ACU, EMU and ECB

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Definition of a Clearing Union

A clearing union can be defined as a multilateral payments arrangement that periodically offsets the debits and credits accumulated by each member against the other members in the process of trade and other transactions.

Multilateral clearing or payments arrangements facilitate the use of national currencies, and thus serve to relax the foreign exchange constraints of the members.

Asian Clearing Union

- Established in December 1974 on the initiative of ESCAP
- Central Banks of Iran, India, Nepal, Pakistan and Srilanka as founding members.
- Bangladesh and Myanmar joined as 6^{th} and 7^{th} members followed by Bhutan (1999) and Maldives (2009)
- Clearing Operations commenced from 1, November 1975.
- The Union was formed to promote the trade among the participating countries in their local currencies; but from 1st January 1996 it was decided to have US$ as a unit of operation for ACU transactions.
- The Union is headquartered at Tehran, Iran. Bank Markazi Jamhoori Iran (BMJI), the Central Bank of Iran act as the agent for managing the affairs of the Union.

Objective and Rationale

- to provide a facility to settle, on a multilateral basis netted payments for current international transactions among the participating countries
- to promote the use of participants' currencies in settlement of current transactions between their respective territories
- to promote monetary co-operation and foster closer banking relations among the participants in order to expand trade and economic activities among the countries in the region
- to provide a currency swap Facility, a medium term credit facility to member central banks.

Powers to Participate

- Section 17(13A) was incorporated in the Reserve Bank of India Act, 1934 to enable the Bank to participate in the Asian Clearing Union.
- The Bank's responsibilities as a member of ACU and all attendant functions relating to funding and settlement is carried out by DEIO.

Organizational set up of ACU

Each participant appoints one Director and one Alternate Director to represent it on the Board of Directors. Each Director has 1 vote.

The Board elects a Chairman from among its members to serve for a period of one year, and a Vice-Chairman to serve in the absence or inability of the Chairman during the same period.

The Secretary General is appointed by the Board to conduct the business of the Asian Clearing Union. He/she acts as the representative of the Board of Directors within the limits prescribed by the Board.

The Board meets at least once a year. All decisions of the Board of Directors are taken by a majority of the votes of all Directors unless a special majority is required by the Agreement.

The official language of the Asian Clearing Union is English.

Unit of Accounts

- The accounts of the Asian Clearing Union are held in "Asian Monetary Units" (AMUs). The AMUs, with effect from 01/01/2009 are denominated as ACU dollar and ACU euro.
- The accounts of the participant central banks are maintained with ACU Secretariat at Tehran. These accounts are mere book entries made by the ACU Secretariat.
- Authorised dealers also designate the Vostro accounts of their correspondents and their own Nostro accounts maintained with the correspondent banks in the ACU member countries in ACU dollars and ACU Euros. These are notional accounts with the balances being held in their US dollar Nostro accounts in New York.

Eligible Payments

- From a resident in the territory of one participant to a resident in the territory of another participant.
- All payments for current international transactions, as defined by the Articles of Agreement of the IMF
- Transactions permitted by the country in which the payer resides
- Transactions not declared ineligible by the Board of Directors of ACU or by a participant country

Ineligible Payments

- Payments which are not current international transactions as defined by the IMF.
- Expenses on account of travel between the member countries.
- Export/Import transactions financed out of loans from International financial institutions like World Bank/ADB etc.
- Bilateral lines of credit between members of the Union.
- Payments between India on the one hand and Nepal and Bhutan on the other, in respect of imports in free foreign exchange. Except exports from India to Nepal where importer has been permitted by Nepal Rashtra Bank to make payments in free foreign exchange, such payments shall be routed through ACU mechanism.

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Clearing Arrangement

- Banks in the participating countries open ACU dollar and ACU Euro accounts with their correspondents in the other participating countries
- Authorised dealers settle import/export transaction by debit/credit to these ACU accounts
- Funding shortfall or repatriating excess liquidity from these ACU accounts are done via the Central Banks
- Netted settlement among Central Banks is undertaken bimonthly
- Central banks having temporary balance of payment adjustment problems can swap their liabilities to the next settlement period

Clearing and Settlement

- Under Article VI of the Agreement to establish the Asian Clearing Union, settlement of balances is effected once every two months.
- Based on the net advices received from the central banks, the ACU Secretariat arrives at the net surplus/deficit position of the member countries and advises the amounts receivable from and payable to one another.
- Interest is computed at daily rests on the balances outstanding with ACU secretariat. The rate of interest applicable for a settlement period is the closing rate on the first working day of the last week of the previous calendar month as offered by BIS for one month US dollar and Euro deposits.
- Member central banks in a net deficit position are advised by the ACU secretariat to arrange payment not later than four days after the receipt of the advice from the ACU Secretariat.
- Delays in payment attract penal interest of a percentage point over the deposit rates mentioned above, or the rate as on the day of default, *whichever higher*.

Swap

- It is a short term financing facility available to member countries incurring deficit at the end of a settlement period in its transaction with other ACU members.
- Every participant is entitled to the facility from every other participant up to 20% of the average gross payments made by it through the ACU mechanism to the other participants during the three previous calendar years.
- The borrower has to pay interest at a rate equal to LIMEAN on USD or Euro for a period of two months.
- A participant may avail of swap facility for a period of two months at a time.

ACU Achievements

- Rapid expansion of trade.
- There has been no default so far by any member in meeting with its obligation for settlement of its net position within the stipulated time period.
- A multi-currency settlement system was established in early 2009, as the participants were authorized to settle transactions either in US dollar or Euro within the Asian Clearing Union mechanism.

Challenges ahead

In 40th BoD meeting held in Kerala on 9 June 2011, Gov. RBI flagged the following Global issues having implications for the ACU members issues:

- Relating to international monetary systems and global reserve currency.
- Protectionism which could affect trade and other linkages of the countries
- Management of capital flows
- Reforms in the financial sector regulations.

ECONOMIC AND MONETARY UNION (EMU)

Rationale for EMU

- European integration
  - Market integration
  - political integration
- Move ahead of EMS
- German unification - lessons
- Strengthening of EU’s position in global economy

EMU's technocratic requirements:

- Single Central Bank
- Common monetary policy – i.e. one central rate and common exchange policy
- Some pooling of foreign reserves
- Common policies (i.e. to a single market)

Road to EMU

- Not new – e.g. Rome, Napoleon, etc

I want the whole of Europe to have one currency; it will make trading much easier

Napoleon in a letter to his brother, Louis, 1807

Emergence of modern EMU

- Werner Report – proposes EMU by 1980
- 1979 European Monetary System - ERM, ECU
- 1989 Delors Report – 3 stage approach to EMU
- 1993 Maastricht Treaty – EMU framework and timetable
- 1992-93 ERM crises
- 01.01.1999 - fixing of exchange rates
- 01.01.2002 – notes and coins in circulation

EMU-The three stages

- At the European Council in Madrid in June 1989, EU leaders adopted a three-stage plan for economic and monetary union. This plan became part of the Maastricht Treaty on European Union adopted by the European Council in December 1991.

The First stages

- **The first stage**, which began on 1 July 1990, involved:
- completely free movement of capital within the EU (abolition of exchange controls);
- increasing the amount of resources devoted to removing inequalities between European regions (Structural Funds);
- economic convergence, through multilateral surveillance of member states' economic policies.

The second stage

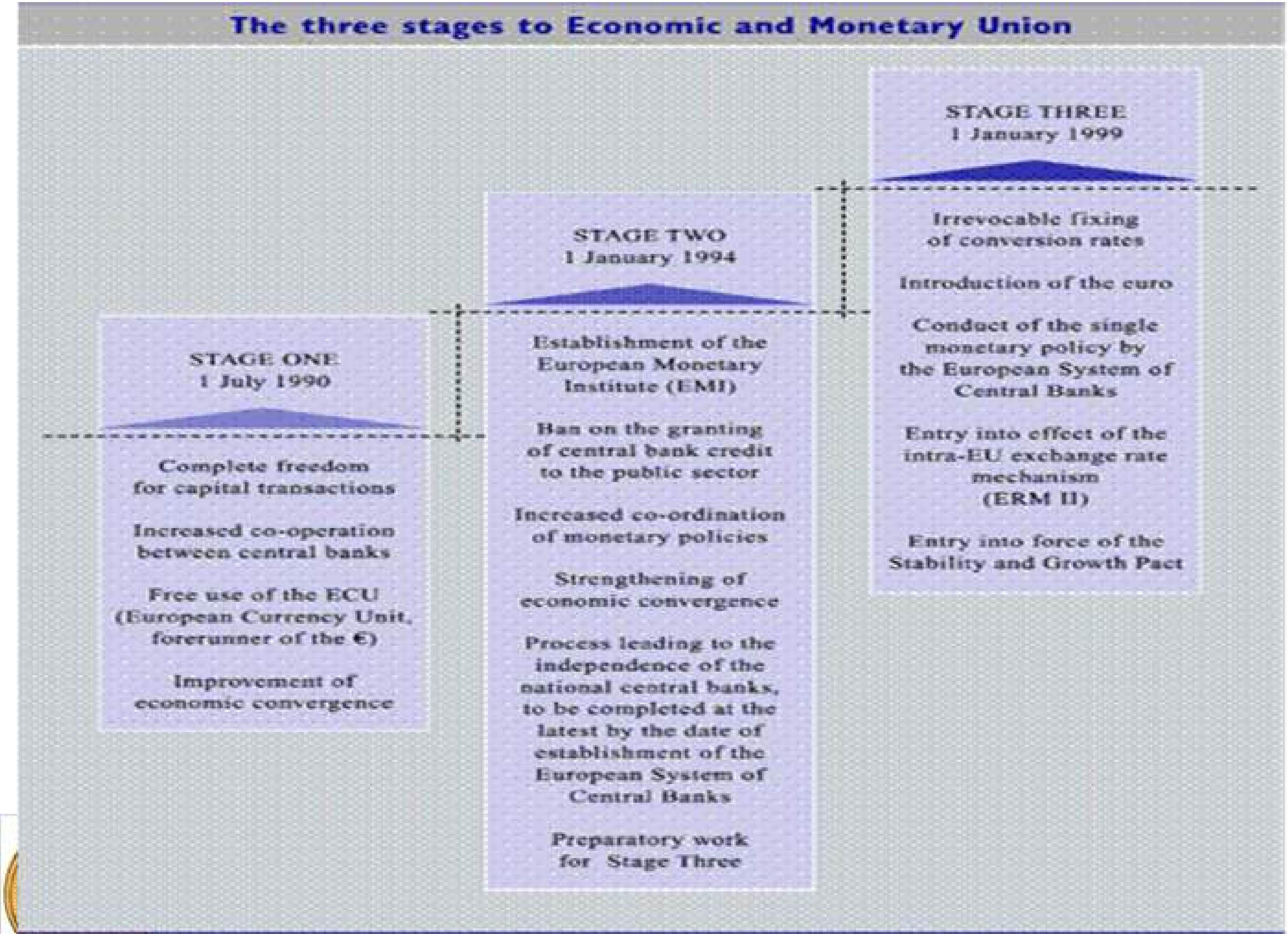
- began on 1 January 1994. It provided for:
- establishing the European Monetary Institute (EMI) in Frankfurt; the EMI was made up of the governors of the central banks of the EU countries;
- independence of national central banks;
- rules to curb national budget deficits.

The third stage

- Culminated into the birth of the Euro. On 1 January 1999, 11 countries adopted the euro, which thus became the common currency of Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. (Greece joined them on 1 January 2001).

- From this point onwards, the European Central Bank took over from the EMI and became responsible for monetary policy, which is defined and implemented in euro.

- Euro notes and coins were issued on 1 January 2002 in these 12 euro-area countries. National currencies were withdrawn from circulation two months later. Since then, only the euro has been legal tender for all cash and bank transactions in the euro-area countries, which represent more than two thirds of the EU population.


The three stages to Economic and Monetary Union
STAGE ONE
1 July 1990
Complete freedom for capital transactions
Increased co-operation between central banks
Free use of the ECU (European Currency Unit, forerunner of the €)
Improvement of economic convergence
STAGE TWO
1 January 1994
Establishment of the European Monetary Institute (EMI)
Ban on the granting of central bank credit to the public sector
Increased co-ordination of monetary policies
Strengthening of economic convergence
Process leading to the independence of the national central banks, to be completed at the latest by the date of establishment of the European System of Central Banks
Preparatory work for Stage Three
STAGE THREE
1 January 1999
Irrevocable fixing of conversion rates
Introduction of the euro
Conduct of the single monetary policy by the European System of Central Banks
Entry into effect of the intra-EU exchange rate mechanism (ERM II)
Entry into force of the Stability and Growth Pact

EMU-Some Facts

- The euro is the single currency of the European Union. Twelve of the then 15 countries adopted it for non-cash transactions from 1999 and for all payments in 2002 when euro notes and coins were issued.
- Three countries (Denmark, Sweden and the United Kingdom) did not participate in this monetary union.
- The new member countries are getting ready to enter the euro area as soon as they fulfil the necessary criteria.
- In parallel with the objective of monetary stability, which is the responsibility of the European Central Bank, the member states are committed to higher growth and economic convergence.

Euro Coins and Notes

Convergence criteria (EMU entry requirements)

- Convergence criteria remain important
  - Operation of EMU - Stability and Growth Pact
  - For countries hoping to join EMU

- Fiscal criteria
  - National budget deficit less than 3% GDP
  - National debt less than 60% of GDP

Convergence criteria

- Monetary criteria
  - Inflation no more than 1.5 percentage points above the average of the 3 countries with the lowest rates
  - Long term interest rates no more than 2 percentage points above the average of the 3 countries with the lowest rates
  - Exchange rate – within normal band of ERM for previous 2 years

Economic benefits of EMU

- Removes exchange rate uncertainty on intra-EMU trade
- Avoids competitive devaluations
- Eliminates transaction costs
- Increases price transparency
- Low and stable inflation and interest rates
- Promotes international specialisation and improves EU competitiveness
- Boosts the EU's international economic profile

Economic risks of EMU

- Short term deflation
- Can ‘one monetary policy fit all’?
- Loss of economic sovereignty?
- Lack of real economic convergence

EMU and the Business Environment

- More predictable trade and investment environment
- Initial transition costs
- Harder for SMEs to adjust?
- Intensified competition
  - greater cost and price transparency
  - some price convergence?
- Impact on external economic environment

ECB

European Central Bank

- Established as core of Eurosystem and ESCB from June 01, 1998
- Independent and supranational
- Responsible for conducting monetary policy and exchange rate policy for the euro area wef Jan 01, 1999
- Primary objective is price stability
- Fiscal policy – remains national – but Growth and Stability Pact to stop member states undermining ECB

Contd.

- ECB has the exclusive right to authorise the issuance of bank notes within euro area
- International and European cooperation

Governing Council

- GC –main decision making body
  - 6 members of Executive Board-President, Vice-President and 4 other members
  - Governors of NCBs of 17 Euro area countries

GC meets twice a month at Eurotower in Frankfurt, Germany

- 1st Meeting- assessment of economic and monetary developments culminating into MP decisions
- 2nd Meeting- issues related to other tasks and responsibilities of ECB and Eurosystem

Wish You All the Best

Thank You