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TOMMASO PADOA SCHIOPPA

Rome, January 2, 1989

Dear Gunter,

this is the introductory note on the EMU. To gain time, feel free to make any amendment you wish even before my arrival at the BIS. I also attach the "compte rendu" of the December meeting.

As a matter of convenience, I have planned to reach Brussels on Thursday night (leaving Basle at 6.30 p.m.) rather than Wednesday morning. But I can still change my plans in Basle.

Best regards,

Tommaso.

03/01/89 03:25 B. T. SEGR. PART II. NO. 236 P005/011

COMMITTEE FOR THE STUDY OF
ECONOMIC AND MONETARY UNION

Draft
CSEMU/7/89

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2 January 1989

The ECU, the common currency and the Monetary Union

1. In view of the discussion concerning the ECU scheduled for the January meeting of the Committee, the following papers have been circulated:

- The ECU in the monetary union process, by C.A. Ciampi.
- The ECU as a parallel currency, by W.F. Duisenberg, and
- The ECU banking market (by H.W. Mayer), presented by A. Lamfalussy.

A background for the discussion is also provided by the parts of the "Skeleton" (CSEMU/5/88) devoted to the question of the single currency, and by the paper "Alternative Paradigms for monetary Union" by D. Gros.

2. The following terminology may be used to facilitate the discussion:

. a common currency is a currency that is used in the Community and is not a national currency of either a member state or of a third country. Two types of ^a common currency are the following: *Can be distinguished:*

. a parallel currency, which is a common currency that is created independently of, and in addition to, national currencies. It circulates in parallel to national currencies, thus competing with them. The idea is that the parallel currency would eventually "crowd out" national currencies, thus establishing a monetary union "in a painless way";

. a single currency is a common currency that has replaced all existing national currencies as a result of an

institutional decision (rather than a market process).

An important question is whether these are the only two forms a common currency could take.

3. Another conceptual distinction, that is introduced in Governor Duisenberg's paper, concerns the respective roles of market behaviour and institutional decisions in the development of a common currency. The role of habits in monetary matters is well known. The use of the ECU by private markets is an example of that.

4. The note presented by Governor Ciampi sees the common currency (the ECU) under yet another form, as the instrument whereby the ^{example} unicity of monetary policy is ^{promoted} fostered and eventually enforced. The note shows that the discussion about the common currency and the role of the ECU cannot be really separated from the discussion of how a monetary union would have to function in order to satisfy the ~~three~~ essential elements of the Werner report definition (locking of parities, capital mobility, ~~unicity of policy~~).

if the ECU is an instrument of monetary policy a common currency?

5. The discussion of the Committee about the ECU could perhaps be organized around the two interrelated questions:
a) What should the Committee's report say about the need for, and role of, a common currency in the process leading to monetary union?
b) What should the report say about the ECU?

6. A common currency in the process leading to monetary union. Various views may be held on this problem. One is that no common currency needs to be foreseen in order to have a monetary union, because irrevocable locking of parities, full mobility of capital, and ^{a single} ~~"unicity of monetary policy"~~ are sufficient. Alternatively, the view may be held that a common currency is necessary for various purposes: as an instrument of the common monetary policy, as a

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convenient denomination for private economic agents, as a way to reduce uncertainties and transaction costs, etc. It may also be observed that no monetary union has ever existed without a common currency, and that the credibility of the "irrevocable locking" would be constantly at danger with the persistence of many different currencies. Is the complete absence of a common currency a realistic proposition for the long run?

7. The role of the ECU. Whatever proposals may be made concerning the ECU, they will be strictly dependent on the answers given to the above questions concerning the common currency. However, the two issues do not fully coincide, because the ECU already exists, it occupies a place in private markets, it has raised a certain amount of expectations concerning its future role in the process towards monetary union, it carries a symbolic value to which political leaders may attach importance. To many observers it seems natural to see the ECU's role growing with the progress towards monetary union, until it becomes the single currency. Others may consider that setting up arrangements concerning a common currency is premature, and that only the promotion of convergence and monetary stability is necessary. If this latter view is taken, what should be said about the ECU, given its present status, role and place in the markets? Is it realistic to disregard the ECU altogether? If a political decision was taken that the ECU will become a common currency, what technical arrangements would make the ECU an instrument of greater monetary discipline and stability, rather than a factor of complication and uncertainty?