CURRENCY UNION TECHNICAL EXPERT GROUP (CUTEG)

DRAFT FOLLOW-UP PAPER (CUTEG) # 1

(1) Topic: **Draft Definition of a Currency Union**

(2) Issues – see CUTEG Issues Paper #1 and CUTEG Outcome Paper #1 (http://www.imf.org/external/np/sta/bop/cuteg.htm)

Background

1. This note provides a definition of Currency Union for inclusion in the draft revised Manual, based on the outcome of the CUTEG Issues Paper #1 and CUTEG Outcome Paper #1.

Definition

2. "For statistical purposes, a currency union (CU) is a union to which more than one economy belongs and has a regional central decision making body, commonly a currency union central bank (CUCB), that has the legal authority to conduct a single monetary policy and issue the same currency within the union. To belong to the CU, the economy must be a member of the central decision making body and participate in its' monetary policy decision making process. Participation in the monetary policy decision process includes representation and voting rights at the central decision making meetings, which would usually be conducted on a regular basis. A CU is established by means of a legal arrangement (e.g., a Treaty signed at the level of governments, a protocol of agreement among national central banks).

3. Bilateral monetary agreements between the CU authorities and third countries to use the CU currency as legal tender outside the CU do not qualify the third countries to membership of the CU, if such agreements do not entail the participation of these countries in the monetary policy formulation process. Similarly, monetary agreements reached by any CU country (on behalf of and in line with guidelines set up by the CUCB) with another economy outside the CU, such as overseas dependent territories, to regulate the use of the common currency does not qualify the other economies to CU membership. The same reasonong applies for unilateral adoption of the CU currency by third party countries (e.g. dollarization, euroization, other "-ization").

4. For statistical purposes, various types of exchange rate agreements linking the exchange rates among different sovereign currencies (through establishing fluctuation bands and exchange rate adjustment mechanisms) do not in themselves mean that the participating economies are in a CU. A specific example is where different economies establish a Common Monetary Area (CMA), which implies free movement of capital and a common exchange control regime with the rest of the world. In the CMA, the different national currencies are legal tender in their respective economies only, and are pegged (normally one-to-one) with the currency of a CMA member (reference currency). Sometimes the reference

currency is also given legal tender status in other CMA countries/jurisdictions, under a dual legal tender arrangement. The CMA is, in essence, a form of monetary coordination among members to support a pegging regime against a reference economy (and its currency), which maintains an independent monetary policy. Therefore, it does not meet the criteria above to be classified as a CU; for instance, it lacks the element of shared monetary policy decision making process. A CMA can also be established among members also by coordinating the peg with a third country."

Points for discussion

What comments do CUTEG members have on the proposed definition of currency union and currency union membership set out in paragraph 2?

What comments do CUTEG members have on paragraph 3 regarding what does not consititute a CU membership. Does paragraph 3 provide a complete list of possible of "borderline" cases that the revised Manual should address?

What comments do CUTEG members have on paragraph 4 regarding arrangements that do not consititute CU's? Does paragraph 4 provide a complete list of possible of "borderline" cases that the revised Manual should address?

References

Annotated Outline for the Revision of BPM5, IMF, April 2004 (Chapter 4).

1993 SNA (paras. 14.34).

BPM5 (para 90).

External Debt Statistic (Guide for Compilers and Users) (para 6.12)

Monetary and Financial Statistics Manual 2000 (paras. 89 – 91; 292).

APPENDIX 1: THE COMMON MONETARY AREA

I. Introduction

The CUTEG focuses on the conceptual issues implied in compiling balance of payments and international investment position (BOP/IIP) statements for a currency union (CU) and its members. This appendix looks at a distinct type of monetary coordination among economies known as a common monetary area (CMA). The note defines the CMA, spells out the differences between a CMA and a CU, and concludes that a CMA is not a form of a CU.

II. What is a common monetary area?

A Common Monetary Area (CMA) occurs when a cluster of (non-core) countries (NCC) decide to peg their exchange rate vis-à-vis the currency of a core country (CC), which is normally the leading economy in the region. Specific agreements among member economies ensure free movement of capital within CMA. Most importantly, a CMA provides for a common exchange control regime with the rest of the world. Because the NCC currency is pegged to the CC, the CMA can be defined as a tight form of monetary coordination or a quasi–currency board.

In the CMA there is a certain degree of monetary and economic cooperation. However, while all the NCCs have independent central banks, only the CC's central bank is engaged in active monetary policy. In other words, the monetary policy objective of the NCC central bank to maintain monetary stability is achieved through the intermediate target of a fixed peg arrangement between it's currency and the CC's currency. So there is a limit to the extent to which each NCC member can undertake discretionary monetary policy. For instance, authorities in the NCC countries aim to minimize interest rate differentials with those prevailing in CC to prevent capital outflow and thus reduce the likelihood of liquidity problems for the domestic economy. On the other hand, the monetary policy objectives of the CC are defined by the CC's central bank only, with no formally binding instruction from any NCC's central bank.

Against this background, we conclude that the CMA does not qualify as a currency union (CU) for statistical purposes. A CMA does not imply the setting up of a regional central decision making body with a single monetray policy for the area. Each CMA country still issues national banknotes, denominated in domestic currency, and there is not single currency.

References

Bank of Namibia: http://www.bon.com.na/content/faq.aspx

World Bank: "Concentration of the Banking Sector in the Common Monetary of South Africa", http://www.worldbank.org/research/interest/confs/042003/cma_charles.pdf