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REPORT BY THE CHAIRMAN ON THE COMMITTEE'S DISCUSSION ON MAKING THE ECU A HARD CURRENCY

General principles

I draw from the Committee's debate first of all some general principles which must guide our action.

1. The ecu will become the single currency of the Community in Stage 3 in an economic and monetary union committed to price stability. The Committee's debate essentially concerned the transition to that stage ; all the actions which we plan for that transition must be consistent with the fundamental goal. One country has a reservation on the single currency but does not rule out the possibility that the ecu will develop in this way ; thus stage 2 might be a transitional period in this country's approach as well, if its people and government so decide.

2. The key factor in improving the ecu will be greater convergence : it is not primarily through technical devices but through better economic policies that the ecu will be turned into a hard currency. The Committee's major concern in this discussion was with the definition of the ecu in Stage 2 and not with avoiding disturbances in the market ; however it does not appear that the changes to the definition of the ecu which we considered would in fact cause disruption. It is the unanimous view that the best way to help the markets is to provide a hard currency for them to operate with.

3. Since the focus of our discussion was on Stage 2, in which monetary policy will be the responsibility of the Member States, there must, in the view of most members of the Monetary Committee, be considerable hesitation about giving a new institution powers to issue notes and intervene in the markets. We all agreed that any change which we make to the ecu in the transitional period must be neutral in its effects on monetary conditions. It is therefore important to ask whether proposals to change the nature of the ecu would produce a currency which needs management or one which is unmanaged and can be left to the markets. This distinction between a managed and an unmanaged currency was considered a key to the evaluation of

a managed and an unmanaged currency was considered a key to the evaluation of the proposals. Whether managed or unmanaged, we were unanimous in our view that the ecu would of course need surveillance by the new institution.

The proposals before the Committee

4. In the light of these principles the Committee first considered proposals to turn the ecu into a hard currency by giving a guarantee that it will not be devalued against any constiuent currency at a realignment. Two different concepts are used in this connection :

- in one the guarantee would attach to a newly created abstract unit ;
- in the other it would attach to the basket, constituent currency amounts being increased at realignments to compensate for the otherwise inevitable devaluation of the ecu against the revaluing currencies.

5. The first concept is central to the British proposals. The abstract ecu which they advocate would clearly require a new institution having powers for its active management. With regard to the second concept, two different positions were taken. A "basket ecu" benefitting from a no-devaluation guarantee would probably behave differently from the present ecu even between realignments. The Spanish authorities have concluded that it would therefore require active management by the new institution, which plays a central role in their proposals. Since most members oppose giving the new institution systematic monetary powers including the right to intervene on a daily basis in the markets, they find that it would be difficult to implement either the British or the Spanish proposals in Stage 2 of EMU as generally understood.

6. However, the German and French members believe that the "no-devaluation" guarantee can and should be given to the "basket" ecu without giving monetary powers to the new institution. They emphasize that a no-devaluation guarantee would give a very clear signal to the markets about the nature of the unit in Stage 2 and the intentions of the authorities for Stage 3. They further argue that realignments cannot be ruled out in Stage 2, but that the wrong signal would be sent by allowing the ecu to be devalued against the strong currencies on these occasions ; the proposal under consideration would protect the ecu from this. The no-devaluation guarantee would be given effect at each realignment by adapting the

amounts of the constituent currencies, as in the Spanish proposal, or even by removing the weakest currencies.

7. The Committee then considered an alternative approach, which would be to announce that the amounts of each currency contained in the ecu basket will not be changed again, that is to "freeze" the definition of the ecu. This step would make the ecu a stronger unit because, to the extent that any constituent currencies loose value against the others, their share in the ecu would diminish. If, on the other hand, exchange rates against the previously strong currencies prove durable, this will mean that we have reached a high degree of convergence and the ecu will have been strengthened by that route. The proposal to freeze the composition of the ecu would not raise complications from the institutional point of view. Further, by renouncing the quinquennial review, the Community would remove one source of disturbance to the markets. However, freezing would harden the ecu more slowly than would the giving of a no-devaluation guarantee.

8. While advancing these different proposals to make the ecu a harder currency, the Monetary Committee generally would wish to encourage its wider circulation by removing all obstacles to its use in Stage 2. Some members also believe that in the course of this expansion of the ecu's use it would be natural for the present distinction between the private and the official ecu to become less clear-cut.

9. As to the timing of the proposed changes, all members advocating a no-devaluation guarantee said that it should be given at the start of Stage 2. This hardening of the ecu would be one of the essential characteristics of that stage. The alternative approach, that of freezing the ecu, would not require legislative change and could be announced well before Stage 2. The announcement would have no mechanical results before 1994, when the next quinquennial review is due, but might have an immediate beneficial effect on the markets' perception of the ecu.

Conclusion

10. The Monetary Committee is unanimously in favour of making the ecu a harder currency in Stage 2 of EMU. Two approaches are possible. The first is a reflection and further development of ideas presented last year by the United Kingdom. It is entirely determined by the objective of hardening the ecu.

In the second approach - freezing - the ecu would still be devalued against the hardest currencies at a realignment ; this approach is determined by the objective of encouraging the development of the markets as well as by the objective of creating a hard currency.

11. Most members of the Monetary Committee would not favour giving the new institution monetary powers in Stage 2. However, it was strongly argued that the first of the two approaches can be adopted without such a transfer of powers, if the no-devaluation guarantee is given to the "basket" ecu, the basket being adjusted at realignments.

12. I am of the opinion that there is enough common ground to enable a formulation to be agreed in the IGC presenting the ecu as the future single currency and giving the new institution the task of active surveillance of the development of the ecu in Stage 2 without impairing the conduct of monetary policy by the Member States.