

INFORMATION**ECONOMY AND FINANCE****THE UNITS OF ACCOUNT AS A FACTOR OF INTEGRATION**

87/75

The unit of account (u.a.) is a device for expressing monetary values other than in national currencies. Contracts, for example, may be expressed in units of account, though once the operations have been completed payment is made in national currency. — unlike the unit of account, a unit of currency has, amongst other things, an important function as a means of payment. Anyone can have money in his pocket that is both a unit of account and a means of payment, but units of account alone cannot yet generally be used for payment purposes.

In the European Communities units of account are used:

- to express and measure claims and liabilities deriving from monetary transactions within the Community;
- to determine the value of financial transactions and to maintain the relative values of claims and liabilities over periods of time, for example in the European Development Fund, the Social Fund and the European Coal and Steel Community;
- to establish and maintain unified price structures in individual sectors of the Community, e.g. agriculture.

Units of account and the Community's past development

The unit of account is used in sixteen areas of the Community's activities, the main ones being the budget, the agricultural policy, the Coal and Steel Community, the European Investment Bank and the Statistical Office. Annex I, setting out the countervalues of various units of account, shows that, for the purposes of the budget, one unit of account has a countervalue of DM 3.66 and, for levy

payments in the Coal and Steel Community a countervalue of DM 3.21. For the Italian Lira, the differences in value as between the two areas is about 25 %.

The units of account used so far in the Communities are based on the principle of fixed parities. They reflect the old system of stable but adjustable exchange rates. This type of unit of account is given a fixed value, for instance 0.88867088 gramme of fine gold, the corresponding value in national currency being adjusted in line with any parity change.

As long as changes in exchange rates took the form of parity adjustments, such changes posed no great difficulties for this type of unit of account. When, however, exchange rates were no longer legally changed through new parities declared to the IMF but were notified in the form of central rates, the management of the unit of account encountered its first major difficulties. With the budget unit of account being linked to currency parities, which, legally speaking, had remained unchanged for a good many years, a country whose currency appreciates (depreciates) pays more (less) of its currency into the Community budget. If the conversion method for the unit of account was adjusted to reflect the real relationships on the exchanges, Germany's budgetary contribution, expressed in DM, would fall while Italy's would increase. If this were done, the countries with appreciating currencies could subsequently be compelled to make adjustment payments because the method for determining budgetary contributions still requires, for the time being, that no country can deviate substantially from the contribution scale.

At the end of 1973 the Commission introduced a new "market-related" conversion method for the ECSC unit of account, in respect of which it alone has the power to take decisions. For currencies participating in the joint float this method is based on the official central rates. For countries whose currencies are floating independently the Commission sets rates based on the actual trend in their exchange rates on the exchanges of the countries participating in the joint float. Consequently, this unit of account is a "hard" and unilateral unit of account since the countries involved in the joint float alone provide the measure of value. The countries whose currencies are floating independently could criticize this unit of account on the grounds that it is unfair since they alone bear the brunt of adjustment. A similar

unit of account is used for settlements made in connection with the Community joint float, i.e. in the European Monetary Cooperation Fund (EMCF). Use of such a unit of account is fully justified here since it involves only central banks, which intervene to underpin fixed exchange-rate relationships. The balances outstanding are settled at monthly intervals.

The agricultural unit of account

The unit of account is extremely important as regards the common agricultural policy, since it is the monetary intermediary in which the common levels of farm prices are expressed. Its original value was the same as that of the budget unit of account. Council Regulation No. 129 of 1962 fixed the value of the unit of account at 0.88867088 gramme of fine gold, which at that time was the value of the US dollar. The unit of account must be converted into national currencies at the IMF parities.

The unit of account applies automatically, and one consequence of this is that countries which revalue (devalue) their currency lower (raise) in terms of the national currency their farm prices, which are expressed in units of account. Since farm prices are also a key component of the agricultural incomes policy, difficulties have arisen whenever parity changes have necessitated price changes. The device of monetary compensatory amounts for agriculture was therefore introduced to offset the modifications in farm prices which the exchange rate variations would otherwise have caused. Since 1971, the direct impact of Community farm price reviews on actual prices has been largely diluted by the working of the compensatory amounts. Incomes policy considerations impel countries with appreciating currencies in particular to resist very strongly the practical implications of automatic conversion of the unit of account. In 1973, following the revaluation of the guilder, the Netherlands did, nevertheless, lower its farm prices accordingly.

Table 1 shows that for Germany the current level of compensatory payments is 12 %. In the absence of these border compensatory payments, farmgate prices in Germany would have had to be lowered by 12 %. Naturally, it would have been expedient to scale the prices down gradually. In 1974, the border compensatory amounts for Italy occasionally touches 28.3 %. Extremely large compensatory amounts tend to distort trade in agricultural products, and since 1973/74 "representative rates" have therefore been fixed by the Council for the Dutch guilder, the pound sterling, the Irish pound and the Italian lira. Since the Council's meeting on

this subject, held in February 1975, the representative rates have been used for all the member States, so that, throughout the Community, it is no longer the unit of account but the representative rate which is used as the basis for converting farm prices expressed in units of account into national currencies.

One example may clarify this: in the summer of 1974 border compensatory amounts of a good 28 % were being levied in Italy and this was the extent to which Italian farm prices trailed behind the general level of prices in that country. The result was a corresponding price distortion between the farming sector and the rest of the economy. The gradual devaluation of the green lira resulting from the fixing of representative rates entailed lower border compensatory amounts and higher farm prices. On 28 October 1974, the date of the last adjustment of the representative rate for Italy, the compensatory amounts for this country were discontinued altogether. Only when the lira drifted down again in the ensuing weeks were they reintroduced, reaching 4.1 % by the end of 1974 (see Annex 2).

The introduction of representative rates enabled what had been extremely divergent trends to be corrected somewhat and unified farm prices to be restored in the Community. Any more detailed examination of the effects and uses of the agricultural unit of account would be outside the scope of this paper.

Outdated gold valuation

Units of account, in the function of parity units which they have had so far, are still equivalent to 0.88867088 gramme of fine gold. When, in 1971, the US dollar ceased to be convertible into gold, this figure became a purely abstract measure of the worth of the unit of account. This raises no difficulties as long as no new official gold price is fixed by the monetary authorities. Technically speaking, it would, moreover, be possible to retain the same type of unit of account in the event of the link with gold being abandoned. The gold reference point could be replaced by a "grid" formed by the monetary relationships between a given group of countries.

New units of account

The fundamental change in the international monetary system has led to the introduction of new units of account, no longer tied to the parity concept but based on "baskets" of several currencies.

The first unit of account of this new type is the EURCO, which was introduced in 1973 by the European Investment Bank. The basket of currencies in this case comprises the following : DM 0.9 + FF 1.2 + £stg 0.075 + Lit 80 + Fl 0.35 + Bfrs 4.5 + Dkr 0.2 + £ Ir 0.005 + Lfrs 0.05. Several loans denominated in this unit of account have been issued by the Bank.

1 July 1974 saw the introduction of a Special Drawing Right (SDR) on the IMF, the value of which was based on a fixed basket of 16 currencies. Since then the IMF has published each day the rate for this international unit of account. Currencies qualifying for a place in the basket are those whose issuing countries have a share of more than 1 % in world trade, the weighting being proportionate to the relative quantity of trade, except that the weighting for the United States was raised from 22 to 33% to take account of the dollar's leading role as a currency used in international transactions. All the Community countries are represented in the SDR basket except Ireland and Luxembourg.

The Commission's approach

In December 1974 the Commission forwarded to the Council a communication concerning the unit of account, in which it proposes the gradual introduction of a new unit of account based on a basket of all the Member States' currencies.

The introduction of this unit of account would have the following advantages inter alia :

- It would permit the unit of account to be reintroduced into the Community's exchange system and thereby to reflect accurately the actual exchange rate relationships ;
- It would also permit unification on the present very divergent implementing procedures, resulting in a greater degree of transparency not only in transactions between the individual administrations but also in financial relations with countries outside the Community. Frequently, the only way in which those who have had to deal with the Community unit of account and wished to know the conversion rate for the sector in question was to contact the Community's headquarters

in Brussels. In future, it will be possible to check the value of the unit of account, after its publication by the Commission, in the daily newspapers;

- If a realistic unit of account based on a basket of currencies is introduced, it is likely that its inherent individuality will once again command more respect: under the old system, the further the unit of account conversion drifted from the actual exchange rate relationships, the greater was the inclination to dispense with it as early as possible in the relevant operation and to revert to national currencies for the purposes of accounting.

The new European unit of account

In its communication to the Council, the Commission presents the case for the introduction of a European unit of account. One obvious question is why the SDR basket, which has been used by the IMF since July 1974, should not also be used within the Community. The Community's Member States have an aggregate weighting of 44.5% in the SDR basket and have made a decisive contribution to the development of this international unit. Adoption of the SDR unit of account unchanged would, however, create several problems in the Community :

- for example, in view of the dollar's heavy weighting within the SDR (33%), the Community's development aid would, to a large extent, carry a dollar guarantee, while a European currency basket offers a guarantee expressed in the currencies of the Member States only. In view of the weakness of the dollar, the value of the European currency basket has in fact been slightly greater than that of the SDR since July 1974. Another point is that as the ACP countries^{*)} have undertaken to spend EDF aid only in Community member countries, it is only fair that they should be given a guarantee as to the average value of the Community currencies;
- with the unit of account being used predominantly for intra-Community settlements the SDR basket would introduce an extra-Community element, since non-member countries' currencies account for a 55 % share of it. Consequently, the advantage of a "currency basket" unit of account, namely the possibility of expressing in monetary terms a representative Community average, would be lost, although the Community as such is a sufficiently representative monetary area to serve as basis for a Community basket;
- a European unit of account would constitute, above all, a point of departure from which to develop the Community's monetary identity.

*) African, Caribbean and Pacific States

As the basis for its analyses and calculations, the Commission took a basket of currencies constructed on similar lines to those of the SDR basket and with the same value as the SDR basket as at 28 June 1974: the existing units of account valued at 0.88867088 gramme of fine gold have an "official" dollar value of US \$ 1.20635. To facilitate the changeover from the old to the new unit of account, it seemed best to choose a day on which the value of the currency basket was the same as that of the old unit of account in terms of SDR: the SDR being based on a basket from 1 July onwards, the unit of account ceased on that date to have the same value as the SDR (\$ 1.20635). Therefore, to link the new basket unit of account to the old parity unit of account, the new calculation had to be made from the day on which the SDR assumed a new dollar value.

On 12 February 1975, the basket was worth \$ 1.289 and the SDR was quoted at \$ 1.239.

European unit of account

Currency	Weighting in %	Units of the currency in one u.a.
Deutsche mark	29.17	0.8990
Pound sterling	15.83	0.07995
French franc	19.49	1.134
Italian lira	12.52	97.82
Dutch guilder	10.45	0.3342
Belgian franc	8.71	3.994
Luxembourg franc	0.31	0.142
Danish krone	2.82	0.2042
Irish pound	0.70	0.003535

The above figures are meant only as guide, since as yet neither the Council nor the Commission have adopted an act introducing this type of unit of account. This matter is still being discussed by the various Community bodies and the figures given here may therefore be changed.

Units of account as forerunners of a European currency

The reform of the unit of account is one aspect of the strategy for constructing a European monetary union. The use of units of account and their extension to non-administrative areas are steps in this direction. As the present distortions in its application are phased out, the unit of account will cease to be a factor of dislocation and will again become a factor of integration. One fallacy must, however, be avoided : the introduction of a new unit of account has nothing to do with the introduction of a European currency. A European currency could be created only if specific economic and political requirements were met, and the unit of account does not provide the right framework for an approach to this problem.

However, this detracts in no way from the relevance of the new unit of account to the policy of integration. Considerable progress still has to be made in the early preparatory stage of the construction of a European currency unit, during which a newly introduced unit of account will in the long term also have to accommodate vigorous forces of change. In a monetary system which has not yet emerged completely from the throes of the oil-supply and payments-balance crisis, the unit of account can do no more than help to solve these problems. Even if greater administrative use were made of a unit of account, the latter would not automatically become a European unit of currency. Important progress on the road towards integration would, however, be achieved if units of account were used consistently in the Community framework.

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Annex 1

CONVERSION RATES FOR CERTAIN UNITS OF ACCOUNT

(as at 31 December 1974)

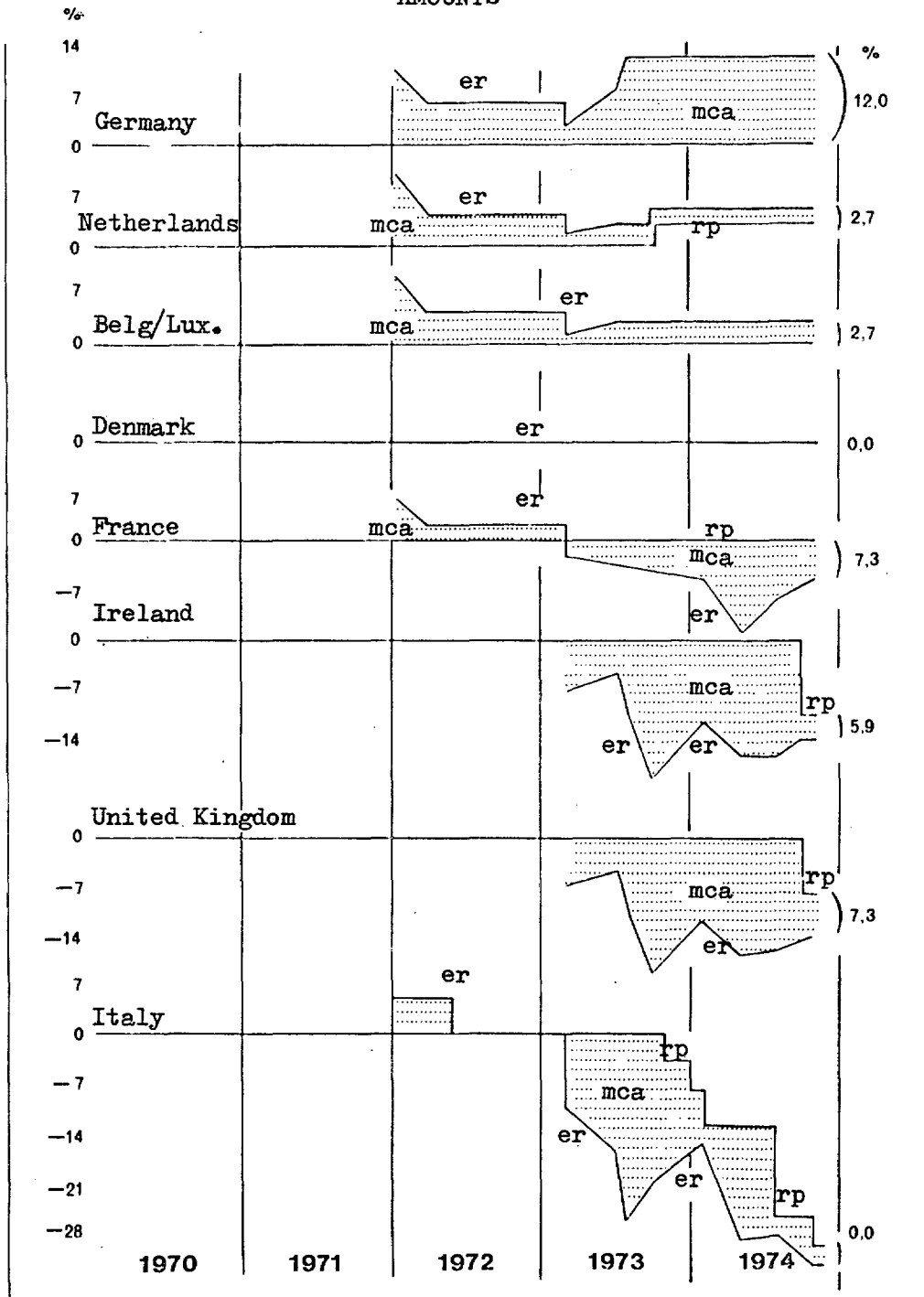
Currency	Budget u.a.	EDF u.a. 1)		ESCS u.a. 2) (average value for the six months June-November 1974, applicable to transactions in first half of 1975)		CAP u.a. 3)			EMUA 4) - ESCS u.a. u.a. for the monetary compensatory amounts (average value 25 - 31 December 1974)	
	Parity given for all currencies	Revaluation or devaluation (%) (1):(2)	Parity or central rate	Revaluation or devaluation (%) (1):(3)	Central rates for "snake" currencies; calculated rates for "non-snake" currencies	Revaluation or devaluation (%) (1):(4)	Parity, central rate or representative rate	Compensatory amounts (%) (5):(4)	Revaluation or devaluation (%)	Central rates for "snake" currencies; calculated rates for "non-snake" currencies
	(1)	(2)		(3)		(4)			(5)	
B(L) frs	50	+ 2.8	48.6572 *)	+ 2.8	48.6572	0.0	50	+ 2.7	+ 2.8	48.6572
Dkr	7.5	- 1.0	7.57831 *)	- 1.0	7.57831	- 1.0	7 57831	0.0	- 1.0	7.57831
DM	3.66	+ 13.7	3.21978 *)	+ 13.7	3.21978	0.0	3 66	+ 12.0	+ 13.7	3.21978
Fl	3.62	+ 7.9	3.35507 *)	+ 7.9	3.35507	+ 5.1	3 44353 **)	+ 2.7	+ 7.9	3.35507
£stg	0.416667	0.0	0.416667	- 22.4	0.536880	- 16.4	0 498679**)	- 13.8	- 26.6	0.56730
£Ir	0.416667	0.0	0.416667	- 22.4	0.536880	- 18.8	0 513215**)	- 10.5	- 26.6	0.56730
Lit	625	- 1.0	631.343 *)	- 24.6	829.753	- 25.0	833 **)	- 4.1	- 27.9	867.273
FF	5.55419	0.0	5.55419	- 7.9	6.03089	0.0	5 55419	- 7.2	- 6.7	5.95174

*) Central rate
**) Representative rate

1) European Development Fund
2) European Coal and Steel Community

3) Common Agricultural Policy
4) u.a. used for calculating interventions in respect of the Community joint float.

CHANGES IN THE "GREEN" EXCHANGE RATES AND
IN THE MONETARY COMPENSATORY
AMOUNTS



mca : monetary compensatory amounts
er : exchange rates
rp : representative "green" rate

NOTE : Until 1973 the system of compensatory amounts was based on the relationship of each currency to the US dollar. Since March 1973, when the central banks were no longer obliged to buy dollars, the Community joint float has been used as the basis for calculating the compensatory amounts.