
Committee of Alternates

UK PROPOSALS FOR A HARD ECU

Report by the Chairman

The Committee of Alternates examined, at its meeting on 15th and 16th October 1990, the United Kingdom's proposals for a hard ecu. The Alternates' discussion focused primarily on the objectives of the UK scheme and on its relationship with the transitional arrangements leading to full Economic and Monetary Union (EMU).

Presentation by Mr. Crockett

Mr. Crockett explained that the UK's proposals offered solutions to a number of important political and economic considerations in the context of progress to the final stage of EMU: the scheme took account of the fact that there was no unanimous commitment to the final stage, although it was acknowledged that the objective of Stage Three of the Delors Report had been accepted by eleven of the twelve Member States; it was designed to address a series of issues in the transitional phase to EMU; it sought to avoid the twin dangers of a transition to full monetary union prior to convergence and of a too rapid move to a single currency.

Moreover, the UK proposals were designed to meet certain key requirements:

- the provision of a framework which would allow all Member States to proceed in a gradual way towards economic and monetary integration, which was not inconsistent with Stage Three as defined in the Delors Report and which would facilitate the transition to that stage;
- the ability to work with the grain of the market by allowing the demand for ecu to manifest itself before mandating a move to a single currency;

- the promotion of convergence in a manner similar to that presently applied in the ERM, i.e. through anchoring Community currencies on a stable and strong currency;
- a clear division of responsibilities between the EMF, responsible for the hard ecu in Stage Two, and the national central banks, responsible for their own national currencies.

Discussion by the Alternates

Although some principles underlying the UK approach were well understood and generally supported, a number of reservations or doubts were nevertheless expressed during the discussion, which related to the scheme's ability to achieve its objectives and to some important institutional or operational aspects of the proposals.

(a) Achievement of the objectives

Most Alternates felt that the creation of the hard ecu and the setting-up of the EMF would not help the transition to a single monetary policy. The degree to which the hard ecu would develop in the market without the active support and commitment of the authorities was challenged. It was pointed out that the whole concept of monetary unification could even be jeopardised if the hard ecu failed to achieve market acceptability.

The view was expressed that the UK scheme would add little to the ERM in the field of convergence towards low inflation. It was indeed pointed out that anchoring national currencies to the hard ecu would offer only nominal exchange rate stability, not price stability.

It was also said that the scheme neglected the need for parallelism between economic unification and monetary unification and that the transitional links between Stages Two and Three were not clear. The principle that the development of EMU should only rely on market forces was questioned; on the contrary, it was stressed that the objective of EMU conferred a precise responsibility on Community institutions to instigate the necessary steps towards this goal, without making them wholly conditional to market developments. Furthermore, the proposed mechanism was not really market-driven but closer to a system for managing an administered currency.

(b) Institutional aspects

Most Alternates felt that the UK scheme was not a substitute for co-operation and co-ordination leading to a single monetary policy. Its institutional framework was considered to be weak or insufficiently worked out and questions were for example raised about the independence of the EMF and its democratic accountability.

It was considered that any institutional change requiring an amendment to the Treaty should only be accepted if, at the same time, the principles of the final stage of EMU were embodied in the Treaty. In addition, most Alternates were of the firm opinion that if a new institution was given central bank responsibilities in the second stage, it should be the same institution as the one which would conduct the single monetary policy in the final stage, and not an intermediate body which might deflect attention from this fundamental requirement of monetary union. It would thus be counterproductive to create in the transitional stage a new institution which would be different from the ECB.

(c) Operational aspects

Some Alternates were of the view that the creation of the hard ecu would cause disturbances in the exchange markets and might lead to competitive interest rate adjustments unrelated to monetary policy conditions which could also have adverse effects on the growth of the economy. Moreover, it was pointed out that the concept of a parallel currency had already been considered and rejected by the Delors Committee.

It was argued that the substitution of national currencies by the ecu would not eliminate the effects of excessive monetary growth. Moreover, this substitution effect will create a permanent situation of instability that will disturb the conduct of monetary policy. Doubts were also expressed as to whether the hard ecu would be capable of emerging as a transaction currency. There was also the question of the co-existence of the hard ecu alongside the basket ecu and the wisdom of hardening a unit for which there already existed a wide range of instruments and contracts. Furthermore, the operational aspects of the scheme were considered somewhat mechanistic and artificial.

The hard ecu proposal has raised some interesting questions concerning the nature and the timetable of a possible change in the definition of the ecu, without making it a parallel currency and without the creation of a new institution. For example, consideration could be given to hardening the existing ecu by leaving unchanged in a realignment

the ecu central rate of that currency which appreciated most against the other currencies. Ideas like this or others along the same lines were currently being discussed in the Monetary Committee.

In his response, Mr. Crockett acknowledged the concerns expressed by Alternates; but he felt that closer examination of the UK proposals would show that they either addressed these concerns, or could be readily adapted to do so:

- he argued that the UK proposals for Stage Two were not designed to retard the progress to EMU and did not prevent the final stage being defined at the same time; the role of the EMF would need to be entirely consistent with the progressive institutional development of the ECB and, in many respects, the EMF would have to enjoy the same statute as the ECB, inter alia with regard to independence;
- he accepted that it was possible to be sceptical concerning the development of the hard ecu in retail use, but argued that the new unit should rather be seen as a standard to which other currencies would peg;
- the UK proposals had been devised to achieve price stability even more than exchange rate stability. Indeed, if it was desired to exert disinflationary pressure, the EMF would be able, by increasing the yield of the hard ecu, to put pressure on other Community currencies and to force them to tighten their monetary policies accordingly;
- the introduction of a hard ecu was not seen in the UK as being incompatible with the continuation of existing contracts in basket ecu. Over time, it was expected that the hard ecu would displace the basket ecu in new contracts, but this was not a requirement of the scheme.

Chairman's conclusions

Although the Alternates did not have time for a detailed consideration of the responses made by Mr. Crockett to the objections raised to other elements of the proposal and whilst there was a broad measure of agreement with some key principles underlying the UK scheme for a hard ecu, the discussion revealed widespread scepticism as to whether the

proposal would be helpful in leading all Community countries towards a common goal. One overriding objection was the scheme's apparent lack of commitment to full monetary union. There were also doubts about the technical feasibility of the scheme as well as its appropriateness as a means of fostering convergence and of developing a new institutional framework to carry out monetary policy.

However, certain elements of the proposal raised some interesting questions, especially with regard to the future status and definition of the ecu.

ECB-PUBLIC

COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS
OF THE MEMBER STATES
OF THE EUROPEAN ECONOMIC COMMUNITY

SECRETARIAT

Basle, 4th December 1990

On behalf of M. Rey, Chairman of the Committee of Alternates of the Governors of the EEC central banks, please note that the Alternates will meet on Monday, 10th December 1990 at 10.00 a.m. The agenda will be as follows:

- (1) Preparation of the Committee of Governors' meeting of 11th December 1990 (the draft agenda has already been circulated). The Alternates' discussion will focus mainly on items III, V and VIII (work programme relating to the draft Statute).
- (2) Miscellaneous. (Under this item the Chairman proposes to have a brief exchange of views on procedural aspects regarding closer co-operation among EEC central banks in the field of payment systems. A note to this effect, prepared by the Banca d'Italia, which also reflects the views of other senior central bank officials who participated in the recent Perugia Conference on payment systems, will be circulated to you shortly. This note will cover wider issues than those raised in the Commission's Green Paper on payment systems which the Governors agreed should be examined by the Banking Supervisory Sub-Committee.)

Kind regards.



Gunter D. Baer