

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
CURRENCY UNION TECHNICAL EXPERT GROUP (CUTEG)**

ISSUES PAPER (CUTEG) # 1

DEFINITION OF CURRENCY UNION

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DEFINITION OF CURRENCY UNION

1. A currency union is an agreement among members of that union (countries or other jurisdictions) to share a common currency, and a single monetary and foreign exchange policy. No definition of a currency union is included in *BPM5*, but in providing methodological guidance for compiling data for a currency union's balance of payments, the updated *BPM5* could include a definition.

I. Current international standards for the statistical treatment of the issue

2. The *External Debt Statistics* (Guide for Compilers and Users) (EDS) provide a clear definition of common currency area in a footnote to paragraph 6.12. According to the EDS, a common currency area is one in which more than one economy belongs and has a RCB with the legal authority to issue the same currency within the area. To belong to this area, the economy must be a member of the RCB.

3. The *BPM5* does not define currency unions. However, it defines the RCB, which is central to the notion of currency unions (though using the term regional central bank rather than currency union central bank). According to the *BPM5*, paragraph 90, a RCB is an international financial institution that acts as a common central bank for a group of member countries. The 1993 *SNA* and *Monetary and Financial Statistics Manual (MFSM)* uses similar language.

4. The *MFSM* makes explicit reference to both concepts of RCBs and monetary unions. With regard to currency in circulation, the *MFSM* explains that difficulties arise in estimating the currency in circulation in the individual member countries of a currency union. Currency issued by the RCB headquarters and/or the national central banks within a currency union circulates as legal tender throughout the union, making it difficult (if at all possible) to estimate the amount of the currency in circulation each currency union member country.

5. Moreover the *MFSM* recommends countries in a currency union to make a two-way distinction in claims on and liabilities to nonresidents in the sectoral balance sheets and surveys (paragraph 91). This distinction is between claims on and liabilities to nonresidents in other union countries and claims on and liabilities to other nonresidents. Claims on and liabilities to the headquarters office of the RCB, when such an office exists, should also be separately identified in the sectoral balance sheets and surveys.

II. Concerns/shortcomings of the current treatment

6. Central to the concept of currency unions is that a RCB exists that has members. The term regional central bank might be more appropriately replaced with currency union central bank (CUCB) for currency union data.

7. The EDS definition rules out as a currency union the circumstance in which a currency of one country is legal tender in another economy(ies), under a dual legal tender arrangement. Under such an arrangement, a country(ies) fixes the exchange rate between their national currency and the currency of another country, which is declared as legal tender in this and perhaps other regional economies. In this situation there is one common regional currency, legal tender in the issuing country and the accepting countries, and several national legal tender currencies, legally circulating in each respective country, but not outside. This is not a currency union.

8. The EDS definition also excludes from currency unions all forms of dollarization or other “-ization” (e.g. euroization) whereby occurs when foreign currency has exclusive or predominant status as full legal tender.

9. On the other hand, a CUCB takes the lead in determining the single monetary and foreign exchange policy and coordinating the practical implementation of the policy decisions. The simple idea behind the notion of a currency union is that a cluster of members (countries or jurisdiction) transfer to a central body, i.e., the CUCB, the sovereignty on the monetary and foreign-exchange policy decisions. This is not explicitly covered in the EDS definition.

10. Also, a currency union can be established without banknotes in the common currency. How does this affect the definition, if at all?

11. When a currency union does exist, does the definition need to clarify what constitutes a member? The wording in the *External Debt Guide* allows some degree of flexibility for currency unions to determine who is a member. On the other hand, defining what a member is could be appropriate, for there are borderline cases. For instance, there are cases where the monetary authority of the monetary union (CUCB, and possibly currency union NCBs) concludes a monetary agreement with other countries or jurisdictions. In light of such bilateral agreements, other countries/jurisdictions are entitled to use the currency union currency as its currency. They are also entitled to grant legal tender status to the currency union banknotes and coins. The agreement specifies whether or not these other countries/jurisdictions shall issue any banknotes, coins or monetary surrogates of any kind, and if yes under which conditions. Normally, such agreements also specify that the financial institutions in the other countries/jurisdictions may have access to payment systems within the currency union under appropriate conditions to be determined with the agreement of the CUCB. But these other countries/jurisdictions might not have voting rights at the decision making meetings. While not explicit, the implications of the *External Debt Guide* definition is that such countries/jurisdictions may be included in the currency union because the CUCB has legal authority to issue the currency in these countries/jurisdictions, and by signing a monetary agreement with the appropriate authorities of the currency union and agreeing to terms and conditions, the other countries/jurisdictions is a de facto member of the CUCB.

III. Possible alternative treatments

12. In light of the issues considered above, it may be argued that the updated *BPM5* should include a definition of currency union drawing on that set out in the *External Debt Guide*, but providing further clarification, such as on a single monetary and foreign exchange policy.

13. Also the manual could discuss the situations of unilateral dollarization (or euroization) and common regional currency, and explain that such arrangements do not constitute a currency union.

14. It could discuss circumstances when banknotes in the common currency are not issued.

15. The manual could acknowledge that countries/jurisdictions adopting the currency union's currency and agreeing to certain terms and conditions through a bilateral monetary agreement, but do not have voting rights in the monetary and exchange rate policy formulation decision making bodies, may be considered members of the currency union for statistical purposes.

16. Finally, for currency union data, the revised manual could replace RCB with the term "currency union central bank."

IV. Points for discussion

- (1) *Would the members of the CUTEG agree on the need for a definition of currency union included in the updated version of BPM5? Can the EXD definition be drawn upon?*
- (2) *Should the updated version of the BPM5 manual refer to currency union central bank when discussing currency unions rather than RCB?*
- (3) *Is there a need to clarify what constitutes membership of a RCB?*
- (4) *Should the currency union also explicitly exclude from currency unions unilateral adoptions of a third currency (dollarisation) and common regional currencies?*
- (5) *Should the updated BPM5 consider as within the currency union, for statistical purposes, those economies that conclude a monetary agreement with the RCB and other union's institutional bodies to adopt the currency union's currency as a legal tender in their economies?*
- (6) *Are there other issues related to the definition that may require clarification?*

References

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

1993 SNA (paras. 14.34).

BPM5 (paragraph 90).

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

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