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MONETARY AND FINANCIAL INTEGRATION OF STATES: EURASIAN REGIONAL PERSPECTIVE

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Abstract

One of the main trends of international relations between states is the process of regional integration, which is typical for every region of the world. As a part of the process there is a tendency of integration in financial sphere, particularly creation of monetary unions. The author analyses the main types of international monetary unions in the light of their usefulness for the developing Eurasian integration process. The paper also gives characteristics of the process of creation of international monetary union within the Eurasian Economic Union.

Key words

Regional integration, monetary union, single currency, European Union, Eurasian Economic Union.

JEL Classification: K33; K34.

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1. Introduction

In recent decades, the world has witnessed a tendency of intensification of regional economic integration. Economic integration, and the consequent deepening of multilevel international economic interdependence, is the most powerful force propelling the transformation of the contemporary international system (Hainsworth, 1995: 586).

This is largely due to the increasing processes of globalization, in the context of which different countries are striving to combine economic and financial potential in the framework of regional integration. Integration processes cover the whole complex of economic relations; however, its monetary and financial level in recent years has become an object of special interest. The intensification of globalization processes, leading, among other things, potentially to global currency and financial crises, makes it necessary for individual groups of countries to cooperate in the monetary and financial field to increase the sustainability of national financial systems and ensure the stability of exchange rates. In order to be sustainable, deep economic integration requires democratic political support. This, however, can be achieved only if the decision over economic policies is transferred to the supranational level, e.g. within the European Union (Lupo Pasini, 2017: 67).

The most successful example of the consistent movement towards economic and monetary integration is the European Union (EU), where a single currency has now been introduced, and a fully integrated financial market is being formed. The analysis of the European experience of economic and monetary integration becomes particularly relevant for the countries of the Eurasian region, primarily for the Eurasian Economic Union (hereinafter – the EAEU). Despite ambitious plans, the real achievements of monetary and financial integration within the framework of the EAEU are currently quite modest. Obviously, the appropriate prerequisites for monetary and financial integration must ripen, and one of the key roles here is played by the achievement of a high degree of development of the economy and financial markets of national states. It should be borne in mind that monetary cooperation has its own internal and definite sequence. It is not achieved overnight, spontaneously, but is a long-term and phased process, which is characterized by multi-level integration relations.

2 Models of regional cooperation in the monetary and financial sphere

Referring to the history of the existence of examples of regional interaction of countries in the monetary sphere, it is necessary to distinguish three main models: West European, Latin American and African.

In Western Europe, the transition to a single currency lasted for several decades (Herrmann, Dornacher, 2017). The main goal of European monetary integration was to provide a system of multilateral settlements, because economic ties in Europe have always been multilateral, and national economies are closely interrelated. It should be noted that already in the late 1950s all countries of the European Economic Community (EEC) supplied to and received from partner countries from 30 to 50 % of export-import goods. At that time, the countries of Europe were united within the framework of the European Payment Union. In the 1970s during the transition of the world to floating exchange rates, multilateral calculations of European countries experienced difficulties. The EEC countries found a way out of the situation in establishing a corridor of mutual currency fluctuations. Later they created the European Monetary System with its own collective unit of account – ECU. These mechanisms constrained (although not always) national courses within a single corridor.

In the 1990s, the general liberalization of capital movements sharply reduced the effectiveness of collective pegging of courses. The brutal crisis of the European monetary system in 1992–1993 proved that to keep more than ten different currencies in a single whole would be very difficult and then it would not work. What remained was either to release them «at will», or abandon them, creating a single currency. The Maastricht Treaty on the European Union (1992: 253), signed in 1992 by the heads of states and governments of the Community, declared the introduction of the single European currency «euro» in cash circulation since 2002. The euro replaced twelve national currencies (at that time the EU eurozone did not include the United Kingdom, Sweden and Denmark). Thus, the process of creating the Economic and Monetary Union (EMU), which lasted for more than 30 years, was completed.

Monetary union is the highest level of international economic integration (Pédussel Wu, 2004: 6), therefore membership in this integration association requires countries to meet the level of countries with well-regulated economies in order to ensure a further high degree of convergence. According to the Maastricht Treaty, there are basic mandatory criteria that should be met by countries. First, the inflation rate should not exceed the average inflation rate of the three states with the lowest level by more than 1.5 %. Secondly, the national currency should not devalue over the past two years and should remain within the range of exchange rate fluctuations at the level of 2.25 % stipulated by the European Monetary System. Third, the state budget deficit should be less than 3 % of the gross domestic product (GDP). Fourth, the size of public debt should not exceed 60 % of GDP.

The beginning of the activities of the European Economic and Monetary Union was successful, and by the time of its creation, the union had the following indicators: the total population of member countries constituted 5 % of world, 15 % of world GDP and 19.5 % of world exports. Positive results and significance of the EMU have been underlined in state practice, in particular, the German Federal Constitutional Court in legal justification recalled the concept of monetary union as a «community stability» (Blazek, 2015: 92).

The second model of regional cooperation of countries in the monetary sphere is the Latin American model. In the 1960–80s there were several international monetary associations in Latin America: the Central American Monetary Union, the Latin American Export Bank, the Balance Compensation and Mutual Lending Mechanism of the Latin American Integration Association and the Caribbean Stabilization Fund. At the same time there were difficulties in creating a common unit of account (Hochreiter et al., 2002).

Member States could not unify national monetary systems, as required by the 1964 Agreement Establishing the Central American Monetary Union (the Agreement for the Establishment of a Central American Monetary Union) and the Central American Monetary Agreement of 1974 (Central American Monetary Agreement). The Central American Peso currency was jointly created, which was used exclusively for mutual offsetting of claims. The Caribbean dollar in turn was strongly pegged to the US dollar. The dollarization process carried out in Latin America in the 1990s completely supplanted the national currency. This process was also promoted by the extremely negative economic situation in a number of countries in the region and the strengthening of the corresponding component in the US foreign economic policy.

In the 1990s in Latin America, the process of dollarization began to gain momentum. The impetus for this process was the sharp deterioration in the economic situation in several countries of the region and the strengthening of the corresponding component of the US foreign policy strategy. In 2000, Ecuador ceased using the national currency — Sucre, preferring the US dollar. Panama and Haiti abandoned the use of national currencies and switched to the use of the US dollar long ago.

In Argentina, for many years, the possibility of replacing the national currency, the Argentine peso with a dollar, has been investigated. At one time, a proposal was made from the Central Bank of Argentina to create a currency union in Latin America that would replace the national currencies with the US dollar and transfer to the United States the authority to regulate issuing and budget policies.

However, the monetary and financial crisis that arose at the end of 2001 made its own adjustments. In Argentina, the monetary and financial crisis intersected with the debt and socio-economic crisis. In the situation that arose, the government was forced to announce the introduction, along with the dollar and the peso, of a new national currency – Argentino. It was intended to alleviate the acute liquidity crisis that arose due to the pegging of the peso to the US dollar (See further: Basnet, Sharma, 2013).

An example of regional interaction of countries in the monetary sphere is also the African model. In Africa, there were two monetary unions in the franc zone – the West African Monetary Union and the Monetary Union of Central Africa. The currency of these unions was the African Community Franc (CFA Franc). It was pegged to the French franc (from January 1, 1999 – to the euro). France guaranteed complete freedom of currency conversion at par, set by the French government, providing unlimited loans to African countries. The member countries of the currency unions agreed on monetary policy, determined uniform rules for issuing a common currency, using common gold reserves, controlling external payments, regulating the activities of banks. France occupied leading positions in the highest issuing institutions of these monetary unions. At its core, the French franc (today the euro) has become for the African countries a parallel currency used for external payments (Mougani, 2014).

The economic community of the states of Western Africa developed the program of introduction by 2004 of the collective monetary unit – afro. The presence of extremely poor countries and countries with a tense domestic political situation in this grouping did not make it possible to implement the project (Sy, 2006).

Currently, within the framework of the COMESA integration group and the African Union, there are ambitious plans to introduce single currencies. In particular, within the COMESA a single regional clearing and settlement system (REPSS) is already functioning.

The combination of individual elements of all of the above models determines the combined model of integration interaction. It should be noted that while the Western European model, being based on stable monetary and financial ties, can be used mainly by economically developed countries, the elements of the Latin American and African models (for example, such as the formation of a payment and settlement system and fixing national currency rates to convertible monetary unit) are implemented both by developing countries and countries with economies in transition.

The EAEU countries can use all available options for cooperation in the monetary and financial sphere to develop their own model for building a monetary and financial space. The forms and instruments of interaction in the monetary and financial sphere will evolve as national economies develop. Russia and its partners in integration associations are laying the foundation for future transformations, unifying national legislation, which is prescribed by EAEU founding treaties. It should be rational to begin to target the level of inflation, budget deficit, to conduct a coordinated tax policy, to set limits on exchange rate fluctuations within the existing integration entities – the Eurasian Economic Union and the Commonwealth of Independent States (CIS).

Thus, we can conclude that the West European version of currency interaction is a currency union created on the basis of an economic union with a single currency of domestic origin. In Latin America, the situation is the opposite. Formerly, countries use external currency for external payments, which subsequently displaces national money from domestic circulation. In Africa, the counting unit is also linked to the foreign currency, which is used only in external accounts.

To date, the world practice has developed three main models of the formation of international monetary unions: West European, Latin American and African. The formation of the monetary union in the Western European variant is possible in conditions of a high level of economic development, while the other models are applicable to countries with transition and developing economies.

3 Creation of the single currency in the Eurasian Economic Union: evaluation of prospects.

Today, the development of the concept of concerted actions aiming at expanding the area of use of national (regional) currencies in order to ensure economic cooperation of the EAEU countries is of great interest.

The Treaty on the Eurasian Economic Union of May 29, 2014, provided for measures to gradually harmonize monetary policy, to ensure the mutual convertibility of national currencies and to enhance their role in foreign trade and investment operations, improve the mechanism of payment and settlement relations (Part XIV «Currency Policy» and Appendix № 15 of the Treaty).

The expansion of payments in national currencies of the EAEU countries will be primarily facilitated by the implementation of a project of creation of an integrated foreign exchange market and the development of mutual trade of the EAEU countries. Despite the current crisis, the countries of the EAEU retain great potential for successful economic development. The main threat to the integration processes in the EAEU is the uneven devaluation of national currencies relative to world currencies.

It is possible to eliminate devaluation pressure on national markets by agreeing on the level of exchange rates of national currencies in relation to reserve currencies. For this, the «currency board» mode can be used. The regulatory framework for the implementation of such a policy already exists. In accordance with the Main Directions of the Macroeconomic Policy of the EAEU member-states for 2019–2020, approved by the decision of the Supreme Eurasian Economic Council on May 29, 2019, the main tool that can ensure the macroeconomic stability of the economies of the EAEU is considered to be the increased use of national currencies of states, including mutual payments in the sphere of external economic activities. The use of such a mechanism will lead to a real increase in the volume of payments in national currencies and eliminate the above risks associated with unequal devaluation of the national currencies of individual countries (Lapenko, 2018).

In the issue of the use of national currencies in international trade calculations, an important role is assigned to national central banks. If the final decision on the circulation of the national currency in order to make payments between two states is made at the government level, then the central banks of the respective countries are involved in the practical implementation and specification of the decision. At a practical level, this is accomplished by signing bilateral agreements between central banks on the organization of payments for foreign trade relations. Typically, these bilateral agreements of central banks are standardized and contain a description of general conditions and basic principles on the basis of which the participants in foreign trade activities of the two countries will cooperate.

Practice shows that the expansion of the use of national currencies in foreign trade takes place gradually and extremely slowly. The process of implementation of the payment agreements signed between the states is connected with the need to solve a very large number of various problems that participants of foreign trade face in practice.

In order to intensify the process of applying national currencies in foreign trade transactions, it is important to eliminate existing legislative, administrative and financial-economic barriers that prevent effective work on the domestic financial markets of national participants in external economic activities by making appropriate additions and changes to previously signed payment agreements between states. Indeed, the same treaties that enable market integration also promote the reduction of those regulatory and administrative barriers that act as a natural safeguard against external instability (Lupo Fasini, 2017: 51).

As part of the integration processes taking place in the countries of the Eurasian Economic Union, the use of national currencies in the provision of services for mutual trade is gradually increasing. This is facilitated by the desire of states to deepen integration cooperation, despite different levels of economic development and the existing imbalances in the economy, and the development of a systematic regulatory framework for economic, including monetary and financial, cooperation. Along with this, there are a number of factors hindering the development of settlements in the national currencies of the EAEU countries. In order to support national currencies in the EAEU countries, market and state regulation measures can be applied to develop operations with these currencies.

In general, the existence of the Union means that:

a) there is a single internal market for goods and services;

b) the customs union is functioning;

c) the common customs tariff and other uniform measures for regulating foreign trade in goods with third countries are applied;

d) there is unified customs regulation;

e) free movement of goods between the territories of the member states is carried out without the use of customs declaration and state control (transport, sanitary, veterinary sanitary, quarantine phytosanitary), with the exception of cases stipulated by the Treaty.

The main bodies of the Union are: the Supreme Eurasian Economic Council; Eurasian Intergovernmental Council; Eurasian Economic Commission; Court of the Eurasian Economic Union.

The EAEU Treaty provides for rules obliging member states to implement a coordinated exchange rate policy. Coordination of the exchange rate policy is carried out by a separate body composed of the heads of the national (central) banks of the Member States and the order of activity of which is determined by an international agreement within the framework of the EAEU.

An important place in the emerging legal framework of the EAEU is occupied by financial and legal norms, both fiscal-oriented and regulating the functioning of the common financial market. According to Section 1 Art. 64 of the Treaty on the EAEU, in order to deepen their economic integration, develop cooperation in the monetary sphere, ensure free movement of goods, services and capital on the territories of the Member States, enhance the role of national currencies of the Member States in foreign trade and investment operations, as well as to ensure mutual convertibility of their currencies, the Member States shall develop and implement agreed monetary policy based on the following principles:

1) phased harmonisation and convergence of approaches to the formation and implementation of their monetary policy to the extent corresponding to the current macroeconomic integration and cooperation requirements;

2) establishment of the required organisational and legal conditions at the national and interstate levels for the development of integration processes in the monetary sphere, as well as for the coordination and harmonisation of monetary policy;

3) inapplicability of any actions in the monetary sphere that may adversely affect the development of integration processes and, when such actions are inevitable, ensuring minimisation of their consequences;

4) implementation of economic policy aimed at increasing confidence in the national currencies of the Member States, both in the internal currency market of each Member State and in international currency markets.

In accordance with Section 4 Art. 64 of the Treaty on the EAEU, exchange rate policy shall be coordinated by an independent authority consisting of the heads of national (central) banks of the Member States, with its activities determined under an international treaty within the Union. The Eurasian Council of Central (National) Banks became such an authority.

In connection with the termination of the Treaty on the Establishment of the Eurasian Economic Community (EurAsEC) of October 10, 2000 from January 1, 2015, there was a need to adapt the constituent documents of the Community to the new situation. In this regard, on November 18, 2015, in Almaty (Republic of Kazakhstan), within the framework of the 33rd meeting of the Council of Heads of Central (National) Banks of EurAsEC member states, representatives of the central (national) banks signed the Agreement on the Eurasian Council of Central (National) Banks. It prescribed, among others, the transformation of the Council of Heads of Central (National) Banks EurAsEC member states to the Eurasian

Council of Central (National) Banks as a consultative and advisory body of the central (national) banks — parties to this Agreement. Council decisions are advisory in nature (Art. 1)[1].

In March 2015, the President of Russia V. Putin instructed the Government and the Central Bank of the Russian Federation together with the central banks of the EAEU countries to assess the prospects for a monetary union. At a meeting with the leaders of the EAEU member states, he stated the need to consider the formation of the single currency. It was decided to postpone the decision of the EAEU member states on the issue. And there still has not been adopted any binding international agreement to implement relevant provisions of the Treaty on the EAEU. But the reflections of aspirations of the EAEU member states and bodies can be found in the main program documents in the field of macroeconomic policy.

In particular, Section V, clause 4 of the Main Directions of Economic Development of the EAEU until 2030 (Adopted by the Decision of the Supreme Eurasian Economic Council of October 16, 2015 № 28) states that «in order to conduct a coherent monetary policy, member states take measures to coordinate the exchange rate policy of national currencies in order to ensure the increased use of the national currencies of member states in mutual settlements between residents of member states, including consultations in order to develop and coordinate exchange rate policy measures».

The Main Directions of the Macroeconomic Policy of the EAEU member states for 2019–2020 were approved by the decision of the Supreme Eurasian Economic Council on May 29, 2019. According to the document, «the priority objective of the macroeconomic policy of member states in the medium term is to ensure dynamic and sustainable economic development by increasing the competitiveness of member states in the domestic and external markets of the Union. It is necessary to focus efforts on strengthening the strategic foundations for stable and sustained growth of the Union's economy». The achievement of this goal will be facilitated by the implementation of national and integration measures, among others, in the form of «creating conditions for expanding the use of national currencies in transactions in mutual trade».

Previously, the Main Directions of the Macroeconomic Policy of the EAEU member states for 2015–2016 prescribed that one of the key areas for ensuring macroeconomic sustainability is «enhancing the use of the national currencies of member states, including:

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1 http://base.spinform.ru/show_doc.fwx?rgn=87860

– the creation of economic conditions that stimulate the formation of deposits in national currencies;

– a ban on pricing in the domestic market in arbitrary units or national currencies of third countries;

– coordination of approaches for the regulation of foreign exchange legal relations;

– continuation of work on creating conditions for expanding the use of national currencies in mutual transactions in the implementation of foreign economic activity;

– improvement of the mechanism of payment and settlement of relations between residents of member states;

– strengthening the coordination of actions in the sphere of currency control carried out in accordance with the currency legislation of the member states».

Conclusion

Monetary and financial integration provides for stabilization of exchange rates, a system of cross-border payments, currency zones, consolidation of currency and financial markets, currency unions, which are the final link in monetary and financial integration and allow creating the single economic space.

Currency unification is a long and complex process. The largest economic union in the world, the European Union, reached the highest form of integration in the monetary sphere: it introduced the single currency for the majority of members of the European Union. Creation of the single monetary system and the formation of the common market of the European Union took 35 years. According to analysts, this process for the EAEU will be somewhat shorter and will take 10–12 years. In other words, the introduction of a unified currency in the Eurasian Union is possible only by 2030, but in the future this is quite feasible. However, it is also possible that the single reserve currency will not be the national currency of any of the participating countries.

In our opinion, evaluating the prospects for the formation of the single currency in the intra-Union space to achieve the goal of introducing a single reserve currency of Eurasian integration project requires a range of measures.

First, it is necessary to harmonize the national legislations of the member countries of the Union on the basis of relevant binding international legal documents.

Secondly, it is obligatory to further deepen economic integration, develop cooperation in the monetary and financial sphere adopting relevant international legal acts, legally ensure the free movement of goods, services and capital on the territory of the EAEU, legally ensure the increasing role of national currencies in foreign trade and investment transactions, as well as ensure the mutual convertibility of national currencies.

Thirdly, among other things, an important condition for the introduction of the single currency on the EAEU territory is the coherence of the central banks of the countries of the Union, ensuring the implementation of a common monetary and tax policy. As already noted, the introduction of a single reserve currency implies the formation of the single currency area. At present, the creation of the single currency area on the territory of the Eurasian Economic Union seems to be one of the most urgent tasks.

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