
Group of experts under the
chairmanship of M. Heyvaert

No. 41

UPDATING THE EUROPEAN UNIT OF ACCOUNT (EUA)
AND THE PRINCIPLES FOR REVISING THE BASKET

At its meeting on 12th September 1978 the Committee of Governors gave the Group of Experts a mandate to examine:

- the principles governing the revision of a standard basket and the implications of using a revisable basket in a new European Monetary System;
- the desirability of revising the present weights of component currencies in the standard basket European Unit of Account (EUA) with a view to the establishment of a new European Monetary System.

This report deals with these two questions in turn.

I. THE PRINCIPLES FOR REVISING THE BASKET

The annex to the Bremen communiqué states that the ECU, which is to be at the centre of the new monetary system, will have the same definition as the European Unit of Account (EUA). The Group's mandate is to examine the implications of defining the ECU in terms of a basket that would be revised less frequently than an adjustable basket, under certain agreed circumstances.

A. General guidelines

In carrying out this examination the Group was guided by a number of unanimously accepted considerations:

* Text revised according to the corrigenda of 6th October 1978, which were circulated at the meeting of the Committee of Governors on 9th October 1978.

- The Group examined the implications of a revisable basket, and the principles that should govern its revision, solely in relation to the operational requirements of the new European Monetary System, without taking into account the fact that the EUA is also used in other areas of Community activity. Revision of the basket naturally entails either adjustment of the EUA in all its Community applications or a divergence between the ECU used for monetary purposes and the EUA.
- In the monetary sector the basket must adequately perform three distinct functions: as the numeraire for expressing central rates, whatever intervention system is adopted, as an indicator of divergence within the band between the bilateral limit rates established on the basis of the parity grid, should this system be adopted (see the Group's Report No. 40), and as the denominator of claims and liabilities and of reserves held in the form of ECUs.
- It is acknowledged that the decision to revise the basket must rest on certain precise criteria and not depend as a general rule on ad hoc judgements.
- Any revision of the basket should be such that on the day on which it comes into effect the overall value of the basket defined in terms of each currency is the same under the new composition as it would have been under the old composition;
- Whenever the basket is revised the new basket will take the place of the old one for all monetary purposes.

B. Views held

Two different views emerged:

(a) The majority of the experts propose that the revisable basket envisaged in this report should be defined as a standard basket whose structure would be reviewed in the following circumstances:

- at set intervals of three or five years, on the basis of a comparison between the development of the currencies' weights during

the period that had elapsed and the development of the weighting ranges derived from the criteria adopted;

- at the request of a country participating in the exchange rate system when the weight of one of the currencies in the basket had changed by more than 25 per cent. since the last revision; the purpose of any revision then made would be to bring the weight structure back into line with the movement in the underlying criteria.

In the view of these experts, the various automatic repercussions of changes in certain currencies' central rates or their withdrawal from the system would not warrant revision of the basket. Such repercussions are held to constitute one of the aspects of solidarity inherent in the use of the standard basket formula. Moreover, if it were considered necessary, at least during the initial period, to attach to very short-term financing an exchange guarantee similar to that applying to the EMUA, this could be achieved even with a standard basket subject to revision in exceptional circumstances as suggested above. For this purpose it could be stipulated that, in the event of a central rate change (or of a currency floating independently), the ECU value of claims and liabilities arising from very short-term financing would be adjusted in such a way that the consequences of the devaluation (or revaluation) were borne entirely by the country whose currency was devalued (or revalued).

(b) However, other experts could not concur with the views expressed above. They consider that the adjustable basket, that is to say a basket that would be adjusted in order to maintain the weight of the devalued or revalued currency whenever a central rate change occurred, would provide a simpler solution to the difficulties presented by use of the ECU as numeraire of the exchange rate system, as denominator of claims and liabilities and as a reserve asset.

II. THE PRESENT STRUCTURE OF THE EUA

In the light of these considerations, the question arises whether, with a view to the establishment of the new European Monetary System, it

would not be desirable to review the present structure of the basket which will constitute the ECU.

(a) The original EUA

The structure of the EUA was agreed upon by the Monetary Committee in March 1975. The relative weights assigned to the Community currencies were not determined by means of a precise arithmetical formula, but were established on the basis of three criteria, namely:

- the economic size of each country, measured in terms of average GDP over the previous five years;
- the size of member countries' foreign trade during the previous five years;
- the standard scale used in the Agreement setting up the system of short-term monetary support.

Although in the course of these discussions it had been envisaged that the structure of the basket would be reviewed periodically, the instruments formally introducing the EUA in various sectors of Community activity do not make specific provision for such a review.

(b) The present weights

Since the adoption of the EUA the respective weights of the Community currencies in the standard basket by which it is defined have changed as a result of the exchange rate movements that have occurred and have been applied to constant amounts of currency units. In the case of three currencies these changes have tended to accumulate, so that they now amount to between 20 and 30 per cent. of the original weights.

On the other hand, the weighting ranges derived from the economic criteria adopted have hardly changed at all if one compares those obtained on the basis of data for 1973-77 with those based on data for 1969-73.

The results of this updating are given in the table attached to this report. It shows that, owing to exchange rate developments, the weights of several currencies have changed by much more than would be warranted by any movement in the underlying criteria. While the present weights of

almost all the currencies nevertheless still lie within the weighting range, the width of the range must be borne in mind before any conclusions are drawn from this fact.

(c) Views held

The Group finds that the divergence between one Community currency's present weight in the EUA and that originally set, and the fact that its current weight lies outside the weighting range derived from the economic criteria adopted, provide sufficient grounds for reviewing the structure of the basket.

On this basis some experts suggest that the structure of the basket should be revised when the new European Monetary System is implemented, considering, moreover, that such a revision would accord with the proposed compromise between a fixed standard basket and an adjustable basket (see Section I).

On the other hand, the other experts do not consider a revision to be necessary in the present circumstances. They stress the advantages of a stable basket structure and the negligible effect of minor changes in structure on the overall value of the basket.

III. SUMMARY

1. It is necessary to decide whether the various questions analysed in this report should be considered solely from the monetary point of view. If this is the case, the long-term result might be a divergence between the ECU and the EUA used in other areas of Community activity.

2. It should be decided:

- (a) whether a basket revised at fairly long intervals or in the event of a large change in weights in order to keep the weight structure consistent with the underlying criteria may be adopted for defining the ECU;
- (b) whether it would be desirable to bring the structure of the EUA basket up to date with a view to the implementation of the new European Monetary System.

Table

COMPARISON OF INITIAL AND CURRENT WEIGHTS IN THE EUA
AND THE WEIGHTING RANGE

Countries	Scale used for short-term monetary support	Weighting range obtained from the economic criteria adopted (1969-73 data)	Initial weight	Current weight*	Percentage variation between current and original weights	Weighting range obtained from the economic criteria adopted (1973-77 data)
in percentages						
Belgium/ Luxembourg ..	7.34	4.4 - 14.7	8.2	9.4	+ 14.63	4.8 - 14.2
Denmark	3.30	2.5 - 4.5	3.0	3.1	+ 3.33	2.6 - 4.3
Germany	22.02	25.6 - 31.0	27.3	32.2	+ 17.95	25.0 - 32.2
France	22.02	16.3 - 23.8	19.5	20.4	+ 4.61	16.7 - 24.2
Ireland	1.28	0.6 - 1.9	1.5	1.2	- 20.00	0.6 - 1.8
Italy	14.68	11.0 - 14.2	14.0	10.1	- 27.86	10.3 - 13.0
Netherlands ..	7.34	5.4 - 15.1	9.0	10.2	+ 13.33	6.2 - 16.2
United Kingdom	22.02	9.6 - 18.7	17.5	13.4	- 23.43	9.7 - 17.5
	<hr/> 100.00		<hr/> 100.0	<hr/> 100.0		

* 12th September 1978