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The European Currency Unit and Its Use in Developing Countries to Solve Foreign Exchange Related Problems: The Case of the People's Republic of China

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Ralph J. Mehnert

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Ralph J. Mehnert†

INTRODUCTION

The chronic scarcity of foreign exchange in developing nations severely threatens their fragile economies.¹ The denomination of international trade and debt transactions in currencies with highly fluctuating exchange rates is often the cause of such scarcity. The present devaluation of the dollar and the appreciation of the mark and yen exemplify this situation for countries that have to repay their mark and yen debt with their dollar reserves.² As a result of this volatility, developing countries must expend relatively more of their dollar foreign exchange earnings on foreign debt repayment. Although

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1. Foreign exchange reserves are important for any country to buy foreign goods and services. This is especially true in the case of developing nations whose currencies usually are not accepted for invoicing or payment purposes in international trade.

2. The decrease in foreign exchange resulting from the depreciation of the dollar only occurs when dollar reserves dominate the number of total foreign reserves.

The development of the deutsche mark value of one U.S. dollar is exemplary of this behavior. The following are the official yearly average rates of one dollar in deutsche mark at the Frankfurt Stock Exchange.

Year	Value (DM/\$)	1980=100%
1980	1.8158	100.00
1981	2.2610	124.52
1982	2.4287	133.75
1983	2.5552	140.72
1984	2.8456	156.71
1985	2.9424	162.04
1986	2.1708	119.55
1987	1.7982	99.03
1988	1.7854	96.84

Source: Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE
10 (Feb. 1989).

exchange fluctuations may benefit these nations at one time or another, the danger of an exchange loss causes these countries to be risk adverse in that they would prefer not to make a profit in order to avoid a loss.

This article presents a possible solution to this dilemma: the European Currency Unit (ECU).³ The ECU has developed into a major currency during the first decade of its existence such that it may become the common currency of the European Communities (EC).⁴ This common currency concept was made official in June 1989, when the European leaders decided to create the Economic and Monetary Union.⁵ The earlier report of the EC Committee on such a union, which was adopted in the June 1989 decision, calls for the introduction of a central bank of the EC and a common currency.⁶ The ECU is regarded as the most logical choice for this EC currency. Its most attractive feature is its stability. Its value fluctuates to a much smaller extent than, for example, the American dollar, the German mark or the Japanese yen.

Part I of this article discusses the ECU's stability and its role as the most important pillar of the European Monetary System (EMS). The stability results from its composition as a "basket of currencies" that includes twelve individual currencies⁷ and their value in dollars. The compensating effect of these twenty-four variables ensures that the ECU's value remains relatively stable. As a part of the EMS, however, the ECU is subject to two technical adjustments. Recompositions adjust the amount of each EMS currency in the basket and they reflect changes in the member countries' economic significance in the EC. Realignment alters the official ECU exchange rates of the EMS currencies. These rates determine the "parity grid" that governs the EMS intervention mechanisms. Neither past realignments nor recompositions have had lasting or significant effects on the ECU's value. This stability has spurred the tremendous growth in the official, private and commercial use of the ECU on the financial markets.

The ECU's stability could solve the two main foreign exchange related problems in developing countries: low foreign currency reserves and foreign exchange losses as result of volatile foreign currency exchange rates. This article suggests two solutions. Developing countries should first attempt to

3. The ECU's name is, of course, derived from the initials of "European Currency Unit." In addition, it also has more historical connotations as the namesake of a widely circulated gold coin introduced by King Louis IX of France in the Thirteenth Century.

4. The European Economic Community (EEC), the European Atomic Energy Community (EURATOM) and the European Coal and Steel Community (ECSC) together form the European Communities [hereinafter EC].

5. Conclusions of the Madrid European Council of June 26-27, 1989, Doc/89/1,6 (June 27, 1989).

6. *Report on Economic and Monetary Union in the European Community*, Committee for the Study of Economic and Monetary Union, (Brussels Apr. 12, 1989).

7. The Spanish peseta and the Portuguese escudo were included in the European Currency Unit [hereinafter ECU] basket as the eleventh and twelfth currencies on September 21, 1989. Decision of the Monetary Committee, *reprinted in Press Communiqué of the Council of EC-Finance Ministers 1* (June 19, 1989).

open their economies to more foreign sources. Such an opening often requires that additional foreign currencies will be permitted because the number of foreign currencies usable in such nations is frequently limited. More importantly, presently used currencies for international transactions should be substituted with the ECU, thus diminishing exchange rate losses and conversion costs.

Part II of this article discusses the foreign exchange situation of the People's Republic of China (PRC) as an example for such difficulties. Chinese problems concerning foreign exchange are predominately related to the extreme fluctuations of the dollar, mark and yen in recent years. These problems, combined with the instability of the domestic currency, the renminbi, have already fueled inflation. Continuing shortages of foreign currencies exert additional strains on the Chinese economy. A major obstacle to the proposed solutions is the traditional limitation of foreign currencies to U.S. and Hong Kong dollars, German marks, Japanese yen, and British pounds in Chinese foreign exchange regulations.

Recent developments in the PRC indicate, however, a trend toward the admission of a greater number of currencies. This trend and higher interest rates for foreign currency deposits with the Bank of China (BOC) have already increased the foreign exchange reserves. In addition, efforts to liberalize the banking business in the PRC signify a willingness of the Chinese government to solve its foreign exchange problems. This article analyzes the possible effects on the PRC of accepting additional foreign currencies, particularly the ECU.

I.

THE STABILITY OF THE EUROPEAN CURRENCY UNIT

A. The ECU in the European Monetary System

The Commission EC established the EMS⁸ on March 13, 1979.⁹ It superseded the "Currency Snake" which had been the first effort to create a European exchange rate system.¹⁰ The "Snake" linked the members' national currencies and allowed certain maximum fluctuations.¹¹ Following the collapse of the Bretton Woods monetary system¹² and the re-introduction of

8. See generally Works, *The European Currency Unit: The Increasing Significance of the European Monetary System's Currency Cocktail*, 41 BUS. LAW. 483 (1986).

9. Council Resolution (EEC), reprinted in EUR. ECON. (No. 3) 95 (July 1979) (on the establishment of the European Monetary System).

10. The Currency Snake had been established in the "Basle Agreement". 15 O.J. EUR. COMM. (No. C 38) 60 (1972).

11. See Declaration of the European Council in Brussels, art. 4, Oct. 19-21, 1972, reprinted in 10 BULL. EC (Special Issue) 6 (1972).

12. See generally T. WILLETT, *FLOATING EXCHANGE RATES AND INTERNATIONAL MONETARY REFORM* (1977).

free-floating exchange rates in the 1970's,¹³ the "Snake" malfunctioned. Great Britain, Ireland, Italy, France, Sweden, and Norway withdrew between 1972 and 1978.¹⁴ Denmark, the Federal Republic of Germany, Belgium, the Netherlands, and Luxembourg remained and became the initial members of the EMS.¹⁵ The goals of the EMS responded to the exchange rate related problems of the 1970's. Specifically, the EMS aims to provide a zone of monetary stability, to support closer monetary cooperation between member states, and to foster economic and monetary unity in Europe.¹⁶

The European Monetary Cooperation Fund (EMCF) manages the EMS.¹⁷ The deutsche mark, French, Belgian and Luxembourg francs, Danish kronen, Italian lira, Dutch guilder, Spanish peseta, and Irish punt participate fully in the system. The British pound, Portuguese escudo, and Greek drachma do not yet partake in the intervention mechanisms.¹⁸ The EMS essentially operates as a system of agreed upon bilateral exchange rates¹⁹ for the participating currencies. The central banks allow the currencies to fluctuate within predetermined margins around these central rates vis-à-vis the

13. The system practically ceased to exist after the United States announced the devaluation of the dollar in February 1972, following the severing of the dollar's value from the gold standard on August 15, 1971. J. MURPHY, *THE INTERNATIONAL MONETARY SYSTEM: BEYOND THE FIRST STAGE OF REFORM* (1979).

14. The following table reflects the membership changes in the "Snake" between 1972 and 1978:

June 1972	British pound, Irish punt and Danish krone leave
October 1972	Danish krone rejoins
February 1973	Italian lira leaves
March 1973	Norwegian krone and Swedish krona join as associate members
January 1974	French franc leaves
July 1975	French franc rejoins
March 1976	French franc leaves
August 1977	Swedish krona leaves
December 1978	Norwegian krone leaves

Source: EUROPEAN ECONOMY (No. 3) 82 (1979).

15. See *supra* note 8.

16. See *supra* note 8.

17. The European Monetary Cooperation Fund [hereinafter EMCF] was founded in 1973. *Council Regulation (EEC) No. 907/73*, 16 O.J. EUR. COMM. (No. L 89) 2 (1973). It is to be superseded by the European Monetary Fund which will act as a "European Federal Reserve Bank." See *Resolution of the European Council Art. 1.4 reprinted in* 12 BULL. EC 10 (1978).

18. Whether the drachma and pound should join the EMS mechanisms has been the subject of many discussions. The final decision is entirely in the hands of the Greek and British governments. *Written Question No. 2484/87*, 31 O.J. EUR. COMM. (No. C 140/38) 24 (1988). The Council has not received any proposal to remove the pound from the basket. *Written Question No. 2146/86*, 30 O.J. EUR. COMM. (No.1/177) (1987) (decision to have the pound participate in the EMS mechanisms is first a matter for the British authorities); *Question No. 90*, EUR. PARL. DOC. (COM No. 2-347/125) (Jan. 21, 1987); *Question No. 61*, EUR. PARL. DOC. (COM No. 2-333/204) (Nov. 12, 1985); *Question No. 92*, EUR. PARL. DOC. (COM No. 2-329/211) (Nov. 9, 1987); See generally EUR. PARL. DOC. (COM No. 2-351/139) (Aug. 4, 1987) (debates of the European Parliament); *Written Question No. 2116/82*, 26 O.J. EUR. COMM. (No. C 118/29) 29 (1983).

19. See *infra* note 22 and accompanying text. The following central rates have been valid since June 19, 1989:

other currencies in the parity grid.²⁰ Whenever the limits of those margins are reached, the central banks are required to intervene and to reestablish rates within the margins.²¹

Four main characteristics contribute to the EMS's proper functioning: (1) obligatory and mandatory exchange rate and intervention mechanisms; (2) financing and credit mechanisms; (3) measures to support less prosperous economies; and (4) the ECU.²²

Mandatory measures are based on the divergence "threshold" as calculated with the divergence "indicator".²³ The divergence indicator determines the relative position of a currency within the fluctuation margins. The currencies may fluctuate around their bilateral rates²⁴ within margins of plus and minus 2.25% (plus and minus 6% for the Italian lira and the Spanish peseta). In theory, a divergence of 100% would equal the maximum limits of 2.25% or 6%.²⁵ The "divergence threshold" is set at 75% of each currency's

0.739615	Pound for one ECU (notional)
7.85212	Kronen for one ECU
6.90403	French franc for one ECU
150.792	Drachma for one ECU (notional)
0.768411	Punt for one ECU
1483.58	Lira for one ECU
2.31943	Guilder for one ECU
2.05853	Deutsche mark for one ECU
42.4584	Belgian franc for one ECU
42.4584	Luxembourg franc for one ECU
133.804	Spanish peseta for one ECU

Source: Communiqué by the Commission of the European Communities No. 10 (89) 469, Luxembourg/Brussels, (June 19, 1989).

The parity grid is obtained by dividing the above fixed rates by each other. Thus, 42.4584 Belgian franc per ECU divided by 2.31943 Dutch guilder per ECU equal a central exchange rate of 18.3054 franc per 1 guilder. Or, in the reverse, 0.0546286 guilder per 1 franc. Margins of up to 2.25% (6% for lira and peseta) are set around these central parities.

20. This grid is used for the EMS intervention mechanisms. For example, 18.3054 Belgian franc per 1 guilder is the central, "perfect" rate. The currencies may move between 17.8985 and 18.7215.

21. *Agreement between the Central Banks of the Member States of the European Community*, art. 2, reprinted in EUR. ECON. (No. 3) 102 (July 1979) (operating procedures for the EMS).

22. Resolution of the European Council of the Establishment of the European Monetary System, reprinted in EUR. ECON. (No. 3) 95-97 (1979).

23. The necessity for the divergence indicator was questioned in the initial stages of the EMS. *Written Question No. 323/83*, 26 O.J. EUR. COMM. (No. C 219) 17 (1983) (Parliamentary question to the EC Commission).

24. See Table 1, *supra* p. 10.

25. In practice, however, this is not true. The individual currency for which the indicator is calculated cannot appreciate or depreciate against itself. Its value will always remain stable against itself thus influencing the final percentage of actual maximum appreciation or depreciation. As a result of the different weights of each currency in the basket (see Table 2, *infra* p. 14) the actual maximum will be smaller than the maximum intervention limit and it will vary among the currencies. The formula used for this determination is: (1 — official weight) X 2.25 for normal currencies and (1 — official weight) X 6.00 for the peseta and the lira. See STATISTISCHE BEIHEFTE, *supra* note 2, at 78.

TABLE 1
 PARITY GRID WITH INTERVENTION POINTS
 (exclusive pound and drachma; Belgian franc includes Luxembourg franc)

		B/LxFranc	Kronen	DMark	Peseta	FFranc	Punt	Lira	Guilder
100 BFranc	+2.25% central rate	100	18,9143	4,959	334,619	16,6310	1,8510	3710.2	5,5870
LxFranc	-2.25%		18,4938	4,84837	315,143	16,2608	1,80981	3494.21	5,46286
100 Kronen	+2.25% central rate	553.0	100	26,810	1809,4	89,925	10,0087	20062.0	30,21
	-2.25%	540,723		26,2162	1704,05	87,9257	9,78604	18894.0	29,5389
100 DMark	+2.25% central rate	2016,55	390,16	100	6901,7	343,05	38,1825	76540.0	115,235
	-2.25%	2016,55	381,443		6500,00	335,386	37,3281	72069.9	112,673
100 Peseta	+6% central rate	33,6930	6,23100	1,63300	100	5,47850	0,609772	1177,30	1,84050
	-6%	31,7316	5,86837	1,53847		5,15981	0,574281	1108,77	1,73345
100 FFranc	+2.25% central rate	628,97	116,32	30,495	2057,8	100	11,3830	22817.0	34,36
	-2.25%	614,977	113,732	29,8164	1938,06		11,1299	21488.6	33,5953
1 Punt	+2.25% central rate	54,025	111,20	29,150	1825,3		10,8825	20238.0	32,8475
	-2.25%	56,5115	10,4511	2,740	184,892	9,1890	1	2050,03	3,0870
1000 Lira	+6% central rate	30,387	5,620	1,4735	95,76	4,9410	0,549952	1930,71	3,01848
	-6%	28,6187	5,29268	1,39754	90,1899	4,65362	0,517943	1818,34	2,9510
100 Guilder	+2.25% central rate	1872,15	346,24	90,770	6125,3	4,3830	0,487799	1000	1,660
	-2.25%	1830,54	338,537	88,7526	5768,83	4,3065	0,487799	67912.0	1,56340
1 ECU	central rate	1789,85	331,02	86,780	5433,1	304,44	33,8868	63963.1	1,4725
		42,4582	7,85212	2,05853	133,804	297,661	32,3939	60241.0	100
						291,04		1483,58	2,31943

Source: Communiqué by the Ministers and Central Bank Governors of the E.C. Member States 2 (June 16, 1989).

maximum divergence.²⁶ Crossing the thresholds creates a presumption, although not an outright duty,²⁷ for the central banks to intervene.²⁸ The central banks must, however, engage in obligatory intervention measures when the 100% divergence threshold is crossed.²⁹

Certain financing and credit mechanisms are the second feature of the EMS.³⁰ "Very Short-Term Financing" assists the EMS members in maintaining the fluctuation margins for their respective currencies. "Short-Term Monetary Support" is a system of mutual debtor and creditor quotas allotted to the central banks. They are used to finance temporary deficits in the balance of payments of the member nations. "Medium-Term Financial Assistance" in ECU denomination will be granted to members with enduring difficulties in their balance of payments.³¹

Measures to support less prosperous member economies consist of three percent interest rate subsidies. These subsidies are granted for loans made by the European Investment Bank (EIB) or under the New Community Instrument for the financing of infrastructural projects.³²

The ECU is the last and most important feature of the EMS.³³ It is a monetary unit of account created as a basket currency of the involved twelve member currencies.³⁴ ECUs are created by deposits of gold and dollar

Divergence Spreads and Divergence Thresholds (September 21, 1989)

Currency	Official Weight 09/21/89	Maximum Divergence in %	Threshold 75%
DMark	30.1%	+/-1.57257	+/-1.1795625
BPound	13.0%	+/-1.9575	+/-1.468125
FFranc	19.0%	+/-1.8225	+/-1.366875
Lira	10.15%	+/-5.391	+/-4.04325
Guilder	9.4%	+/-2.0385	+/-1.528875
BFranc	7.6%	+/-2.079	+/-1.55925
LxFranc	0.3%	+/-2.24325	+/-1.6824375
Krone	2.45%	+/-2.194875	+/-1.6461562
Punt	1.1%	+/-2.22525	+/-1.6689375
Drachma	0.8%	+/-2.232	+/-1.674
SPeseta	5.2%	+/-5.688	+/-4.266
PEscudo	(not participating)		

26. Bremen Resolution, reprinted in EUR. ECON. (No. 3) 93 (1979).

27. *Id.*

28. Such measures include outright intervention in the form of buying or selling the currencies involved, or changes in domestic monetary policy, other policy measures, and possible changes in the central rates. *Id.*

29. *Id.*

30. *Conclusions of the Presidency Art. 4*, reprinted in 12 BULL. EC 11 (1978).

31. Article 108 of the Council Regulation, founding the European Economic Community, contemplated medium term financial assistance. Council Regulation, March 25, 1957, art. 108, 298 U.N.T.S. 11. The medium-term financial assistance and the Community loan mechanisms have been merged into a single facility for medium-term financial support. 31 O.J. EUR. COMM. (No. L 178) 1 (1988).

32. Brussels Resolution, *supra* note 22, sec. B, art. 3.

33. The ECU is the "centre of the EMS." Council Regulation (EEC), Section 2.1 (Dec. 5, 1978).

34. See Table 2, *infra* p. 14.

reserves of the central banks with the EMCF.³⁵ The ECU serves a number of official functions in the EMS. First, it is a common denominator for the exchange rate and intervention mechanisms. Second, it is the basis for the "divergence indicator."³⁶ Finally, it is used as a denominator in the EMS credit mechanisms, as a reserve instrument, and as a means of settlement for the EC institutions.³⁷

B. The Composition of the ECU

The ECU's most important characteristic is its exchange rate stability. This stability derives predominately from its composition. The creators of the EMS faced a major problem in the existence of individual currencies in the member nations. They required a common denominator in the form of a "basket of currencies."³⁸ The earlier European Unit of Account (EUA), composed of certain currency amounts, had already been established on such a basis.³⁹ Its definition was retained and its name changed to European Currency Unit.⁴⁰ The amounts of each currency in the "basket" are fixed per agreement in accordance with the individual countries' economic importance. These amounts may change every five years.⁴¹

Nevertheless, this composition does not provide the actual value of one ECU. It merely represents how much of each currency is included in the basket. To use the ECU as an independent currency, some value must be assigned to it.⁴² The ECU is first expressed in dollars⁴³ by multiplying the amounts of each currency with their respective dollar exchange rate. The EC

35. Council Regulation (EEC) No. 3181/78, Art. 1, 21 O.J. EUR. COMM. (No. L 379) 2 (1978) (although the broad term "monetary reserves" is used, the EMCF accepts only twenty percent of the member banks' gold and dollar reserves).

36. See *supra* notes 23-26.

37. Conclusions of the Presidency Art. 2, reprinted in 12 BULL. EC 10 (1978).

38. The ECU is defined as the sum of certain amounts of the currencies of the EMS member states. Council Regulation (EEC), art. 1, No. 3180/78, 21 O.J. EUR. COMM. (No. L 379) 1 (1978).

39. The European Unit of Account [hereinafter EUA] was created in 1973 as part of the EMCF. Its value equalled 0.88867088 grams of fine gold. Regulation (EEC) No. 907/73 of the Council, 16 O.J. EUR. COMM. (No. L 89) 2 (1973). It was later changed into a basket currency. See Commission, 19 O.J. EUR. COMM. (No. C 21) 4 (1976).

40. Effective January 1, 1978, the operations of the EMCF have been expressed in terms of ECU. Council Regulation (EEC), art. 1, No. 3180/78, 21 O.J. EUR. COMM. (No. L 379) 1 (1978). As one important addition to the EUA, the ECU includes a "Revision Clause" permitting the recomposition of the basket. *Id.* art. 2.

41. *Id.*

42. The dollar, for example, has such independent value. The value of one dollar is one dollar. The value of one ECU, on the other hand, is technically the sum of 0.08784 British pound, 0.1976 Danish kronen, 1.332 French franc, 1.440 Greek drachma, 0.008552 Irish punt, 151.8 Italian lira, 0.2198 Dutch guilder, 0.6242 Deutsche mark, 3.301 Belgian franc, 0.130 Luxembourg franc, 6.885 Spanish peseta, and 1.393 Portuguese escudo.

43. The Commission also calculates the value in French, Swiss, Belgian and Luxembourg francs, German marks, Dutch guilders, British pounds, Danish krone, Italian lira, Irish punts, Greek drachmas, Spanish pesetas, Portuguese escudos, Swedish krona, Norwegian krone, Canadian dollars, Austrian schillings, Finnish markka, Japanese yen, and Australian and New Zealand dollars. See generally Commission Information 30 O.J. EUR. COMM. (No. C 98) 1 (1987).

TABLE 2
 COMPOSITION OF ONE ECU SINCE SEPTEMBER 1989

One ECU consists of the sum of the following
 amounts of its component twelve
 currencies:

0.08784	British pound
0.1976	Danish kronen
1.332	French franc
1.440	Greek drachma
0.008552	Irish punt
151.8	Italian lira
0.2198	Dutch guilder
0.6242	Deutsche mark
3.301	Belgian franc
0.130	Luxembourg franc
6.885	Spanish peseta
1.393	Portuguese escudo

Source Commission Information (*New Composition of the ECU*), 32 O.J. EUR. Co. (No. C 241) 1 (1989).

Commission so determines the *official rate*⁴⁴ of the ECU in Brussels daily at 2:30 p.m.⁴⁵ This rate is used in the EMS, for official transactions and as a definition of the private and commercial ECU.⁴⁶ This article will use the exchange rates of September 22, 1989, unless otherwise specified.

TABLE 3
 EXCHANGE RATES OF THE COMPONENT
 CURRENCIES
 (September 22, 1989)

One British pound costs	\$1.5800
One Danish krone costs	\$0.1322
One French franc costs	\$0.1521
One Greek drachma costs	\$0.005931
One Irish punt costs	\$1.3710

44. *Id.*

45. The twelve central banks communicate the representative exchange rates for their currencies against the dollar (*see* Table 3, *infra* p. 16) through the National Bank of Belgium to the EC Commission. The rates represent the actual conditions on the exchange markets at 2:30 p.m. If no such rate can be fixed, an agreed substitute will be determined. In the case of the Belgian and Luxembourg francs, which operate under a two-tier exchange system with 'financial' and 'commercial' rates, the latter are used. Communication on the Calculation of the Equivalents of the ECU, 27 O.J. EUR. COMM. (No. C 247) 1 (1985).

46. The official rate only reflects the value of the ECU at a certain, arbitrarily chosen point of time.

One Italian lira costs	\$0.000714
One Dutch guilder costs	\$0.4562
One German mark costs	\$0.5145
One Belgium franc costs	\$0.0246
One Luxembourg franc costs	\$0.0246
One Spanish peseta costs	\$0.008234
One Portuguese escudo costs	\$0.006150

Source: Washington Post, Sept. 22, 1989, at D14.

To find the dollar value of each currency amount in one ECU for September 22, 1989, the respective exchange rates in Table Two must be multiplied with the corresponding rates in Table Three. One pound, for example, costs \$1.5800. The amount of the pound in the ECU, 0.08784 pound, only costs \$0.13879. The individual dollar values are added to determine the ECU's value.

TABLE 4
DOLLAR VALUE OF EACH CURRENCY AND OF ONE ECU

	Currency Amount	x	Currency in dollars	=	Currency amount in dollars
Pound	0.08784		1.5800		\$0.13879
Krone	0.1976		0.1322		\$0.02612
FFranc	1.332		0.1521		\$0.20260
Drachma	1.440		0.005931		\$0.00854
Punt	0.008552		1.3710		\$0.01172
Lira	151.8		0.000714		\$0.10839
Guilder	0.2198		0.4562		\$0.10027
Mark	0.6242		0.4630		\$0.2890
BFranc	3.301		0.0246		\$0.08120
LxFranc	0.130		0.0246		\$0.00320
SPeseta	6.885		0.009234		\$0.05669
PEscudo	1.393		0.006150		\$0.00857
					<u>\$1.03509</u> Total = One ECU

This composition in itself fosters stability. A total of twenty-four variables influence the final value. The twelve currency amounts are fixed by the EC Commission.⁴⁷ They represent the countries' economic significance in the European Community. The twelve exchange rates depend on the supply and demand situation on the foreign exchange markets. This composition distinguishes the ECU from any other currency. Any such currency's exchange rate against the dollar, for example, depends on the supply and demand forces on the markets for such currency and the dollar. The ECU's

47. See Table 2, *supra* p. 14.

dollar exchange value, on the other hand, depends on twelve such situations in addition to the twelve different amounts. This, of course, means that the ECU's value will be much less influenced by the supply and demand forces of any *single* one of its component currencies toward the dollar. The price of the yen in dollars, for example, is determined by the supply and demand for the two currencies, which may depend upon other factors, such as political or monetary circumstances. There are no other variables. The price of the ECU, in contrast, depends on twelve similar situations and the amounts in the basket.

The greater number of variables buffers the ECU against fluctuations. Variability is limited because "stronger" and "weaker" currencies are included. A "smoothing out" of possible depreciations by appreciations thus results.⁴⁸ The ECU's exchange rate stability is the result of the somewhat modified negative correlations among the EMS currencies. Although it would be incorrect to assume, for example, that whenever the pound depreciates, the mark appreciates, it is correct to anticipate that some of the EMS currencies show opposite exchange rate fluctuations. The latter premise is based on a variety of factors. These include the number of currencies included in the basket, the traditional exchange fluctuations of the individual currencies, differing market interventions by the national authorities, the degree of speculation in the national markets, and differences in the economic performance of the individual economies. The existence of modified negative

48. Average Monthly Values of the ECU in Dollars (1986 to 1989):

Month	ECU in dollars	Percent Change
1986		
January	0.891352	
February	0.927562	+4.06
March	0.954474	+2.90
April	0.950818	-0.38
May	0.964452	+1.43
June	0.961605	-0.29
July	0.990211	+2.97
August	1.02136	+3.15
September	1.02805	+0.66
October	1.04026	+1.12
November	1.02936	-1.05
December	1.04454	+1.47
1987		
January	1.11197	+6.46
February	1.12988	+1.58
March	1.13173	+0.16
April	1.14709	+1.36
May	1.16241	+1.35
June	1.14093	-1.85
July	1.12384	-1.50
August	1.11642	-0.66
September	1.14474	+2.54
October	1.15184	+0.62
November	1.22741	+6.55
December	1.26372	+2.96

correlations is one of the major reasons for the ECU's exchange rate stability. The following theoretical examples emphasize this aspect of the ECU's stability resulting from decreased exchange rate fluctuations:

The deutsche mark accounts for approximately one third (30.09%) of the total ECU basket.⁴⁹ If the mark depreciates 10% against the dollar, an American investor who had purchased a DM100-security would lose 10% of its dollar value. Using the rates of September 22, 1989,⁵⁰ the investor would have paid \$51.45 (\$0.5145 per mark) for the DM100-investment before the depreciation. After the depreciation, the investor would only receive \$46.30 if he sold the securities and exchanged the DM100 to dollars. A loss of \$5.15, or 10%, results regardless of how the securities performed.

Had the investor bought ECU-denominated securities, the loss would be approximately of the above 10% loss because only one third of the ECU is based on the deutsche mark. Again using the September 22, 1989 rates, the investor would have paid \$106.72 for an ECU 100-security. A 10% depreciation of the mark (to \$0.4630) would result in a \$0.0322 decrease in the value

1988		
January	1.25010	-1.08
February	1.21687	-2.66
March	1.23432	+1.43
April	1.24066	+0.51
May	1.22834	-0.10
June	1.18424	-3.59
July	1.12736	-4.80
August	1.10391	-2.08
September	1.11065	+0.61
October	1.14031	+2.67
November	1.18535	+3.95
December	1.18437	-0.01
1989		
January	1.13817	-3.90
February	1.12517	-1.15
March	1.11527	-0.88
April	1.11211	-0.28

Source: Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE 56 (Feb. 1988); *ECU-SME Information*. EUROSTAT 8 (May 1989).

49. See *infra* note 63.

50. See *supra* note 46.

of the ECU (to \$1.03509)⁵¹ and a \$3.220 decrease in the value of the ECU 100-security (to \$103.51). This represents a 3.017% loss on the investment.

The above calculation will apply as long as all other currencies remain unchanged. If, for example, the pound and the French franc (combined weight of 31.98%) each simultaneously appreciated⁵² by 10% against the dollar, the value of the investment would essentially remain constant. As above, the investor would pay \$106.72 for the ECU 100-security. The mark would depreciate to \$0.4630. However, with the appreciation of the French franc to \$0.16731 and the pound to \$1.738, the resulting value of the ECU would be \$1.06923.⁵³ This difference of \$0.00199 represents a loss of only 0.18646%.

51.

	Currency Amount	Currency in dollars	Currency amount in dollars
Pound	0.08784	1.5800	\$0.3879
Krone	0.1976	0.1322	\$0.02612
FFranc	1.332	0.1521	\$0.20260
Drachma	1.440	0.005931	\$0.00854
Punt	0.00852	1.3710	\$0.01172
Lira	151.8	0.000714	\$0.10839
Guilder	0.2198	0.4562	\$0.10027
Mark	.5242	0.4630	\$0.2890
BFranc	3.301	0.0246	\$0.09320
LxFranc	0.130	0.0246	\$0.00320
SPeseto	6.885	0.008234	\$0.05669
PEscudo	1.393	0.006150	\$0.00857

\$1.03509 Total

(Dollars per ECU)

52. When currency A appreciates against currency B, less of A is needed to buy B, but more of B is needed to buy A.

53.

	Currency Amount	Currency in dollars	Currency amount in dollars
Pound	0.08784	1.738	\$0.15267
Krone	0.976	0.1322	\$0.02612
FFranc	1.32	0.16731	\$0.22286
Drachma	1.440	0.003931	\$0.00854
Punt	0.008552	1.3710	\$0.01172
Lira	158.8	0.000714	\$0.10839
Guilder	0.2198	0.4562	\$0.10027
Mark	0.6242	0.4630	\$0.2890
BFranc	3.301	0.0246	\$0.08120
LxFranc	0.30	0.0246	\$0.00320
SPeseta	6.885	0.008234	\$0.05669
Pescudo	1.393	0.006150	\$0.00857

\$1.06923 Total
(Dollars per ECU)

ECU investments could, of course, lose 10% or more of their value if all the currencies depreciated 10% against the dollar. The twelve currencies have not, however, shown such concerted behavior in the past.⁵⁴

Theoretically, changes could also occur as result of readjustment in the currency amounts, as when a "recomposition" alters the relative weights of the currencies.⁵⁵ In practice, such changes cannot occur; recompositions, by definition,⁵⁶ cannot change the external dollar value of the ECU.⁵⁷

In addition to the stability of the ECU itself, the currencies included in the EMS have experienced decreasing exchange rate variability.⁵⁸ This decreasing variability, although separate from the performance of the ECU, indicates that the EMS *per se* assists in decreasing exchange rate fluctuations.

In summary, the ECU's value depends on the values of its twenty-four component variables. This relatively large number ensures that the rate will

54. See *infra* page 30.

55. For the calculation of the currencies' weights, see *infra* note 63. The influence of a currency's appreciation or depreciation on the total value would also shift in the case of a recomposition. The relative weight of the currency is multiplied by the percentage of the appreciation or depreciation. If the deutsche mark had a weight of 20% a depreciation of 10% would lower the ECU's value by 2% (20% of the 10% depreciation). If it had a weight of 50%, the value would decrease by 5% (i.e., 50% of the 10% depreciation).

56. Council Resolution, *supra* note 9.

57. Recompositions are based on changes in the percentage weight of each currency. Thus, although a currency's individual weight can change, the total basket will remain at 100%. This fact makes it easy to change the weights without disturbing the value of the ECU. See Brussels Resolution, *supra* note 22, art. 2.3. For example, the 1984 Recomposition did not alter the ECU's value on the foreign exchange markets. See *infra* note 59 and accompanying text.

58. Between 1979 and 1983, for example, the average fluctuations from one month to the next in the nominal exchange rates of the other EMS currencies against the mark (taken as the standard reference currency) ranged from 0.5% to 0.8%. The average changes of the three major floating currencies, the dollar, the yen and the pound, were, however, three times as great (between 2.4% and 2.7%).

In addition, the average changes of the French franc and the lira (which floated freely before joining the EMS) against the deutsche mark were reduced by more than half after 1979, as compared to the period 1974-1978. The average change of the French franc fell from 1.7% to 0.8%, and that of the lira, from 2.2% to 0.8%.

Effective Exchange Rate Variability

Currency	1974-											
	1974	1975	1976	1977	1978	1978	1979	1980	1981	1982	1983	1979-1983
BFranc/LxFranc	1.5	1.0	1.5	1.0	1.7	1.3	1.0	1.0	1.4	1.8	0.9	1.2
DMark	2.1	1.4	1.9	1.3	2.2	1.8	1.3	1.5	1.9	1.4	1.2	1.5
FFranc	2.4	1.5	2.0	1.0	2.1	1.8	1.2	1.5	1.9	1.7	1.3	1.5
Lira	1.9	1.3	3.8	1.1	1.9	2.0	1.3	1.5	2.0	1.6	1.1	1.5
Guilder	1.8	1.2	1.6	1.1	1.8	1.5	1.1	1.2	1.6	1.3	1.0	1.2
U.S.\$	2.0	1.8	1.5	1.3	2.9	1.9	2.0	2.4	2.9	2.6	1.5	2.3
Yen	2.1	1.5	1.4	1.8	3.5	2.1	2.6	3.5	3.0	3.3	1.5	2.8
Pound	1.7	2.0	2.8	1.3	2.5	2.1	2.4	2.4	3.2	2.0	2.3	2.5

Source: *Written Question No. 388/84*, 27 O.J. EUR. COMM. (No. C 243) 10, 11 (1984) (progress in monetary cooperation within the Community after five years operation of the EMS).

The effective exchange rate is the average rate of exchange weighted for the composition of the global foreign trade of the country concerned.

fluctuate much more modestly than other currencies. The ECU is an extremely stable currency. Any user can, therefore, rely on the ECU without fear of great exchange rate related losses.

C. *Changes in the Composition of the ECU*

As underscored above, the composition of the ECU promotes its stability. Its dollar value can only change significantly when all or most of the twelve currencies depreciate or appreciate simultaneously against the dollar. Theoretically, fluctuations could also result from alterations in the ECU-basket or changes in the member currencies' EMS exchange rates. Within the framework of the EMS, the ECU is subject to two such technical adjustment measures: realignments and recompositions. Eleven of the former and two of the latter have occurred since 1979.⁵⁹

1. *Recompositions*

Recompositions are relative changes in the amount of each currency included in the ECU-basket.⁶⁰ They are legally based on the Brussels Resolution⁶¹ and the "Revision Clause" of Article 2 of Council Regulation 3180/78 of December 1978.⁶² The European Council has outlined five requirements with regard to recompositions: (i) the weight⁶³ of the currencies will be examined in September 1979 and every five years thereafter; (ii) the weight of a currency will be examined upon request when it has changed more than

59. Realignments occurred on September 24, 1979; November 30, 1979; March 23, 1981; October 5, 1981; February 2, 1982; June 14, 1982; March 21, 1983; July 22, 1985; April 7, 1986; August 4, 1986; and January 12, 1987. Recompositions occurred on September 17, 1984 and September 21, 1989. Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE 62 (Feb. 1989).

60. See *supra* note 40.

61. Resolution of the European Council, Dec. 7, 1978, reprinted in 12 BULL. EC 10 (1978).

62. "The Council, acting *unanimously* on a proposal from the Commission after consulting the Monetary Committee and the Board of Governors of the [European Monetary Cooperation] Fund, shall determine the *conditions* under which the composition of the ECU may be changed." Council Regulation (EEC) No. 3180/78, art. 2, 21 O.J. EUR. COMM. (No. L 379) 1 (1978) (emphasis added).

63. The actual value of one ECU in terms of each of the component currencies depends on the supply and demand situation on the foreign exchange markets. For example, one ECU is worth \$1.06724 (see *supra* p. 19) and one deutsche mark is worth \$0.5145 (see Table 3, *supra* p. 16). By dividing the ECU/dollar rate by the DM/dollar rate, one arrives at the actual value of one ECU in mark, or DM2.0743245.

twenty-five percent; (iii) revisions must be *unanimously* accepted; (iv) revisions will not modify by themselves the external value of the ECU; and (v) revisions will be made with certain economic criteria.⁶⁴

In accordance with these requirements, the following measures have been undertaken since 1979. First, the weights of the currencies were examined in September 1979, and no changes were made. The basket was again examined on September 17, 1984. All currencies, with the exception of the

	TOTAL One ECU in \$	Table 3 Currency in \$	=	Results II One ECU is worth
Pound	1.06724	1.5800		0.6754683 pound
Krone	1.06724	0.1322		8.0729198 kronen
FFranc	1.06724	0.1521		7.0166995 French franc
Drachma	1.06724	0.005931		179.94267 drachma
Punt	1.06724	1.3710		0.778439 punt
Lira	1.06724	0.000714		1494.7338 lira
Guilder	1.06724	0.4562		2.3394124 guilder
Mark	1.06724	0.5145		2.0743245 mark
BFranc	1.06724	0.0246		43.383739 Belgian franc
LxFranc	1.06724	0.0246		43.383739 Luxembourg franc
SpPeseta	1.06724	0.008234		129.61379 peseta
PEscudo	1.06724	0.006150		173.53495 escudo

The relative weights of the currencies in the basket reflect the economic strength of the countries in the EC and their share in intra-community trade. The weight is derived by dividing the amount of each currency (see Table 2, *supra* p. 14) by the actual value of the ECU in terms of that currency (Results II).

	Table 2 Amount	Results II Actual Value	=	Weight in % of the basket
Pound	0.08784	0.6754683		13.00%
Krone	0.1976	8.0729198		2.45%
FFranc	1.332	7.0166995		18.98%
Drachma	1.440	179.94267		0.80%
Punt	0.008552	0.778439		1.10%
Lira	151.800	1494.7338		10.16%
Guilder	0.2198	2.3394125		9.40%
Mark	0.6242	2.0743245		30.09%
BFranc	3.301	43.383739		7.61%
LxFranc	0.130	43.383739		0.30%
Sp Peseta	6.885	129.61379		5.31%
P Escudo	1.393	173.53495		0.80%
				100.000%

These weights can change daily as a result of two developments. First, the dollar exchange rates of the currencies (Table 2) fluctuate. Second, the amounts of the currencies may be changed in "recompositions."

64. Council Resolution, *supra* note 9, art. 2.3.

The weights of currencies in the ECU will be reexamined and if necessary revised within six months of entry into force of the system and thereafter every five years or, on request, if the weight of any currency has changed by twenty-five. Revisions have to be mutually accepted; they will, by themselves, not modify the external value of the ECU. They will be made in line with underlying economic criteria.

Id.

Luxembourg franc, were adjusted to more accurately represent *each* member's share in the Community's economy.⁶⁵ At the same time, the Greek drachma was incorporated in the basket as outlined in the Treaty of Accession.⁶⁶ In the last recomposition, on September 21, 1989, all currencies but the pound were adjusted. In addition, the Spanish peseta and the Portuguese escudo were incorporated into the basket.⁶⁷

Second, the EC Council has declined to revise the basket at the request of a member whose currency has changed more than twenty-five percent. The mark, punt, and lira have already crossed the twenty-five percent margin. Only the Italian government has requested such an extraordinary revision. It failed, however, to obtain the unanimous vote required for all changes.⁶⁸

Third, the requirement that any recomposition must not change the external value of the ECU was satisfied in the 1984 and 1989 recompositions.⁶⁹

To ensure that the new weights are determined by objective economic criteria, the Council must evaluate the following criteria for any member whose currency's share is to be changed: (1) the member's portion of the

65. The recompositions resulted in the following changes:

Currency	March 13, 1979	September 17, 1984	Percent Change	September 21, 1989	Percent Change
Belgian Franc	3.66	3.71	+1.4	3.301	-11.03
Danish Krone	0.217	0.219	+0.9	0.1976	-9.78
French Franc	1.15	1.31	+13.9	1.332	+1.68
German Mark	0.828	0.719	-13.2	0.6242	-13.18
Greek Drachma		1.15	added	1.440	+25.22
Irish Punt	0.00759	0.0087	+14.8	0.008552	-1.70
Italian Lira	109.00	140.00	+28.4	151.80	+8.43
Luxembourg Franc	0.14	0.14	no change	0.13	-7.14
Dutch Guilder	0.286	0.256	-10.5	0.2198	-14.14
British Pound	0.0885	0.0878	-0.8	0.08784	no change
Spanish Peseta	(	not a member	)	6.885	added
Portuguese Escudo	(	not a member	)	1.393	added

Source: Council Regulation (EEC) No. 3180/78, 21 O.J. EUR. COMM. (No. L 379) 1 (1978); Council Regulation (EEC) No. 2626/84, 27 O.J. EUR. COMM. (No. C 247) 1 (1984); Commission Information (New Composition of the ECU), 32 O.J. EUR. COMM. (No. C 241) 1 (1989).

66. Act of Accession of the Hellenic Republic Annex VIII, III(3), 22 O.J. EUR. COMM. (No. L 291) 9 (1979) (which provided for the inclusion of the drachma in the ECU before December 31, 1985 if, before that date, a revision of the ECU was undertaken).

67. See *supra* note 59.

68. Resolution by the European Council, *supra* note 9.

69. The following table suggests that there also were no significant changes in the monthly average value of the ECU against selected currencies:

Community's gross domestic product; (2) its share in intra-community trade; and (3) its quotas in the EMS short-term monetary support mechanism.⁷⁰

The new weights must also fall within a certain percentage range of the calculated data.⁷¹ For example, the drachma's relatively low weight of approximately one percent⁷² indicates Greece's relatively smaller proportion of the total EC economy.

The composition may also be changed on a five-year basis to include new currencies in the basket.⁷³ The Spanish peseta and Portuguese escudo were included in the ECU basket in the recomposition on September 21, 1989.⁷⁴ The peseta had already joined the Exchange Rate Mechanisms (ERM) with a six percent fluctuation margin on June 21, 1989.⁷⁵ The escudo may be added

		B/LxFranc	Deutsche Mark	Guilder	Pound	Krone
1984	January	46.0675	2.25796	2.53790	0.570643	8.17693
	February	45.9560	2.24447	2.53265	0.577004	8.18814
	March	45.6872	2.23252	2.51980	0.590668	8.17985
	April	45.6146	2.23232	2.51781	0.593993	8.20516
	May	45.5925	2.24049	2.52120	0.586579	8.20223
	June	45.5489	2.23481	2.51877	0.592492	8.19884
	July	45.3258	2.23629	2.52404	0.594974	8.17862
	August	45.2289	2.23942	2.52562	0.590902	8.16470
	September	45.1987	2.24111	2.52721	0.588981	8.12027
	October	45.1855	2.23406	2.51890	0.596911	8.07398
	November	45.0090	2.23045	2.51590	0.600636	8.05803
	December	44,8441	2.23203	2.51920	0.605887	8.00200
		French Franc	Lira	Punt	Drachma	US Dollar
1984	January	6.90343	1371.21	0.728804	82.3314	0.804401
	February	6.90731	1385.29	0.728348	84.4476	0.830503
	March	6.88044	1388.11	0.829052	87.9078	0.860041
	April	6.86710	1382.08	0.728826	88.4996	0.845384
	May	6.88304	1382.64	0.729483	88.1878	0.814622
	June	6.86808	1382.34	0.730303	88.6930	0.815858
	July	6.86370	1373.61	0.729191	88.1135	0.785575
	August	6.87400	1381.39	0.726438	89.2391	0.775908
	September	6.87730	1383.84	0.723417	89.1267	0.741608
	October	6.85135	1382.92	0.721180	91.4207	0.728342
	November	6.84268	1387.03	0.719764	91.9384	0.746118
	December	6.83782	1375.66	0.715655	91.3499	0.719644

Source: Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE 52 (Feb. 1985).

70. See Council Resolution, *supra* note 9.

71. *Id.*

72. For the calculation of the currencies' weights as of September 22, 1989, see *supra* note 63.

73. It has been noted by the European Commission that all member states have the right to include their currency in the ECU. *Accession Treaty of the Kingdom of Spain and the Portuguese Republic to the European Economic Community and to the European Atomic Energy Community — Joint Declaration on the inclusion of the peseta and the escudo in ECU*, 28 O.J. EUR. COMM. (No. L 302) 484 (1985).

74. See *supra* note 6.

75. *Id.*

to the ERM in 1992.⁷⁶ These inclusions are based upon a joint declaration to the Accession Treaty of Spain and Portugal.⁷⁷ They were not to impede the stable development of the ECU's functions and uses.⁷⁸ Similar provisions were included for the drachma.⁷⁹ These provisions ensured that the ECU basket would not have been revised to include additional currencies if there had been any possibility that such a revision might impede the functioning of the ECU.

Generally speaking, the requirements that the EC Council must unanimously adopt revisions and that the ECU's external value may not be changed ensure that recompositions have no lasting impact. The 1984 and 1989 recompositions were broadly publicized and anticipated in the financial markets. They did not disturb the dollar value of the ECU.⁸⁰ They also left the interest rates for ECU-instruments virtually unchanged.⁸¹ Furthermore, possible disruptions of the actual exchange rate would be limited to the normal five-year recomposition intervals.⁸²

2. *Realignments*

Realignments are changes in the fixed rates of the ECU in terms of each EMS currency. These fixed rates are used in the EMS to establish the bilateral parity grid.⁸³ They represent the "perfect"⁸⁴ value of one ECU in terms of EMS currencies. As of June 19, 1989, the ECU central rates are as follows:

76. See *Written Question No. 750/87*, 31 O.J. EUR. COMM. (No. C 42) 36 (1988) (Spain and Portugal will seek to join the EMS mechanisms only when macroeconomic conditions permit and only when this will not impose intolerable constraints on their economies and hence the cohesion of the EMS).

77. *Accession Treaty of the Kingdom of Spain and the Portuguese Republic to the European Economic Community and to the European Atomic Energy Community — Joint Declaration on the inclusion of the peseta and the escudo in ECU*, 28 O.J. EUR. COMM. (No. L 302) 484 (1985).

78. *Id.* (The decision to include peseta and escudo must account for the necessity of ensuring a stable development of the functions and uses of the ECU.)

79. The efforts of the Greek government to ensure that the inclusion of the drachma in the ECU will protect the smooth functioning of the ECU market were explicitly mentioned in *Council Regulation (EEC) No. 2626/84*, 27 O.J. EUR. COMM. (No. L 247) 1 (1984).

80. See *supra* note 69.

81. *The ECU*, 5 EUROPEAN DOCUMENTATION 11 (1987).

82. The twenty-five percent rule permits such changes outside the five-year framework. See *supra* note 9.

83. See Table 1, *supra* p. 10.

84. The official exchange rates of the currencies against the ECU, as set by the Commission of the EC, represent the most desirable value of the ECU in terms of each currency. The central exchange rates for the currencies against each other indicate what each currency should cost in terms of each other currency. The 2.25% and 6.0% margins set around these merely account for possible fluctuations. These fluctuations result from temporary shifts in the economic performance of the countries. Should these differences develop into a more permanent nature, the intervention limits will be reached and crossed more often. In such cases, the perfect exchange rates have become not-so-perfect and must be readjusted to the changed economic circumstances.

0.739615	British pound (notional)
7.85212	Danish kronen
6.90403	French franc
50.792	Greek drachma (notional)
0.768411	Irish punt
1483.58	Italian lira
2.31943	Dutch guilder
2.05853	Deutsche mark
42.4584	Belgian franc
42.4584	Luxembourg franc
133.804	Spanish peseta

Changes in these rates do not have a direct bearing on the value of the ECU itself. The latter only depends on the currency amounts and their dollar values. Realignments, however, are changes in the *status quo*. As such, the exchange rate behavior on the extremely sensitive markets might reflect such changes.

As a general rule, realignments become necessary as a result of differences in the inflation rates within the member countries.⁸⁵ Theoretically speaking, the values of the currencies would not depreciate or appreciate if inflation rates were the same in all countries. Therefore, as long as these rates differ, adjustments in the parity rates will be necessary.⁸⁶

85. Of course, changes in real interest rates, the balance of payments, and monetary reserves, as well as changes resulting from pure speculation and governmental intervention as in the case of the dollar, also result in differing exchange rates.

86. The inflation rate differences have significantly decreased since 1979. The average rate decreased from 8.8% in 1979 and 12.1% in 1980 to 4.36% in 1987. The discrepancy between the highest and the lowest inflation rates has also gradually become smaller.

INFLATION RATES IN THE EUROPEAN COMMUNITY

Country	1979	1980	1981	1982	1983	1984	1985	1986	1986	1988	1989*
Belgium	4.5	6.6	7.6	8.7	7.7	6.4	4.9	1.3	1.6	1.2	2.9
F.R. Germany	4.1	5.4	6.3	5.3	3.3	2.4	2.2	-0.2	0.4	1.2	2.0
Denmark	9.6	12.3	11.7	10.1	6.9	6.3	4.8	3.6	4.0	4.6	5.0
France	10.7	13.6	13.4	11.8	9.6	7.3	5.7	2.5	3.3	2.7	3.5
Greece	(	non-member	)	)	)	18.3	19.3	23.0	16.4	13.4	13.0
Ireland	13.2	18.2	20.4	17.2	10.4	8.6	5.4	3.8	3.2	2.1	3.5
Italy	14.8	21.2	17.8	16.5	14.7	10.8	9.2	5.9	4.7	5.0	6.5
Luxembourg	4.5	6.3	8.1	9.4	8.7	5.6	4.1	0.3	-0.1	1.5	N/A
Netherlands	4.3	7.0	6.7	5.7	2.7	3.2	2.2	0.2	-0.5	0.6	1.5
Portugal	(	non-member	)	)	)	)	)	11.8	9.4	9.6	6.5
Spain	(	non-member	)	)	)	)	)	8.8	5.3	4.8	6.0
U.K.	5.3	13.4	18.0	11.9	8.6	4.6	5.0	6.1	3.4	4.9	4.7
EC Average	8.8	12.1	11.5	10.4	7.6	7.4	6.0	5.66	4.26	4.40	5.0

* Estimate

Source: Eurostat, Statistical Office of the European Communities, Luxembourg 1989.

New parity rates have been upheld for between two and over thirty-five months.⁸⁷ Realignments are measures of last resort and are carried out on a need only basis. They are used only when all other efforts to limit currency fluctuations have failed.

The EMS is very effective in providing a balanced grid of bilateral exchange rates on the basis of the set ECU exchange rates of each currency. Past changes in the rates have closely reflected actual economic situations. These changes have not disturbed the value of the ECU.⁸⁸ The adjustments are proportionally small. They have ranged from minus 8.5% to plus 5.5% for currencies participating in the ERM.⁸⁹

87. *See supra* note 59.

88. *See generally* EUR. PARL. DOC. (No. 1-285) 151 (1982) (debates of the European Parliament on the effects of central parity adjustments).

89. REALIGNMENT OF EMS CURRENCIES. See Table.

REALIGNMENT OF EMS CURRENCIES

	9/24/79	11/30/79	3/23/81	10/5/81	2/22/82	6/14/82	3/21/83	5/18/83	7/22/85	4/7/86	8/4/86	1/12/87
DMark	+2.0	—	—	+5.5	—	+4.25	+5.5	-1.9	+2.0	+3.0	—	+3.0
FFranc	—	—	—	+3.0	—	-5.75	-2.5	-1.9	+2.0	-3.0	—	—
Guilder	—	—	—	+5.5	—	+4.25	+3.5	-1.9	+2.0	+3.0	—	+3.0
BFranc	—	—	—	—	-8.5	—	+1.5	-1.9	+2.0	+1.0	—	+2.0
LFranc	—	—	—	—	-8.5	—	+1.5	-1.9	+2.0	+1.0	—	—
Lira	—	—	-6.0	-5.0	—	-2.75	-2.5	-1.9	-6.0	—	—	—
DKronen	-3.0	-5.0	—	—	—	—	+2.5	-1.9	+2.0	—	—	—
IrPunt	—	—	—	—	—	—	-3.5	-1.9	+2.0	—	-8.0	—
BPound	—	—	—	—	—	—	—	+7.28	—	—	—	-7.75
Months in effect	2	16	7	4	4	9	2	26	9	4	5	35

In addition, they compensate each other⁹⁰ because not all currencies move the same direction at the same time.⁹¹ This differing behavior of the individual currencies is partly based upon modified negative correlations between the EMS currencies. Although such correlations are not guaranteed, chances are that some currencies will display opposite exchange rate behavior. Two different patterns have emerged in this respect.

First, there are cases where only a few currencies were realigned. On November 30, 1979, for example, only the kronen depreciated by five percent.⁹² All other currencies remained unchanged.

Second, there are instances in which all or almost all currencies are realigned. On March 21, 1981, for example, the Belgian and Luxembourg francs appreciated by 1.5%, the kronen by 2.5%, the guilder by 3.5%, and the mark by 5.5%.⁹³ The French franc, the punt, and the lira, on the other hand, depreciated by 2.5%, 3.5%, and 2.5%, respectively. The underlying pattern indicated is that some currencies appreciate while others depreciate. The currencies have yet to move all in one direction.⁹⁴

The nominal percentage changes in the realignments do not correspond to the actual change of each currency's parity rate. This is due to each currency's different weight⁹⁵ in the ECU basket.⁹⁶ A change in one rate automatically alters the rates for all other currencies because of the ECU's basket

90.

CHANGES IN THE ECU'S DOLLAR RATES

Realignment Date	Change in Percent
09/02/1979	0.09517
11/30/1979	0.53862
03/23/1981	-1.33502
10/05/1981	0.65586
02/22/1982	-0.17429
06/14/1982	-2.09027
03/21/1983	-1.09183
07/22/1985	0.37302
04/07/1986	+1.04539
08/04/1986	-0.09442
01/12/1987	+2.12714

Note: 04/07/1986 is based on monthly averages for March and May

Source: Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE (1979-1987).

91. See *infra* text accompanying note 93.

92. See *supra* note 89.

93. See *supra* note 89.

94. It is clear, however, that the relative majority of the currencies in the last example appreciated as a result of the different weights. See *supra* note 63.

95. See *supra* note 63.

96. See THE EUROPEAN MONETARY SYSTEM: RECENT DEVELOPMENTS (IMF Occasional Papers No. 48) 36 (1986).

composition.⁹⁷ The actual depreciations and appreciations have surpassed five percent only in a few instances.⁹⁸

97. *See supra* text accompanying note 38.

98. *Appreciations and Depreciations*, see Table.

APPRECIATIONS AND DEPRECIATIONS										
	BFr/LxFr	DKr	DM	FFr	IrL	Lira	HFI	Pound	Drachma	
09/24/79	-0.97	-3.80	+1.01	-0.97	-0.97	-0.97	-0.97	+2.70		
11/30/79	+0.14	-4.36	+0.14	+0.14	+0.14	+0.14	+0.14	+0.14		
03/23/81	-2.47	-2.47	-2.47	-2.47	-2.47	-8.32	-2.47	+19.70		
10/05/81	+0.10	+0.10	+5.61	-2.90	+0.10	-2.90	+5.61	-9.80		
02/22/82	8.81	-3.33	-0.34	-0.34	-0.34	-0.34	-0.34	-7.90		
06/14/82	-0.61	-0.61	+3.61	-6.32	-0.61	-3.34	+3.61	-0.61		
03/21/83	+1.36	+2.36	+5.36	-2.63	-3.63	-2.63	+3.36	-11.00		
05/18/83	-1.19	-1.19	-1.19	-1.19	-1.19	-1.19	-1.19	+7.28		
07/22/85	+0.15	+0.15	+0.15	+0.15	+0.15	-7.70	+0.15	+5.52		
04/07/86	+2.65	+2.65	+4.68	-1.42	+1.63	+1.63	+4.68	-11.90		-13.14
08/04/86	+1.30	+1.30	+1.30	+1.30	-6.80	+1.30	+1.30	-7.20		-25.70
01/12/87	+1.54	-0.45	+2.54	-0.45	-0.45	-0.45	+2.54	-8.16		-9.11

Note: Boldface numbers indicate changes over five percent

Source: Deutsche Bundesbank, 5 STATISTISCHE BEIHEFTE 56-57 (Aug. 1987)

The majority of these (twelve out of twenty) pertain to the pound and drachma, which do not participate in the ERM.⁹⁹ This fact lends credence to the stabilizing effects of the EMS on the member currencies.

To summarize, past technical changes have not significantly influenced the ECU's overall value. Resulting from the general procedure surrounding recompositions and realignments, similar stability can be expected in the future.

D. *The Use of the ECU*

With regard to being a "real" currency, the ECU has a special status. There are to date no ECU-denominated banknotes, and only the Bank of Belgium has issued ECU-coins, which are treated as legal tender in that country. There has also been no designation of the 1/100th part of one ECU.¹⁰⁰ Only a "semi-official" currency symbol for the ECU has been established.¹⁰¹ In addition, there is no central bank that acts as issuer of ECUs or ECU "lender of last resort."¹⁰² The EC Council and the Commission have addressed these points in several regulations.¹⁰³

The ECU has, however, been accepted as full currency in many non-EMS countries. The Council regulations legally define the ECU as a currency.¹⁰⁴ The significant use of the ECU has long established its economic definition as currency.¹⁰⁵ Following the recent decision to create an EC currency¹⁰⁶ and given the fact that the ECU is the most likely contender for this position, the ECU may be granted true currency and legal tender status in the EC in the near future.

Nevertheless, problems with the acceptance of the ECU as a currency appear in the EMS countries themselves as result of its composition. The ECU is partially composed of a nation's own currency — its amount in the ECU basket — and partially of currencies foreign to that nation — the share of the other members' currencies. The question arising, of course, is to what extent a nation's regulations for foreign currencies apply to the ECU, which

99. See *supra* note 18.

100. Similar to a cent, centime or pfennig.

101. The ECU's currency symbol is made up of the '+' sign and a rounded version of the letter 'e'. *Motion for Resolution*, EUR. PARL. DOC. (No. A 2-167/87) 20 (1987) (European Parliament Session Documents, Document B 2-1661/86).

102. See generally Ballardur, *Rebuilding an International Monetary System*, Wall St. J., Feb. 23, 1988, at 1 (discussing three possible approaches toward an improved system on the basis of the EMS).

103. See generally *Progress Report on the European Monetary System and the Liberalization of Capital Markets*, Commission of the European Communities, (COM(87) 650 final) (December 17, 1987); *Report on the European Monetary System*, EUR. PARL. DOC. (No. A 2-196/85) (1986) (Working Documents of the European Parliament).

104. The ECU is a unit of account, *Council Regulation (EEC) No. 3180/78*, 21 O.J. EUR. COMM. (No. L 379) 1 (1978) and a means of payment, *Council Regulation (EEC) No. 3183/78*, 21 O.J. EUR. COMM. (No. L 379) 2 (1978).

105. See *infra* text accompanying notes 123-36.

106. See *supra* note 5.

incorporates that very nation's own legal tender. The European Commission has proposed that all EC countries unconditionally treat the ECU as a foreign currency.¹⁰⁷ Not all nations have accepted this proposal to the same extent. This has resulted in one of the most interesting aspects of the ECU: its nature as a "de-facto-currency" in some EMS nations.¹⁰⁸ Despite its increased use, it is not legal tender to any country, with the exception of the Belgian ECU coins. Denmark, Greece, Ireland, Italy, the Netherlands, and the United Kingdom grant the ECU full currency-status. Belgium, Luxembourg, and France classify it as a currency, whereas the Federal Republic of Germany only authorizes it as such.¹⁰⁹ Four EMS countries have issued formal decrees or other instruments.¹¹⁰ The others merely suggest the ECU's respective status. The World Bank, on the other hand, has taken a "wait-and-see" attitude toward the ECU after initially rejecting it.¹¹¹ The International Monetary

107. *Communication from the Commission to the Council (No. (83)/(274) Final)* (May 24, 1983) reprinted in P. COFFEY, *THE EUROPEAN MONETARY SYSTEM* 132 (1984).

108.

CLASSIFICATION OF THE ECU IN THE EMS-MEMBER STATES

Country	Classification	Classifying Instrument
Belgium/Luxembourg	Classed as currency	IBLC Rules on the ECU
Denmark	Treated as currency	Implicit recognition
F.R. Germany	Authorized as currency	Decision by Central Bank Council, June 1987
Greece	Treated as currency	<i>De Facto</i>
France	Classed as currency	Treasury Letter 15891
Ireland	Treated as currency	<i>De Facto</i>
Italy	Currency	Ministerial decree
Netherlands	Treated as currency	<i>De Facto</i>
Great Britain	Treated as currency	<i>De Facto</i>

Source: *The ECU*, EUROPEAN DOCUMENTATION 22, 42 (1987).

109. *The Notice of the Deutsche Bundesbank No. 1010/87 of June 16, 1987*, reprinted in 39 Monthly Report of the Deutsche Bundespost 37 (Aug. 1987), provides that:

... To the extent that the incurrence of money debt in foreign currency between residents has been permitted heretofore (Notice No. 1009/61), this shall also apply in future to the same degree to liabilities denominated in the European Currency Unit ECU. Accordingly, residents are hereby permitted pursuant to Section 3 of the Currency Act (Wahrungsgesetz) . . . to incur liabilities denominated in the European Currency Unit ECU

110. The countries issuing formal decrees or other instruments are:

- Belgium/Luxembourg: Official Regulations of the Belgo-Luxembourg Exchange Institute (October 1, 1983).
- F.R. Germany: Bundesbank Decision of June 1987, reprinted in Monthly Report of the Deutsche Bundesbank 37 (Aug. 1987).
- Belgium: Royal Decree No. 509, art.13, Feb. 1987, reprinted in SCAD, Dossier Bibliographique 1 'ECU 218 (1988).
- France: Letter of the Ministère de L'Economie et des Finance to the President, No. 015891 2 (May 1982).

111. See *Written Question No. 409/86 and Written Question No. 426/86*, 30 O.J. EUR. COMM. (No. C 82) 2 (1987) (The World Bank has decided to raise no further objections in the immediate future to the ECU's use in invitations to tender and payments connected with the Bank's lending operations).

Fund accepts the ECU for reserve purposes in Special Drawing Right calculations.¹¹²

In spite of this unusual legal status, the ECU is accepted as more than an abstract unit of account. In addition to its official use in the EC, the ECU has gained a dominant position in the private and commercial markets.¹¹³ The following three subsections summarize the official, private and commercial use of the ECU. Special attention will be placed upon the commercial ECU in subsection three.

1. *The Official Use of the ECU*

The ECU is used in the EMS as a common denominator, as the basis for the divergence indicator, as a reserve instrument and as a means of settlement and payment for the EC monetary institutions.¹¹⁴ The ECU's role as official reserve and payment currency has significantly expanded in recent years. It now includes the use of the ECU as denominator for all budgets and a growing number of transactions in the EC. In summary, the official use as "unit of account" includes use: (1) as a reserve currency;¹¹⁵ (2) as a means of payment and settlement;¹¹⁶ (3) in the EC budgets;¹¹⁷ (4) for statistical purposes;¹¹⁸ (5)

112. See 37 INT'L FINANCIAL STATS. 7 (Jan. 1984).

113. See generally Report on the wider use of the ECU and the simplification of payment transactions within the Community, EUR. PARL. DOC. (No. A 2-167/87) (1987) (Session Documents of the European Parliament).

114. Art. 2 Council Regulation (EEC) No. 3183/78, 21 O.J. EUR. COMM. (No. L 379) 2 (1978) (The EMCF and the monetary authorities in the member states are empowered to use ECU as means of settlement and for transactions between those authorities and the fund).

115. The use of the ECU as a reserve currency was one of the explicit goals in its establishment by the EC Council. See *supra* note 9. The EMS members must deposit twenty percent of their reserves of gold and dollars with the EMCF which, in turn, credits the member central banks with the corresponding amount of ECU. Council Regulation (EEC) No. 3181/78, art. 1, 21 O.J. EUR. COMM. (No. L 379) 2 (1978). Initially, the use of the ECU was limited to the member central banks. Since 1985, however, non-community countries and international institutions may use ECU as "other holders". Council Regulation (EEC) No. 2626/84, 27 O.J. EUR. COMM. (No. L 247) 1 (1984).

116. The ECU is used as a means of payment and settlement between the EC-institutions, especially under the very-short term financing mechanisms of the EMS. Furthermore, the credit granted under the short-term monetary support programs are denominated in ECU when initial grants are prolonged. ECU-denomination is exclusively used in the medium-term financial assistance program. See *supra* note 31.

117. The ECU is the official unit of account and denomination for all EC budgets. This includes the general EC budget as well as the budgets of the individual institutions. Other uses include the ECU-denomination of grants and loans, fines for infringements of EC provisions and payments for services rendered to the EC by private or corporate specialists.

118. The increasing use of the ECU for statistical purposes by the Statistical Office of the EC since 1987 now allows the creation of directly comparable statistics.

in the common agricultural policy;¹¹⁹ (6) by the EIB;¹²⁰ and (7) in the European Development Fund.¹²¹ These official functions were the only ones contemplated in 1979. Unexpectedly, private and commercial use have surpassed these functions in volume and significance.¹²²

2. *The Private Use of the ECU*

The development of the private ECU market has taken place entirely within the banking system.¹²³ In spite of the ECU's unusual character as a currency, a great array of private investment and financial instruments is available in ECUs world-wide.¹²⁴

119. Common agricultural prices are fixed in ECU and subsequently converted into the national currencies. To avoid possible fluctuations of their exchange rates against the ECU, so called "green-rates" are used for the conversion. These rules, however, will be abolished in the near future.

120. The European Investment Bank [hereinafter EIB] denominates about eight percent of its long-term liabilities, nine percent of the outstanding loans made available, and an increasing amount of its cash funds, usually money-market papers, in ECU. The EIB serves as the financing institution for the EC and as agent for certain projects financed by the EC or the European Development Fund [hereinafter EDF] under the New Community Instrument [hereinafter NCI] or the Lomé III Convention. *See generally* European Investment Bank, Annual Report (1987).

121. The EDF utilizes the ECU in denominating the reserves it receives from the member states, as well as expenditures for certain projects in over sixty-six African, Caribbean, and Pacific countries. The EDF was created under the Lomé I Convention in 1975. It is renegotiated every five years. The total value of ECU used has been set by the most recent Lomé III Convention at ECU 8,500 million. Lomé III Convention, Dec. 8, 1984, art. 194, *reprinted in* 24 ILM 574, 621 (1985).

122. In 1987, the value of the ECU market as a whole was estimated at close to ECU 100 billion (\$113 billion). *Report on the Wider Use of the ECU*, EUR. PARL. DOC. (No. A 2-167/87) 9 (1987) (European Parliament Session Document).

123. *See generally* *Written Question No. 51/82*, 26 O.J. EUR. COMM. (No. C 167) 16 (1982). The private ECU market became possible with the opening of ECU accounts by certain Belgian banks for the EC institutions. These accounts facilitated cash management and transfers to the EIB. The EIB, in turn, deposited received but unused ECU-assets with Italian banks. An ECU-denominated loan and foreign exchange market was thus created. Following the deposits, some banks granted credits and accepted deposits in ECU from a limited number of private customers. These deposits, credits, and the establishment of an ECU-clearing system have increased the number of private participants and the variety of banking services in ECU. The development from a one-way deposit to a two-way short term deposit and loan market took place entirely within the banking system. There is no central supervising authority on a governmental or institutional level.

124. *See generally* *ECU — The Market Approaches Critical Mass*, EUROMONEY 67 (Jan. 1989).

ECU-denominated bonds¹²⁵ are one example.¹²⁶ A total of over ECU 51,271 million was issued as of March 1989,¹²⁷ 9,699 million of which were issued in 1988 alone. The bond-market profits in particular from swap-transactions, in which two parties gain from each other's relative advantage in different markets.¹²⁸ In October 1987, the EC Commission introduced ECU *Schuldscheine*, a typical German form of investment.¹²⁹ A similar acceptance of the public debt market, on the other hand, has been delayed by the lack of liquidity in maturities between one and five years — representing the end of the interbank and the beginning of the bond markets. The gap is being filled by the issues of treasury instruments. The Italian government issued approximately ECU 7,250 million in treasury bonds and ECU 8,250 million in treasury notes between March 1988 and March 1989. The British government issued a total of ECU 2,400 million in treasury bills in the first quarter of 1989.¹³⁰

The amount of ECU-loans granted to private parties within the EC increased similarly to ECU 5,091 million in 1987 and over ECU 4,078 million in 1988. A total of over ECU 17,972 million were issued within the EC until March 1989.

The United States leads the trade in ECU-futures and options.¹³¹ Over \$5.5 billion have been traded since January 1987.

125. Several types of ECU-bonds are currently available: **FIXED RATE BONDS** with average maturities between 3 and 15 years and comparable interest rates. They account for about 88 percent of the total market. **ADJUSTABLE RATE BONDS** with interest adjustments every three to six years at the investor's or issuer's option or per bilateral agreement. **ZERO COUPON BONDS** with fixed interest payments at the end of the maturity. **FLOATING RATE NOTES**, issued mainly by state-guaranteed banks and sovereign states, with interest rate adjustments every three to six months to reflect market movements. **PARTLY PAID BONDS** and **SAINT GOBAIN TITRES PARTICIPATIFS** — portions of the latter's yield are linked to the issuer's profit. **CONVERTIBLE BONDS** permit the conversion into bonds or shares. They are well suited to countervail foreign exchange risks. **CUM WARRANT ISSUES** entitle the holder to purchase additional bonds ("DEBT WARRANTS") or the issuer's shares ("EQUITY WARRANTS"). The latest novelty on the market are **ECU-TREASURY BONDS** by the Italian and British governments. See generally *Survey: The Primary ECU Bond Market*, 22 *ECU NEWSLETTER* 15 (Oct. 1987).

126. The ECU now accounts for 2.5% of international bank lending and 4% of all international bond issues. *ECU — The Market Approaches Critical Mass*, *supra* note 124.

127. Investors with high national interest rates benefit from the relatively low borrowing costs of ECU-bonds, whereas investors with low national rates obtain higher interest revenue. The attractiveness of ECU-bonds is enhanced by the increasing liquidity on the secondary market. All bonds are listed and traded on some stock exchange. Most business takes place via telecommunication between the leading international market makers. See generally *Survey: The Primary ECU Bond Market*, *supra* note 125, at 15.

128. See *Swap-Driven ECU Bond Issues*, 24 *ECU NEWSLETTER* 9 (April 1988).

129. *Schuldscheine* are loans made against borrower's notes. See *MACMILLAN DIRECTORY OF INTERNATIONAL FINANCE* 177 (1985).

130. *ECU Futures and Options*, 24 *ECU NEWSLETTER* (No. 28) 6 (April 1989).

131. Following the first ECU/US\$-option on the European Options Exchange in Amsterdam in 1985, similar contracts were admitted at the FINEX in New York, the Chicago Mercantile Exchange (CME) and the Philadelphia Board of Trade. Significant trade developed only at the FINEX, where a daily average of 147 contracts, totalling 37,263 contracts of ECU 100,000, was traded in 1987. In 1988, 18,844 contracts changed hands until June. Future contracts in ECU/US\$ and ECU/Yen will be available at the *Marché à Terme des Instruments Financiers*

Approximately 10 billion ECUs are exchanged daily on the European foreign exchange markets.¹³²

Large commercial banks in Europe and the United States have established about forty-five ECU-denominated investment funds during the last few years. They are composed of bonds, money market and other financial instruments denominated in ECU. Such investment approached ECU 2,000 million by mid-1989.¹³³ In addition, ECU are available as traveller's checks,¹³⁴ credit cards,¹³⁵ and checking, time and savings accounts,¹³⁶ including certificates of deposit.¹³⁷ ECU-coins minted in Belgium have a special status on the private markets because they are legal tender in the Kingdom of Belgium.

3. *The Commercial Use of the ECU*

The commercial use of the ECU by businesses and industries for payments,¹³⁸ invoicing, and accounting has grown significantly in recent years. The premier example of this increase is the French Saint-Gobain conglomerate with approximately 105 subsidiaries which has used the ECU for accounting, transfers, and payments since 1980.¹³⁹ The International Air Transportation Association denominates transactions between twenty-four African and European airlines in ECUs. The volume is estimated at about \$14,400 million.¹⁴⁰ Other users include Eutelsat, Lesieur, Synthelabo, Gaz de France,¹⁴¹ and Black & Decker.¹⁴²

(MATIF) in Paris. Negotiations are held between MATIF, CME and SIMEX in Singapore to ensure 24-hour trading possibilities. The London International Financial Futures Exchange (LIFFE) pursues similar plans. See *How Futures and Options Provide Flexibility In Hedging ECU Price Risks*, 23 ECU NEWSLETTER 14 (Jan. 1988); *ECU Futures and Options*, *supra* note 130, at 11.

132. See generally *Report on the Wider Use of the ECU*, EUR. PARL. DOC. (No. A 2-167/87) 10 (1987) (Session Documents).

133. *ECU Money Markets*, 28 ECU NEWSLETTER (No. 25) 37 (Apr. 1989).

134. Thomas Cook, in cooperation with Euro Travellers Cheque International (United Kingdom) and Société de Chèque de Voyage en ECU with American Express (France), offered the first ECU-denominated traveler's checks. See *ECUs for Travellers*, THE BANKER 63 (Aug. 1984).

135. *ECU Money Markets*, *supra* note 133, at 11.

136. See *Written Question No. 2128/83*, 27 O.J. EUR. COMM. (No. C 177) 10 (1984) (question to the EC Commission) (general discussion of private accounts in ECU in the member states of the EC); *Motion for a Resolution on the creation of a European Savings Account in ECU*; EUR. PARL. DOC. (No. 1-425/83) (1983) (Working Documents of the European Parliament).

137. See, e.g., *ECU Money Markets*, *supra* note 133.

138. See *supra* note 122.

139. *Saint Gobain shows strength of the ECU*, Fin. Times, Dec. 3, 1984, at II-1, col. 1; *Growing Popularity*, THE BANKER 62 (Dec. 1984).

140. *The ECU Takes Wing*, 4 TARGET 1992 2 (July 1988).

141. See *Wall St. J.*, Feb. 28, 1985, at 33, col. 3.

142. In order to promote the commercial use of the ECU, the ECU Banking Association [hereinafter EBA] published the following list of possible ECU-applications:

- ECU-denominated shares
- cash management system in ECU
- increased invoicing in ECU

There are significant advantages of the commercial ECU for multinational and import and export businesses. First, the ECU is used in internal invoicing systems by companies with subsidiaries in European countries. It can simplify the maintenance of a "scale of charges" for transactions between the branches or the branches and the parent. It would be unnecessary, for example, to denominate the prices and charges in the individual currencies of the country in which the branches or the parent are located. Every transaction, price or charge, will simply be in ECU. There will be no conversion costs as there is no need for currency conversions. As a result of the relative stability of the ECU, the ECU-denominated scales are not subject to frequent adjustments. The prices, once they are set for each country, need not be changed because the underlying value of the ECU does not change. Were they based on national currencies, revisions would be necessary with every appreciation and depreciation of the currencies against each other. St. Gobain bases its ECU-invoicing system on yearly revisions.¹⁴³ The stability of the ECU also improves financial management because there is greater certainty regarding the value of future expenditures and receipts.

In addition, more companies use ECU in dealing with their outside customers. Such external invoicing systems put trading partners on a more equal footing. The ECU is a foreign currency for both parties.¹⁴⁴ Its use is neutral and does not prefer any party's national currency. Exchange risks are in the hands of the individual parties. They have to find ways to exchange their currencies into the ECU. The underlying transaction, however, is independently denominated in ECU and its value is secured by the ECU's stability.

Export financing is generally cheaper in ECU than in other "hard" currencies. This result has increased the ECU's share in the foreign trade between Italy, France, the United States, the Federal Republic of Germany, Sweden, the USSR, and other Comecon countries.¹⁴⁵ The ECU is, for example, included under the export credit agreement currencies of the Organization for Economic Co-Operation and Development (OECD).¹⁴⁶ Commercial

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- pricing of European products in ECU
 - the use of the ECU as coverage instrument
 - standardization of ECU exchange fees
 - ECU-quotation of primary products at European markets, including the London metal, the Amsterdam oil and the Paris sugar markets

EBA NEWSLETTER (No.3) 19 (1988).

143. David, *The ECU — A Natural Currency for Saint-Gobain*, *The ECU*, in *THE EUROPEAN CURRENCY UNIT* 121 (R. Levich ed. 1987).

144. See generally *The World's Hottest New Currency*, *DUN'S BUSINESS MONTH* 86 (Apr. 1984).

145. *Id.*

146. The Organization for Economic Co-operation and Development's [hereinafter OECD] credit arrangements set minimum interest rates for export credits that receive official subventions. They are the lower of matrix minimums for poor countries or the fixed commercial interest reference rates [hereinafter CIRR] for rich countries. CIRR are set for each participating currency and the ECU in monthly intervals. Between February 15 and March 13, 1989, the following rates were determined:

interest reference rates (CIRR) are fixed for ECU-denominated credits.¹⁴⁷ The CIRR are the minimum rates that must be charged for officially financed export credits under the OECD arrangements. In the present rate structure, the rates for the ECU (8.50%) are located between the extremes (5.50% for credits in Japanese yen and 15.05% for credits in Australian dollar).¹⁴⁸ Thus, financing for countries with minimum interest rates of over 8.50% will be cheaper if the credits are denominated in ECU instead of the national currencies. At the moment, this effect applies to the majority of the countries participating in the agreement.¹⁴⁹

In addition, the interest rates for ECU-denominated financing instruments, such as bonds and loans, fall between the high rates of "soft" currency

Currency of Credit	CIRR (2/15-3/13)
Japanese yen	5.50%
Swiss franc (< 8 years)	7.05%
(> 8 years)	7.30%
Deutsche mark	7.58%
Austrian schilling	7.60%
Dutch guilder	7.65%
ECU	8.50%
Belgian franc	9.13%
French franc	9.54%
Finnish mark	9.65%
U.S. dollar (< 5 years)	10.05%
U.S. dollar (> 5 years)	10.45%
Danish krone	10.10%
Canadian dollar	11.20%
British pound	11.38%
Swedish krone	11.54%
Italian lira	11.64%
Norwegian krone	12.08%
New Zealand dollar	14.04%
Spanish peseta	14.21%
Australian dollar	15.05%

Source: OECD Press Release No. A(89)7, Feb. 10, 1989.

147. *Id.*

148. *See supra* note 146.

149. Namely Belgium (9.13%), France (9.54%), Finland (9.65%), the United States (10.05% and 10.45%), Denmark (10.10%), Canada (11.20%), Great Britain (11.38%), Sweden (11.54%), Italy (11.64%), Norway (12.08%), New Zealand (14.04%), Spain (14.21%) and Australia (15.05%). *See supra* note 146.

instruments and the low rates of "hard" currency instruments.¹⁵⁰ Borrowers from countries with such high interest rates prefer the relatively lower rates of the ECU-instruments. Investors from countries with low interest rates favor the higher interest return in combination with the ECU's stability.

This stability also decreases expenditures for hedging and exchange rate losses. The value of ECU-denominated future payments and revenues are not subject to extreme fluctuations.¹⁵¹ As result, hedging will be unnecessary and exchange rate losses are minimized. In an internal invoicing system, for example, the exclusive reliance on the ECU will make any conversion fees obsolete. No currency will be converted because all transactions are carried out in ECU. The ECU has generally been accepted in the business community as a very diverse currency and has assisted in the opening of new financing sources.¹⁵²

4. *The Use of the ECU in Developing Countries*

Decreasing foreign exchange related losses and costs in combination with more stable foreign exchange revenues are extremely important to developing nations. The currencies of these nations are either instable or not freely convertible. Exchange rates are often fixed by government decree instead of through the foreign exchange markets. Domestic currencies are generally not, however, used in any dealings between the industrialized nations and these countries. Payments that have to be made by these nations to their foreign trading partners are usually denominated in globally accepted currencies. Developing nations must, for example, exchange dollars earned in one transaction into marks needed for payments in another, or for repayments of

150.

AVERAGE LONG TERM INTEREST RATES 1985 — 1987

Country	1985	1986	1987
Belgium	10.61	7.93	7.82
Denmark	11.24	10.05	11.31
F.R. Germany	6.87	5.92	5.84
Greece	15.77	15.78	17.47
Spain	13.39	11.36	12.81
France	11.87	9.12	10.22
Ireland	12.68	11.06	11.27
Italy	13.32	10.92	10.83
Luxembourg	9.53	8.68	7.96
Netherlands	7.32	6.36	6.35
Portugal	25.41	17.87	15.36
United Kingdom	10.58	9.87	9.50
United States	10.75	8.14	8.63
Japan	6.34	4.94	4.21
ECU	9.65	8.31	8.51

Source: ECU-EMS Information (No. 1) 4 (1989); *Money and Finance*, EUROSTAT (No. 3/4) 78 (1988).

151. See *supra* pp. 13-21.

152. CORPORATE FINANCING WEEK 2 (July 29, 1985).

mark-denominated foreign debt. As a result of fluctuations in the global currency exchange rates, however, these nations risk losing part of their dollar earnings when the mark appreciates. Indonesia, for example, encountered this problem a few years back.¹⁵³ These nations would, of course, be able to reduce their payments for their foreign debt if, for example, the mark appreciates against the dollar. In such a case, fewer dollars would be needed to pay off the deutsche mark-debt. These nations, however, usually pursue a policy of risk aversion. They are more willing to forego possible gains than to subject themselves to the dangers of increased payments owing to appreciated exchange rates.

Developing nations simply cannot afford the luxury of losing foreign currencies to exchange fluctuations that do not even involve their national currencies. Instead, the ECU should be substituted for more volatile global currencies.¹⁵⁴

Part II describes foreign exchange problems that can occur in a developing country. The People's Republic of China is used as an example. Although some of the foreign exchange problems are country-specific, the underlying questions apply to most developing countries.

II.

FOREIGN EXCHANGE IN THE PEOPLE'S REPUBLIC OF CHINA

This Part is divided into two sections. The first discusses foreign exchange related problems in the PRC. The second deals with the current PRC foreign exchange regulations prescribing specific foreign currencies for certain international transactions. Recent developments in these regulations and the general dealing with foreign exchange are outlined.

153. The country's debt was denominated mainly in yen. Its revenue, on the other hand, consisted almost exclusively of dollars. After the rapid depreciation of the dollar against the yen, Indonesia needed many more of dollars to pay back its yen obligations. These losses in foreign exchange reserves decreased its ability to buy goods on the international markets.

A hypothetical: Indonesia owes ¥200. It will receive \$2 in export revenues. The dollar-yen exchange rate depreciates from ¥150 per \$1 to ¥100 per \$1. Instead of retaining ¥100 of the initial ¥300 revenue ($\$2 * ¥150$), Indonesia will have to expend all of its dollar revenues, now worth ¥200, to repay its obligation.

154. The European Parliament envisioned such use in 1980 and 1987. *Resolution on the European Monetary System (EMS) as an aspect of the international monetary system*, 23 O.J. EUR. COMM. (No. C 117) 56 (1980) (resolution adopted by the European Parliament); *Question No. 62*, EUR. PARL. DOC. (No. 2-352) 187 (1987) (question to the Council on extending the use of the ECU in international transactions).

A. Problems With Foreign Exchange in the PRC

Despite efforts to promulgate¹⁵⁵ more liberal foreign exchange regulations,¹⁵⁶ the PRC experiences a number of exchange-related difficulties. Major problems have followed the volatility of the dollar and have spurred fears of a foreign exchange crisis.¹⁵⁷ These problems also include increasing domestic inflation, problems of Sino-foreign joint ventures in balancing foreign exchange amounts, and the instability of the national currency — the renminbi ("RMB").

1. Increasing Foreign Exchange Rate Volatility

The recent devaluation of the dollar against other currencies, such as the mark and yen¹⁵⁸ has increased foreign exchange losses for Chinese entities.¹⁵⁹ China suffered foreign exchange losses similar to the Indonesian example discussed above,¹⁶⁰ where planned foreign exchange surplus had to be diverted to pay for appreciated foreign debt.

Such conversion losses prompted the State Administration of Exchange Control (SAEC) to promulgate its Regulations on Spot and Forward Foreign Exchange Transactions.¹⁶¹ Banks and other financial institutions are now permitted to engage in spot¹⁶² and forward¹⁶³ transactions for hedging purposes. Hedging secures a present exchange rate for a future obligation, payment or revenue in foreign denomination. A future revenue would be sold at

155. Foreign exchange regulations in the People's Republic of China [hereinafter PRC] are essentially promulgated by four entities: the State Council, the People's Bank of China [hereinafter PBOC], the State Administration of Exchange Control [hereinafter SAEC], and the Bank of China [hereinafter BOC]. See R. GOSSEN, *BUSINESS LAW AND PRACTICE IN THE P.R.C.* 151 (1987). The PBOC is the main bank in the PRC. The BOC is a subsidiary to the PBOC dealing with international monetary matters.

156. See *infra* text accompanying notes 253-81.

157. Other problems relate to issuances of letters of credit of importance to Hong Kong companies. See Tao-tai Hsia, *Recent Legal Developments in the People's Republic of China*, 28 *HARV. INT'L L.J.* 249 (Spring 1987). Uncertainties also exist concerning the foreign exchange transferability between Chinese provincial governments. See R. GOSSEN, *supra* note 155, at 164.

158. *Id.*

159. Export-oriented Chinese firms found that their foreign exchange earnings are influenced by exchange rate fluctuations, increasing the possibilities for exchange rate losses. See also *State Moves to Fight Dollar-Related Anxieties*, Foreign Broadcast Information Service, Daily Report: China, Mar. 28, 1988, at 32.

160. See *supra* text accompanying note 153.

161. Administrative Regulations on Spot and Forward Foreign Exchange Transaction (approved Dec. 13, 1987 by the State Council and promulgated March 5, 1988 by the SAEC), reprinted in *CHINA LAWS FOR FOREIGN BUSINESS* 10,891 (CCH Australia Ltd.).

162. The spot price is the "price of a commodity for immediate delivery as distinct from its forward price for delivery at some date in the future." J. HANSON, *A DICTIONARY OF ECONOMICS AND COMMERCE* 209 (1982).

163. Forward transactions are "means of hedging against fluctuations in the rate of exchange between different currencies. [They are] very similar to futures [transactions] in commodities. . . . A forward [transaction] enables a dealer to hedge against exchange rate fluctuations, which hamper and increase the risks and uncertainties of foreign trade. *Id.*

a present rate. This rate would be fixed under the contractual obligation between buyer and seller regardless of the currency's performance between the contract and the future receipt. Consequently, there would be no losses between the present and the future receipts.

2. Problems With Foreign Exchange and the Trade Balance

The PRC also faces a possible foreign exchange crisis as a result of its low gold and foreign exchange reserves and increasing foreign debt.¹⁶⁴ Although a crisis has not occurred, the continued strain on fragile reserves may result in future difficulties. The \$30 billion of foreign debt and increasing demand for foreign currencies are the most obvious sources for depletion of these reserves. In addition, the volatile exchange rate of the dollar has increased the amount of foreign exchange needed to satisfy foreign debt obligations.¹⁶⁵ Alternative measures to increase foreign exchange income and decrease losses must be sought to lessen the threat of such a crisis.

3. Inflation-Related Problems

In addition, China's inflation rate is increasing.¹⁶⁶ Increases in the prices for goods and services have prompted the State Council to issue the Report on Measures to Control Currency and Stabilize Finance.¹⁶⁷ Tighter currency controls, especially the reduction of loans,¹⁶⁸ were announced to stabilize the domestic economy.¹⁶⁹ The growth in the loan business and the issuance of additional currency became necessary with the increases in agricultural and industrial production, purchases of agricultural and other products, and personal consumption funds.

164. Bo Ming, advisor to the BOC, denied that there would be an exchange crisis or that China would be unable to meet its foreign payments. *Bank Advisor Denies Foreign Exchange 'Crisis'*, Foreign Broadcast Information Service, Daily Report: China, Apr. 28, 1987, at K5.

165. See *supra* note 153.

166.

INFLATION RATES IN THE PRC 1977 — 1987

1. Index (1980 = 100)

1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
90.7	91.3	93.1	100.0	102.5	104.6	106.7	109.6	121.2	129.5	139.0

2. Change over previous year (in percent)

0.66	1.97	7.41	2.50	2.05	2.20	2.70	10.58	6.8	7.3
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167. See *More On Currency Control*, Foreign Broadcast Information Service, Daily Report: China, Aug. 18, 1988, at 35.

168. Loans granted in the first half of 1988 amounted to 55.6 billion yuan or 24% more than in 1987. The circulating currency was increased by 39% to 164.5 billion yuan. *Further Council's Actions*, Foreign Broadcast Information Service, Daily Report: China, Aug. 18, 1988, at 36.

169. One way to decrease inflation is to decrease the demand by limiting the money available for purchases. See *supra* note 168.

The growing Chinese involvement with foreign parties¹⁷⁰ has spurred demand for loans in foreign currencies. These are used, for example, in Sino-foreign joint ventures to finance the initial establishment or the operation of the underlying businesses. Foreign exchange loans are always given with a certain portion in RMB. The increase of such loans by 17.5% in 1988 forced the BOC to restrict grants in September 1988¹⁷¹ because the amount of RMB so granted had grown proportionally. These RMB increased the demand for goods and services even more and thereby contributed to inflation.

4. *Problems of Joint Ventures in Balancing Foreign Exchange*

Joint ventures established with Sino-foreign capital in the PRC¹⁷² continue to experience problems in balancing foreign exchange accounts.¹⁷³ Profits are usually denominated in RMB. The sending or holding of RMB outside the PRC, however, is illegal.¹⁷⁴ Profits made must, therefore, be exchanged into foreign currencies. Foreign investors are often unable to procure the foreign exchange necessary¹⁷⁵ to change the RMB profits and remit

170. See generally S. HO, CHINA'S OPEN DOOR POLICY: THE QUEST FOR FOREIGN TECHNOLOGY AND CAPITAL 73 (1984).

171. *BOC Curbs Foreign Exchange Credit*, Foreign Broadcast Information Service, Daily Report: China, Sept. 26, 1988, at 33.

172. In order to encourage PRC-foreign joint ventures, to assist in maintaining balances between the foreign exchange receipts and expenditures of these enterprises and to facilitate the remittance of profits to the foreign investors in their respective currencies, the State Council promulgated the Provisions on Balance Between Foreign Exchange Income and Expenses for Joint Ventures Using Chinese and Foreign Investment (promulgated on Jan. 15, 1986 by the State Council), *reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA*, Code 860115 (vol. III 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

173. See *Foreign Exchange Problems For Joint Ventures*, Foreign Broadcast Information Service, Daily Report: China, Oct. 14, 1988, at 37; T. Chang, *Foreign Exchange Balancing Provisions for Joint Ventures*, EAST ASIAN EXECUTIVE REPORTS 7 (Feb. 15, 1988).

174. See *infra* note 174.

175. These enterprises are required to open accounts for deposits and all business transactions denominated in renminbi and foreign exchange with the BOC, or, upon application to the SAEC, may deposit foreign exchange with banks outside the PRC. Foreign exchange receipts from exports must be deposited on the accounts with the BOC, whereby conversions between renminbi and foreign currencies according to the official exchange rates are permitted. As a general rule, renminbi are to be used in transactions with other corporate entities. Furthermore, the enterprises are permitted, upon application, to submit their earnings, net profits and any liquidation balances, to make certain transfers and payments, and to remit wages and earnings of staff members and workers to foreign countries by debiting the foreign exchange accounts. Implementing Rules for Exchange Control Regulations Concerning Enterprises with Overseas Chinese Capital, Enterprises with Foreign Capital, and PRC-Foreign Joint Ventures (approved on July 19, 1983 by the State Council and promulgated on Aug. 1, 1983 by the SAEC), *reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA*, Code 850405 (Vol. II 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

them abroad.¹⁷⁶ There simply is not enough foreign exchange available in the PRC.¹⁷⁷

5. *Instability of the Renminbi*

The exchange rates between the RMB and foreign currencies are determined by the People's Bank of China (PBOC).¹⁷⁸ These rates have fluctuated greatly in recent years.¹⁷⁹ As result of these fluctuations, the prices for goods imported for domestic assembly or reprocessing have increased significantly.

Production costs, prices and inflation will continue to rise. These developments also lessen chances that the RMB will be fully convertible in the near future.¹⁸⁰ It is very improbable that the Chinese authorities will 'release' the RMB with the risk of drastic changes in its present exchange values. The exchange rates of the RMB are not subject to the supply and demand forces of the foreign exchange markets because they are set centrally by the PBOC.¹⁸¹ If these artificial rates did not reflect the actual value of the RMB, full convertibility would immediately adjust the currency's value on the markets.

Foreign exchange problems within the PRC can be traced back to two major causes. First, the PRC does not have enough available foreign exchange. Second, the foreign currencies used for international transactions are too volatile, thus inducing foreign exchange losses.

176. An earlier survey by the Beijing municipal government shows that eighty-one percent of the area's 108 foreign-funded enterprises were able to balance their foreign exchange budgets. Although the validity of these results should not categorically be questioned, similar balancing problems have had a long history in the development of Sino-foreign joint ventures. *See Joint Ventures Maintain Foreign Currency Balances*, Foreign Broadcast Information Service, Daily Report: China, June 21, 1988 at 49.

177. *See supra* note 164.

178. *See Business Law and Practice in the PRC*, *supra* note 155, at 158.

179. The average exchange rates for the Renminbi for August 1989 were as follows:

US\$100	=	RMB372.21
HK\$100	=	RMB47.68
DM 100	=	RMB193.26
BPd100	=	RMB594.78
FFr100	=	RMB57.25
Yen1,000	=	RMB23.38

Source: International Monetary Fund, Washington, D.C. (Sept. 29, 1989)

180. Chinese Vice Premier Tian Jiyun expressed the government's intention to make the renminbi convertible to other international currency. He also indicated, however, that such a process would take time and could not be achieved hastily. *On Currency, Economic Policies*, Foreign Broadcast Information Service, Daily Report: China, May 13, 1988, at 5.

181. Its actual value, however, would be reflected by the PRC's dealings with foreign entities who would strive for higher concessions from their PRC counterparts if the perceived value of the RMB were lower than the set rate.

B. Solutions For the Foreign Exchange Problems of the PRC

The positive results of the so-called 'Shenzhen-Experiment' underscore the value of foreign currencies for the domestic economy.¹⁸² In Shenzhen, a province of the PRC, a foreign trade equilibrium was created by permitting the concurrent utilization of RMB, Hong Kong and U.S. dollars, and foreign exchange certificates for daily transactions. This liberalization of the day-to-day transactions and the RMB-monopoly balanced imports and exports abolished the overvaluation of the RMB and decreased inflation.¹⁸³ A corresponding acceptance of additional foreign currencies, namely the ECU, could solve a number of similar Chinese exchange problems.

1. The Admission of Additional Foreign Currencies and the ECU

Problems with scarce foreign exchange reserves could be resolved in three different ways. The first two are traditional methods of expanding foreign exchange reserves: (1) exporting more goods to and importing more foreign investment capital from current joint venture or trading partners; and (2) developing additional sources of foreign currency reserves from new countries. These methods would automatically increase foreign exchange reserves because all foreign exchange must be deposited with the BOC.¹⁸⁴ China is a very attractive market for many industrialized nations, but its government restricts foreign currencies usable for some transactions to the mark, pound, yen, U.S. and Hong Kong dollars ("the five principal currencies"), and possibly the French franc.¹⁸⁵ Some countries may have refrained from engaging in similar business relations because the exchange rates of those currencies have fluctuated significantly in the past. One approach would be to use a neutral and stable third currency. If, for example, the ECU were used by the PRC and countries whose currencies are not exchangeable in the PRC, neither would have to take the risk of exchange rate fluctuations, both would profit.¹⁸⁶

A third solution to increase foreign exchange reserves is the decrease of foreign exchange related losses. As in the Indonesian example above, the PRC could at least retain most of its earned foreign currencies by not losing them to exchange rate differentials in subsequent payments in other foreign currencies. Chinese entities have experienced such losses following fluctuations of the six permitted currencies.¹⁸⁷ Hedging transactions could decrease these losses,¹⁸⁸ but they are costly and require experience in international financial markets. A simpler alternative is to use the stable ECU.

182. *Shenzhen Foreign Trade Equilibrium Examined*, Foreign Broadcast Information Service, Daily Report: China, Dec. 17, 1987, at 18.

183. *Id.*

184. *See infra* note 204.

185. *See infra* at 227.

186. *See infra* at 15.

187. *See supra* note 49.

188. *See supra* note 76.

The preceding considerations also apply to the second problem, namely the volatility of the common foreign currencies. The use of the stable ECU would decrease the effects of such fluctuations and assist the PRC in lowering inflation rates.

Permitting additional foreign currencies, especially the ECU, would solve the PRC's foreign exchange related problems. In addition to the above advantages, there are a number of other considerations. There are currently indications that the RMB might become fully convertible in the future.¹⁸⁹ To succeed with the full convertibility, the PRC must gain experience with the RMB's exchange rate behavior against foreign currencies. A "pre-convertibility" acceptance of a greater number of currencies would significantly decrease the time needed to establish the proper rates and mechanisms for the convertibility toward these currencies.

Less volatile currencies would also safeguard the position of the PBOC regarding RMB loans granted to Chinese enterprises against foreign currency mortgages.¹⁹⁰ Mortgaged foreign exchange is deposited with the PBOC and repaid in the same denomination without accounting for possible exchange rate fluctuations.¹⁹¹ Unless the PBOC deposits the mortgaged amounts in the original denomination, they cannot be converted into other currencies without taking the risk of conversion losses. These losses may result from fluctuating exchange rates between the time of the initial deposit and the final repayment to the mortgagor. The length of the underlying loans¹⁹² and the denomination of most deposits in U.S. dollars may cause significant lost earnings or outright losses.¹⁹³ If, however, the PBOC would accept stable currencies, namely the ECU, exchange rate losses would be insignificant. The ECU could be exchanged into other currencies. Losses would thereby be decreased or practically non-existent in the case of the EMS currencies.¹⁹⁴

The inclusion of the ECU has a number of specific advantages for the PRC.¹⁹⁵ Transactions with EMS members could be denominated in ECU,

189. See *supra* note 180.

190. See Rules Governing the Application of Renminbi Loans Mortgaged by Foreign Currency (art. 9), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 861126 (vol. III 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

191. *Id.* art. 9.

192. *Id.* art. 3.

193. The exchange rates of most currencies change significantly during periods of three months to five years.

194. See *supra* pp. 13-21.

195. On a more practical basis it should be noted that not every foreign bank conducts ECU-denominated business. The introduction of the ECU in the PRC could be facilitated by the fact that at least three banks permitted under the Provisional Regulations on Providing Foreign Exchange Guarantees by Institutions inside China (promulgated on Feb. 5, 1987), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 870502 (vol. III 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.) to conduct certain business in foreign exchange, namely the Banque Indosuez, the Société Générale and the Banque Nationale de Paris, are also members of the ECU Banking Association [hereinafter EBA]. The EBA is a major promotor of the ECU.

which would eliminate conversions into any of the twelve individual currencies. The ECU could be used as denominator for all transactions between the involved Chinese authorities for payments and settlement of all foreign exchange accounts. The PRC could raise capital on the ECU-markets with relatively low interest rates.¹⁹⁶ There would be little risk of value losses or increases in interest-payments resulting from exchange rate movements of the borrowed currency. The ECU has proven to be an extremely reliable tool in this respect.¹⁹⁷ The Foreign Exchange Control Measures for Non-Banking Institutions¹⁹⁸ and the Regulations on Spot and Forward Foreign Exchange Transactions¹⁹⁹ should be amended by the Chinese authorities. In these regulations, the U.S. dollar is prescribed as denominator for balance sheets and performance security deposits. The use of the ECU for the same purposes would result in more accurate balance sheets and profit-and-loss statements. Earnings would only change as a result of decreases of actual earned capital, not unrelated exchange rate fluctuations. On a more futuristic note, the PRC might find the ECU of such advantage that it could consider making the ECU into the sole foreign currency for exchange purposes in the PRC.²⁰⁰

A controlled increase in the number of foreign currencies permitted appears to be very advantageous to the PRC. It is important, however, that such an increase be a strictly controlled currency-by-currency measure. The additional currencies must be relatively stable and secure to prevent further foreign exchange losses.

The use of foreign currencies for certain transactions in the PRC is governed by a number of foreign exchange regulations. Traditionally, these currencies have been limited to the five principal currencies. Subsection 2 emphasizes the regulations which restrict the foreign currencies. Recent changes and trends in the treatment of foreign exchange are introduced in subsection 3.

2. *Foreign Exchange Regulations in the PRC*

The Procedures for Prohibiting the State Currency from Entering or Leaving the Country²⁰¹ were formulated to consolidate the value of the RMB

196. See *supra* note 146.

197. See *supra* notes 147-50 and accompanying text.

198. Foreign Exchange Control Measures for Non-Banking Institutions (promulgated on Oct. 1, 1987 by the PBOC), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 871001 (vol. III 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

199. See *supra* note 161.

200. As a matter of practicality, a similar proposal has been made by Gabon's President Omar Bongo. He indicated that an "ECU-area" would be advantageous for all African nations associated with the EC. See *An 'ECU Area' for Africa?*, TARGET 1992 4 (Oct. 1988).

201. Procedures for Prohibiting the State Currency From Entering or Leaving the Country (promulgated on Mar. 6, 1951 by the Government Administrative Council), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 800319 (vol. I 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

and to stabilize the nation's financial system. They pose an absolute ban on the transfers of national currency across the borders of the PRC.²⁰² RMB can, therefore, not be legally held outside the PRC. Similar regulations can be found in other nations with planned economies.²⁰³

In addition to the Provisional Regulations for Exchange Control,²⁰⁴ the PBOC promulgated the Foreign Exchange Control Measures for Non-Banking Financial Institutions.²⁰⁵ They apply only to non-banking financial institutions without foreign or Chinese-foreign capital,²⁰⁶ thus, only purely Chinese institutions. Upon application, these institutions may engage in specified foreign exchange operations.²⁰⁷ Limitations on the volume of such transactions are also prescribed. The total volume of foreign exchange loans is limited to twenty-five percent of an institution's total foreign assets.²⁰⁸

202. *Id.* art. 3.

203. The Socialist Government of the German Democratic Republic, for example, absolutely disallows the export and import of its national currency across its national borders. See generally SOZIALISTISCHE AUSSENWIRTSCHAFT 110-113 (1984).

204. Provisional Regulations of the PRC for Exchange Control (promulgated on Dec. 18, 1981 by the State Council and effective Mar. 1, 1981), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 801218 (vol. I 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.). The State Council issued the Provisional Regulations for Exchange Control of the PRC in 1981 in order to "strengthen[] exchange control, increas[e] national foreign exchange income, and economiz[e] on foreign exchange expenditure." *Id.* art. 1. These regulations establish the centralized control and management of foreign exchange policies under the auspices of the SAEC for foreign currencies, securities denominated in foreign currencies, instruments payable in foreign currencies and other foreign exchange funds. *Id.* art. 3. Essentially, all foreign exchange proceeds of any foreign or domestic individuals or organizations must be sold to or deposited on accounts with the BOC. *Id.* art. 9. State organizations and collective economic units are permitted to retain portions of their receipts of foreign exchange. *Id.* arts. 11, 12. Profits from Chinese enterprises located outside the country have to be sold back to the BOC. *Id.* art. 13.

205. See *supra* note 198. See also Jack C. Young, *Foreign Exchange Control of Financial Institutions*, East Asian Executive Reports, February 15, 1988, at 7.

206. *Id.* art. 33.

207. *Id.* art. 10. Article 10 provides:

A non-banking financial institution may apply to engage in all or some of the following foreign exchange operations:

- (i) foreign exchange trust deposits within China and abroad;
- (ii) foreign exchange trust loans within China and abroad;
- (iii) foreign exchange trust investment within China and abroad;
- (iv) foreign exchange loans within China and abroad;
- (v) issuing or acting as an agent in the issuing of negotiable securities within China and abroad;
- (vi) purchasing and selling or acting as an agent in the purchasing and selling of foreign currency negotiable securities;
- (vii) foreign exchange investment using its own funds;
- (viii) international finance leasing;
- (ix) foreign exchange guarantee and testimony services;
- (x) [necessary] renminbi dealings [. . .];
- (xi) [Upon application for concurrent services]: (1) foreign exchange loans within China;
(2) accepting foreign exchange deposits involved with foreign exchange investment, loans, leasing or guarantee services;
- (xii) other[s].

208. *Id.* art. 17.

Foreign exchange debts and foreign guarantees can be granted up to twenty percent of its foreign exchange funds.²⁰⁹ Foreign exchange investment is restricted to the total foreign exchange funds;²¹⁰ foreign exchange loans and guarantees to thirty percent of such funds.²¹¹ Financial institutions submit, *inter alia*, foreign exchange balance sheets compiled of the various foreign currency assets and liabilities, as well as foreign currency profit and loss statements. The latter comprise currency gains and losses converted into U.S. dollars.²¹²

Foreign currency deposits and special RMB deposits are regulated by four different BOC regulations:

- Regulations for Foreign Currency Deposits (Category A) (1983) (“Category A Regulations”);²¹³
- Regulations for Foreign Currency Deposits (Category B) (1983) (“Category B Regulations”);²¹⁴
- Regulations for Foreign Currency Deposits (Category C) (1985) (“Category C Regulations”);²¹⁵ and
- Regulations on Foreign Currency Deposits and Special Renminbi Deposits by the Bank of China(1983) (“Regulations for Special Renminbi Deposits”).²¹⁶

209. *Id.* art 18.

210. *Id.* art. 19.

211. *Id.*

212. A non-banking financial institution shall compile and submit on schedule the following balance sheets, profit and loss statements and other statements and information:

- i) balance sheets of renminbi and the various foreign currencies;
- ii) foreign exchange balance sheets compiled of the various foreign currency assets and liabilities converted into US dollars;
- iii) balance sheets compiled of foreign exchange assets and liabilities converted into renminbi and renminbi assets and liabilities;
- iv) renminbi and the various other currency profit and loss statements;
- v) foreign currency profit and loss statements compiled of the various foreign currency gains and losses converted into US dollars;
- vi) profit and loss statements compiled of foreign currency gains and losses converted into renminbi and renminbi gains and losses;
- vii) other statements and information as required by the exchange control department.

Id. art. 27.

213. Regulations of the Bank of China for Foreign Currency Deposits (Category A) (promulgated on Jan. 1, 1983 by the BOC, effective Jan. 1, 1983), *reprinted in* CHIN, P.R.C. LAWS FOR CHINESE TRADERS AND INVESTORS 324 (1988) [hereinafter Category A Regulations].

214. Bank of China Regulations for Foreign Currency Deposits (Category B) (promulgated on Jan. 1, 1983 by the BOC, effective Jan. 1, 1983), *reprinted in* CHIN, P.R.C. LAWS FOR CHINESE TRADERS AND INVESTORS 327 (1988) [hereinafter Category B Regulations].

215. Regulations of the Bank of China for Foreign Currency Deposits (Category C) (promulgated in Nov. 1985 by the BOC), *reprinted in* CHIN, P.R.C. LAWS FOR CHINESE TRADERS AND INVESTORS 340 (1988) [hereinafter Category C regulations].

216. Regulations on Foreign Currency Deposits and Special Renminbi Deposits by the Bank of China (promulgated in Jan. 1983 by the BOC), *reprinted in* STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 851120 (vol. II 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.) [hereinafter Regulations for Special Renminbi Deposits].

The Category A Regulations for deposits permit members of foreign missions and organizations, Chinese and foreign enterprises, enterprises in the PRC with foreign capital or joint ventures, state organs, and other persons to open fixed and current deposit accounts with the BOC.²¹⁷ Depositable foreign exchange includes banknotes, funds of enterprises, and any others that the BOC accepts.²¹⁸ Funds can be remitted within China or abroad, converted into RMB and transferred to other foreign currency accounts.²¹⁹ Transfers abroad are limited in denomination to the currencies deposited.²²⁰

The Category B Regulations permit fixed or current deposits by foreign nationals in their own names.²²¹ Foreign exchange in convertible currency, remittances from overseas Chinese for commercial buying houses and in other form are acceptable.²²² Balances can be utilized for transfers abroad, for conversion into RMB, and for payments of travel expenses. They can be withdrawn in the deposited foreign currency.²²³

Chinese residents are entitled to open accounts for convertible foreign exchange under the Category C Regulations.²²⁴ Deposits may be converted into RMB at preferential treatment.²²⁵ Remittances abroad and withdrawals of reasonable portions are permitted in the same foreign currency as deposited.²²⁶

All the above regulations restrict the foreign currencies depositable to the five principal foreign currencies.²²⁷ Any other currency must be converted into one of these five before deposits are possible.²²⁸

Under the Regulations for Special Renminbi Deposits may be maintained by foreign diplomatic and international bodies, by enterprises and organizations set up abroad or operating in China with Sino-foreign capital, and by foreign or Chinese nationals who are permitted to retain foreign exchange.²²⁹ Remittances from abroad may be converted into RMB, deposited,

217. Category A Regulations, *supra* note 213, art. 2.

218. *Id.* art. 3.

219. *Id.* art. 6.

220. *Id.* art. 3(4).

221. Category B Regulations, *supra* note 214, art. 2.

222. *Id.* art. 3.

223. *Id.* art. 7.

224. Category C Regulations, *supra* note 215, art. 2.

225. *Id.* art. 9(2). This preferential treatment indicates that the Chinese authorities are willing to pay relatively more to obtain foreign currencies for the national reserves.

226. *Id.* art. 9(6).

227. Category A Regulations, *supra* note 213, art 4(2); Category B Regulations, *supra* note 214, art. 4(3); Category C Regulations, *supra* note 215, art. 5. The BOC apparently also accepts deposits in French francs. See *Bank Relaxes Restrictions on Foreign Deposits*, Foreign Broadcast Information Service, Daily Report: China, May 11, 1987, at K14; *Interest Raised on Foreign Currency Savings*, Foreign Broadcast Information Service, Daily Report: China, Sept., 12, 1988, at 33.

228. Category A Regulations, art. 4, Category B Regulations, art. 4 and Category C Regulations, art. 5.

229. Regulations for Special Renminbi Deposits, *supra* note 216, art. 2.

or transferred to other normal or special RMB accounts. They may be re-converted into foreign currencies and remitted abroad or withdrawn in physical RMB. In the latter case, however, they cannot be re-deposited in the special accounts.²³⁰ Regulations limit the re-exchange possibilities and ensure that any foreign currency will remain in the possession of the BOC once exchanged into RMB. They also give the BOC possession of the foreign exchange. Those reserves thereby bolster the national foreign exchange reserves.

There is no explicit restriction of the foreign exchange convertible into RMB to any specific currency. It appears that any foreign currency is acceptable.²³¹

The Rules Governing the Application of Renminbi Loans Mortgaged by Foreign Currency²³² respond to the increasing demand for RMB loans. All enterprises registered in the PRC, including state-owned, collective and foreign enterprises, are eligible to apply for such loans. They are mortgaged by the borrower's own foreign exchange deposits with the BOC.²³³ Maturities range from three, six or twelve months to one to five years.²³⁴ A RMB loan may not exceed the value of the foreign exchange deposited with the BOC on the day of the grant.²³⁵ The SAEC manages the mortgaged foreign exchange and retransfers it to the borrower upon repayment of the loan principal.²³⁶ Usable foreign currencies for mortgaging are limited to the five principal foreign currencies.²³⁷ With regard to the redemption of the mortgaged amounts, no fluctuations in the exchange rates between RMB and the foreign currencies are taken into account.²³⁸ No interest will be charged for the loans or paid for the mortgaged foreign exchange.²³⁹

The last two provisions may actually limit possible foreign exchange earnings for the PRC.²⁴⁰ The redemption policy, for example, restricts the mortgaged foreign currency amounts to the initial denomination. As no fluctuations will be taken into account, the BOC cannot use these deposits effectively. It could exchange them into third foreign currencies for the period of the deposit. Such exchanges would be necessary if other denominations were

230. *Id.* art. 6.

231. *But see* CHIN, *supra* note 213, at 332 (interpretation of the Regulations for Special Renminbi Deposits) ("According to the new regulations, five foreign currencies — US dollar, British pound sterling, Hongkong dollar, German mark and Japanese yen — will be accepted. The old regulations only accept the first three.").

232. Rules Governing the Application of Renminbi Loans Mortgaged by Foreign Currency (promulgated on Dec. 12, 1986 by the PBOC), *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS: BUSINESS REGULATIONS 10,719 (1987) (CCH Australia Ltd.).

233. *Id.* art. 1.

234. *Id.* art. 3.

235. *Id.* art. 10.

236. *Id.* art. 12.

237. *Id.* art. 4.

238. *Id.* art. 9.

239. *Id.* art. 11.

240. *See supra* note 204.

needed for international transactions or when interest rates for third currencies would be higher than for the initial denomination. Possible gains could not be realized without subjecting the mortgage deposits to the risk of exchange losses. In essence, the BOC can only deposit the currencies in the initial denomination abroad for the entire loan period of up to five years,²⁴¹ and thus, the lost gains may be significant. With regard to the non-payment of interest, the PRC could engage in lucrative banking transactions. It could charge interest for the loans and pay lower interest on the mortgaged deposits.

Under the Procedures for Extending Loans to Enterprises with Foreign Investment,²⁴² the BOC may grant stand-by credits, fixed asset and working capital loans, and RMB loans. PRC-foreign joint ventures, cooperative enterprises, and foreign-owned enterprises registered in China are eligible for such financial support.²⁴³ Loans are granted in RMB or foreign currencies. The latter explicitly include the five principal foreign currencies and "other convertible currencies acceptable to the BOC of China."²⁴⁴ Interest rates for state-owned enterprises apply to RMB loans. Consolidated rates set by the BOC or agreed rates reflecting global market conditions are used for foreign currency loans.²⁴⁵

The most recent regulations are the Administrative Regulations on Spot and Forward Foreign Exchange Transactions by Financial Institutions on Behalf of Clients.²⁴⁶ Its goals are to induce hedging against exchange rate risks, to stabilize import and export costs, and to develop spot and forward transactions. The regulations follow substantial exchange rate losses by Chinese holders of foreign exchange.²⁴⁷ The BOC²⁴⁸ is authorized to engage in

241. See *supra* note 234.

242. Procedures for Extending Loans to Enterprises with Foreign Investment (promulgated on Nov. 26, 1986 by the PBOC), reprinted in STATUTES AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA, Code 870424 (vol. III 1987) (University of East Asia Press and Institute of Chinese Law, Ltd.).

243. *Id.* arts. 3, 5.

244. *Id.* art. 6.

245. *Id.* art. 11.

246. Administrative Regulations on Spot and Forward Foreign Exchange Transactions by Financial Institutions on Behalf of Clients (promulgated on Mar. 5, 1988 by the SAEC), reprinted in CHINA LAWS FOR FOREIGN BUSINESS: BUSINESS REGULATIONS 10,891 (1987) (CCH Australia Ltd.).

247. See *supra* note 161.

248. The Regulations also permit certain specialized banks, financial institutions, and other clients to conduct such transactions themselves, or, in the case of the latter, to commission a designated financial institution to undertake such transactions. Administrative Regulations on Spot and Forward Foreign Exchange Transactions by Financial Institutions on Behalf of Clients, *supra* note 246, art. 6. The banks and financial institutions are not bound by the requirement of an underlying business transaction. *Id.* art 4(1).

transactions on the spot and forward markets for approved entities.²⁴⁹ Clients must provide performance guarantees in the form of mortgages on foreign exchange quotas or cash downpayments.²⁵⁰ If a foreign exchange quota is used as a cash downpayment, its denomination is restricted to U.S. dollar.²⁵¹ Foreign currencies, therefore, must be converted into U.S. dollar before they may be utilized as a cash downpayment to secure the performance of the underlying transaction. Spot and forward transactions are restricted to hedging, and therefore, transactions for the sole purpose of speculation are disallowed. Transactions must be based on actual business obligations.²⁵² There is, however, no restriction on the foreign currencies in which these transactions can be undertaken.

3. *Developments and Trends*

Some changes have taken place in the area of foreign exchange. Most importantly, the PRC appears to be willing to allow in more foreign currencies. Other developments include changes in foreign exchange practices, legal developments for domestic and foreign banks, and the general banking business.

a. *Trends to Include Additional Foreign Currencies*

There has been a general trend toward liberalizing Chinese exchange regulations since 1987. The 1983 regulations on Category A and B deposits²⁵³ restrict depositable currencies to the five principal foreign currencies.²⁵⁴ Any other foreign currency must be exchanged into one of these before deposits are possible.²⁵⁵ The same five currencies and, *arguendo* the French franc, are allowed for deposits in Category C.²⁵⁶ The regulations for special RMB deposits, on the other hand, do not explicitly prescribe the use of specific foreign currencies.²⁵⁷ The Rules Governing the Application of Renminbi Loans Mortgaged by Foreign Currency of 1986 also restrict the collateral for loans to denominations in the five principal foreign currencies.²⁵⁸ Some liberalization appears in the 1987 Regulations on Providing Loans to Foreign-Invested Enterprises.²⁵⁹ In addition to the five currencies, "any other convertible currencies acceptable to the Bank of China"²⁶⁰ will be used by the BOC for the underlying loans. This change from the absolute

249. *Id.* art. 2.

250. *Id.* art. 7.

251. *Id.*

252. *Id.* art. 6.

253. *See supra* notes 213-14.

254. *See supra* note 227.

255. *See supra* note 228.

256. *See supra* note 215.

257. *See supra* note 230.

258. *See supra* note 237 and accompanying text.

259. *See supra* note 242.

260. *Id.*

restriction in the prior regulations indicates a willingness to refrain from categorically disallowing other currencies. It could also mark efforts of the PRC to tackle some of its foreign exchange problems in ways similar to the proposals of this article. The most obvious changes are in the 1988 Regulations on Spot and Forward Foreign Exchange Transactions.²⁶¹ Spot and forward transactions are not restricted to any specific currencies.²⁶² The only limitation is that of foreign currency cash downpayments for performance security deposits.²⁶³ This deposit, if denominated in a foreign currency, can only be submitted in U.S. dollar. The main importance of the regulations, however, is the apparent change in the Chinese attitude toward foreign exchange. Arguably, business can now be transacted more easily in *any* foreign denomination as *any* such currency may be hedged against.

b. Developments in Foreign Exchange Practices

The introduction of a system of "self-responsibility" in 1987 indicates a more relaxed attitude toward foreign currency earnings.²⁶⁴ Businesses in the arts and crafts, light fixture manufacturers, and clothing industries will be held responsible for their foreign exchange balances.²⁶⁵ They may retain seventy percent of their foreign exchange earnings after releasing placed quotas to the government. Problems with this system and the highly volatile foreign exchange rates resulted in significant foreign exchange conversion losses.²⁶⁶ Owing to the Administrative Regulations on Spot and Forward Foreign Exchange Transactions,²⁶⁷ hedging transactions are to diminish fluctuation losses. They could, of course, also be limited through the use of ECUs in the underlying business contracts.

The government, in contemplating the creation of a central organization for the adjustments of foreign exchange in Beijing,²⁶⁸ would act as a mediator between enterprises with foreign currency surpluses and those with deficits.²⁶⁹ Furthermore, controls on foreign currency transactions of state-owned enterprises and the management of foreign exchange would be eased as part of a reform of the foreign exchange controls.²⁷⁰ There have also been indications that the RMB may be allowed to be fully convertible to other currencies.²⁷¹

261. See *supra* note 246.

262. *Id.* art. 3.

263. *Id.* art. 7.

264. *Self-Responsibility System to be Instituted*, Foreign Broadcast Information Service, Daily Report: China, Dec. 12, 1987, at 28.

265. *Id.*

266. See *supra* text accompanying note 157.

267. See *supra* note 236.

268. *Relaxation of Foreign Exchange Controls Pondered*, Foreign Broadcast Information Service, Daily Report: China, May 4, 1988, at 43.

269. *Id.*

270. *Foreign Currency Controls Eased Further*, Foreign Broadcast Information Service, Daily Report: China, July 12, 1988, at 42.

271. See *supra* note 180.

c. *Developments for Domestic Banks*

Regulations for spot and forward transactions also reflect efforts to liberalize the foreign exchange transactions of domestic banks.²⁷² These regulations permit the BOC to undertake such transactions for Chinese clients.²⁷³ They also allow other institutions to apply for similar licenses.²⁷⁴ In addition, Chinese banks have extended their relationships with international banks and other financial institutions to raise the funds necessary for overhauling and improving the domestic economy.²⁷⁵

d. *Changes for Foreign Banks in China*

An important development for foreign banks is the PBOC's decision to allow some of the foreign banks' branches to offer RMB-denominated banking services.²⁷⁶ This development partially lifts restraints on the currently twenty-eight foreign and Sino-foreign institutions. Although this permission is restricted to offering services to foreign or Sino-foreign enterprises, it indicates that Chinese authorities recognize the need and demand for RMB business by foreign banks.²⁷⁷ The number of foreign banks permitted in selected coastal cities will also be increased.²⁷⁸

e. *Effects of the Foreign Exchange Policy Changes*

Increasing deposits of foreign exchange reflects the liberalizations effects. The deposits of the BOC's 680,000 individual depositors, for example, totaled \$430 million in March 1987.²⁷⁹ Following increases in the interest rates, the average monthly growth amounted to \$50 million in 1988. By September 1988, a total of over \$975 million had been deposited and the number of individual depositors had surpassed one million.²⁸⁰ Interest rates for individual deposits were raised by the following percentages compared to 1987:²⁸¹

272. See *supra* note 161. See also *Bank Given More Freedom with Foreign Money*, Foreign Broadcast Information Service, Daily Report: China, Mar. 7, 1988, at 49.

273. See, *supra* note 161, art. 12.

274. *Id.*

275. The Investment Bank of China, for example, has been able to raise the equivalent of one billion U.S. dollars for project funding purposes over the last seven years. The Bank also plans to increase its long-term borrowing from foreign banks and banking consortia. *Investment Bank Borrows from Foreigners*, Foreign Broadcast Information Service, Daily Report: China, July 25, 1988, at 57.

276. *Foreign Banks Allowed to do Renminbi Business*, Foreign Broadcast Information Service, Daily Report: China, May 16, 1988, at 33.

277. *Id.*

278. *Li Guixian Urges Foreign Currency Exchange Reform*, Foreign Broadcast Information Service, Daily Report: China, June 3, 1988, at 30.

279. *Bank Relaxes Restrictions on Foreign Deposits*, Foreign Broadcast Information Service, Daily Report: China, May 11, 1987, at K14.

280. *'Surge' in Personal Foreign Exchange Deposits*, Foreign Broadcast Information Service, Daily Report: China, Sept. 30, 1988, at 36.

281. *Interest Raised on Foreign Currency Savings*, Foreign Broadcast Information Service, Daily Report: China, Sept. 9, 1988, at 33.

British pound	+ 69.0%
U.S. dollar	+ 41.0%
Hong Kong dollar	+ 40.0%
Deutsche mark	+ 25.0%
French franc	+ 22.3%

The new rates more closely reflect the conditions on the global markets. They should attract more foreign currency deposits from non-Chinese entities. The corresponding influx of foreign exchange could alleviate some of the PRC's foreign exchange problems.

CONCLUSION

The ECU differs in many respects from any other asset. Its role in the EMS explains its still unusual status as a *de facto* currency. The ECU may be selected to become the aspired common EC currency in the near future. Its composition as a "basket" of twelve European currencies is the basis for its greatest resource: the ECU is one of the most stable and widely used currencies in the monetary community. It is not subject to significant exchange rate fluctuations.

Many developing nations have encountered serious financial problems. The inability to repay foreign debt, depleting foreign exchange reserves, and economic stagnation are only a few such difficulties. Many problems, however, are traceable to two sources: (i) the use of highly fluctuating foreign currencies in international trade and debt transactions; and (ii) low foreign exchange reserves resulting from losses in the conversion of those currencies.

The troubles of the PRC exemplify this situation. Low foreign exchange reserves have led to increased inflation and other problems, specifically in the area of Sino-foreign joint ventures. Foreign currencies usable in certain transactions were traditionally restricted to the five principal foreign currencies and fluctuations in their exchange rates prompted significant foreign exchange losses.

The ECU should be used by the PRC and other developing nations as foreign currency. It is a simple solution to many foreign exchange-related problems. Using the ECU as a denominator for foreign trade and debt transactions decreases conversion losses because the ECU's exchange rates fluctuate significantly less than those of other currencies. The foreign exchange revenues of developing countries adopting the ECU would stabilize and the effects of exchange related problems, such as rising inflation rates, would decrease.