

CONFIDENTIAL

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Mr. Gray.

A Central Bank for Europe

In my brief discussions of CBE, in the context of the ERM, on my visits to No. 10, I fear that I may have left the wrong impression of my thinking. May I be rather dogmatic, but mercifully brief in stating some conclusions ?

First, I think it would be wrong economically, aside from issues about sovereignty, to impose a single currency on Europe, irrespective of the nature of the governance of the CBE. Even if the currency with the best record, the mark, were adopted (this is the solution entertained by Pohl), there is no guarantee that this record would continue, and, more important, there is no reason to suppose that people would wish to use marks more than sterling, ECUs, etc. No body of Eurocrats or national politicians should control and dictate what transactions media should be used by the private sector. In effect a CBE would eliminate competition among different currencies in Europe and this would also eliminate one of the important safeguards, that is the competition of different currencies within the Community.

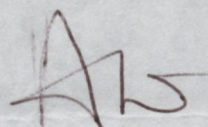
Secondly, in the interests of greater competition in Europe, members should eliminate any capital and exchange controls (as required by 1992) and laws and restrictions relating to legal tender. Currencies, including some variant of the ECU, should compete for primacy in Europe. Since many economists have argued that one currency would be most efficient for Europe, competition would ensure that the appropriate currency won the custom of the private sector. On the other hand if it was efficient to have several currencies then this would be the choice of the market process.

Thirdly, in order to give a composite currency, like an ECU, a chance to emerge, one should construct an ECU that is a composite according to some rules, rather than the present rather arbitrary concoction. And the rules should

be such that the components of the ECU change according to the revealed preferences of the private sector. Money (the product) should respond to demand, rather than demand adjust to whatever product (money) the Eurocrats feel is appropriate.

The essential feature of this system is one where currencies are free to compete and people are free to choose within the Community. That was the spirit of Rome. And if one currency, be it mark, sterling or ECU, wins the preponderance of intermediation, then it has demonstrated the efficacy of a uniform currency area. If no such preponderance emerges, we may take it that the costs of such uniformity exceed the benefits. I do not believe that anyone, and that includes all economists, know what currency arrangements are good for the private sector. We should admit it and let the market work.

There are many technicalities involved - particularly in the choice of the composition and rules governing the ECU. But these are secondary matters compared with the principles on which we should stand.



A.A. Walters.