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COMMENT

A Rapid or Evolutionary Approach: The EEC's Adoption of the ECU as a Common Currency

INTRODUCTION

One of the goals of the Single European Act (SEA) was to "ensure the convergence of economic and monetary policies" among the European Economic Community (EEC or Community) member states.¹ The reference in the SEA's preamble to the European Council's resolution in December 1978 regarding the introduction of the European Economic Resolution indicates that the SEA anticipates the European Currency Unit (ECU) as part of that convergence.²

The SEA also indicates that any further development of economic and monetary policy that necessitates institutional changes requires an amendment to the EEC's founding treaty.³ The EEC's December 1990 conference discussed amending the Treaty of Rome for monetary union.⁴ A draft of the amendment should be available for signing in December 1991. Two major proposals were tabled at this conference. The EEC's proposal, known as the Delors Report, sees a common currency for member countries as a desirable feature of monetary union, and the proposal suggests that the ECU should fulfill this role.⁵ In addition, the

¹ The Single European Act, 30 O.J. EUR. COMM. (No. L 169) 8 (1987) [hereinafter Single European Act].

² Resolution of the European Council of 5 December 1978 on the Establishment of the European Monetary System (EMS) and Related Matters, *reprinted in* THE ECU 49-50 [hereinafter THE ECU].

³ Single European Act, *supra* note 1, at 9.

⁴ Wall St. J., Aug. 17, 1990, at 7.

⁵ See generally Committee for the Study of Economic and Monetary Union, Report on Economic and Monetary Union in the European Community (1988) [hereinafter Delors Report].

Delors Report views a European System of Central Banks as a requirement of monetary union.⁶ Under this proposal, adoption of the ECU by member countries is implicitly expected.⁷ However, not all of the Community countries are in agreement with this proposal. Great Britain, in particular, is opposed to this idea and has developed its own proposal.⁸ Britain's alternative, known as the "hard ECU" proposal, sees no need to mandate the acceptance of the ECU as the EEC's currency.⁹ Rather, it envisions issuing ECUs as a dual currency, available on demand in lieu of the national currencies of member countries.¹⁰ Market forces, rather than political mandates, would dictate the ECU's acceptance as a Community currency.¹¹ In addition, instead of creating a European System of Central Banks to administer the ECU, the British proposal suggests developing an alternative institution called the European Monetary Fund that would co-exist and be jointly owned by member state central banks.¹² This seemingly radical departure from EEC policy has been gaining support from several member countries.¹³

Which proposal is better for the EEC? Section I of this comment examines the history and use of the ECU. Section II discusses the legal foundation and evolution of the European Monetary System (EMS) and ECU. Section III looks at the economic theory of optimum currency areas and examines whether the EEC is economically suited for a single currency. Section IV discusses the private ECU, and how a change in the official ECU could affect the private market for ECUs. Finally, Section V examines the two proposals for the next stage of monetary union in the EEC. As the analysis herein suggests, the EEC should adopt Great Britain's alternative proposal for a dual currency system. It is in line with market forces, and consequently will allow for a smoother transition both for the private sector and national monetary policies.

I. HISTORY AND USE OF THE ECU

With the formation of the EEC,¹⁴ a common measure of value was

⁶ *Id.*

⁷ *Id.*

⁸ See generally Butler & Richards, *The Next Stage in an Evolutionary Approach to Monetary Union*, British Invisible Exports Council, Mar. 28, 1990 [hereinafter *Evolutionary Approach*].

⁹ *Id.*

¹⁰ *Id.* at i.

¹¹ *Id.* at ii.

¹² *Id.*

¹³ *Europe: The Union Debate*, *The Independent*, Dec. 15, 1990, at 10.

¹⁴ The EEC was created by the Treaty Establishing the European Economic Community, *opened for signature* Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter *Treaty of Rome*], which entered into force on Mar. 1, 1958. France, West Germany, Italy, the Netherlands, Belgium and Luxembourg all

needed for the community budget, settling claims and obligations, and expressing common prices for agricultural goods.¹⁵ Consequently, the ECU began its life as a unit of account.¹⁶

There were many predecessors to the ECU. The European Payment Union set up the first unit of account in 1950.¹⁷ This unit was valued in gold, and had the same weight in gold as the U.S. dollar.¹⁸ The unit could be converted into national currencies based upon the member states' fixed exchange rates under the Bretton-Woods Agreement.¹⁹ The degeneration of fixed exchange rates led to experimentation with many different units of accounts within the Community.²⁰ Most notably, in 1972 the EEC adopted the "snake".²¹ The snake permitted exchange rate fluctuations of $\pm 2.25\%$ against the U.S. dollar and $\pm 4.5\%$ among any two Community currencies.²² This allowed Community currencies to float together.²³ Central banks in the Community needed to take steps to keep currency fluctuations within a narrow band.²⁴

Following President Nixon's announcement that the dollar was no longer convertible into gold, there was a widening of fluctuation margins against the dollar and other European currencies.²⁵ The oil crisis in the 1970s, along with other economic pressures, repeatedly put the snake currencies under pressure.²⁶ The market exchange rates changed often, and many of the currency participants could no longer participate in the snake because of the need for greater independence in the area of currency management.²⁷

ratified the Treaty. In 1973, Britain, Denmark and Ireland joined the EEC. Greece joined in 1981, and Portugal and Spain became members in 1986.

¹⁵ THE ECU, *supra* note 2, at 6.

¹⁶ *Id.* at 5. The term "unit of account" is defined as a unit in which prices are quoted and books are kept. See R. DORNBUSCH & S. FISCHER, *MACROECONOMICS* 250 (1984).

¹⁷ THE ECU, *supra* note 2, at 6.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ The snake "combined adherence to international agreements with partial implementation of the Werner Plan." T. HITIRIS, *EUROPEAN COMMUNITY ECONOMICS: A MODERN INTRODUCTION* 95 (1988) [hereinafter *EEC ECONOMICS*]. The Werner Report advocated that fixed but adjustable parities among member currencies, and mutual monetary defense and support mechanisms, were essential features of a monetary union of member countries. Mehnert, *The European Currency Unit - The ECU - Currency for the United States of Europe*, 23 *GEO. WASH. J. INT'L L. & ECON.* 349, 354 (1989).

²² *EEC ECONOMICS*, *supra* note 21, at 95.

²³ *Id.*

²⁴ *Id.*

²⁵ Levich, *The ECU and the European Monetary System*, in *EUROPEAN CURRENCY UNIT 17* (R. Levich ed. 1987).

²⁶ *EEC ECONOMICS*, *supra* note 21, at 96.

²⁷ *Id.*

On April 21, 1975, the EEC created the European Unit of Account (EUA).²⁸ The EUA was made up of specific quantities of the nine member states' currencies, and was based on the International Monetary Fund's Special Drawing Right (SDR).²⁹ The EUA laid the foundation for the ECU. When the EMS was established by a European Council Resolution on December 5, 1978,³⁰ the resolution included a clause that renamed the EUA the European Currency Unit.³¹ It is interesting to note that since the signing of the EEC Treaty in 1957, there have been over ten different units of account used by the EEC.³² Thus, it is difficult for a common currency to survive in "volatile economic conditions and divergent nationalistic goals" such as varying inflation rates and unemployment rates.³³

Since its inception in 1979, the composition of the ECU has only been revised twice. The first time was in 1984, when the Greek drachma was added to the basket.³⁴ The second time was in September 1989, when the Spanish peseta and the Portuguese escudo were added.³⁵ Revisions of the ECU must be mutually accepted and do not, by themselves, modify the value of the ECU.³⁶

The European Council envisioned four uses for the ECU.³⁷ The ECU would be used as: first, "the denominator (*numeraire*) for the exchange rate mechanism;"³⁸ second, "the basis for a divergence indicator;"³⁹ third, "the denominator for operations in both the intervention and the credit mechanisms;"⁴⁰ and fourth, "a means of settlement be-

²⁸ THE ECU, *supra* note 2, at 6.

²⁹ *Id.* The SDR consisted of 16 currencies in a common basket and included the U.S. dollar. *Id.*

³⁰ THE ECU, *supra* note 2, EMS Resolution at A1.1.

³¹ *Id.* at A2.1. See also Single European Act, *supra* note 1.

³² Levich, *supra* note 25, at 17.

³³ *Id.*

³⁴ EEC Council Regulation No. 2626/84, 27 O.J. EUR. COMM. (No. L 247) (1984).

³⁵ EEC Council Regulation No. 1971/89, 32 O.J. EUR. COMM. (No. L 189) (1989).

³⁶ J.V. LOUIS, FROM EMS TO MONETARY UNION 20 (1990).

³⁷ THE ECU, *supra* note 2, EMS Resolution at A2.2.

³⁸ *Id.* at A2.2(a).

³⁹ *Id.* at A2.2(b). The deviation of a currency's market rate from its central rate is measured in terms of its weight in the ECU. These divergence thresholds are 75% of the currencies' fluctuation rate ($\pm 2.25\%$) multiplied by the currencies weight in the ECU. Thus each currency has divergence thresholds depending on that currency's weight in the ECU. If a currency deviates over its divergence threshold, this creates a presumption that the country that issued the currency should correct the divergence by either buying or selling the currency. EEC ECONOMICS, *supra* note 21, at 100 - 101.

⁴⁰ THE ECU, *supra* note 2, EMS Resolution at A2.2(c). "Intervention consists of the country's monetary authority buying or selling the foreign currency against the national currency with the aim of influencing their own currency's exchange rate by expanding or reducing supply." *Id.* at 14-15.

tween monetary authorities of the European Community."⁴¹

The ECU is a basket currency, and is defined as a fixed amount of the national currencies of the European Community member states.⁴² Once the amount of each component currency in the basket is set, it can be changed by unanimous consent of the Council of Ministers of the European Community.⁴³ As foreign exchange rates change, the value of the ECU may shift along with the weight of individual currencies.⁴⁴ The composition of the ECU remains unchanged despite fluctuations in composite currency rates.⁴⁵ Consequently, the ECU is suitable for private markets because it can hedge or replicate fixed portfolios.⁴⁶

Another important facet of the EMS and the ECU is the Exchange Rate Mechanism (ERM). The ERM attempts to create convergence among member countries' monetary policies by fixing member currency exchange rates to fluctuate no more than $\pm 2.25\%$.⁴⁷ While membership in the ERM is not mandatory, Great Britain's recent ascension to the mechanism means that all of the currencies making up the ECU, except the Portuguese escudo and the Greek drachma, are now part of the ERM.⁴⁸ A 6% fluctuation rate allows additional flexibility for new members of the ERM.⁴⁹ Within the ERM, each currency has a central rate against the ECU; each central rate is fixed for each currency in the EMS. These ECU-related central rates are used to establish a grid of bilateral exchange rates.

Official ECUs are created through a subscription of member state central banks to the European Monetary Cooperation Fund (EMCF).⁵⁰ Central banks exchange 20% of their gold reserves and gross dollar reserves in exchange for ECUs issued by the EMCF.⁵¹ These three monthly exchanges are mandatory for members of the ERM.⁵² The interest accrued on ECUs swapped is equivalent to the interest accrued on the dollars transferred. This results in no exchange rate risk for the as-

⁴¹ *Id.* at A2.2(d). The ECU's use as an instrument of settlement is limited by an agreement between the member states' central banks. J.V. LOUIS, *supra* note 36, at 22.

⁴² THE ECU, *supra* note 2, at 8.

⁴³ *Id.* at 10.

⁴⁴ *Id.* The composite currencies added together equal 100%. As a currency goes up in value, this can lead to the ECU rising in value as well. *Id.* at 11.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ J.V. LOUIS, *supra* note 36, at 23.

⁴⁸ *Thatcher Links Pound to Europe*, Chicago Tribune, Oct. 6, 1990, § 2, at 1.

⁴⁹ The Spanish peseta and the British pound all have fluctuation rates of 6%. Bruce, *Spanish Wizard Bedeviling Delors*, Financial Times, Oct. 12, 1990, at 2.

⁵⁰ J.V. LOUIS, *supra* note 36, at 22.

⁵¹ *Id.*

⁵² *Id.*

sets transferred for ECUs, and consequently, these swaps occur at par.⁵³

II. LEGAL FOUNDATION AND EVOLUTION OF THE EMS AND ECU

The legal foundation of the ECU and the EMS has been more political and economic will than any set of enforceable laws. The Treaty of Rome contains little on the subject of economic and monetary union.⁵⁴ The European Council formed the EMS in an effort to fill this void,⁵⁵ and created the EMS by resolution.⁵⁶ Resolutions are not defined in the original Treaty of Rome, and thus the legal consequences of resolutions are not spelled out.⁵⁷ As a result, there was no requirement to join the EMS because a resolution can not obligate member countries to do anything. Consequently, many think the success of the EMS is due to the political and economic will of the EEC for some type of monetary policy convergence.⁵⁸

The EMS was not legally recognized until Article 2 of the Single European Act (SEA) came into force on July 1, 1987.⁵⁹ The twelve member states of the European Communities adopted the SEA in 1986 by way of an amendment to the original Treaty of Rome.⁶⁰ By amending the founding Treaty of the EEC, the SEA, unlike the EMS Resolutions, is binding on community members.⁶¹ The SEA is considered to be the most important modification of powers and processes on European integration since the Treaty of Rome.⁶²

The adoption of the SEA was the result of a continued effort to pursue economic and monetary union in the EEC.⁶³ However, when the SEA was first introduced, the member countries reacted differently to its provisions. Germany did not want monetary union until the economic policies of the member states were coordinated.⁶⁴ Great Britain, Denmark, and Greece did not want the Treaty to link the liberal internal

⁵³ *Id.*

⁵⁴ Harris, *Legal Implications of European Monetary Union*, 139 NEW L. J. 1083, 1083 (1989).
See also *Evolutionary Approach*, *supra* note 8.

⁵⁵ THE ECU, EMS Resolution, *supra* note 2.

⁵⁶ Comment, *The ECU: Prospects for a Monetary Union in the European Economic Community*, 21 LAW & POL'Y INT'L BUS. 273, 279 (1989) [hereinafter *Prospects for a Monetary Union*].

⁵⁷ Usher, *Legal Regulation of the European Currency Unit*, 37 INT'L COMP. L. Q. 249, 259 (1988).

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ Single European Act, *supra* note 1, at 4.

⁶¹ *Prospects for a Monetary Union*, *supra* note 56, at 279.

⁶² Riesenfeld, *The Single European Act*, 13 HASTINGS INT'L & COMP. L. REV. 371 (1990).

⁶³ *Id.* at 372.

⁶⁴ Louis, *Monetary Capacity in the Single European Act*, 25 COMMON MKT. L. REV. 9, 14 (1988).

market with further monetary regulation.⁶⁵ President of the EEC Jacques Delors, however, felt the two were explicitly linked.⁶⁶ France, Italy, Belgium, and Luxembourg wanted a new monetary chapter added to the Treaty, while Great Britain and Germany did not.⁶⁷

From the start, President Delors wanted to enshrine the EMS and the ERM within the Treaty, and ensure the status and role of the European Fund for Monetary Cooperation.⁶⁸ The European Monetary Commission and Committee of Central Bank Governors thought this approach put too much of an emphasis on monetary union.⁶⁹ They wanted more flexible provisions to give member countries and the EEC leeway in the event of unexpected economic developments.⁷⁰ Thus, rather than laying out specific provisions regarding the EMS and the ERM, the Commission and the Central Bank Governors felt the Treaty should contain a statement of a European Monetary Union (EMU) objective.⁷¹ In addition, they felt the Treaty should state the necessity for the convergence of national monetary and economic policies.⁷²

These differences resulted in a number of compromises which are embodied in the SEA. To begin with, the preamble of the SEA is concrete and precise.⁷³ It makes an explicit reference to the EMS resolution and the 1972 conference on European Monetary Union.⁷⁴ Article 18 of the SEA amends the EEC Treaty by allowing a qualified majority to act on a proposal concerning the internal market rather than requiring unanimous consent.⁷⁵

Subsection II of Section 2 of the SEA contains the provisions on monetary capacity.⁷⁶ Article 20 of this subsection amends the EEC Treaty with a chapter on Economic and Monetary Policy in a new Article 102a. It also contains the enabling clause which gives the Community the unambiguous right to establish monetary union within the EEC.⁷⁷

The new Article 102a explicitly acknowledges the goal of economic

⁶⁵ *Id.*

⁶⁶ *Id.* at 15.

⁶⁷ *Id.* at 13-15.

⁶⁸ *Id.* at 16.

⁶⁹ *Id.* at 17.

⁷⁰ *Id.*

⁷¹ *Id.* at 18.

⁷² *Id.*

⁷³ Single European Act, *supra* note 1, at 2.

⁷⁴ *Id.* at 2.

⁷⁵ *Id.* at 8.

⁷⁶ *Id.*

⁷⁷ *Id.*

and monetary policy convergence among member countries.⁷⁸ Policy convergence is not a prerequisite for development in the monetary field, but it is, "necessary for further development of the Community."⁷⁹

Article 102a asks member states to "take account of the experience acquired in cooperation within the framework of the EMS and in developing the ECU," and to "respect existing powers in this field."⁸⁰ This statement embodies an official recognition of the EMS and the ECU. The reference to the ECU indicates a desire for the progress of both the private and official ECU.⁸¹ The reference to "experience acquired" is vague. The vagueness of the phrase allows for great future flexibility in the monetary field. If the SEA were more explicit, this flexibility would not exist.

The second part of Article 102a provides the legal basis for building the EMU and ECU short of institutional developments. These institutional developments are scheduled to occur in the final stages of the EMU, and will require additional revisions of the EEC treaty. The unanimous consent of the European Council, member states, and their central banks is required for any changes in EEC institutions regarding the EMS or EMU.⁸²

The implications of the SEA are still debated. First, the SEA did nothing to resolve the absence of any legal obligation to participate in the ERM.⁸³ However, even though political will is the only impetus for the ERM, it seems to be doing a good job. Great Britain's recent decision to join the ERM in early October 1990⁸⁴, despite a long period during which it refused to join, indicates that the political will for such an arrangement is alive and well in Europe.

The Single European Act never referred explicitly to how the ECU would be implemented because such a provision would have been too broad and would not have been acceptable to the initial opponents of a monetary chapter in the SEA.⁸⁵ The fact that it does mention the ECU and the EMU indicates that they are among the SEA's objectives. Moreover, some feel that the adoption of the SEA will restrain the central banks' freedom.⁸⁶ The process of integration among member states'

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ Louis, *supra* note 64, at 26.

⁸² Single European Act, *supra* note 1, at 9.

⁸³ Louis, *supra* note 64, at 30.

⁸⁴ *Thatcher Links Pound to Europe*, Chicago Tribune, Oct. 6, 1990, § 2, at 1.

⁸⁵ Louis, *supra* note 64, at 25.

⁸⁶ *Id.* at 26-27.

monetary policies implies pooling sovereignties, which will affect a central bank's autonomy.⁸⁷ Losing control over a country's currency can have potentially harsh effects on a country's economy.⁸⁸

President Delors felt that the SEA embodied the essential elements of reference to the EMU, EMS, and the ECU.⁸⁹ Delors also thought that the SEA provided the possibility for the Community to have a say in these elements.⁹⁰ Former Prime Minister Thatcher felt it changed nothing because it required additional revisions.⁹¹ The European Parliament thought that the SEA imposed new obstacles to the development of the EMS. The resolutions in the SEA were too global and did not indicate any "necessary short term measures to strengthen the EMS."⁹²

Others think that the mere expression of objectives within the SEA will lead to additional progress. The SEA has not created a monetary capacity in the EEC, but rather has confirmed a long-standing goal within the community for European monetary union.⁹³ The fact that the SEA requires an additional revision of the EEC Treaty to establish the institutional framework needed for the final stages of EMU reflects a gradual movement toward monetary union within the EEC. Thus, the success of the EMS in the opinion of many, including the author of this article, has been and continues to depend on the political and economic will behind the system rather than any set of enforceable laws. Consequently, any further revisions of the Treaty of Rome regarding monetary union should reflect this will.

III. OPTIMUM CURRENCY AREAS

Often, political will goes hand-in-hand with the proper economic circumstances. In order to determine whether these circumstances exist, and to determine if the EEC is ready for a transition from a system of moderately flexible exchange rates to a common currency, it is helpful to look at the economic theory of optimum currency areas. This theory is utilized to determine whether a group of countries would benefit from fixing their exchange rates in relation to one another.⁹⁴ This theory is normally applicable to fixed exchange rate agreements that can be bro-

⁸⁷ *Id.* at 27.

⁸⁸ See *infra* notes 94-132 and accompanying text.

⁸⁹ Louis, *supra* note 64, at 21.

⁹⁰ *Id.* at 22.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 23.

⁹⁴ Odrodnick, *Optimum Currency Areas and the International Monetary System*, 44 J. INT'L AFF. 241 (1990).

ken. This is not a feature of a common currency area. However, many of the features of a fixed exchange rate system are similar to that of a common currency area, and thus an area that is optimal for fixed exchange rates will be a good area for a common currency as well. Consequently, the theory can be applied to countries contemplating currency union.

A currency area is a "domain within which exchange rates are fixed."⁹⁵ An area that is not optimal for fixed exchange rates needs a flexible exchange rate system.⁹⁶ There are several factors that determine whether an area is an optimal currency area. The first of these is factor mobility.⁹⁷ When factors of production, such as labor, are mobile, (i.e. they can move easily from one region to another), fixed exchange rates are useful. However, when they are not mobile, flexible exchange rates are needed to restore balance of payment deficits or surpluses.⁹⁸

Another important feature of an optimal currency area is the "openness" of a country's economy. A country that has a high ratio of imported goods as compared to nationally produced goods is considered to be an open economy.⁹⁹ Open economies are generally favorable for the establishment of a currency area.¹⁰⁰

A country's "openness" can affect its monetary policy.¹⁰¹ Often, a country will devalue its currency in order to encourage other countries to purchase its goods. When a country depreciates its currency, its goods become cheaper for other countries to purchase.¹⁰² Thus, currency depreciation attracts other nations to buy its goods, and discourages imports because they are too costly for the depreciating country's consumers.¹⁰³ This would be undesirable for countries contemplating a currency union, and it is something member countries are seeking to eliminate.¹⁰⁴

However, depreciation of the national currency in an open economy will not diminish imports because the economy depends too heavily upon

⁹⁵ *Id.* at 241.

⁹⁶ *Id.*

⁹⁷ *Id.* at 243.

⁹⁸ *Id.* Country A has inflation and Country B has unemployment. If factors of production are mobile, then they will move from Country B to Country A and restore the balance of payments in both countries without changing exchange rates. Absent this factor mobility, Country A's currency will appreciate while Country B's currency will not. This will lead to a decrease in demand for Country A's goods and an increase in demand for Country B's goods, and the flexible exchange rates have solved the balance of payments problems.

⁹⁹ *Id.* at 244.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Europe: The Union Debate*, *The Independent*, Dec. 15, 1990, at 10.

imports.¹⁰⁵ This ties in with the diversity and size of a nation's economy. An economy that does not produce a diverse range of goods needs to import many goods, and thus is most likely an open economy.¹⁰⁶ Most smaller economies are less diversified, and more open, while most larger economies are more diversified and more likely to be closed. As a result, small, open and non-diverse economies may be better for larger currency areas than big, diverse, closed economies.¹⁰⁷

Furthermore, inflationary preferences need to be similar in order to create an ideal area for fixed exchange rates. In a fixed rate system, countries' central banks lose control of their domestic monetary policy because the setting of exchange rates has already been established.¹⁰⁸ Consequently, in a fixed exchange rate regime, countries with higher inflation will export their inflation to countries with lower inflation.¹⁰⁹ In addition, it is also helpful if countries within a currency area have similar preferences for growth and unemployment.¹¹⁰ A regional leader who is able to set the tone for monetary policy amongst members of the currency area is important for an optimal currency area.¹¹¹

Finally, countries with floating exchange rates are insulated from external economic shocks, while countries in a fixed rate regime are able to export their internal shocks (e.g. inflation and unemployment) to the other countries in the regime.¹¹² Sometimes, one country's internal shock is another's external shock.¹¹³ As a result, it is better if the economic shocks of each country are random and uncorrelated in order for a system of fixed exchange rates to increase overall price stability.¹¹⁴

In applying this theory to the EEC, it is first important to state that the EMS is not a system of rigidly fixed rates. Rather, it is a framework of limited flexibility. Each currency can fluctuate within its margins and the EMS allows realignments of the participating currencies. Indeed, from the beginning of the EMS in 1979 to 1989, there have been eleven realignments within the ERM.¹¹⁵

In the area of factor mobility, the EEC has already removed tariffs on member countries, thus creating a "free trade area" among member

¹⁰⁵ Odrodnick, *supra* note 94, at 244.

¹⁰⁶ *Id.* at 245.

¹⁰⁷ *Id.* at 246.

¹⁰⁸ *Id.* at 247.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.* at 248.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 256.

countries.¹¹⁶ The Single European Act aspires to create a common market by removing other non-tariff barriers to goods, and by removing restrictions that hamper the free movement of labor and capital among member nations.¹¹⁷ Generally, a move to a common market enhances factor mobility and increases the desirability of fixed exchange rates.¹¹⁸ However, the Single European Act's removal of remaining trade barriers on goods may discourage factor mobility.¹¹⁹ If this decrease in factor mobility is enough to outweigh the rise in mobility the Single European Act seeks, then the EEC would be better off with exchange rates that allow for some flexibility.¹²⁰

The European Community countries, for the most part, have open economies. Six of the countries in the ERM are small, and Germany is the only large country whose economy can be compared with the economies of the United States and Japan.¹²¹ Due to their common market arrangements, most of the Community's countries' economies are closely integrated.¹²² Germany is the predominant economy, and would probably best fill the role of a leader. Although it has been a leader in determining EEC monetary policies in the past, Germany's recent reunification may defuse its interest in taking on such a role.

Inflation rates for most EEC countries are not widely divergent, but are far from convergent.¹²³ Germany continues to carry a low inflation rate of merely 3%.¹²⁴ Great Britain's inflation rate, after hitting an eight-year high of 10.9%,¹²⁵ continues to be a problem, and is far above the Germany rate. Inflation rates are even higher in Italy, Spain, Portugal and Greece.¹²⁶

In addition, it is still uncertain what kind of effect German reunification will have on the deutschmark. This is important because the deutschmark is the dominant weight in the ECU basket and problems in the German economy can have substantial effects on the economic policies of other European nations. Indeed, Germany's deficits have been

¹¹⁶ *Id.* at 250, 251-52.

¹¹⁷ *Id.* at 251-52. See generally Single European Act, *supra* note 1.

¹¹⁸ Odrodnick, *supra* note 94, at 252.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.* at 257.

¹²² *Id.*

¹²³ *Time Became Right for the ERM*, Daily Telegraph, Jan. 1, 1991, at 22.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Cracks Appear in Economic Cooperation as EC Conference Nears*, Reuters Report, Dec. 12, 1990.

rising to finance the reunification.¹²⁷ This may force the German Bundesbank to tighten monetary policy,¹²⁸ boosting the deutschmark's interest rate as well as the interest rates of other European currencies, like the French franc, which currently pin their monetary policies to the deutschmark.¹²⁹ Thus, other European currencies, through their increased interest rates, will be partially financing German reunification.¹³⁰

In addition, growth rates among member countries are also still divergent. Predictions are for Germany to grow at 3.25% in 1991, while France's growth is estimated at only 2.5%, and Great Britain at a mere 0.75%, according to a recent Commission report.¹³¹ The report singled out Italy and Greece for "excessive" budget deficits, and said that Great Britain's high wage settlements were not compatible with the EEC's ERM.

These factors make movement to a system of entirely fixed exchange rates undesirable. Thus, "based on a theory of optimum currency area . . . the EMS exchange rate arrangements of limited flexibility or realignable fixed margins are close to optimal for the European Community."¹³² Indeed, moving to a regime of fixed exchange rates with no transition could have disastrous effects on member countries.

IV. THE PRIVATE ECU

Private ECUs represent contracts between private individuals and banks.¹³³ Private banks receive convertible currencies when they create private ECUs.¹³⁴ These banks issue a guarantee that their ECUs can be changed into component currencies, thereby insuring the value of the private ECU.¹³⁵ The private ECU began in 1979 when a number of Belgian banks opened ECU-denominated sight and time deposit accounts at the request of a number of Community institutions. This allowed the European Commission of the EEC to simplify its cash management.¹³⁶ Eventually banks saw the ECU as a good hedging instrument.

Although there is currently no link between the private ECU and

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² Odrodnick, *supra* note 94, at 258.

¹³³ Levich, *supra* note 25, at 18.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ THE ECU, *supra* note 2, at 25.

the official ECU,¹³⁷ the two still have a significant effect on one another. The private ECU reflects an "open basket". An open basket denotes that the composition of the private ECU reflects the official definition of the ECU at a particular moment.¹³⁸ A "closed basket" would maintain the definition of the official ECU as it was on the date the contract was made.¹³⁹ In other words, if an investor buys a private ECU contract at time A, and wants to convert it to the component currencies at time B, then conversion will reflect the official ECU basket value at time B. Consequently, the value of the private ECU is subject to the changes of the official ECU.¹⁴⁰ This creates an element of risk for those using the ECU to hedge underlying positions in component currencies, whose composition and alignment within the official ECU are subject to change.¹⁴¹

There are many advantages of the private ECU for individuals and private businesses. These advantages are similar to those of the official ECU and have encouraged the growth of the private ECU over the past eleven years. The most often cited advantage of the private ECU is that less exchange rate risk exists since the private ECU represents a basket of currencies. The variability of a basket currency will be less than the weighted sum of the variability of each currency that makes up the basket.¹⁴² In addition, the ERM keeps the fluctuations of participating currencies within narrow limits of one another.¹⁴³ Consequently, exchange rate movement between the ECU and the individual Community currencies can be predicted with greater certainty than exchange rate movements of Community currencies against one another.¹⁴⁴

Another advantage of the private ECU is the reduction in transaction costs. Any transaction with the ECU could be replicated by transacting with each of the component currencies. However, with twelve component currencies, there are many more transaction costs.¹⁴⁵

Furthermore, foreign exchange restrictions in member countries that stunt the development of substantial financial products do not apply to the private ECU. Member states have created a legal and institutional framework to enable ECU transactions within their countries,¹⁴⁶ en-

¹³⁷ Levich, *supra* note 25, at 22.

¹³⁸ *Id.* at 18.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 13.

¹⁴² *Id.*

¹⁴³ THE ECU, *supra* note 2, at 26.

¹⁴⁴ *Id.* at 27.

¹⁴⁵ Levich, *The ECU: Introduction and Overview*, in EUROPEAN CURRENCY UNIT 13 (R. Levich ed. 1987).

¹⁴⁶ THE ECU, *supra* note 2, at 26.

abling banks to tailor ECU products to their customers' needs.¹⁴⁷ Countries treat the ECU as a foreign currency.¹⁴⁸ A number of countries, most recently Germany, have relaxed their foreign exchange controls to allow commercial banks to carry out "in their respective currencies the converting transactions associated with ECU transactions."¹⁴⁹ As a result, the ECU is subject to much less restriction, and it is easier for the ECU to be competitive in financial markets. "By moving transactions into the ECU market, agents may be able to trade a wider range of products at more favorable terms than they might in their domestic markets."¹⁵⁰ While this advantage may decline if member countries relax their foreign exchange controls on domestic currencies, many of the EEC countries have small financial markets, giving the ECU an advantage due to economies of scale.¹⁵¹

These advantages allow businesses to simplify their cash management by replacing a multitude of European currencies with one. In trade, exchange rate risk is reduced when importers and exporters, who want to use a third currency for invoicing purposes, use the ECU in place of the dollar.¹⁵² Any non-Community country that uses the ECU simplifies the administrative problems and the exchange rate risk of dealing in numerous different currencies.¹⁵³ The ECU's ability to reduce exchange rate risk is used by banks for their own purposes in foreign exchange dealings.¹⁵⁴ These dealings are not limited to member state banks, but also include banks in the U.S. and the Far East.¹⁵⁵

In addition, the need for non-European firms to protect themselves against fluctuations of their own currencies was met by the creation of ECU futures and options. The ECU option has been traded on the Philadelphia Stock Exchange since February 1986. ECU futures have been traded on the New York Cotton Exchange and the Chicago Mercantile Exchange since 1986.¹⁵⁶

¹⁴⁷ *Id.* at 29.

¹⁴⁸ *Id.* at 26.

¹⁴⁹ THE ECU, *supra* note 2, at 26. During the first nine years of the EMS, Germany had problems recognizing the ECU. It was classified as a unit of account and not as a currency. Under German currency laws, the authority for operations on foreign currencies existed, but this authority did not apply to the ECU. This changed on June 16, 1987 when the Bundesbank changed its policy and authorized that the private ECU was to be treated like any other foreign currency. J.V. LOUIS, *supra* note 36, at 33.

¹⁵⁰ Levich, *supra* note 145, at 13.

¹⁵¹ *Id.*

¹⁵² THE ECU, *supra* note 2, at 28.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 31.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 34.

In the area of bonds, the ECU bond market has risen steadily since 1981.¹⁵⁷ In the autumn of 1988, the United Kingdom Treasury issued ECU Treasury bonds with a maximum six month term.¹⁵⁸ The same year, Italy issued ECU bonds, and in 1989 the French government launched its first long-term loan in ECUs.¹⁵⁹ The Italian and Greek governments have also issued significant amounts of ECU-denominated paper in their national markets.¹⁶⁰ Since 1985, the issuance of these bonds has shifted from almost entirely public issuers, such as publicly-held corporations, to almost half private issuers.¹⁶¹ There has also been a shift from private investors to institutional investors since ECU bonds were first issued.¹⁶² The Japanese are among the most active in the ECU bond market,¹⁶³ and ECU denominated notes are being issued by U.S. corporations as well.¹⁶⁴

At the end of 1987, the total issuance of ECUs exceeded 28 million, while lending at the end of the first half of 1987 was 60 million.¹⁶⁵ Some European financial institutions have issued ECU travelers cheques, as well as ECU credit cards.¹⁶⁶ Thus, the Community's efforts to increase the use of the private ECU both within the EEC and internationally appear successful.

The European Community has taken an active role in fostering the development of the private ECU. During the 1984 and 1989 revisions of the ECU, the European Commission was concerned about the effect a revision would have on private investors with contracts signed before the date of the revision.¹⁶⁷ In order to avoid market fragmentation, the European Commission made sure that the value of the private ECU corresponded to that of the official ECU regardless of the date of the contract.¹⁶⁸

In addition, the Community is aware that a change in the official ECU basket will have unavoidable effects on the private market, even

¹⁵⁷ *Id.* at 32.

¹⁵⁸ J.V. LOUIS, *supra* note 36, at 31.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ THE ECU, *supra* note 2, at 32-33.

¹⁶² *Id.* at 33.

¹⁶³ *Prospects for a Monetary Union*, *supra* note 56, at 278.

¹⁶⁴ *Id.*

¹⁶⁵ J.V. LOUIS, *supra* note 36, at 31.

¹⁶⁶ Levich, *New Markets and Uses for the ECU*, in EUROPEAN CURRENCY UNIT 127 (R. Levich ed. 1987).

¹⁶⁷ THE ECU, *supra* note 2, at 30.

¹⁶⁸ *Id.*

though the private and official ECUs are not officially linked.¹⁶⁹ The Community wants to provide as smooth a transition as possible for the private ECU market.¹⁷⁰ It also wants to avoid damaging business transactions done in private ECUs.¹⁷¹ As a result, the Community has done a number of things to minimize the effect of any redefinition of the official ECU on the private ECU.¹⁷² First, the rules governing the alteration of the official ECU composition are designed to promote the stability of the official ECU and optimize its allure as a currency.¹⁷³ By stabilizing the alteration of the official ECU, a smoother transition for the private ECU is ensured. Specifically, there are four provisions in the EMS Resolution that accomplish these goals. First, weights of component currencies are examined every five years or on request if the currency has changed over 25% in value.¹⁷⁴ Second, weights of component currencies should be set in line with economic criteria.¹⁷⁵ Third, revisions of the ECU basket cannot alter the external value of the ECU on the date the change becomes effective.¹⁷⁶ Finally, revision of the ECU basket must be approved by a unanimous vote by the European Council.¹⁷⁷

Upon the introduction of the Greek drachma into the basket, the Community noted that the Greek authorities had taken the proper steps to ensure that the introduction would not affect the use of the private ECU.¹⁷⁸ Given the EEC's past efforts to ensure that any change in the official ECU would be accompanied by a smooth transition for private ECU holders, any move to use the ECU as a single currency should try to continue such efforts.

V. THE NEXT STAGE IN MONETARY UNION

In December 1990, the EEC held an intergovernmental conference to revise the existing Treaty of Rome and to establish the necessary institutions to proceed with monetary union.¹⁷⁹ There are currently two main proposals concerning this revision. The first is embodied in the

¹⁶⁹ Levich, *supra* note 25, at 21-22.

¹⁷⁰ *Id.* at 21.

¹⁷¹ *Id.* at 22.

¹⁷² *Id.* at 21.

¹⁷³ *Id.*

¹⁷⁴ THE ECU, *supra* note 2, at A2.3.

¹⁷⁵ Levich, *supra* note 25, at 21.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ J.V. LOUIS, *supra* note 36, at 31.

¹⁷⁹ *Delors Losing Grip on ECU Debate*, *The Independent*, Dec. 17, 1990, at 9.

Delors Report,¹⁸⁰ and the second is Great Britain's "hard ECU" alternative.¹⁸¹

A. The Delors Report

The Delors Report proposes to take decisive steps towards monetary union. It foresees free circulation of capital and integrated financial markets among the EEC countries.¹⁸² In order to achieve this goal, member states' economic and monetary policies need to be more closely coordinated; this includes, but is not limited to, convergent inflation and unemployment rates and similar budgetary and competition policies. This would result in increased economic interdependence among member countries as well as a decrease in independent monetary policies.

The Delors Report points out the need for a new treaty to realize the EMU provisions in the SEA.¹⁸³ It also proposes that such a treaty should lay down the "basic functional and institutional arrangements, as well as [the] provisions governing their step-by-step implementation."¹⁸⁴ In addition, the Report provides the alternative for new treaties at each stage of monetary union.¹⁸⁵ While such an option is positive because it would "reaffirm the political consensus at each stage,"¹⁸⁶ it would also be a slow and possibly counter-productive process.¹⁸⁷

Although the Delors Report envisions some degree of national autonomy among the member states, this is not a top priority of the report. Instead, it would allow for a transfer of power from member states to EEC institutions if this power would be beneficial to further development of European monetary union.¹⁸⁸ Consequently, the Delors Report does not rule out a United States of Europe. Once again, the Delors Report remains consistent with the tradition of political will driving further development by noting that any emphasis on maintaining the independence of each member state is a reflection of the current political and economic developments within the Community.¹⁸⁹

The Delors Report, in setting out to execute monetary union for the EEC, describes three principle features of monetary union:

¹⁸⁰ See generally Delors Report, *supra* note 5.

¹⁸¹ See generally *Evolutionary Approach*, *supra* note 8.

¹⁸² Louis, *A Monetary Union for Tomorrow*, 26 COMMON MKT. L. R. 301, 303 (1989).

¹⁸³ Delors Report, *supra* note 5, at 13 § 18.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* at 37.

¹⁸⁶ *Id.*

¹⁸⁷ Louis, *supra* note 182, at 306.

¹⁸⁸ *Id.* at 305.

¹⁸⁹ *Id.*

- 1) Irreversible conversion of exchange rates,¹⁹⁰
- 2) Liberalization of capital transactions and integration of banking and other financial markets, and¹⁹¹
- 3) Elimination of margins of fluctuations and irrevocable locking of exchange rate parities.¹⁹²

According to the Delors Report, the first of these two features are almost realized or will be attained once the internal market program is complete.¹⁹³ The discussion has been over the third feature, and the Delors Report sees a system of irrevocably fixed exchange rates as, “[t]he single most important condition for monetary union.”¹⁹⁴ Soon after these rates are fixed, the European System of Central Banks¹⁹⁵ would issue the ECU as the EEC’s currency. The Delors Report prefers a single currency because it facilitates the monetary management of the Community, removes intra-Community exchange rate uncertainties, and avoids the transaction costs involved in converting multiple currencies.¹⁹⁶ Moreover, a single European currency eliminates exchange rate variability and reduces the Community’s susceptibility to external shocks from non-EEC countries.¹⁹⁷

At this point, it seems the Delors Report begins to ignore the “political will” doctrine. The Report never states that a switch to fixed exchange rates, and subsequently to a single currency, should be a reflection of the current political and economic developments within the Community. The Delors Report also proves to be a little over-enthusiastic about achieving monetary union. The Delors Report suggests that locking exchange rates is the first step in achieving monetary union.¹⁹⁸ Once this occurs, Community countries’ interest rates would tend to converge when, “[h]ouseholds, labor unions, and other economic agents were convinced that the decision to lock exchange rates would not be reversed.”¹⁹⁹ The Delors Report then attempts to fulfill other optimum currency area requirements by noting that, “[b]oth coherent monetary management and convincing evidence of an effective coordination of non-monetary policies would be crucial” for a monetary union.²⁰⁰

¹⁹⁰ Delors Report, *supra* note 5, at 14 § 22.

¹⁹¹ *Id.* at 15 § 22.

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *See id.* at 21 § 32.

¹⁹⁶ *See* Louis, *supra* note 182, at 306.

¹⁹⁷ Delors Report, *supra* note 5, at 17 § 26.

¹⁹⁸ *Id.* at 15.

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

The problem is that the Delors Report expects the requirements of an optimum currency area to be met *after* fixed exchange rates are enforced. This is completely contrary to the economics of optimum currency areas.²⁰¹ Simply imposing fixed exchange rates on an area could court disaster.²⁰²

In addition, only having one currency implies that member countries can no longer use their exchange rate adjustments to correct imbalances in their own economic policies. These imbalances have certainly occurred in the past. For example, German prospects for economic growth in post-cold war Eastern Europe have driven up the value of the deutschmark. This increase in the value of the deutschmark was sufficient to require the Italian government to undertake an emergency devaluation of the lira in January 1990.²⁰³

It is possible that the removal of barriers to trade and factor mobility will affect different regions of the EEC at different times, and result in some countries needing to devalue their currency.²⁰⁴ While the Delors Report does acknowledge this problem, it advocates the parallel advancement in economic and monetary integration,²⁰⁵ noting, however, that such parallel advancement is not always possible.²⁰⁶ An attempt at parallel advancement might result in the exporting and importing of other member countries' inflation and/or unemployment,²⁰⁷ demonstrating the Delors Report's rigid and often unrealistic approach.

The Report also explicitly rejects issuing the ECU in addition to the existing Community currencies and allowing them to compete.²⁰⁸ The Delors Report views this so-called *parallel currency strategy* as inflationary.²⁰⁹ Furthermore, the Report proposes that a parallel issuance of the ECU will complicate the already difficult process of coordinating members' monetary policies because there will be an additional monetary policy, that of the ECU, to coordinate.²¹⁰ In addition, the Report barely

²⁰¹ See *supra* notes 94-132 and accompanying text.

²⁰² *Id.*

²⁰³ Templeman, *German Unity: A Threat to Europe 1992?*, BUSINESS WEEK, Jan. 22, 1990.

²⁰⁴ Delors Report, *supra* note 5, at 28 § 42.

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ See *supra* notes 94-132 and accompanying text.

²⁰⁸ Delors Report, *supra* note 5, at 29 § 47.

²⁰⁹ *Id.* An issuance of a parallel currency in addition to the existing national currency would result in an increased money supply, though in different currencies, while the same amount of goods would still be produced for that country. This would result in too much money chasing too few goods, which is the classic inflation scenario. See R. DORNBUSCH & S. FISCHER, *MACROECONOMICS* 450 (1984).

²¹⁰ Delors Report, *supra* note 5, at 29 § 42.

discusses the repercussions that a move to a common currency may have on the private ECU. Rather, it believes that a transformation of the basket ECU into a true currency would not reduce the attraction of the basket ECU for private investors.²¹¹

Finally, Section 31 of the Delors Report states, "[e]conomic and monetary union would require the creation of a new monetary institution, placed in the constellation of Community institutions."²¹² This gives rise to the creation of a European System of Central Banks, which would be an autonomous institution and would be somewhat analogous to the U.S. Federal Reserve System.²¹³

The Delors Report proposes a three stage progression to monetary union in the EEC.²¹⁴ The deadline for each stage should remain flexible because the legislature cannot remedy the economic situations which may delay the movement to another stage.²¹⁵ Furthermore, certain countries may take longer to join the EMU than others due to economic and political considerations.²¹⁶

The first stage of monetary union is essentially where the EEC is at now. During this stage, the Community should take decisive steps toward monetary union by aiming toward economic convergence.²¹⁷ All obstacles to financial integration should be removed, and one financial area should exist where all monetary and financial instruments revolve liberally.²¹⁸ All Community currencies would participate in the ERM, and exchange rate realignment would still occur but with countries relying more heavily on other adjustment mechanisms.²¹⁹ All obstacles to the use of the private ECU should be removed.²²⁰ The transition to Stage Two would be signaled by the preparation and ratification of a change to the Treaty of Rome.²²¹

Stage Two would begin with the ratification of such an amendment, and would call for setting up new Community institutions and revising old ones. This would effect a transfer of power from member countries to the EEC regarding macroeconomic policies and certain deci-

²¹¹ Louis, *supra* note 182, at 317.

²¹² Delors Report, *supra* note 5, at 21 § 31.

²¹³ Louis, *supra* note 182, at 311.

²¹⁴ See generally Delors Report, *supra* note 5.

²¹⁵ *Id.* The EC is currently at Stage One. Stage Two is set for January 1, 1994. *Adding Up the Costs of the EMS*, Sunday Times (London), Dec. 16, 1990.

²¹⁶ Louis, *supra* note 182, at 316.

²¹⁷ Delors Report, *supra* note 5, at 30 § 50.

²¹⁸ *Id.* at 31 § 52.

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.* at 30 § 50.

sion-making processes.²²² One of these institutions would be the European System of Central Banks (ESCB).²²³ The crucial function of the ESCB would be the "transition from independent national monetary policies . . . to the formulation and implementation of a common monetary policy."²²⁴ Exchange reserves would be pooled to use in exchange rate intervention, exchange rate realignments would become less frequent, and fluctuations within the ERM would decrease.²²⁵

The third stage of monetary union would begin with a shift to irrevocably locked exchange rates, and a shift to Community powers in the macroeconomic and budgetary areas.²²⁶ Finally, the next logical step would be to move to a single currency.

B. Great Britain's Evolutionary Approach

While the Delors Report was certainly the leading proposal prior to the December 1990 conference, many countries have problems with its strategies and have suggested alternative proposals.²²⁷ Great Britain is one country to put forth an alternative proposal. It is interesting to note that of all the member countries, Great Britain, especially during the Thatcher government, has been the most resistant to European monetary union. There is some question as to whether Britain's plan is a genuine alternative or merely a way of stalling monetary union.²²⁸ However, Britain's recent membership in the ERM, and the internal strife between Thatcher and the Liberal Democratic members of Parliament that led to her demise,²²⁹ cast doubt on this speculation. In addition, the recent rise to power of Prime Minister John Major (who helped write the British alternative while Thatcher was still Prime Minister) indicates that the British may be sincere about their proposal.²³⁰

²²² *Id.* at 33 § 55.

²²³ *Id.* at 34 § 57.

²²⁴ *Id.*

²²⁵ *Id.* at 34-35 § 57.

²²⁶ *Id.* at 35 § 58.

²²⁷ *Britain No Longer Sole EC Skeptic*, Daily Telegraph, Dec. 19, 1990, at 12.

²²⁸ *See Tories Seek to Head Off Split on Monetary Union*, Financial Times, Oct. 23, 1990, at 14. ("If the 'hard ECU' plan is to have a slim chance of success, Britain's European partners must be persuaded that it is more than a diversionary tactic.")

²²⁹ *Id.* *See also Liberal Democrats Eager for a Place in the EMU Fast Lane*, Financial Times, Oct. 23, 1990, at 14.

²³⁰ *Same Song, Softer Voice on European Currency*, N.Y. Times, Nov. 28, 1990. Major is staunchly against a single European currency. However, the Community views him as calmer and more reasonable on the subject than Mrs. Thatcher. He also seems more willing to bargain and listen to other alternatives. *Id.*

1. *Background to the Proposal*

Prior to this proposal, Great Britain's Treasury proposed a number of fundamental principles for economic and monetary integration.²³¹ These recommendations included: 1) a desire to enlarge the leverage of markets and competition;²³² 2) respect for the principle of subsidiarity,²³³ and 3) a strengthening of the forces that stabilize prices.²³⁴

The Treasury felt that stable prices could be achieved through market competition within the EEC single market, while maintaining decisions about national monetary policy at a national level.²³⁵ This is in contrast to the Delors Report which purports that monetary decisions should be made at a Community level. Consequently, the Treasury did not think that any revision of the EEC Treaty was necessary because no new Community institutions would be needed under its proposals.²³⁶

2. *The Proposal*

However, other member countries did not think that these Treasury alternatives went far enough.²³⁷ Thus, Great Britain needed a new alternative proposal. The current proposal from the British Invisible Export Council attempts to combine the Treasury suggestions with Stage Two of the Delors Report.²³⁸ It also addresses Section 57 of the Delors Report, which advocates the transfer of decision-making power from national authorities, who have all the power in Stage 2, to Community institutions, which have all the power in Stage 3.²³⁹

The British approach suggests the formation of an alternative Community institution called the European Monetary Fund (EMF) as part of the ESCB in Stage 2.²⁴⁰ The EMF would allow the central banks to remain accountable at a national level. Further, it would allow central banks to compete within the infrastructure of the single market and the EMS, with the objective of keeping inflation low, while also ensuring the convergence of their respective monetary policies.²⁴¹ The EMF would also be in charge of either fixing exchange rates (although not irrevoca-

²³¹ *Evolutionary Approach*, *supra* note 8, at 2.

²³² *Id.*

²³³ *Id.* The notion of subsidiarity states that the EEC will not undertake any policies which the independent members can do better and more efficiently on their own.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.* at 3.

²³⁹ *Id.*

²⁴⁰ *Id.* at 4.

²⁴¹ *Id.*

bly), or allowing rates to float within a narrow margin.²⁴²

Furthermore, the EMF would also ensure that interest rate differences between member currencies would be reduced.²⁴³ The EMF would be owned by the respective national banks, and these banks would provide the necessary capital to insure the EMF's operation.²⁴⁴ The EMF would have three key purposes: 1) setting a "European Standard" for EEC exchange rates to reflect "the best" in the Community rather than "the average";²⁴⁵ 2) issuing the ECU as a dual currency;²⁴⁶ and 3) assuming the administration of the EMS and ERM.²⁴⁷

The most interesting of these goals for the purposes of this article is the issuance of the ECU as a dual currency. Under this system, individuals and business consumers would have the choice of transacting their business in national currencies or ECUs.²⁴⁸ ECUs would be issued on demand by consumers, and the currencies would be convertible to the ECU on the proposed European Standard.²⁴⁹ This would result in a competition between national currencies and the ECU, with the strongest one emerging as the single currency.²⁵⁰ Thus, this Community policy would result in a currency that would be stronger than member state national currencies, and the Community would not be performing a policy that member countries could do more efficiently on their own.²⁵¹

Initially, national currencies would most likely be used in national transactions.²⁵² The ECU would be used more and more in transactions between particular member states and the rest of the EEC.²⁵³ Consumers could switch back and forth from ECUs to national currencies on demand.²⁵⁴ Eventually, this would lead to a decline in exchange rate uncertainty, and a decline in transaction costs involved in changing currencies.²⁵⁵ This would occur because, "[t]he objective would be that any exchange risk arising from the EMF's operations in ECUs would be borne by each member country in relation to the extent to which its cur-

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.*

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ *Id.* at 5. This is the way that currencies can currently be converted into gold.

²⁵⁰ *Id.* at 4.

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ *Id.*

²⁵⁵ *Id.*

rency was converted into ECUs, rather than by all member countries in proportion to their central banks' shareholdings in the EMF."²⁵⁶ The ECU would emerge as the common currency of the EEC when a substantial amount of national currencies had been traded in for ECUs.²⁵⁷

This proposal is very different from the Delors Report proposal of irreversibly issuing the ECU in substitution for national currencies once exchange rates are fixed. Under the U.K. approach, any transfer of power to Community institutions coincides with demand for the ECU among businesses and individual consumers.²⁵⁸ Thus, a move to monetary union occurs only when market preferences of individual and business consumers in the Community favor ECUs in substitution for their national currencies.²⁵⁹ Unlike the Delors Report, this approach seems more consistent with the political will that has been driving developments toward monetary union since the inception of the EMS.²⁶⁰

The British alternative also sets up a "European Standard" for the ECU. Under this standard, the common monetary policy of the EEC would be based on ECUs rather than gold.²⁶¹ In order to achieve this, exchange rates among Community countries would need to be either fixed (though not irrevocably) in terms of the ECU or allowed to fluctuate within very narrow margins.²⁶² This enables the ECU to become a fixed monetary standard like gold. National central banks would possess separate responsibilities for monetary policies of their own currency, and would take collective responsibility for issuing the ECU.²⁶³ In both cases, this would be done through the Council of the EMF which is made up of the Committee of Central Bank Governors.²⁶⁴ This allows member countries to maintain some degree of independence in their monetary policies, and takes into account the fact that member countries still have very different economies and need to implement different policies within their economic sectors.²⁶⁵ Yet, it still allows for political and economic will to dictate the emergence of the ECU, which is consistent with past approaches towards EMU.²⁶⁶

²⁵⁶ *Id.* at 10.

²⁵⁷ *Id.* at 4.

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ See *supra* notes 54-93 and accompanying text.

²⁶¹ *Evolutionary Approach*, *supra* note 8, at 5.

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ *Id.* at 5.

²⁶⁵ See *supra* notes 108-126 and accompanying text.

²⁶⁶ See *supra* notes 54-93 and accompanying text.

The British alternative also calls for a redefinition of the ECU.²⁶⁷ Currently, the ECU is defined as a basket currency representing fixed weights of the member currencies. This proportion is revised every five years and currencies of new member countries are incorporated into the ECU value at that time. Consequently, the ECU represents an "average" of its component currencies.²⁶⁸ Under the British proposal, the ECU should represent the "best" currency rather than the "average". This means that the ECU's exchange rate needs to be as strong as the EEC's strongest currency in terms of third currencies like the dollar or the yen.²⁶⁹

The EMF can achieve this by managing the ECU independently of other Community currencies.²⁷⁰ It would be necessary for member currencies to be managed by fixing their exchange rates in terms of the ECU and allowing either narrow or no margins of fluctuations.²⁷¹ As a result, the ECU would appreciate or depreciate within these narrow margins; once exchange rates were fixed, the ECU could never depreciate in terms of the currency of another country.²⁷² In addition, the rate of return on the ECU would depend on the interest differential between the ECU and the national currencies as well as exchange rate changes.²⁷³ In the long run, the return on the ECU would be no higher than the rate of return on national currencies.²⁷⁴

3. *Criticism of the British Proposal*

This aspect of the British proposal, known as the "hard ECU" proposal, has received varied responses across Europe.²⁷⁵ It has won backing from the Bank of France Governor Jacques De Larosier.²⁷⁶ Spain, while supportive, fears that a hard ECU may have recessionary effects on poorer countries.²⁷⁷ Germany, however, opposes the hard ECU and instead suggests a gradual hardening of the ECU.²⁷⁸ According to Germany's proposal, the value of the strongest currencies in the basket

²⁶⁷ *Evolutionary Approach*, *supra* note 8, at 6.

²⁶⁸ *Id.* at 5.

²⁶⁹ *Id.* at 6.

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ *Id.*

²⁷⁴ *Id.*

²⁷⁵ See *EC Single Currency Talks Not Just Britain vs. the Rest*, Reuters Library Report, Dec. 16, 1990 [hereinafter *Single Currency Talks*].

²⁷⁶ *DeLarosier Offers Backing for Major's Hard ECU*, Reuters Money Report, Dec. 4, 1990.

²⁷⁷ *Single Currency Talks*, *supra* note 275.

²⁷⁸ *Id.*

would be increased at every new realignment of the ECU.²⁷⁹ The ECU would gradually harden as the weight of the those strong currencies increased.²⁸⁰ This proposal is consistent with Germany's past pushes for the deutschmark to be adopted as Europe's currency.²⁸¹ While the proposal does fit the British aim of creating the "best" ECU, it only works as long as the deutschmark and the other strong currencies making up the ECU are themselves strong.²⁸² If any of these currencies should fall, the ECU would fall in value as well.²⁸³ It is possible that German reunification will weaken the deutschmark and consequently weaken the ECU.²⁸⁴

Spain has recently submitted a proposal, based on the British proposal, that suggests a hardening of the existing ECU basket rather than the creation of a new ECU.²⁸⁵ The hardening would occur when there was an EMS realignment.²⁸⁶ During these realignments, the value of the weaker currencies that make up the basket ECU would be increased.²⁸⁷ This would prevent the ECU from losing value against those currencies not devalued.²⁸⁸ The Spanish plan also eliminates another key feature of the British plan: the hard ECU-issuing bank would not exert pressure on lax national treasuries.²⁸⁹ Others suggest hardening the existing ECU by freezing the existing currency amounts that make up the ECU basket. At the start of Stage Two in 1994, member countries would avoid future realignments.²⁹⁰ Both proposals would help attain the British goal of low inflation by stabilizing prices.²⁹¹ In addition, they suggest that there would be no confusion over the type of ECU in circulation, yet the amount of ECUs in circulation would still be decided by market forces and not the government.²⁹²

While it is easy to see how continuing with the old ECU would eliminate the confusion incurred by a switch to a new ECU, it may not meet

²⁷⁹ *Id.*

²⁸⁰ *Id.*

²⁸¹ See *Adding up the Cost of the EMU*, Sunday Times (London), Dec. 16, 1990.

²⁸² *Evolutionary Approach*, *supra* note 8, at 5.

²⁸³ *Id.*

²⁸⁴ *Id.*

²⁸⁵ *Spain and France Attempt to Find Seats for Everyone on Board the EMU Train*, Financial Times, Jan. 30, 1991, at 7 [hereinafter *EMU Train*].

²⁸⁶ *Id.*

²⁸⁷ *Id.*

²⁸⁸ *Id.* Since the current value of the ECU is based on the weight of the component currencies multiplied by their respective value, a devaluation would make the ECU lose value against the stronger currencies.

²⁸⁹ *Id.*

²⁹⁰ *Another Way of Evolving the Hard ECU Plan*, The Independent, Jan. 15, 1991, at 23.

²⁹¹ *Id.*

²⁹² *Id.*

the British goal of the ECU being the "best". Rather, it would still be an average of its component currencies, and thus unable to compete with the dollar and the yen because it would not be as strong as the strongest currency in the basket. While the Spanish plan addresses this problem by revaluing the currency when EMS realignments occur, Spain's version of the hard ECU would still represent an average. Additionally, adjusting the ECU may sustain its foreign exchange value, but it would introduce uncertainties on the ECU interest rate.²⁹³

Moreover, switching to a completely new ECU has some advantages. A basket currency's exchange rates and interest rates must remain close to the sum of its component currencies.²⁹⁴ Currently, the proportion of the ECU money supply to member currencies is very low, and the ECU's exchange and interest rates are manageable.²⁹⁵ However, if the ECU supply increases greatly (which is one of the goals of Stage Two), it becomes more and more difficult to manage the ECU's exchange and interest rates.²⁹⁶ Consequently, it is important that a new institution control the development of a new ECU. This institution would control the ECU's interest and exchange rates, and consequently its money supply, by issuing the ECU in substitution of national currencies.²⁹⁷

Furthermore, the British proposal should be preferred because it addresses the effect of the ECU redefinition on the private ECU more fully than the Delors Report. As mentioned earlier, the ECU is an "open basket" that reflects the official definition of the ECU at the moment and creates some risk for those using the ECU to hedge underlying positions in component currencies.²⁹⁸ Realignments of the official ECU could have a serious impact on the private market ECU, and consequently the EEC has tried to minimize potential damages that realignments could cause in the private market.²⁹⁹ Obviously, a complete redefinition of the ECU would have serious repercussions on the private market.

Despite criticism that the British plan would involve "discontinuity" with the private ECU market,³⁰⁰ the British proposal tries to remain consistent with the EEC's approach. It recognizes that there needs to be continuity at the point of exchange between the external value of the newly defined ECU and the old ECU. This reassures those in the private

²⁹³ *EMU Train*, *supra* note 285.

²⁹⁴ *The Way Forward for the ECU*, *The Independent*, Jan. 10, 1991, at 25.

²⁹⁵ *See id.*

²⁹⁶ *Id.*

²⁹⁷ *Id.*

²⁹⁸ *See supra* notes 137-141 and accompanying text.

²⁹⁹ *Id.*

³⁰⁰ *EMU Train*, *supra* note 285.

market with contracts (written in ECUs) that are due to mature after the redefinition.³⁰¹ While this continuity has occurred with previous revisions of the ECU, the difference with this change would be that "the ECU exchange rate and the ECU interest rate would not be determined by a new mix of component currencies."³⁰² Rather, there would be a new ECU that was no longer comprised of a basket of currencies. To achieve continuity for this revision, interest rates would need to be set by the EMF with the goal of low inflation, and the external value of the ECU "would be enforced by changes in interest rates and exchange intervention in ECUs against third currencies (e.g. the dollar)."³⁰³ This British approach to the problem is more consistent with the Community's past efforts to maintain continuity during ECU revisions than the Delors Report, which barely addresses the problem.

The British proposal has been subject to some criticism. First of all, proponents of the Delors Report oppose any simultaneous issue of the ECU with national currencies because they fear it will cause inflation.³⁰⁴ This is a valid fear if the ECU were issued as a parallel currency because there would be additional money in circulation, but no additional goods. This would create the classic inflationary scenario of too much money chasing too few goods. However, the British proposal seeks to have the ECU issued in substitution for national currencies as market forces require.³⁰⁵ As a result, the same amount of purchasing power will remain in the market, and no inflationary pressure will occur.³⁰⁶ In addition, part of the EMF's responsibilities would be to control the supply of ECUs and reduce inflation.³⁰⁷

The Delors Report also criticizes parallel currency suggestions because such a system would complicate the task of coordinating national monetary policies.³⁰⁸ This is not applicable to the British proposal because whatever the mix of ECU and national currencies, it is always clear which entity (either national or Community) is responsible for monetary decisions.³⁰⁹ In addition, it is easier for member countries to accept the coordination of their national monetary policies when there is not a

³⁰¹ *Evolutionary Approach*, *supra* note 8, at 6. Any change in the definition of the official ECU will have an undeniable effect on the private ECU.

³⁰² *Id.* at 6-7.

³⁰³ *Id.* at 7.

³⁰⁴ *Id.*

³⁰⁵ *Id.*

³⁰⁶ *See id.*

³⁰⁷ *Id.* at 7.

³⁰⁸ Delors Report, *supra* note 5, at 29 § 47.

³⁰⁹ *Evolutionary Approach*, *supra* note 8, at 8.

transfer of control from the national to the Community level.³¹⁰ Thus, neither of these criticisms are applicable to the British proposal of the ECU as a dual currency.

However, under both the British proposal and the Delors Report, the ECU would be subject to outside speculation.³¹¹ The British proposal suggests that in this event, the EMF should intervene against the yen or the dollar with ECUs, and the national central banks should intervene with their own currency.³¹² This would have the effect of sterilizing the net monetary effects a speculation might have on the ECU.³¹³

The EMF would have monetary control over the ECU.³¹⁴ This control would be similar to a central bank's control over its national currency. The EMF would influence ECU interest rates through open market operations in ECUs. The EMF would reinforce the Community policy of low inflation by buying and selling ECUs to keep the interest rate low.³¹⁵ The EMF would also be the lender of last resort.³¹⁶ The idea is to let the market set the interest level for ECUs based on its redefinition as the strongest currency.³¹⁷ As a strong currency the ECU would be attractive to investors, while the low interest rates would attract borrowers as well.³¹⁸ In addition, by setting a low interest rate for the ECU, the EMF would cause national monetary policies to follow suit because residents would purchase ECUs due to their lower interest rates.³¹⁹ Eventually this would lead to more control over national monetary policies once the ECU substantially substitutes for the national currencies.³²⁰

The EMF would also be responsible for intervention between the ECU and third currencies.³²¹ The EMF would issue ECU securities for dollars, or sell dollars and purchase ECU securities where circumstances demanded. Any exchange risk arising from the EMF's operations in ECUs would be borne by each member country in proportion to the amount of their currency converted into ECUs, instead of by all member

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.*

³¹³ *Id.*

³¹⁴ *Id.*

³¹⁵ *Id.*

³¹⁶ *Id.* at 11.

³¹⁷ *Id.*

³¹⁸ *Id.*

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ *Id.* at 13.

countries in proportion to their Central Bank's share in the EMF.³²²

Unlike the Delors Report, the British proposal's Stage Two is a set of significant monetary arrangements in its own right. The transition to Stage Three will occur depending on how long it takes for the ECU to be accepted. Perhaps at some specific proportion, 80% for example, there would be an irrevocable switch to the ECU as the common currency.³²³

4. *Recent Developments*

The December 1990 intergovernmental conference of the European Community proved to be very beneficial for the British alternative.³²⁴ The Delors Report lost backing while Great Britain's proposal gained support from Spain, France, and Italy.³²⁵ One reason the Delors Report lost support at the conference was because it was very unclear on the implementation of its proposals.³²⁶ Member countries are also aware of the divergence in their respective economies.³²⁷ Countries with weaker economies fear that the fixed exchange rates of Delors' Second Stage could prove to be too tight of a monetary discipline for them, while countries with stronger economies fear that countries with weaker economies will press for inflationary policies.³²⁸ This is consistent with the theory of optimum currency areas, which, as stated earlier, discourages fixed exchange rates among countries with divergent economies.³²⁹ Thus, the British alternative, which incorporates both monetary discipline and gradualism, gained support and was seriously considered as a plausible alternative to the Delors Report.³³⁰

In Germany, where the Government foresees Stage Two of the European Monetary Union starting in 1994, Bundesbank President Karl Otto Poehl has spoken out against the establishment of the ECU as a thirteenth currency, and specifically against the British proposal of establishing the ECU as a parallel currency.³³¹ Poehl sees no advantage to the British alternative over the Delors Report.³³² Indeed, he thinks that the

³²² *Id.* at 10.

³²³ *Id.* at 18.

³²⁴ *Hard ECU: Mark II*, The Times (London), Jan. 9, 1991 [hereinafter *Hard ECU*].

³²⁵ *Id.*

³²⁶ *See id.*

³²⁷ *Id.*

³²⁸ *Id.*

³²⁹ *See supra* notes 94-132 and accompanying text.

³³⁰ *Hard ECU*, *supra* note 324.

³³¹ *Poehl Carries On Campaign of Cautious Approach to the EMU*, Daily Rep. for Executives (BNA), (Oct. 26, 1990) [hereinafter *Poehl Carries On*].

³³² *Poehl Says Monetary Union Does Not Require Establishment of a European Bank*, 55 Banking Rep. (BNA) 840 (Nov. 19, 1990).

hard ECU and the creation of the EMF could create an "indeterminate area of monetary policy."³³³ He recently argued that choosing to use the ECU as the currency for Community monetary policy operations would cause the EEC to orient itself toward the Community's average inflation rates.³³⁴ Germany is against this since its inflation rate is below the Community's average. The Dutch have echoed these concerns.³³⁵ However, Poehl also noted that the British proposal contains some good points, and agreed that the value of the ECU needs to be strengthened.³³⁶ Indeed, Germany has drafted its own alternative to the Delors Report which shows some softening of Germany's original hard line position.³³⁷ Prime Minister Major and Chancellor Kohl have recently agreed that "both sides will work to help each other along and avoid direct confrontation" despite their differences.³³⁸

Italy has also written a paper giving some support to the British proposal with respect to the strengthening of the ECU. The paper explicitly calls for the EEC not to reject the British proposal.³³⁹ Furthermore, Spanish Finance Minister Carlos Solchaga Catalan has stated that the British proposal would be "useful as 'practice' runs towards a single currency and a central European bank."³⁴⁰ Danish Prime Minister Poul Schlüter has also recently advocated the use of parallel currencies.³⁴¹

A recent report from the European Commission points out that the smaller EEC countries like Belgium, Luxembourg, Ireland, Denmark, and the Netherlands stand to gain the most from replacing their currencies with the ECU because the ECU would be used far more widely in international payments than their national currency.³⁴² Moreover, the report acknowledges that at this time, "the EC is ill-suited as a geographic unit to have a single money because labor is not mobile enough within it."³⁴³ This is consistent with optimal currency areas theory.

Since December 1990, there have been recurring intergovernmental

³³³ *Id.*

³³⁴ *Poehl Carries On*, *supra* note 331.

³³⁵ *UK's Lamont Again Rules Out Single Currency*, Reuters Money Report, Jan. 24, 1991.

³³⁶ *Poehl Carries On*, *supra* note 331.

³³⁷ *Britain and the EMS; Stiff Conditions for the Next Move to Monetary Union*, Financial Times, Oct. 8, 1990, at 6.

³³⁸ *Anglo-German Entente Points to New European Order*, The Independent, Feb. 13, 1991, at 10.

³³⁹ *Italy Tries to Defuse EMU Time Table Row*, The Times (London), Oct. 23, 1990.

³⁴⁰ Bruce, *supra* note 49.

³⁴¹ *Danish Prime Minister Doesn't See EC Currency in EMU Third Phase*, Reuters, Mar. 15, 1991.

³⁴² *Smaller Member States Stand to Gain from the Move Towards Single Currency*, Financial Times, Oct. 22, 1990, at 6.

³⁴³ *Id.*

conferences. Great Britain submitted an amendment consistent with its proposals for the EMF and the hard ECU.³⁴⁴ Jacques Delors also presented a proposal consistent with his Report,³⁴⁵ while Spain and France have submitted their own proposals.³⁴⁶

Most recently, though, the British alternative seems to have lost some of its ground. Many believe that the other eleven members of the European Community do not take the hard ECU seriously.³⁴⁷ However, there are signs that the British government still backs its proposal.³⁴⁸ Prime Minister Major has signaled that his hard ECU proposal could be subsumed in other EC government proposals.³⁴⁹ There are some indications that Great Britain is willing to amend substantial parts of its proposal if the other member countries are willing to accept its idea of a thirteenth currency as a route to monetary union.³⁵⁰ Great Britain has already accepted that earlier plans for a European central bank could fill the shoes of its proposed EMF,³⁵¹ and that such an authority could be independent of national political control.³⁵² Finally, Prime Minister Major has even gone as far to say that there would need to be a political decision, most likely preceded by an election, to convert the ECU into a single currency.³⁵³

There is some indication the Great Britain may be willing to accept the Spanish alternative.³⁵⁴ This proposal calls for a "hard basket" ECU.³⁵⁵ Parts of this plan are also supported by Germany.³⁵⁶ The main thrust of the proposal is to disallow any devaluations of the ECU against EMS currencies starting in 1994.³⁵⁷ The basket would still be composed of the twelve national currencies.³⁵⁸ When the EMS realigns its currencies, the amount of each national currency in the basket "would be adjusted to preserve a basket composed of some of each of the twelve

³⁴⁴ *EC Single Currency Talks Start Well - Luxembourg*, Reuters Money Report, Jan. 15, 1991.

³⁴⁵ *European Monetary Union: What is Phase Two?*, THE ECONOMIST, Jan. 19, 1991.

³⁴⁶ *EMU Train*, *supra* note 285.

³⁴⁷ Davies, *Britain Converges with Europe*, Daily Telegraph, July 28, 1991, at 32.2

³⁴⁸ Steven, *Hard ECU Not Dead Says Britain*, The Press Association Ltd., July 3, 1991.

³⁴⁹ Stephens, *Major Closer to Accepting Economic Union Timetable*, Financial Times, June 29, 1991, at 1.

³⁵⁰ *Britain May Adopt its Hard ECU Plan to Win Support*, Reuters Library Report, Jan. 8, 1991.

³⁵¹ *Europe Not Yet Ready To Put Its ECU in One Basket*, The Times (London), Jan. 30, 1991.

³⁵² *Id.*

³⁵³ *Id.*

³⁵⁴ Norman, *EC Ministers Pursue EMU at Walking Pace*, Financial Times, June 3, 1991, at 19.

³⁵⁵ *U.K.'s Major Talks with Dutch on "Hardening" ECU*, Reuters, June 28, 1991.

³⁵⁶ McCune, *EC Debates Path to Strong ECU But Not a Hard One*, Reuters, Apr. 16, 1991.

³⁵⁷ *Id.*

³⁵⁸ *Id.*

national currencies.”³⁵⁹ While this could transform the ECU into a strong currency, the occasional changes in the composition of the basket would still disturb the private ECU market.³⁶⁰

The EC Commission has put forth an alternative proposal to freeze the ECU basket.³⁶¹ This proposal has received French support, and suggests irrevocably freezing the level of national currencies that make up the basket at the currencies' current levels.³⁶² This would be better for the private ECU market, but there is no guarantee that the twelve composite currencies would naturally converge toward the best performance and guarantee the ECU's value against the strongest national currency.³⁶³

VI. CONCLUSION

Perhaps the EEC should move to a common currency, but there is no reason to rush towards such a dramatic change. According to optimal currency area theory, the current system of limited flexibility within the EEC is ideal. Any move to a common currency should be flexible in that it initially allows member states the ability to use national monetary policy if necessary. The British proposal allows just this kind of flexibility.

Moreover, the history of progress toward monetary union shows a reliance on political will. The EMS was originally a mere resolution that worked because of prevailing political and economic will. The Single European Act was left vague specifically to allow for such will. The Delors Report, however, does not seem to reflect this feeling. Rather, it proposes a regimented change to a single currency. In contrast, the British proposal recognizes this need for political will by allowing national currencies to be exchanged on demand for ECUs. Given Germany's recent reunification, and the problems in the Persian Gulf, this is a time when flexibility in economic and monetary policies is high in demand, and consequently, the British proposal is the better option for any amendment to the Treaty of Rome.

Susan B. Shulman

³⁵⁹ *Id.*

³⁶⁰ *Id.*

³⁶¹ *Id.*

³⁶² *Id.*

³⁶³ *Id.*