A “Hard” or “Hardened” ECU for Europe?

Following the complete liberalization of capital movements in the core countries of the EC, the first stage of the process that should culminate in monetary union began on 1st July 1990. The entry of the pound sterling into the exchange rate mechanism of the EMS was necessary for the United Kingdom to be included in the moves towards monetary integration. The draft statute for a European central bank, modelled largely on the Bundesbank Law, met with the approval of EC Finance Ministers, if one excludes the United Kingdom’s usual reservations. In addition, at the end of October 1990 the European Council decided, again without the agreement of the British Government, to begin the second stage of monetary unification at the start of 1994. The stated preconditions for this are the completion of the European internal market, further lasting progress in economic and monetary convergence and the independence of the European Central Bank that will then be established.

Concrete proposals for the second stage are a rarity. There is talk of narrower margins of fluctuation between currencies, the permanent transfer of part of national foreign exchange reserves to the European Central Bank, more binding co-ordination of national monetary policies, possibly complemented by centralising EMS exchange market intervention at the European Central Bank, and the irrevocable locking of exchange rates between EMS currencies, which have in any case fluctuated within very narrow limits in recent years.

One of the preconditions for any transfer of responsibility for monetary policy to a Community institution must be that national central banks be granted the same independence from governments and EC institutions as is foreseen for the future European Central Bank. As some member countries are unwilling to make a strict separation between government and the central bank, the second stage is likely to consist only of minor technical changes in the procedures for co-ordinating monetary policy. In that case, a second stage would be superfluous.1

It is probably this lack of ideas as to the content of the second stage, for which the starting-date has already been set, that has generated interest in the British Government’s proposal to introduce a “hard” ECU, despite the lack of a comprehensive concept so far. The upholding of the principle of subsidiarity, and hence of the responsibility of national central banks for their own monetary area while providing a further independent European currency whose value is at least as stable as that of any other EC currency, a currency that is to compete freely with national currencies and should ultimately establish itself as the sole means of payment in the EC as a result of the free choice of all Europeans—that is a proposal that promises nothing but benefits to all the citizens of Europe. Is this apparent squaring of the monetary circle the substance of the second stage? Is the “hard” ECU the shape of things to come?

Let us first look back to November 1989, when the UK Treasury presented a so-called “evolutionary” approach to the realisation of economic and monetary union,2 in which the currencies of all EC countries were to compete with one another to establish which was to be the stability anchor of the European Monetary System. Flexible exchange rates were, it claimed, a prerequisite if a single EC currency were to emerge as a result of a protracted market process. This proposal was not seriously discussed as an alternative to the Delors Plan, as it was obvious that flexible exchange rates were not the way for Europe to achieve a single currency.3 The British proposal now on the table is attractive, for like the Delors Plan it intends that the ECU should gradually develop into the single European currency, but it goes further than the

3 The problems of a pure market solution leading to a single currency in an integrated area are discussed at length in P. Bofinger: Währungswettbewerb, Cologne 1985.
Delors plan in that it promises a "hard" ECU, which must offer advantages over the existing ECU.

The shape of this "hard" ECU has not yet been described in detail, only its outlines are discernible so far.4

☐ First, the "hard" ECU would be a thirteenth EC currency, issued by a European Monetary Fund (EMF)5 in exchange for EC currencies.

☐ Secondly, the "hard" ECU would never be devalued against any EMS currency. It would therefore be at least as strong as the strongest Community currency.

☐ Thirdly, every citizen would have the option of exchanging national currencies for more stable "hard" ECUs.

☐ Fourthly, the EMF would be given the right to sell national currencies for "hard" ECUs in order to exert pressure for a monetary policy consistent with stability.

☐ Fifthly, the principle of subsidiarity would be upheld in the monetary domain, and with it the undivided responsibility of national central banks for their respective monetary areas.

☐ Sixthly, the EMF would be able to pursue an independent interest rate policy for the "hard" ECU.6

The stated aim of the UK Treasury and the Bank of England is to replace the imposed institutional change postulated in the Delors Report by an evolutionary development that would, after a fairly long transitional period, eventually lead to a single European currency, namely the "hard" ECU.7 However, even the few characteristics of the "hard" ECU that are known raise serious doubts whether this is a feasible route to a single European currency.

It is unclear whether the ECU would continue to be based on a basket of currencies. The present structure of the ECU, consisting of fixed amounts of each currency in the basket, means that it cannot appreciate against all the constituent currencies. On the other hand, it would not be inconsistent with being a basket of currencies that the ECU should never depreciate against the strongest EMS currency. For that purpose, the proportion of each currency in the basket would have to be adjusted if other EMS currencies were devalued against the ECU and the strongest EMS currency. If the "hard" ECU is to have qualitative advantages over all EC currencies, the link with them would have to be cut, and hence it would have to cease to be basket-based. If that were to happen, however, it is unclear how the value of the ECU would be determined.

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5 The Bank of England working paper "The hard ECU in stage 2", op. cit., still talks of a "Hard ECU Bank (HEB)".

6 "The HEB's ability to issue interest-bearing hard-ecu paper in unlimited amounts (subject to its intervention obligation), and at interest rates of its own choosing, would give it the power to manage ecu interest rates." (The hard ECU in stage 2, op. cit., p. 7.)

7 See The United Kingdom's proposal for economic and monetary union, op. cit.