. Date of instrument	1 March 1982, then 1 October 1983		(a) 16 June 1987 (b) BBK Mitteilungen No 1015/78 of 9 June 1978	14 July 1984
4. Official quotation on the foreign exchange market	Fixing	Fixing	No quotation yet of ECU	Fixing
5. Date of first quotation	3 September 1984	17 September 1984	n. a.	24 January 1985
6. Place of quotation	Brussels Stock Exchange	Copenhagen, Central Bank	n. a.	Athens Stock Exchange
7. Bank of ECU for quotation	2	After component currencies	n. a.	Last
8. Opening quotation	Average representative rate suggested by a commercial bank	Theoretical rate based on fixing of component currencies	n. a.	Market rate
9. Start of fixing (local time)	13.30	12.00	n. a.	13.00
10. Official rate	Average rate (bid/offer)	Seller rate	n. a.	Average rate (bid-offer)
11. Intervention of central banks at fixing	Exceptional	Yes	n. a.	At the arbitrage limits

The ECU and its status on the foreign exchange markets of the countries whose currencies make up the basket (continued)

	France	Ireland	Italy	The Netherlands	United Kingdom
1. Status granted to the ECU	Classed as a currency	Treated as a currency	'Valuta di conto valutario' i.e. currency	Treated as a currency	Treated as a currency
2. Official instrument granting this status	Letter No 15891 from Director of Treasury	<i>De facto</i>	Ministerial decree	<i>De facto</i>	<i>De facto</i>
3. Date of instrument	21 May 1982	-	17 July 1981	-	-
4. Official quotation on the foreign exchange market	Fixing	n. a.	Fixing	Fixing	n. a.
5. Date of first quotation	4 June 1984	-	Calculated: October 1981 Market: May 1984	5 July 1985	
6. Place of quotation	Paris Stock Exchange	-	Milan and Rome Stock Exchanges	Amsterdam Stock Exchange	
7. Bank of ECU for quotation	2	-	After component currencies	16 (last rank)	-
8. Opening quotation	Initial spot rate suggested by Banque de France	-	Previous day's fixing	Market rate	-
9. Start of fixing (local time)	13.30	-	13.15	13.30	-
10. Official rate	Average rate (bid/offer)	-	Average rate (bid/offer)	Average rate (bid/offer)	-
11. Intervention of central banks at fixing	Exceptional	-	Yes	Exceptional	-

**TABLE 2**  
**International banking market for ECUs**

	Liabilities				Assets			
	in USD <sup>1</sup>	in ECU <sup>2</sup>			in USD <sup>1</sup>	in ECU <sup>2</sup>		
	Total	Total	<i>vis-à-vis</i>		Total	Total	<i>vis-à-vis</i>	
		banks	non-banks			banks	non-banks	
December 1982	5.5	5.68	—	—	6.5	6.72	—	—
December 1983	10.0	12.09	10.76	1.33	11.9	14.38	9.67	4.71
March 1984	14.7	17.09	15.35	1.74	17.8	20.70	14.19	6.51
June 1984	16.5	20.52	18.41	2.11	20.9	25.99	18.16	7.83
September 1984	18.8	25.44	23.41	2.03	23.9	32.34	23.27	9.07
December 1984	22.3	31.45	28.77	2.68	28.2	39.77	28.49	11.28
March 1985	29.9	41.12	37.00	4.12	37.1	51.02	37.27	13.75
June 1985	33.4	45.45	39.60	5.85	38.8	52.79	39.32	13.47
September 1985	42.4	51.31	43.93	7.38	46.6	56.40	42.84	13.56
December 1985	48.4	54.51	47.30	7.21	54.3	61.15	47.19	13.96
March 1986	54.9	58.61	51.67	6.94	61.4	65.54	51.13	14.41
June 1986	57.8	59.08	52.33	6.75	64.5	65.93	50.91	15.02

<sup>1</sup> 'International banking developments', quarterly bulletin produced by the Monetary and Economic Department of the Bank for International Settlements, Table 3(a).

<sup>2</sup> Dollar exchange rate against the ECU at the end of each quarter:

31.12.1982 USD 1 = 1.03341 ECU	29. 3.1985 USD 1 = 1.37531 ECU
30. 6.1983 USD 1 = 1.121137 ECU	28. 6.1985 USD 1 = 1.36064 ECU
30.12.1983 USD 1 = 1.20865 ECU	31. 9.1985 USD 1 = 1.21033 ECU
30. 3.1984 USD 1 = 1.16302 ECU	31.12.1985 USD 1 = 1.12622 ECU
29. 6.1984 USD 1 = 1.24395 ECU	27. 3.1986 USD 1 = 1.06754 ECU
28. 9.1984 USD 1 = 1.35330 ECU	30. 6.1986 USD 1 = 1.02226 ECU
31.12.1984 USD 1 = 1.41055 ECU	

**TABLE 3**  
**ECU bond issues on the international market<sup>1</sup>**  
Breakdown of borrowers

	1983	1984	1985	1986	1987 First semester
Belgium	70		123.5	147	275
Denmark		177	325	489.8	850
FR of Germany		50	240	75	—
Spain		46.5	—	100	150
France	550	557.2	1 870	1 075.5	1 083
Ireland	90	50	250	100	100
Italy	60	60	945.5	493	250
Luxembourg		60	60	83.75	—
The Netherlands	—	—	300	206	100
United Kingdom	50	100	230	50	—
Community institutions	505	950	955	1 285	895
<b>Total – EEC</b>	<b>1 325</b>	<b>2 050.7</b>	<b>5 299.0</b>	<b>4 105.1</b>	<b>3 703</b>
Austria		160	132.5	75	—
Finland		35	223.5	210	100
Iceland	—	—	—	50	—
Norway	70	—	70	30	—
Sweden	140	107.5	—	395	—
Switzerland	—	—	—	100	—
Other European institutions	35	—	75	—	—
Multinational groups <sup>2</sup>	40	285	325	200	275
<b>Total – Europe</b>	<b>1 610</b>	<b>2 638.2</b>	<b>6 125.0</b>	<b>5 165.1</b>	<b>4 078</b>
Japan	80	180	831	400	450
Hong Kong			50	—	—
Korea			50	—	—
Australia/New Zealand	—	90	640	100	350
South Africa	—	80	150	—	—
Canada	50	85	40	276	50
United States of America	40	96	939.3	752.7	175
International institutions	150	275	585	115	150
<b>Total – Rest of world</b>	<b>320</b>	<b>806</b>	<b>3 285.3</b>	<b>1 643.7</b>	<b>1 175</b>
<b>Grand total</b>	<b>1 930</b>	<b>3 444.2</b>	<b>9 410.3</b>	<b>6 808.8</b>	<b>5 253</b>
<b>Number</b>	<b>44</b>	<b>63</b>	<b>131</b>	<b>79</b>	<b>55</b>

Source: Commission of the European Communities.

<sup>1</sup> This table shows ECU issues on the Euromarket and ECU issues by non-residents on national domestic markets. ECU issues by residents on their own domestic markets cannot be included in international ECU issues; however, their volume is considerable in Italy, where State loans denominated in ECU have totalled more than 6 000 million ECU since 1981, including 2 500 million ECU in 1985.

<sup>2</sup> Scandinavian Airlines System, Eurofima, etc.

## *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**

#### *1. 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 (numéraire) 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 Fund<sup>1</sup>*

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,<sup>2</sup> 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;

<sup>1</sup> OJL 379, 30. 12. 1978, p. 1.

<sup>2</sup> 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 to 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<sup>1</sup>**

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*

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<sup>1</sup> With effect from 17 September 1984 the composition of the ECU as laid down in Article 1 of Council Regulation (EEC) No 3180/78 of 18 December 1978 is amended as follows:

BFR 3.71, DKR 0.219, DM 0.719, DR 1.15, FF 1.31, HFL 0.256, IRL 0.00871, LFR 0.14, LIT 140, UKL 0.0878.



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

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;<sup>2</sup>

Having regard to the opinion of the Economic and Social Committee;<sup>3</sup>

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;<sup>4</sup>

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.

<sup>1</sup> OJ L 379, 30. 12. 1978, p. 2.

<sup>2</sup> OJ C 296, 11. 12. 1978, p. 62.

<sup>3</sup> Opinion delivered on 29 and 30 November 1978.

<sup>4</sup> OJ L 89, 5. 4. 1973, p. 2.

The Fund is also empowered to grant to the monetary authorities of non-member countries and international monetary institutions the status of 'other holders' of ECU as referred to in Article 1 and to fix the terms and conditions under which such ECU may be acquired, held and used.<sup>1</sup>

#### 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*

### **Procedure followed for calculating the ECU's rates in terms of its component currencies**

The central bank of the Member States whose currencies are in the ECU record, at 2.30 p.m. each day, the rate of the United States dollar against their own currency on their respective currency market. The dollar rate was chosen as being the most representative in all financial centres. These rates are then forwarded through the National Bank of Belgium to the Commission, which uses them to calculate the 'official' ECU rate of the day, first in dollars and then in each of the currencies of the Member States. If an exchange market is closed, the central banks agree on a representative rate of the dollar against that currency.

The Commission also calculates the rate of the ECU in other currencies, using for each of these their dollar rate at 2.30 p. m.

The ECU rates calculated by the Commission are published daily, correct to six significant figures, in the 'C' edition of the *Official Journal of the European Communities*.

They are also made available through an automatic telex answering service. This service can be used as follows:

- (i) call telex number Brussels 23789 or 23794;
- (ii) give own telex code;
- (iii) type four times the letter C, which triggers the automatic ECU rate answering system into operation.

The ECU rates of the day are available from 3.30 p. m. onwards (Brussels time).

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<sup>1</sup> Council Regulation (EEC), No 3066/85 of 28 October 1985 amending Article 2 of Council Regulation (EEC) No 3181, with effect from 4 November 1985 (OJ L 290, 1. 11. 1985, p. 95).

**Example: Calculation of ECU rates for 17 February 1986**

National currency amount in ECU		US dollar rates on 17.2.1986	Equivalent in dollars of of national currency amounts	ECU rate in each national currency
(a)		(b)	(c) (a):(b)	(d) 0.922330x(b)
DM	0.719	2.345	0.30661	2.16286
DR	1.15	143.65	0.008006	132.493
FF	1.31	7.196	0.182046	6.63708
UKL <sup>1</sup>	0.0878	1.4175	0.124456	0.650674
DR	1.15	143.65	0.008006	132.493
LIT	140	1 595.25	0.087761	1 471.35
HFL	0.256	2.649	0.09664	2.44325
BFR	3.85	47.995	0.080217	44.2672
DKR	0.219	8.639	0.02535	7.96801
IRL <sup>1</sup>	0.00871	1.291	0.011245	0.714430
ECU rate in dollars		USD	0.922330	

<sup>1</sup> 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 (c) by the rate in column (b).

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