

# THE ASIAN CLEARING UNION

Towards Monetary  
Cooperation

B K MADAN

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Research and Information System  
for the Non-Aligned and  
other Developing Countries



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## Towards Regional Monetary Cooperation

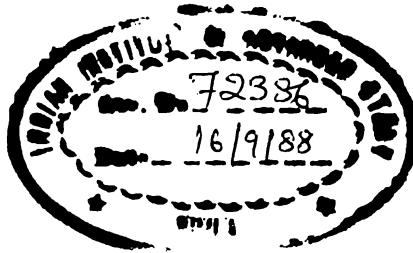
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# Preface

The Research and Information System for the Non-aligned and Other Developing Countries (RIS) is an autonomous body set up in New Delhi (India), with the financial support of the Government of India.

RIS is a forum of providing analytical support to the developing countries on the various international economic issues of concern to the process of their development.

Its aims and objectives, include among others, promotion of the concept of self-reliance among the non-aligned and other developing countries and forging and maintaining a system of effective links amongst the various research institutions of these countries with a view to utilise their research capabilities for the maximum common benefits. It also seeks to serve and effectively function on a continuous basis as a data bank/information storage, retrieval centre on global and regional problems bearing on the interests of non-aligned and other developing countries.

The RIS has initiated different types of publication series—Occasional Papers, Discussion Papers, Reprints, *Digest* on current issues and events, etc.—with a view to generating debate on and awareness of current international economic issues among different sections of the Third World community.

The Asian Clearing Union has been one of the early attempts by the developing countries in Asia towards mutual monetary cooperation. This paper by B.K. Madan discusses the evolution of this institution and lessons to be learnt from its experiences. It is being released with a view to generating wider awareness.

The views expressed in this Occasional Paper are those of the author and not necessarily of the RIS.

V R PANCHAMUKHI  
Director





# The Asian Clearing Union

## Towards Regional Monetary Cooperation

B K MADAN

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The post-war years witnessed emergence of a strong trend toward regional and sub-regional economic co-operation among groups of contiguous countries having historical and cultural links among them. The trend was stimulated with the crippling effects on trade of markets splintered by multiple restrictions, foreign exchange shortages and inconvertible currencies on the one hand, and increasing appreciation of the advantages of economies of scale and larger markets for fuller utilisation of their resources on the other. At the same time, the prospect for global trade and universal economic co-operation remained difficult, alike on account of the sheer size of such an enterprise and the problem of bringing together countries with vastly disparate patterns and levels of development.

Regional economic co-operation among developing countries derives reinforcement from growing protectionism in the developed countries, in particular against the exports of raw materials and manufactured products from developing countries. This

\*This paper was presented at the Second Conference of Research and Information System for Non-aligned and Other Developing Countries, New Delhi, 20-22 November 1985.

worsens the terms of trade of developing countries in the context of a prolonged new phase of subdued international economic activity and trade with sagging international commodity prices. Also a relative decline has been occurring in the flow of aid and capital investment from developed to developing countries. Withal, there is an overhanging international debt crisis of unprecedented proportions. All this lends particular urgency to exercises in what has come to be termed South-South co-operation, though the augury for any comprehensive co-operation among developing countries as a whole is not improved by the above dismal train of developments. However, the fact that Asian countries, including South Asian economies, have held up well against the ravages of the recent recession and have remained buoyant despite an adverse international economic climate, brings into relief the importance of strengthening the ties of regional co-operation in Asia, including smaller groups of countries, e.g. in South Asia, for the benefit of all.

## **I. TOWARDS A PAYMENT ARRANGEMENT IN ASIA**

The beginnings of regional co-operation in Asia go back to the establishment in 1947 of the United Nations Economic Commission for Asia and the Far East (ECAFE) changed in 1974 to Economic and Social Commission for Asia and the Pacific (ESCAP). This was itself an acknowledgement of the relevance of a regional approach to economic and social problems. The Economic Commission started early to explore the avenues of co-operation among its large and sprawling membership, with the help of successive groups of experts from Central Banks and governments of its members as well as from developed countries and the IMF. In relation to the subject matter of this monograph, the ESCAP arranged for a study group to consider the question of a suitable payments arrangement in Asia as early as 1948. On its recommendations, the IMF was inducted into investigation of the scope for a regional clearing arrangement and the IMF on review of the inter-regional trade reported against such a move. Another experts group was set up in 1953 and reported in December 1954. The group took note of the

considerable use made in the region of extra-regional currencies—the sterling, franc and guilder for multilaterally offsetting payments in their respective areas and recommended against a payments union for the region. The group felt that there were limited possibilities for extension of multilateral settlement through such a Union. Also with the pattern of trade imbalance (surpluses and deficits) in the region, the prevalence of persistent creditors and debtors was unlikely to encourage extension of credit to deficit countries in the absence of financial support from outside the region, in particular from the United States which was unresponsive to development of such a regional payments facility.

It was not until the First Ministerial Conference on Asian Economic Co-operation held in Manila in December 1963 that a positive thrust to establishment of a payments arrangement in the ESCAP region was given. This came with the working group of experts on Trade Liberalisation set up by ESCAP definitely favouring some form of a payments arrangement reinforced by an element of credit to obviate self-balancing trade exchanges and to provide for a degree of trade expansion. The proposals for a payments arrangement assumed some concrete shape with the detailed recommendations of the Seminar on Financial Aspects of Trade Expansion convened at Bangkok in August 1967 jointly by ESCAP and the U.N. Office of Technical Co-operation. The conclusion of the seminar touched on such aspects as the optional or mandatory nature of use of the facility, the types of transactions—current or capital, to be eligible for clearance, the periodicity of settlement and interim finance, ceilings on credit, the unit of account, desirability of a large number of members and of providing for inclusion of some members with strong overall balance of payments to enable a greater volume of compensable trade to be covered, etc.

Thereafter, following the strong support of the Third Ministerial Conference on Asian Economic Co-operation in 1968 in ESCAP Secretariat, with the assistance of IMF and UNCTAD experts formulated programmes, including draft guidelines, of trade liberalisation and payments arrangements. A high-level expert Mission set up by ESCAP canvassed the draft proposals

with concerned authorities of prospective member countries in 1970 and draft guidelines for establishment of the Asian Clearing Union (ACU) emerged. With the stamp of approval of the Kabul Declaration on monetary co-operation the Preparatory Committee for ACU got into stride and a meeting of senior government and Central Bank officials held in February 1973 adopted by the Draft Agreement for establishment of the ACU. The agreement entered into force on 9 December 1974 when directors representing the Central Banks of Iran and Sri Lanka the first signatories (11-23 April 1973) and the Central Banks of India, Pakistan, Bangladesh and Nepal who signed subsequently, held their first meeting; Burma became a member in January 1977. The Union commenced operations with effect from 1 November 1975, with its headquarters at Tehran (Iran), and the Central Bank of the Islamic Republic of Iran as the Agent of the Union.

The Union's Board of Directors is made up of the governors of the Central Banks of the participating members, with an alternate each, one of whom is Chairman for a year by rotation. The Board appointed a Technical Committee of Officers to work out expeditiously the clearing procedure and sort out operational issues; technical officers continue to be nominated to be in charge of the Union matters in each of the Central Banks.

### **The Asian Clearing Union: Geographical Scope**

It will be observed that what started out in its search to be a payments arrangement for Asia or the ESCAP region came to be and remains in effect as an arrangement for a somewhat enlarged South Asia, though its doors remain open to a larger membership. Ideally, an extension of ACU's scope to the entire region for which the scheme was originally formulated, would seem eminently desirable. However, as it turned out the inordinately slow pace of development of economic co-operation in the ESCAP region as a whole, with its far-flung and heterogeneous character stimulated development of co-operation in more compact and contiguous sub-regions. This apparently limited the immediate appeal of membership of the ACU to what it is at present. Similarly, there had come into being the Regional

Co-operation for Development (RCD) Union for Multilateral Payments Arrangements among Iran (Islamic Republic of), Pakistan and Turkey as early as 1967 on the one hand, and the Arab Monetary Fund comprising 19 Arab states in 1976 on the other, closely followed by ASEAN with its Swap Arrangement among five (now six) Southeast Asian states—Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. The development of the sub-regional organisation has also thrown into relief the identity of South Asia with a number of common traits and problems of its member countries as a sub-region or region suitable for development in co-operation. The geographical coverage proper of ACU thus has come to coincide for the present in large part with the South Asian region accepted as such in other contexts, with the inclusion of Iran and Burma and with some other adjustments.

#### **Payments arrangements in ESCAP region: Case for clearing arrangement**

It will be of interest at this point to review the payments arrangements which prevailed in the ESCAP region on the eve of establishment of ACU, which also give a closer clue to the circumstances of its establishment.

In many countries of the then ECAFE (now ESCAP, region a predominant part (75 to 90 per cent) of the intra-regional receipts and payments was effected in sterling and the U.S. dollar, the sterling area members setting the transactions primarily in sterling. The exchange control regulations of the countries were basically designed to ensure that receipts were obtained in convertible currencies. However, in some South Asian countries payments could be received in certain regional currencies, chiefly the Indian rupee which predominated in India's transactions with Afghanistan and Nepal and was prominent in settlement of trade between India and Sri Lanka.

British and American banks maintained a network of branches and an even wider coverage of correspondent relationship in the Asian countries. The regional commercial banks had a limited number of branches in foreign countries but over time had developed fairly widespread correspondent and agency

relationships, particularly in London and New York. These arrangements facilitated international payments within the region as well as generally. However, with final payments between any two countries having to be squared generally in London and New York, appreciable working balances had to be maintained in these centres for settling international transactions. The factors favouring such extra-regional settlement arrangements were apart from tradition inherited from the colonial past, the requirement to receive export proceeds in convertible currencies and the availability of trade financing and foreign exchange conversion facilities in the financial centres abroad.

The instrument of payment commonly utilised for conducting intra-regional trade was the bill of exchange, mostly under letter of credit (l.c.). The l.c. of the importer, besides assuring payment to the exporter, facilitated trade financing. The use of telegraphic transfers, mail transfers and banker's drafts was limited to non-trade items.

Two reports about that time, an ECAFE report of 1971<sup>1</sup> and an IMF study of 1969<sup>2</sup> dealt with the case of a regional multilateral payments arrangement in some depth in the context of the prevalent systems and practices for payments at the time. The ECAFE report was more forthright in appraising the likely benefits of an Asian clearing arrangement, broadly as follows:

With the primary purpose of a clearing scheme for compensable transactions<sup>3</sup> being the multilateral offsetting of claims arising over a period through settlement in foreign exchange only of the *net* position (net credit or debit) of members at the end of the period rather than of the sum of all export and import transactions, and appreciable saving in use of foreign exchange reserves by a country could be achieved through it. The banks could also reduce the working balances (including short-term borrowing) in foreign exchange required by them to settle intra-regional transactions in the financial centres of London and New York.

The major costs in settling international transactions were:

- i) for double conversion of currency of the importer into

- foreign exchange and of foreign exchange into the exporter's currency, dependent on the buying and selling rates for currencies of banks;
- ii*) for financing of trade where the interest rate applicable to the transit time of a transaction appeared to form the largest component of the costs;
  - iii*) commission for opening and confirming letters of credit and commission for collection of bills, and other handling charges;
  - iv*) other charges such as cost of cables, postage and stamp duty.

With regard to these costs it was noted that, for one thing, with a regional clearing mechanism, the need for double conversion of currencies would be obviated, with consequent reduction in settlement cost. Also, the margins between the buying and selling rates for sterling or U.S. dollar, applied for conversion into regional currencies, were much larger than between currencies of industrial countries, which were cut to very fine margins through competition (and a larger turnover).

The IMF study was less clear in regard to the possible direct benefits of regional payments mechanism, but it seemed to appreciate more clearly some general advantages from the institution of such a scheme. Thus, it saw some possible gains "from multilateralization of payments now settled through bilateral account," though the amount of this gain could be "only marginal" as bilateralism played a minor role in the region. Again, interim credit that a country might receive would be available to the Central Bank, not to the trader who benefited more by the speed of effecting transactions; and such speed was unlikely to be improved where active relationships existed among banks. Also, "the cost of financing trade has to be borne by the trader whether a clearing arrangement exists or not." However, the IMF study acknowledged "the fact that a clearing arrangement removes the need for foreign exchange conversion at one end of the transaction" which "also means that the need for forward cover is eliminated for one party." As regards the transactions demand for foreign exchange, viz. the need for commercial banks to keep working balances abroad,

the change in clearing mechanism was “unlikely to make a perceptible reduction” in such need, since trade with countries outside the region would continue to be settled in foreign exchange and banks needed access to international credit for financing extra-regional transactions. The IMF study concluded:

On general grounds, it is undeniable that regional cooperation by such means as trade liberalization, co-ordination of investment programmes, and integration of national markets can be of advantage, as access to a larger market will permit fuller utilisation of the economies of scale and greater specialization. The enlargement of the market through regional co-operation can provide a framework for more efficient allocation of resources. The justification for a clearing arrangement could perhaps be sought in the context of wider regional economic co-operation. . . . It can be argued that co-operation in monetary and exchange matters is important for any effective regional or sub-regional programmes to promote trade and, economic growth. A clearing arrangement, by promoting close contacts among monetary authorities and commercial banks, could provide opportunities for such co-operation.

## II. ASIAN CLEARING UNION: PROVISION AND OPERATIONS

The Asian Clearing Union has now been in operation for a decade to facilitate payments for current international transactions on a multilateral basis among its members. The Union owes its origin to the growing recognition in the sixties and early seventies that a multilateral clearing arrangement among countries in Asia, as in other developing countries was a useful ancillary to regional trade expansion. Established at the end of 1974, the objectives of ACU are:

- a) to provide a facility to settle, on a multilateral basis, payments for current international transactions among the members;
- b) to promote the use in *current* transactions of regional



member currencies and reduce that of extra-regional currencies, and thereby help effect economies in the use of participants' exchange reserves; and

- c) to promote monetary co-operation among the participants and closer relations among their banking systems and thereby contribute to the expansion of trade and economic activity among the member countries.

All the countries have now made it mandatory to route their transactions arising out of trade among members through the Union. To start with, payments for petroleum and petroleum products, natural gas and its products were not eligible to be made through the clearing facility. In 1983, the Islamic Republic of Iran announced its decision in principle to include such payments within the scope of clearing through ACU. However, it appears that it took quite some time for the Union to sort out with the Iranian authorities various technical problems arising out of this major move, including modalities of conversion of U.S. dollars into Asian Monetary Units (AMU), the accounting unit of the Union and into Iranian Rials. Finally, the decision to route all trade transactions of Iran has come into effect from 15 July 1985. The Reserve Bank of India too has introduced compulsion to route all eligible payments, other than payments for travel, for transactions between India and member countries of ACU to be settled through the mechanism of the Union with effect from 1 January 1984.<sup>4</sup>

These two decisions taken by India and the Islamic Republic of Iran are expected to significantly increase the volume of operations of the ACU, and thereby improve the effectiveness of the Union.

For settling transactions through the ACU, the commercial banks of each country are required to keep separate accounts with their branches or correspondents in other member countries designated as "ACU Clearing Accounts" and designed to facilitate intra-regional settlements. The commercial banks can dispose of any surpluses in their ACU Clearing Accounts with the correspondent banks or get such accounts replenished by sales to, or purchases from, the Central Bank.

The Central Bank is prepared to sell to and buy from

Commercial Banks in the country the currencies of other members at rates based on the exchange rates, in terms of the AMU which is equivalent in value to one unit of the Special Drawing Rights (SDR). For settlement between Central Banks of the member countries, the accounting unit is the AMU.

For purposes of accounting each calendar month is divided into three "accounting periods"—1 to 10, 11 to 20 and 21 to the last day of the month. The cross-rates of AMU vis-a-vis each participant's currency are announced by the Union for each accounting period. Settlement between the Central Banks is, however, made at the end of each two-month period on the basis of the *net* position and accrued interest calculated on the daily outstandings and of the amounts a Bank has to pay to or receive from other participants. This feature of the clearing mechanism whereby settlement is of the net outstanding debit position as of the end of each two month settlement period helps to effect a measure of economy in the use of foreignexchange. The actual settlement among the participating countries is made in any (convertible) international reserve assets specified by the Board of Directors or in the currency of the creditor subject to its consent.

It is of interest to observe the comparative growth of (a) the total intra-ACU trade of the member countries and (b) the part of the trade cleared through the ACU, country wise. This is brought out in the tables A and B.

It will be seen from Table A that the total value of trade among ACU members (including oil) increased in 1983 over 1982 by 430.6 million U.S. dollars or by 20 per cent. The total transactions channelled through ACU also rose considerably (by 39 per cent) from 466.5 million AMUs to 646.7 million AMUs (about U.S. \$ 700 million) (see Table B.). However, the transactions routed through the Union are still a fraction (less than 30 per cent) of the total intra-trade leaving 70 per cent of trade outside the system. The considerable lee-way of the channelled in relation to total trade is explained by two factors:

- 1) Payments for oil and oil products were still made outside

**Table A: Total trade and trade balance of ACU members (millions of US dollars)**

	<i>Exports to ACU</i>		<i>Imports from ACU</i>		<i>Surplus (+) or Deficit (-)</i>	
	1982	1983	1982	1983	1982	1983
Bangladesh	87.5	130.2	96.7	73.9	-9.2	+56.3
Burma	33.1	45.4	20.8	6.5	+12.2	+38.9
India	319.0	355.0	1208.0	1117.0	-889.0	-762.0
Iran	1276.0	1196.0	282.0	756.0	+994.0	+440.0
Nepal	18.2	18.7	85.3	79.9	-67.1	-61.2
Pakistan	239.7	571.8	152.1	207.0	+87.6	+364.5
Sri Lanka	82.1	75.5	314.2	349.4	-232.1	-273.9
<b>Total</b>	<b>2055.6</b>	<b>2392.6</b>	<b>2159.1</b>	<b>2589.7</b>	<b>-103.5</b>	<b>-197.1</b>

(i) Exports f.o.b.

(ii) Imports (c.i.f.)

(iii) Iran imports/exports from 170 ACU members derived from partner country for the entire years 1982 and 1983.

Source: Asian Clearing Union, *Annual Report, 1984*; Originally compiled from International Monetary Fund, *Direction of Trade Statistics, Year Book 1984*.

**Table B: Asian Clearing Union: Total\* transactions debited/credited to participants, 1984 (in million AMUs)**

<i>Country</i>	<i>Debit (-)</i>		<i>Credit (+)</i>		<i>Net</i>	
	1983	1984	1983	1984	1983	1984
Bangladesh	20.3	40.8	130.8	137.4	110.5	96.6
Burma	1.9	1.0	11.0	36.9	9.1	35.9
India	42.9	84.4	201.5	278.4	158.6	194.0
Iran	209.7	238.2	3.0	7.4	(-)206.7	230.8
Nepal	2.5	6.1	0.1	0.1	(-) 2.4	6.0
Pakistan	101.5	137.0	23.9	41.5	(-) 77.5	95.5
Sri Lanka	87.6	139.2	96.05	144.9	8.4	5.8
<b>Total</b>	<b>466.5</b>	<b>646.7</b>	<b>466.5</b>	<b>646.7</b>		

\*Including interest.

Source: Asian Clearing Union, *Annual Reports, 1983 and 1984*.

the system—these accounted for 46 per cent of the total intra-trade;

- 2) Payments between Iran and Pakistan and between India and Nepal are not eligible for clearance through the Union; these amounted to about 24 per cent of the total intra-trade.

The inclusion of payments for oil and oil products within the system should thus make a big change in the entire pattern of payments balances of ACU members and considerably increase the volume of ACU operations during 1985 itself and even more from 1986.

Table B shows that the main net creditors in the system are India and Bangladesh with their credits being much larger than debits, and the main net debtors have been Iran and Pakistan, whose debits have greatly exceeded their credits. Sri Lanka has had fairly large credits as well as debits, with a small net credit position. India has generally been a heavy netcreditor throughout the period of working of ACU with its exports to ACU members routed through the Union being consistently and considerably in excess of its imports thus settled.

At this stage, the continued increase in the total amount of transactions channelled through the ACU from year to year since the first full year after commencement of its clearing operations may be observed, as in the figures below:

**Transactions cleared through ACU**

<i>Year</i>	<i>Total amount (in million AMUs)</i>	<i>Percentage increase</i>
1976	22.2	
1977	68.0	205
1978	109.9	62
1979	124.9	14
1980	140.5	13
1981	228.5	62
1982	272.1	19
1983	466.5	71
1984	646.7	39

It will be seen that the operations of ACU have been expanding by fits and starts and have now assumed sizable dimensions.

### Assessment of functioning of ACU

The *raison d'être* of a regional clearing arrangement being to facilitate intra-regional trade, it is of interest to enquire what has been the impact, if any, of increasing ACU operations on intra-regional trade. The available data in this regard are not sufficiently up-to-date to reflect any incidence of the very recent expansion of ACU operations; also figures for Burma and Iran are not available. The following Table gives figures of intra-regional trade of five South Asian countries from 1979 to 1982.

Table C: Intra-regional trade\* (in millions of US dollars)

	<i>Exports</i>			<i>Imports</i>		
	<i>World</i>	<i>South</i>	<i>Percentage</i>	<i>World</i>	<i>South</i>	<i>Percentage</i>
<i>Bangladesh</i>						
1979	656.0	51.6	7.9	1,928	74.7	3.9
1981	791.8	65.4	8.25	2,651	124.3	4.7
1982	768.0	63.0	8.2	2,334	72.7	3.1
<i>India</i>						
1979	7,679	307	4.0	9,099	65.0	0.65
1981	8,185	215	2.6	16,850	152.0	0.91
1982	8,559	180	2.1	16,131	98.0	0.6
<i>Nepal</i>						
1979	67.1	28.1	41.9	163.4	84.9	51.95
1981	68.1	27.1	39.8	207.5	92.2	44.4
1982	45.8	13.5	29.5	252.4	78.1	30.9
<i>Pakistan</i>						
1979	2,056	126.1	6.1	4,061	114.6	2.8
1981	2,881	157.8	5.5	5,410	105.9	2.0
1982	2,374	121.3	5.1	5,230	99.2	1.9
<i>Sri Lanka</i>						
1979	978.1	60.7	6.2	1,449	183.3	12.65
1981	1,011.1	88.2	8.7	1,857	96.9	5.2
1982	1,033.0	63.0	6.1	1,813	90.7	5.2

Source: IMF, *Direction of Trade Statistics*.

The above figures bring out that except for Nepal which is a special case, intra-regional trade within South Asian countries (excluding Iran and Burma) is small in relation to their world trade. It will also be seen from the percentage figures of exports to and imports from South Asian countries that these declined generally during the period. Such a decline could not have occurred *because of* ACU's functioning during the period. It apparently occurred *despite* the favourable framework of the ACU for trading, presumably owing to the simultaneous operation of other hurdles to trade within the subregion of South Asia: trade among the developing countries of Asia as a whole expanded in relative as well as absolute terms. On the whole, a period of three years coinciding with the initial phase of ACU is too short for definitive conclusions about the effects on trade of the Union. By next year the full effect of inclusion of payments for oil and oil products will be reflected in the operations of the Union, which have already gone up substantially with compulsory routing of all eligible transactions through ACU by India. An in depth study after a couple of years to analyse the impact of the enlarged base of ACU transactions in the context of trade trends within the region will be timely and useful.

In the meanwhile, a preliminary assessment may be formed of the likely benefits realised from the working of the ACU facility on such tentative observations as are available. In this connection, the author was associated with studies of the functioning of various aspects of ACU conducted at the instance of the Committee for Studies in Co-operation for Development (CSCD) based on interview surveys among commercial banks conducted during 1983. The views expressed by commercial bankers regarding their experience of the operation of ACU are of some interest. The bankers considered that the settlement being of *net* balance, at intervals of two months, there was an appreciable saving in foreign exchange to the Central Banks. Regarding the advantage to the traders, there was, it appeared a saving in the transaction cost since the normal transit time which largely conditions the cost was less for settlement of receipts and

payments in local currency through the ACU procedure than for sterling or dollar bills, though the relatively underdeveloped state of communication services in the region reduced this advantage. The advantage was further reduced since, unlike under the earlier procedure of general recourse by commercial banks to the Central Bank, the present requirement to hold working balance, with their correspondents in other member countries for making the settlements, entailed a cost to banks. However, there were further elements of saving in transaction costs which are confirmed by banks, arising out of the fact that the conversion of currencies under ACU procedure was at one end instead of at two ends through sterling or dollars, and the comparatively smaller exchange rate fluctuations in dealing through AMUs than through sterling or dollars. There appeared to be a consensus too that banking connections which are much more intimately developed with London and New York will have to be oriented toward the region to under-pin the development of intra-regional trade and counter-balance some of the weightage enjoyed by trade with and through the developed centres.

Development of an effective network of banking relationships posits more efficient postal and telecommunications services as infrastructure for financial services and for trading. This is thus another direction of development of intra-regional services that claims some priority of attention. However, all these—more effective and less costly settlement facilities supported by more efficient banking and communication services can only *facilitate* intra-regional trading, provided the environment for such trading is favourable. For an increase in intra-regional trade actually to take place, direct measures are required to remove the administrative and other obstacles to trade which have sometimes reduced its flow to a trickle even where the potential is considerable.

### III. POSSIBLE FUTURE DEVELOPMENT OF ACU: TOWARDS MONETARY COOPERATION

What are the possible directions of further development of the clearing arrangement of ACU? The last major development

in this facility which has come into effect only very recently is the inclusion of oil and oil products within the scope of clearing through the Union. This would change Iran's status from a chronic net debtor in the system to a large net creditor, and correspondingly change other net creditors such as India into possible net debtors. The system will have to be allowed to absorb the impact of these large shifts in relative positions of members vis-a-vis the Union before any other important changes in the system were considered.

The subject of further improvement in the payments infrastructure of trading, viz. the clearing mechanism shades into that of closer monetary co-operation. Payments and clearing arrangements are in themselves an articulate form of monetary co-operation. As we have seen, monetary co-operation in this form as embodied in the Asian Clearing Union is now well developed, the Union having functioned as an operating mechanism of co-operation among central banking systems of participating countries of Asia for a decade, with its coverage of transactions enlarged recently, its use made compulsory and its operations multiplied manifold, and set to increase further. Any widening of the area of monetary co-operation could best be based on the foundations that exist.

### **Geographical coverage of ACU**

A principal part of this foundation being the ACU, an issue of importance regarding it is whether its geographical coverage could not with advantage be enlarged. A major limitation of the present coverage is that only one member, viz. India has been a large net creditor and henceforth with the inclusion of oil and oil products within the clearings, Iran might take this place. Various studies, among them by S de S Gunnetilleke on the Scope and Strategy for Consolidation and Expansion of the Asian Clearing Union (December 1983) and by Mahbub Matin (Bangladesh Development Studies, September 1982) have shown that the scope for offsetting transactions multilaterally and for reducing settlement in extra-regional currencies would be much greater if the area of clearings were to include Southeast Asia and, say, Korea, China, Japan or Australia. Since a formal



extension of the membership of ACU to include far-flung countries might not be feasible at this stage, an alternative possibility may be explored for ACU to be able to compensate payments, through reciprocal arrangements with other clearing systems or countries—developed as well as developing—having significant trading relations or potential for trading with members of ACU. This suggestion of building up linkages in due course between functioning clearing schemes, in particular of developing countries, has relevance in the context of the focus on South-South co-operation.

#### **Transactions coverage of ACU**

In due course, another look at the ineligible transactions with a view to enlarging the scope of eligible transactions in the ACU may be worth taking. Apart from trade between entire countries which is excluded at present (e.g. between Iran and Pakistan or between India and Nepal), an item—a constituent of current invisibles—which may be suggested to be considered for inclusion within the clearing system of ACU is travel among ACU members, which at present involves use of extra-regional currencies and acts as a hinderance to educational, cultural, tourist and business exchanges among the member countries.

#### **Asian Development Bank: A symbol of monetary cooperation**

Reference to monetary co-operation in Asia may not omit to take note of another symbol of such active co-operation in the area in the Asian Development Bank. A development bank or investment bank is one of the hallmarks of regional monetary and economic co-operation and Asia has come to be equipped with this instrumentality for development in co-operation like other regions, notably Latin America, Africa and the Arab States, besides, of course, Europe.

#### **Monetary Union?**

An ideal of monetary co-operation among countries finds expression in a monetary union with highly integrated currency and central banking systems among the co-operating countries. Examples of this are few and with highly specialized

backgrounds. Or, as in the European Monetary System it remains as aspiration rather than a near-term target. On the whole, deliberate merger of essential elements of the identity of independent monetary systems is yet to find an actual illustration. We may leave it out of account at present in the South Asian context.

A weaker relationship among member countries of a group than a monetary union is one of fixed, though adjustable, exchange rates. Inasmuch as greater stability in exchange rates and approximation in exchange systems is desirable for the promotion of trade and economic co-operation in a region, this may remain a medium-term goal of policies among members of the ACU. For the present, however, this objective would require exploration of the measure and pace of harmonisation of domestic monetary policies which would conduce to progress in its direction, and it remains a suitable subject for research and consultations in the Technical Committee of the Union.

In general, it seems that in approaching monetary co-operation among South Asian countries, its more ambitious forms which might involve a derogation from autonomy of domestic policies and a high degree of deference to common goals and standards for such policies might well be held in abeyance.

#### **More credit for clearings**

However, a review of various clearing arrangements shows that the 'interim finance' provided by ACU covers a relatively short period of two months as compared with four to six months and even longer periods in other arrangements. As and when a further move toward strengthening the clearing facility can be taken, as a first step toward liberalization of the interim finance facility, the feasibility of extension of the settlement period may be considered. It is to be understood that such a limited financial facility which is incidental to clearing operations, would be of help to countries experiencing balance of payments problems of some severity or duration.

A normal and effective ancillary to clearing arrangements has been found to be the introduction of an additional dose of credit whether through the machinery of the Clearing Union

and as an integral component of it (e.g. by lengthening the period of settlement) and/or through a complementary network of credit lines. Once the shifts in relative positions in the clearings following the inclusion of oil products have been effected, a further step in the direction of liberalisation of credit associated with clearings may be considered by ACU members as a contribution toward monetary co-operation.

Since monetary co-operation is designed to subserve the wider objective of trade liberalization and expansion there is a presumption that a move toward larger credit could well be complementary to, and progress therein *pari passu* with, a deliberate advance toward freer and larger trade among the members. Availability of some support in resources from outside the system could facilitate progress in both directions.

### **A South Asian Monetary Cooperation Fund**

The forms of monetary co-operation in other (developed as well as) developing countries suggests another possible direction of further development of monetary cooperation in the South Asian region, again in the years ahead if not in the immediate future. This is to consider the establishment of what may be termed a South Asian Monetary Co-operation Fund, on the lines of various institutions/funds which have been set up in different countries—developed as well as developing—generally supportive of the operations of clearing schemes as well as complementing the IMF's operations and furthering its broad aims in a regional context. Such institutions/funds also reflect the principle of joint management of foreign exchange reserves of the member countries.

The development of such institutions took place earlier in developed countries. Notable among these has been the Bank of International Settlements and a more apt illustration is that of the European Monetary Co-operation Fund allied to the European Monetary System and supporting it. In the developing countries, there are the precedents of the Central American Monetary Stabilization Fund, the Financial Assistance Agreement of the Latin American Free Trade Association replaced by the Santo Domingo Agreement and the Andean Reserve Fund—a

credit agreement linked to a sub-regional integration scheme (the Cartagena Treaty) having a juridical status of its own. The first and the last among these also manage small proportions of the reserves of member countries in addition to extending balance of payments support to those in need. There are, besides the Abu Dhabi Fund for Arab Economic Development, the Arab Development Fund and the Kuwaiti Fund. Many developing country funds complement and support the operations of clearing schemes for respective areas. Should there be a willingness to consider an advance in monetary co-operation in this direction, an intensive study of the working of various funds will be worthwhile.

#### **A SWAP arrangement**

Alike a lengthening of the settlement period and establishment of a Monetary Co-operation Fund involve a certain formal adaptation of the present mechanism, and either of these would operate with a degree of automaticity, generally within a framework of contribution (costs) and credit availability (benefits). Until Governments and Central Banks of the member countries are prepared to adopt such changes, which imply a centrally operated multilateral network of credit lines, they may like to consider a lesser step of agreeing on the outlines of a SWAP arrangement as in ASEAN bilaterally determined and centrally operated for facility as a complement of the clearing arrangement.

#### **Cooperation in exchange systems and exchange arrangement**

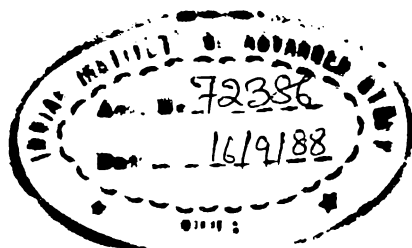
As mentioned earlier, a crucial aspect of monetary cooperation consists in working toward greater accommodation and approximation among the exchange rate arrangements and exchange systems of the member countries with a view to reaping the benefit of comparative exchange rate stability and freedom from exchange restriction for mutual trade expansion. This form of co-operation can, indeed, be as important as measures of trade liberalisation, for the risks of exchange rate instability and exchange restrictions or inconvertibility of currencies can pose big hurdles to trade and international transactions. Hence it was

that the European Monetary System placed co-operation in exchange rate management, and in domestic policies therefore, as the centre-piece of monetary co-operation. Therefore, it would seem worthwhile for the monetary authorities of South Asian countries, given a common forum of consultation and discussion, to explore whether and how far they can: a) advance toward harmonising their exchange systems and arrangements, and b) reduce and, in due course, eliminate any exchange (as distinct from trade, viz. tariff and non-tariff) restrictions so as to introduce and establish, consistently with their IMF obligations, limited convertibility of their currencies *inter se*. An area which may in particular be considered for introduction of limited convertibility of currencies among South Asian countries/ACU members relates to the field of travel for education, business, culture, sports and tourism in general.

#### **Data banks for South Asian economies**

A serious difficulty facing scholars and researchers of South Asian problems concerns the lack of statistical and other information relating to the progress and development of South Asian economies. This suggests the need of setting up data banks on South Asia, if possible at more than one place among South Asian countries, and establishment of institutes or centres of research in South Asian problems for objective and systematic analysis of the threads that form the web of monetary and economic and indeed wider co-operation.

The objectives of economic co-operation and trade expansion require a number of measures directly favouring them. A degree of monetary co-operation is a necessary but not a sufficient ancillary for the achievement of these objectives. It will remain an element—an important one—of the overall framework to facilitate fulfilment of the larger economic goals of concerted development in cooperation among a group of countries. These can, however, be effectively promoted by a variety of actions and policies impinging on trade itself by member countries of the group or region, progressively operating in greater concord. #



## References

- 1 United Nations, New York, 1971 Economic Commission for Asia and the Far East, Bangkok, "Trade and Monetary Co-operation in Asia and the Far East"—Regional Economic series No. 7.
- 2 "Existing International Banking and Credit Facilities in the ECAFE Region," IMF Staff Papers, Vol. 16, No. 3, November 1969.
- 3 Compensable is defined as exports or imports, whichever is lower, multiplied by two, which gives the amount of trade that can be settled by offsetting payments in local currencies, only the balance remaining to be settled by final payment in foreign exchange.
- 4 However, import or export transactions involving settlement on deferred payments are to be excluded from the scope of compulsory settlement of the deferred instalments through ACU. Also, payments for import of goods from India by importers in Bangladesh under the Wage Earners Scheme (WES) operation in that country are kept outside the purview of compulsory ACU procedure. Under the WES, importers in Bangladesh are permitted to buy foreign exchange from the inward remittances pool of Bangladesh at premium rate to finance such goods import.

## **RIS Publications**

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- 2 Transfer of Resources to Developing Countries: Nature and Direction of Reform in the International Financial System** by M. Narasimham, 1984, 24 pp., Rs. 10, \$2
- 3 The World Crisis: How to Serve the Interests of the South?** by Jan Tingerben, 1984, 10 pp., Rs. 10, \$2
- 4 New Perspectives in North-South and South-South Economic Relations,** 1985, 69 pp., Rs. 10, \$2
- 5 Industrialisation, Foreign Capital and Technology Transfer: Mexican Experiences, 1930-1985** by Miguel S. Wionczeck, 1985, 24 pp., Rs. 10, \$2
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