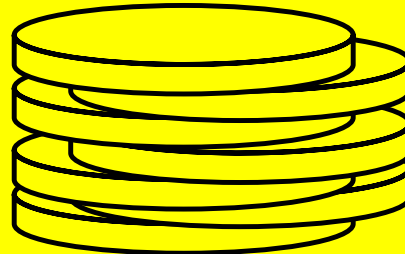


# SINGLE CURRENCY FOR SOUTH ASIA



**An IS Presentation**

**By:**

**Abdul Majid Yousfani**

**SZABIST**

*SHAHEED ZULFIKAR ALI BHUTTO*

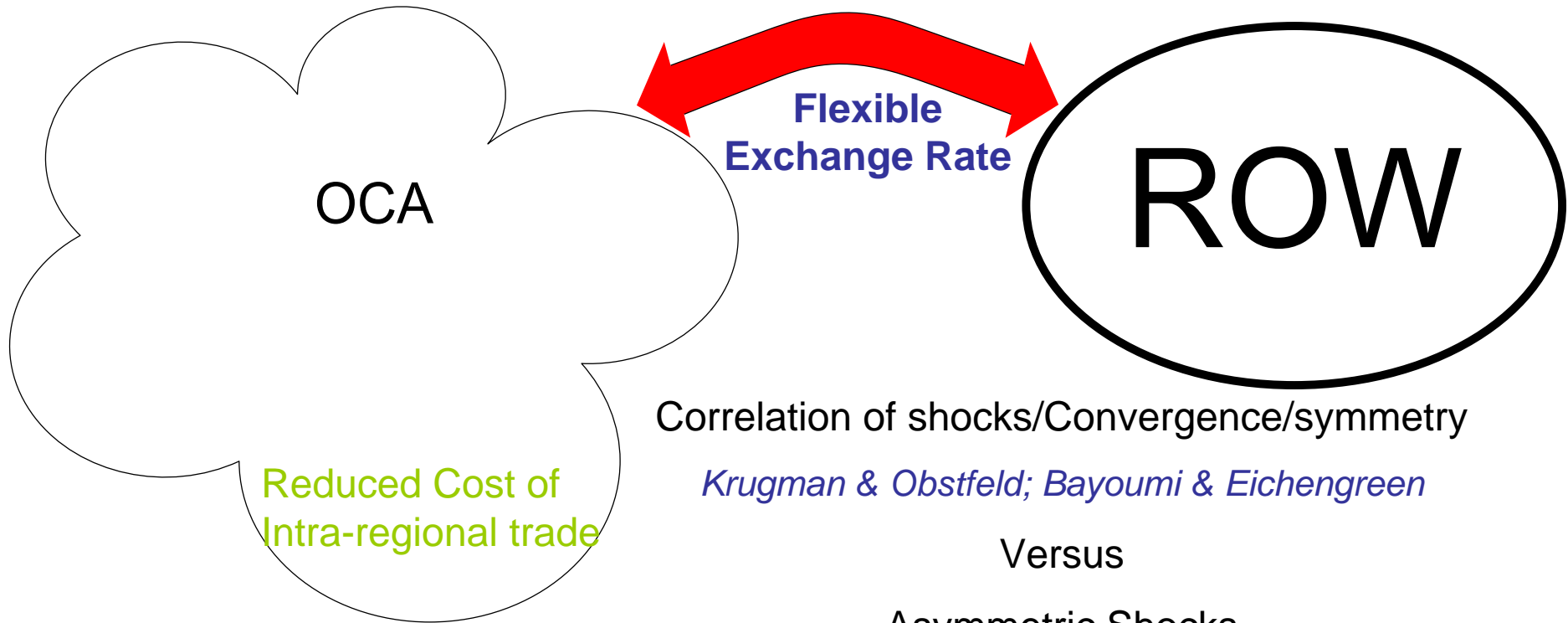
**INSTITUTE OF SCIENCE & TECHNOLOGY**

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# Scheme of Presentation

- Introduction to OCA
- Why Single Currency for South Asia ?
- Economic Integration in South Asia
  - Welfare Effects of SAPTA/SAFTA
- The Four Tests, Brown Test, VAR
- Recommendations
- Conclusion
- Questions and Answers

# Concept of Single Currency

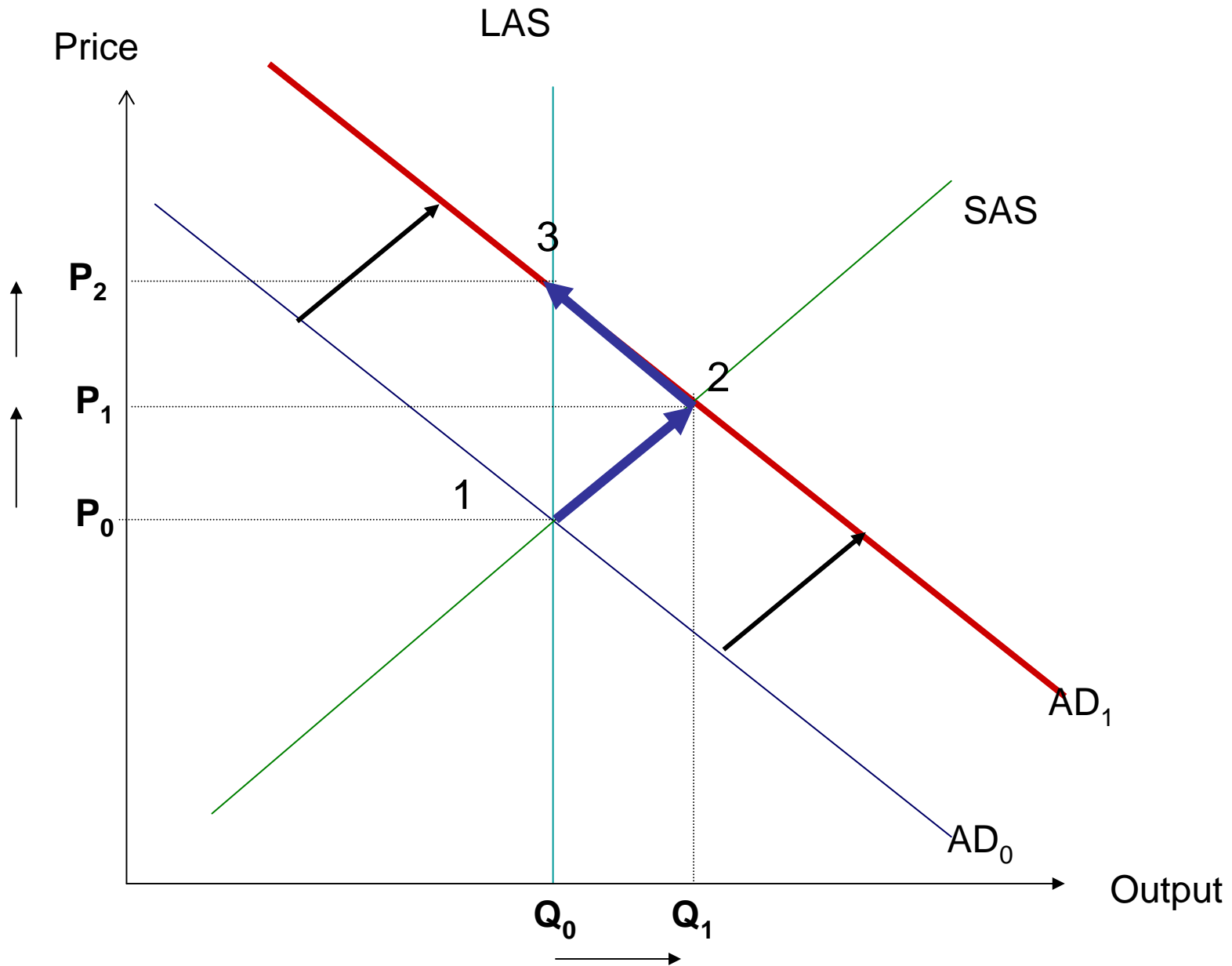


**Flexible Exchange**  
Rate is positively harmful

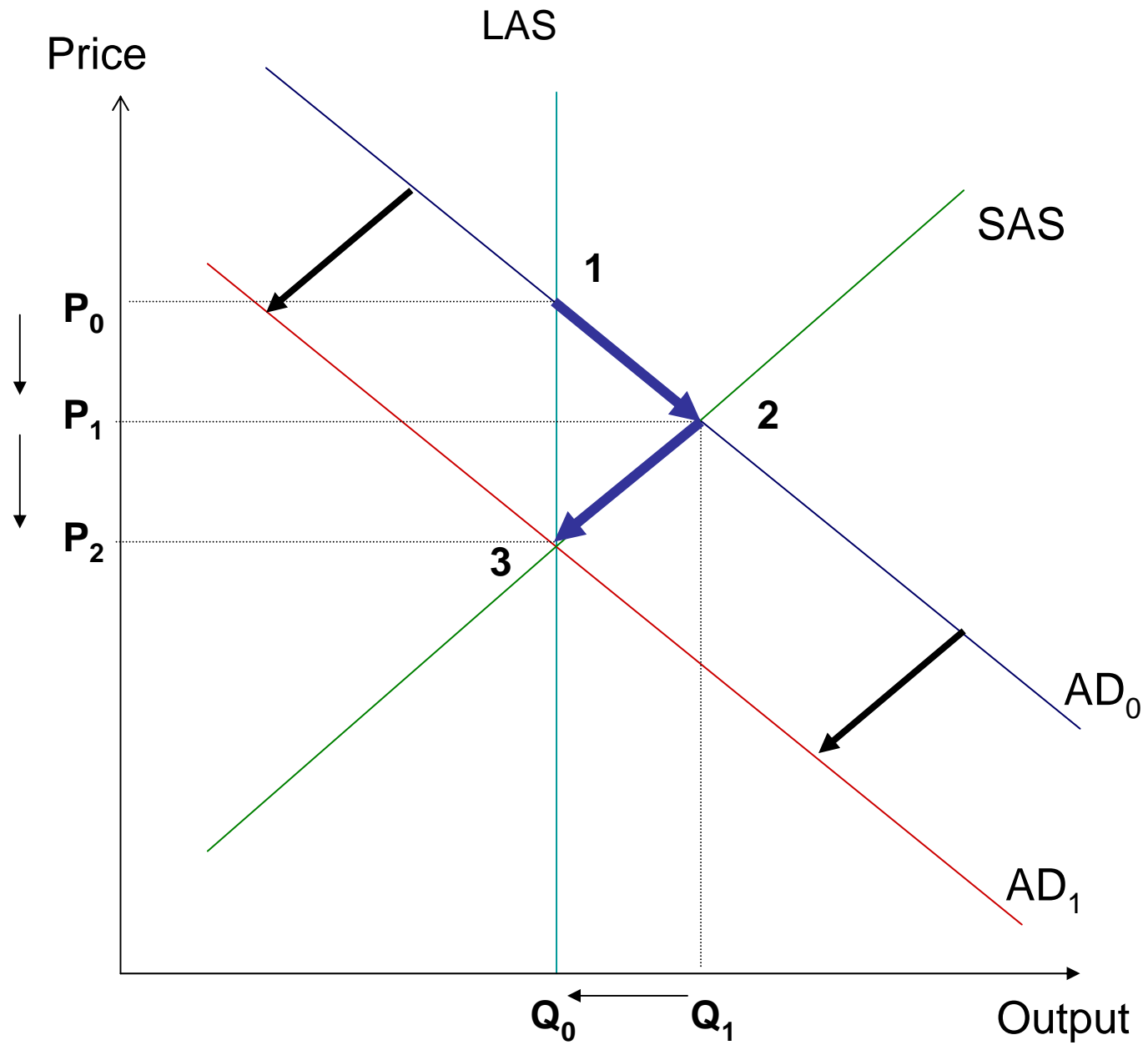
**Country / Group of countries / Region**  
Extent of Intra-regional Trade

Specific Country Characteristics  
**Factor mobility**  
(Labor & Capital)  
Economic size, Geography, Socio-cultural compatibility

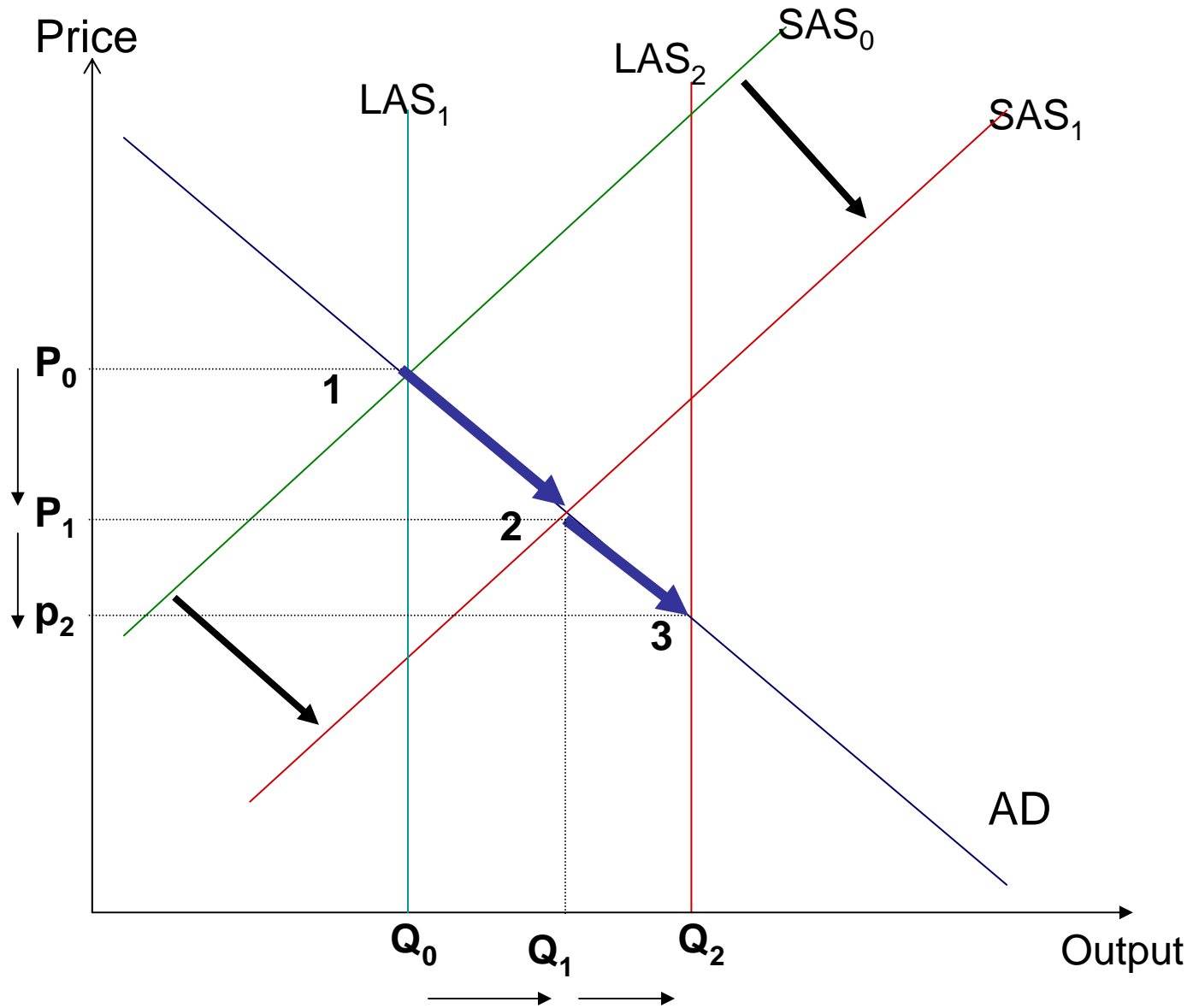
# An Analysis of Positive Demand Shocks



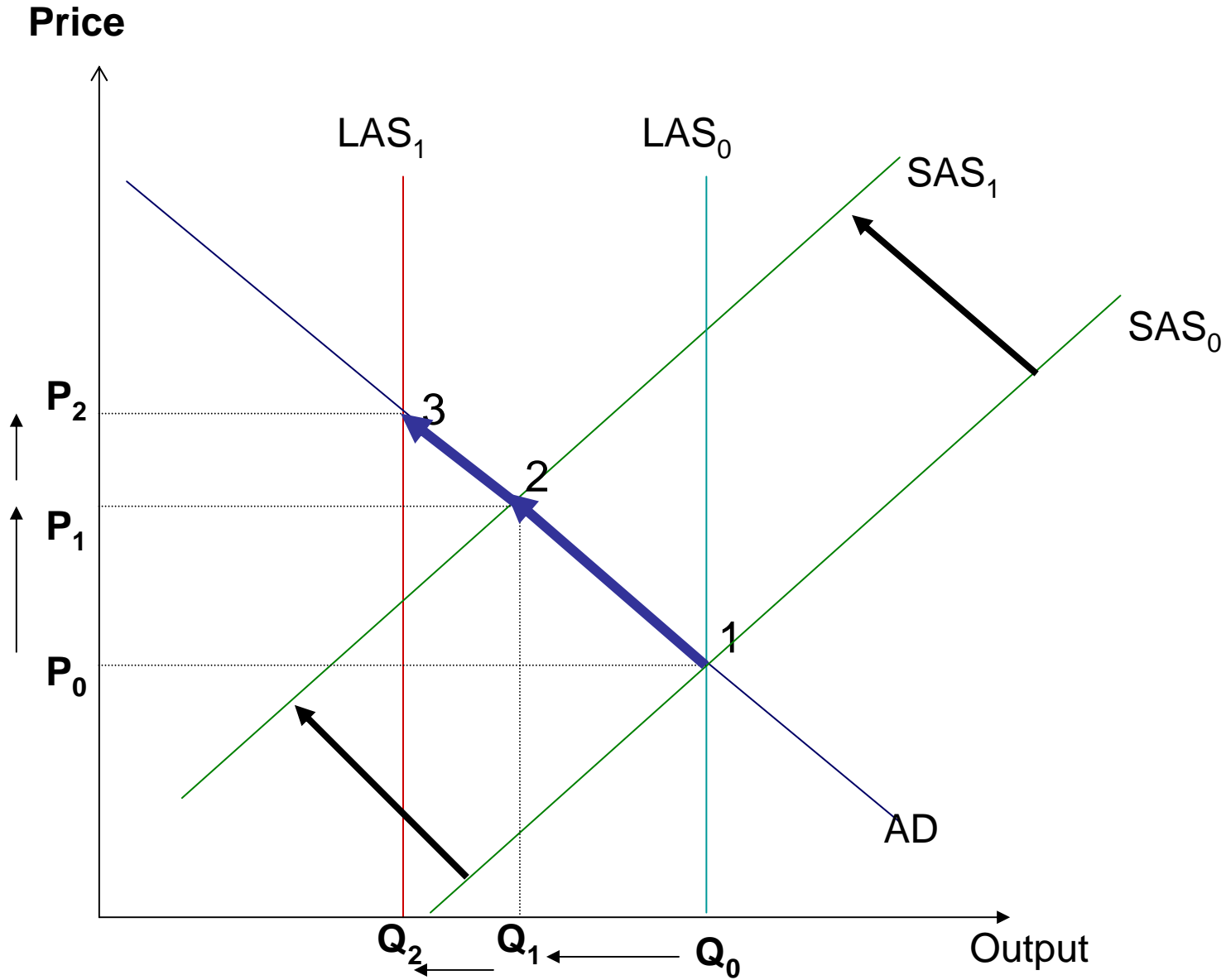
# An Analysis of the Negative Demand Shocks



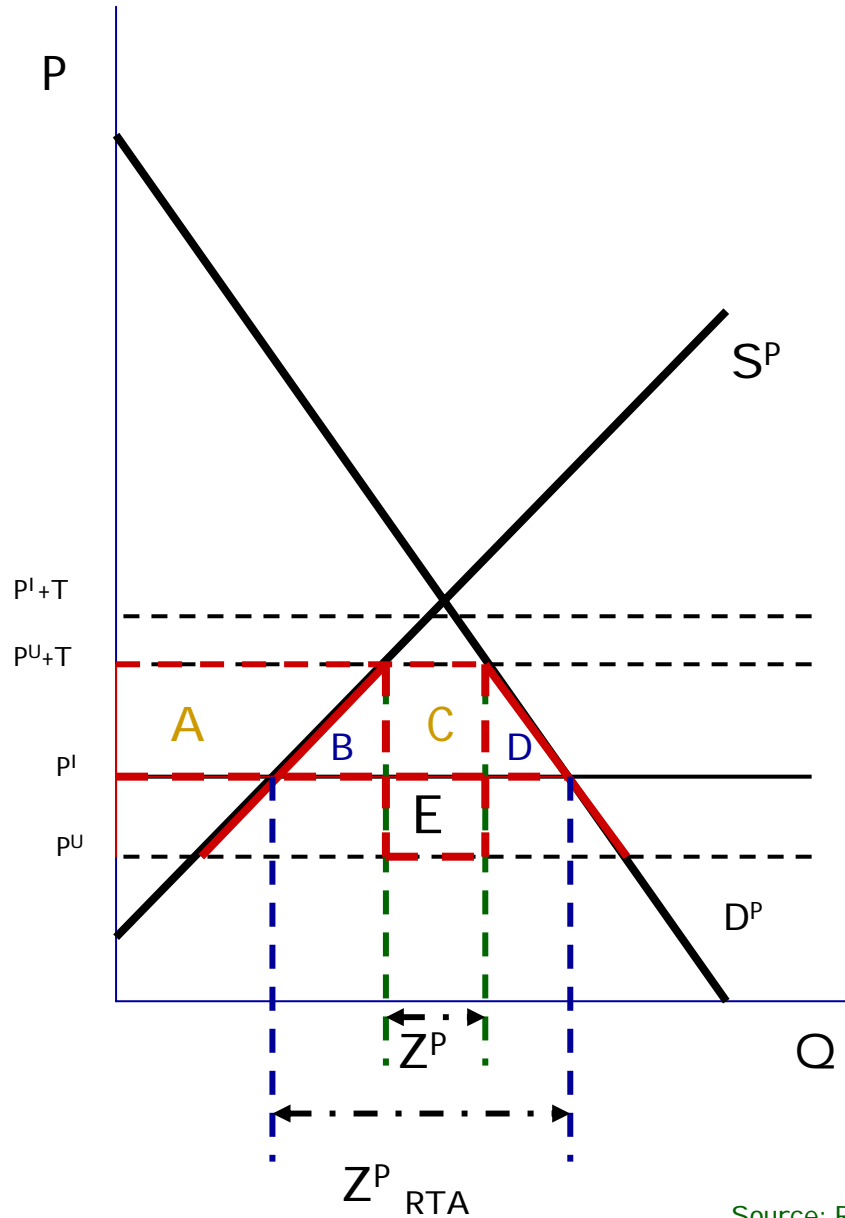
# An Analysis of Positive Supply Shocks



# An Analysis of Negative Supply Shocks



# An Analysis of SAPTA/SAFTA

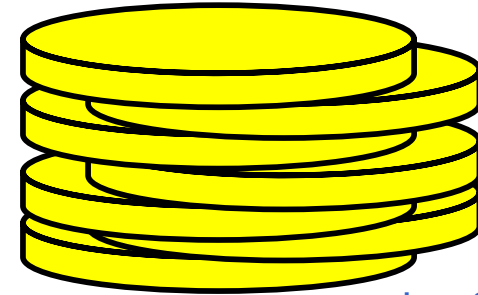


WELFARE IS AMBIGUOUS

Three Countries, India (I), Pakistan (P), USA (U);  
 FTA between India & Pakistan;  
 Pakistan's Perspective;  
 USA is lower cost source compared with India;

Source: Reinert (2003)

# Euro



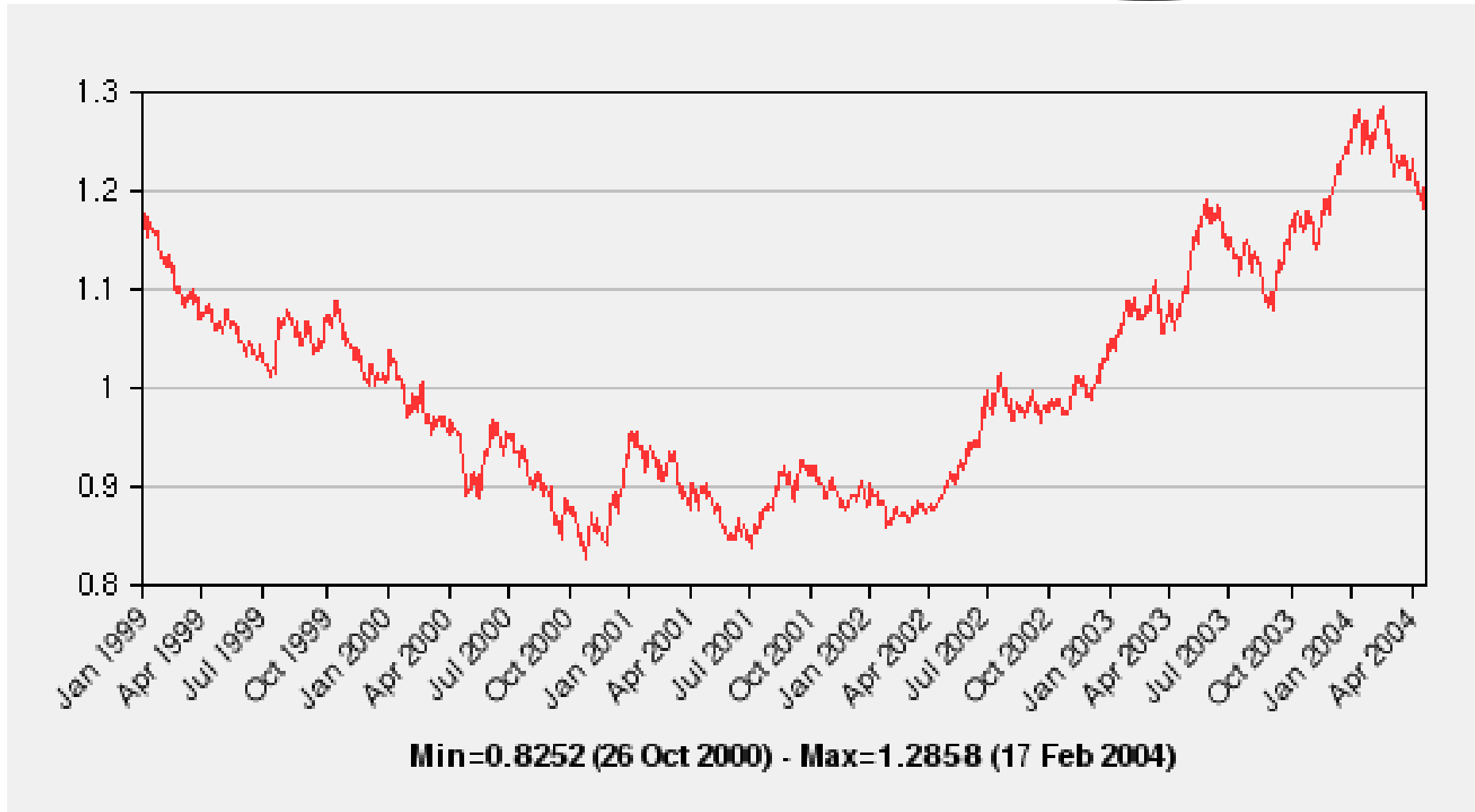
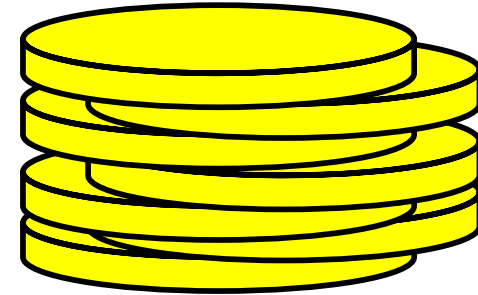
Savings on currency conversion **\$30 bn**;

Seignorage Revenues **\$10-15 bn**;

Low Cost in Int'l Borrowing **\$10-15 bn**;

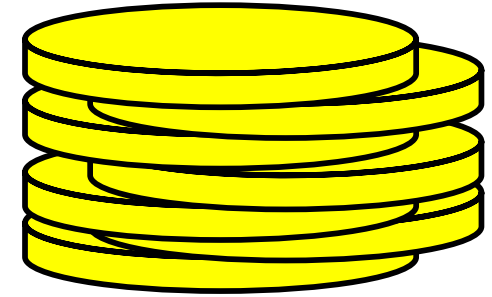
- Political versus Economic Desire
  - Single entity, diversity and independence;
  - 1998: Heads of EU decide to form EMU;
- Criteria for EMU (“The Four Tests”)
  - 3% Deficit and 60% Debt or close;
  - Inflation and Long Term Interest Rate Convergence  
(1.5 PP & 2PP of 3 lowest)
  - Currency within ERM (Exchange Rate Mechanism) for 2 two years
  - Independence of the Central Bank
- Jan 1999 – Birth of Euro (11 countries except Greece, Sweden, Norway & UK)
- Jan 2002 – Greece joins EMU; Euro Notes circulated

# Euro



Source: European Central Bank Website (<http://www.ecb.int/>)

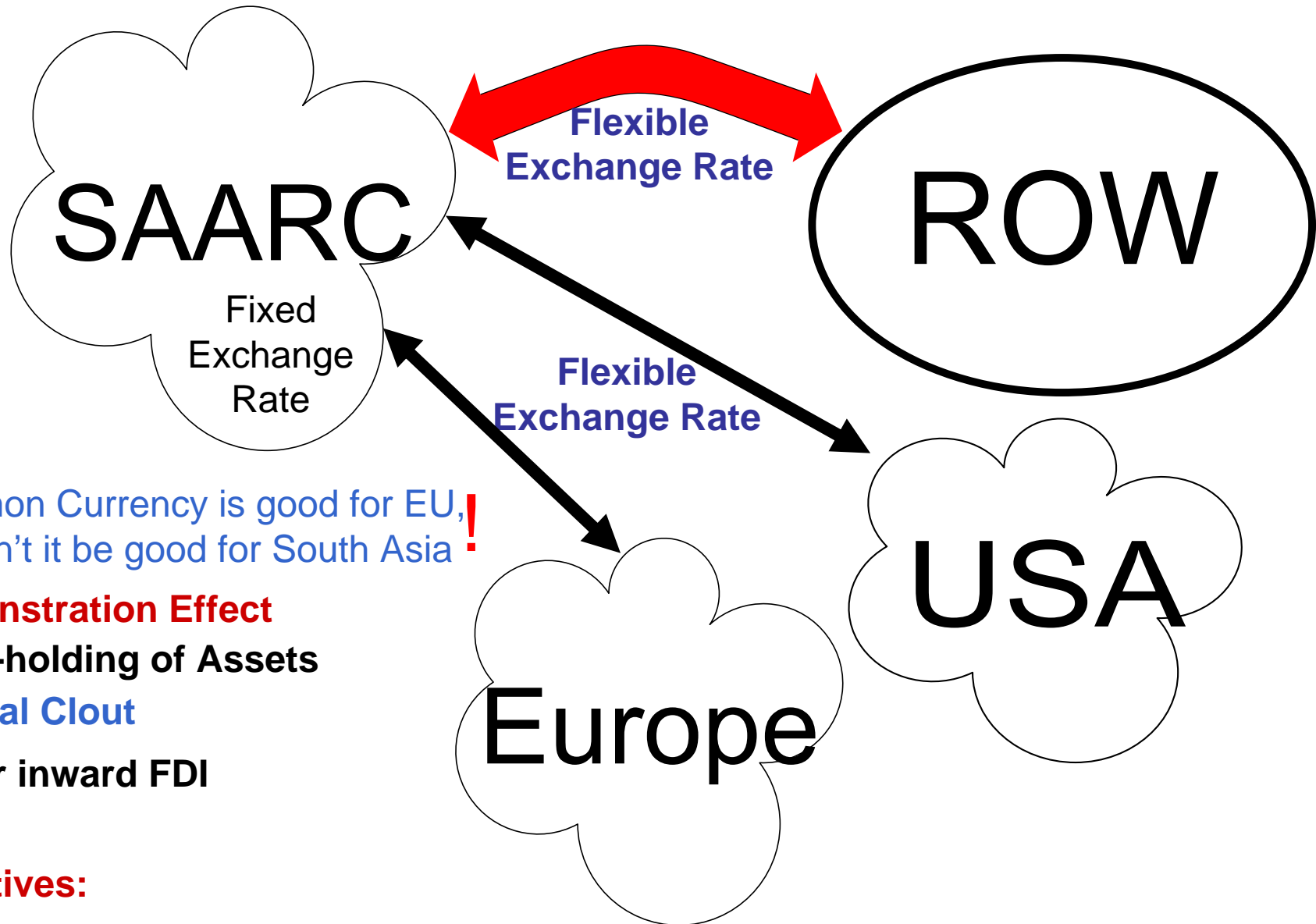
# UK Stays Out of Euro



## •Brown Test

- Are business cycle and economic structure compatible so that we and others can live comfortably with Euro Interest Rates on permanent basis?
- If problems emerge, is there sufficient flexibility to deal with them?
- Would joining EMU create better conditions for firms making long term decisions to invest in Britain?
- What impact would Euro on Competitive position of the UK's financial services industry, particularly the London City's wholesale markets?
- In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?

# Why Single Currency for South Asia



If Common Currency is good for EU,  
why can't it be good for South Asia !

**Demonstration Effect**

**Cross-holding of Assets**

**Political Clout**

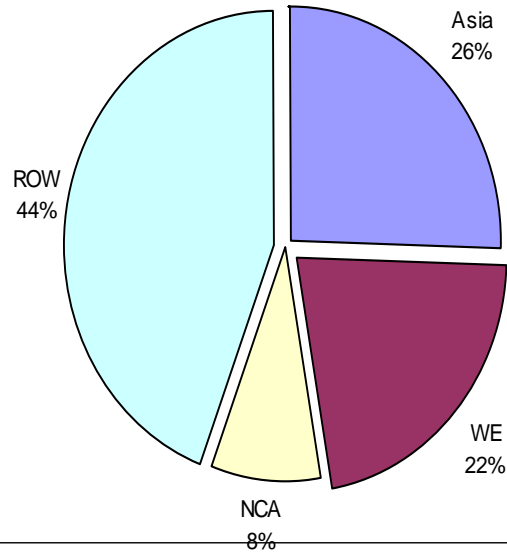
**Greater inward FDI**

**Alternatives:**

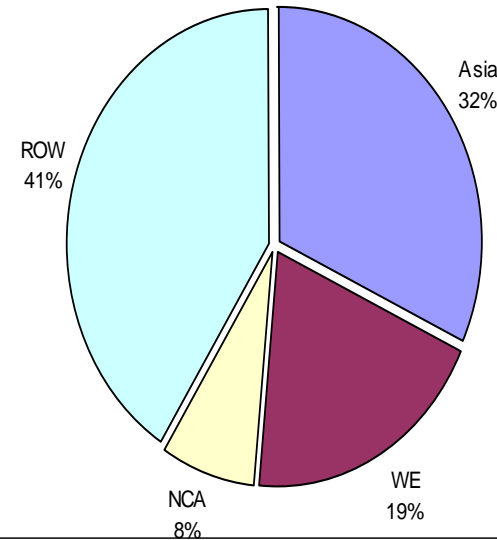
Dollarization, Currency Basket, New Currency, Parallel Currency

# Chart: 01 SAARC Direction of Import Trade

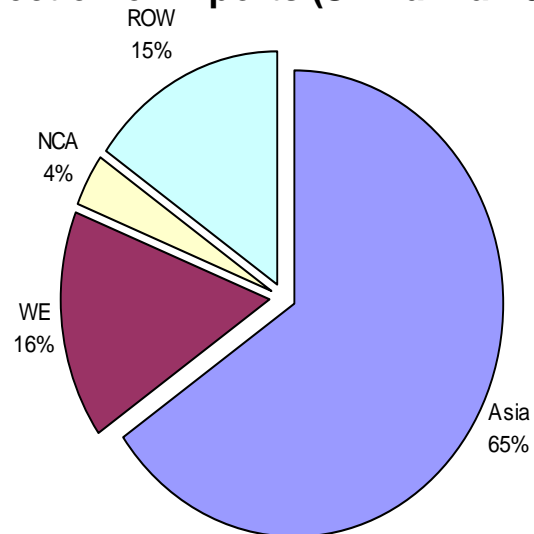
## Direction of Imports (India-2002)



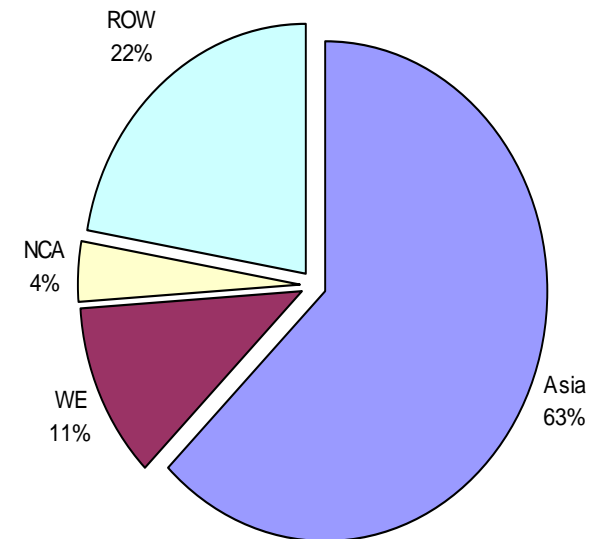
## Direction of Imports (Pakistan-2002)



## Direction of Imports (Sri Lanka-2002)

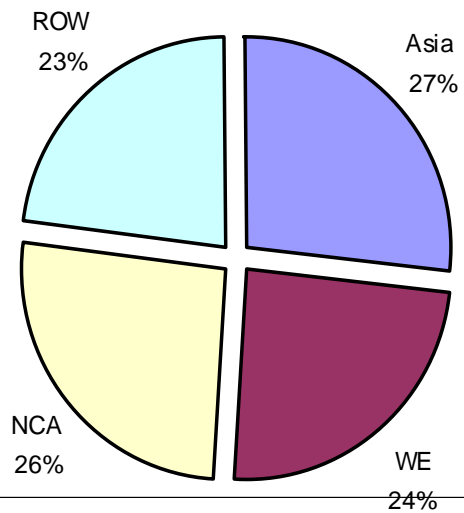


## Direction of Imports (Bangladesh-2002)

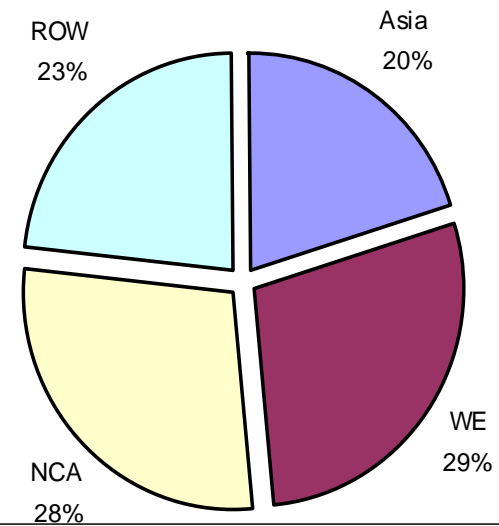


# Chart: 01 SAARC Direction of Export Trade

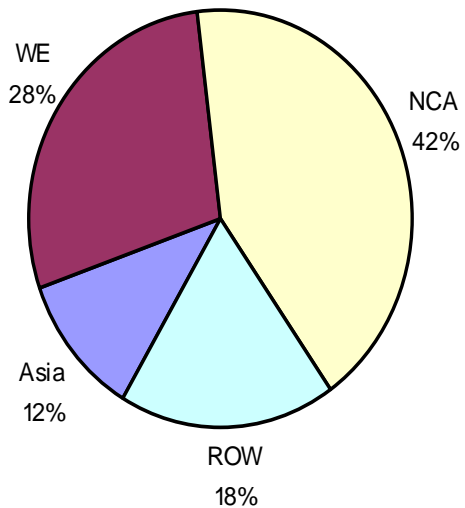
## Direction of Exports (India-2002)



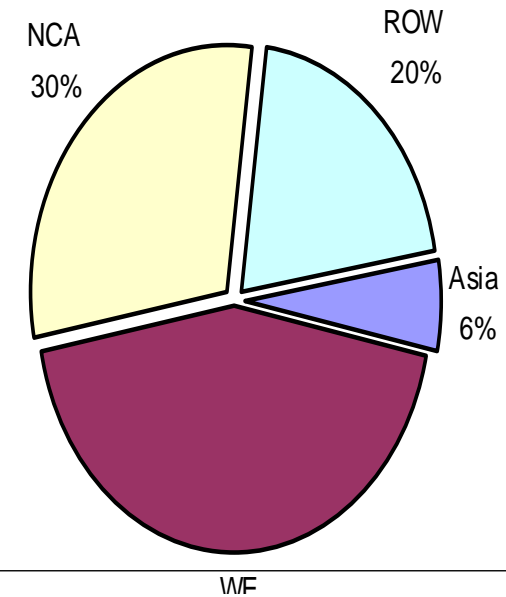
## Direction of Exports (Pakistan-2002)



## Direction of Exports (Sri Lanka-2002)



## Direction of Exports (Bangladesh-2002)



## Regional Trade Patterns

PTA/FTA/CU	Intra Regional Trade* (Percentage)	Openness**
SAARC (1998)	3.8	23.4
ASEAN (1998)	<b>23.5</b>	<b>101.2</b>
Euro Area (1998)	<b>24.8</b>	<b>50.8</b>
MERCOSUR (1998)	4.4	18.1
NAFTA (1998)	10.7	23.9

## Regional Trade Patterns

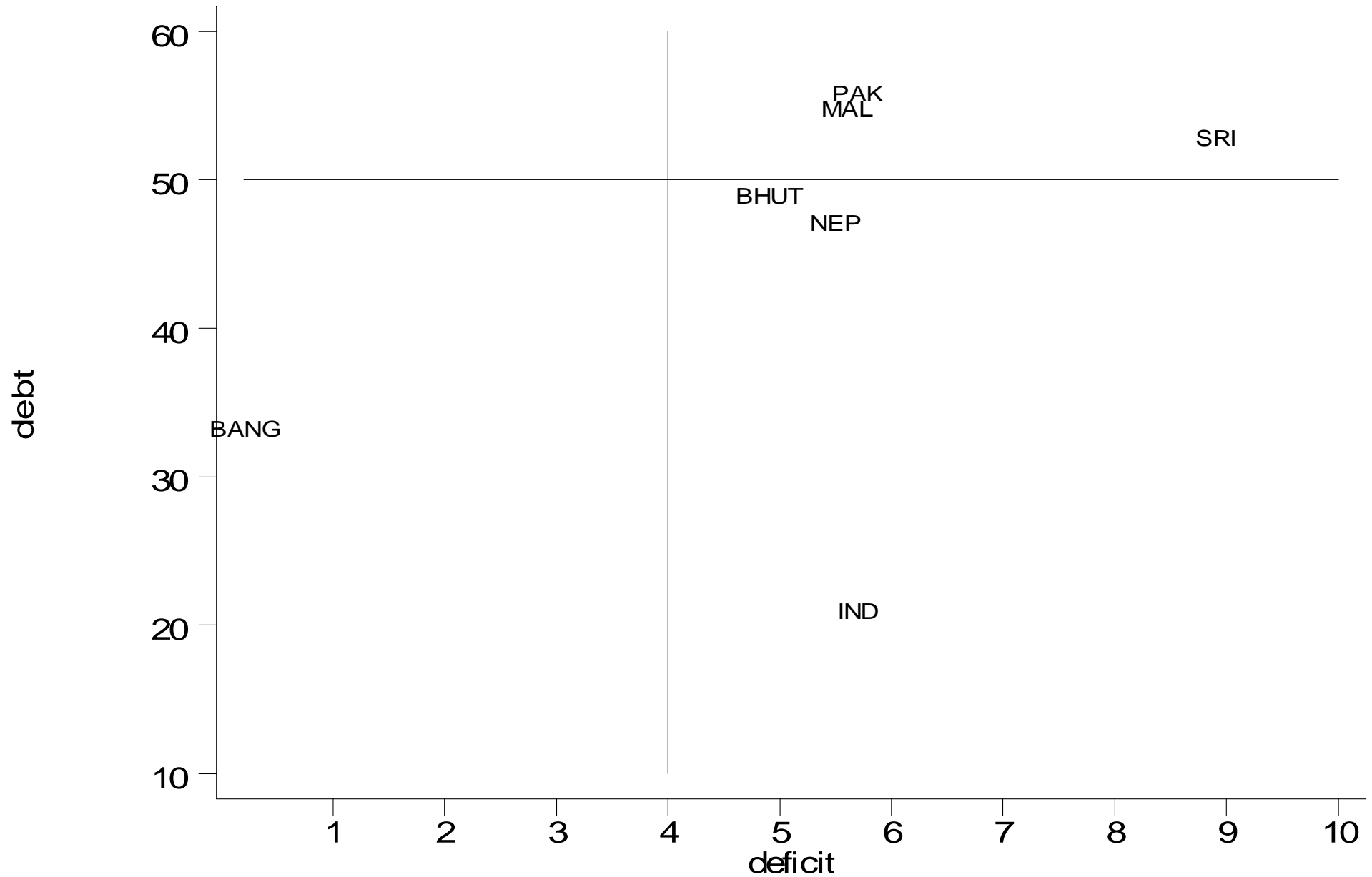
<b>Country</b>	<b>Intra SAARC Trade* (%age) 1999</b>	<b>Openness** (1990) Trade/GNI</b>	<b>Openness** (2002) Trade/GNI</b>
Bangladesh	1.91	16.9	27.52
Bhutan	-	55.	53.86
India	5.42	14.3	22.46
Maldives***	16.13	-	74.8
Nepal***	6.90	22.3	35.32
Pakistan	4.36	28.7	29.56
Sri Lanka	2.73	58.5	66.26
SAARC	4.90	17.3	24.84

Source: \* [27]; Original Source RIS based on IMF Data

\*\* Openness is defined as the total trade (imports + exports) as a percentage of GNI (Calculated from ADB Key Economic Indicators)

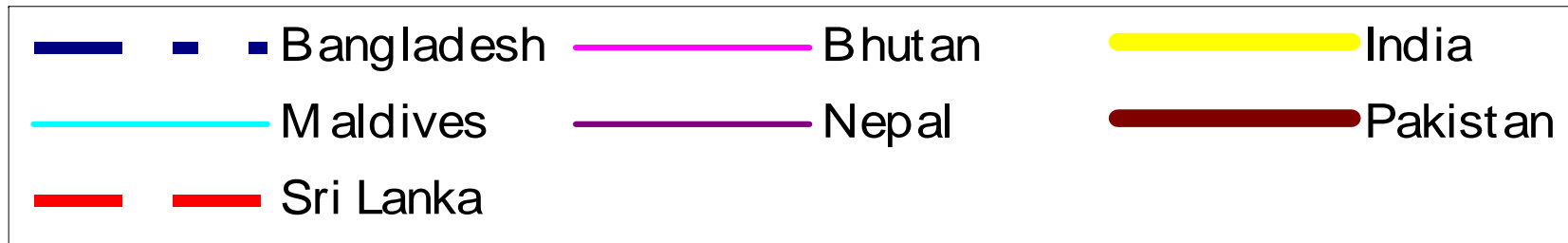
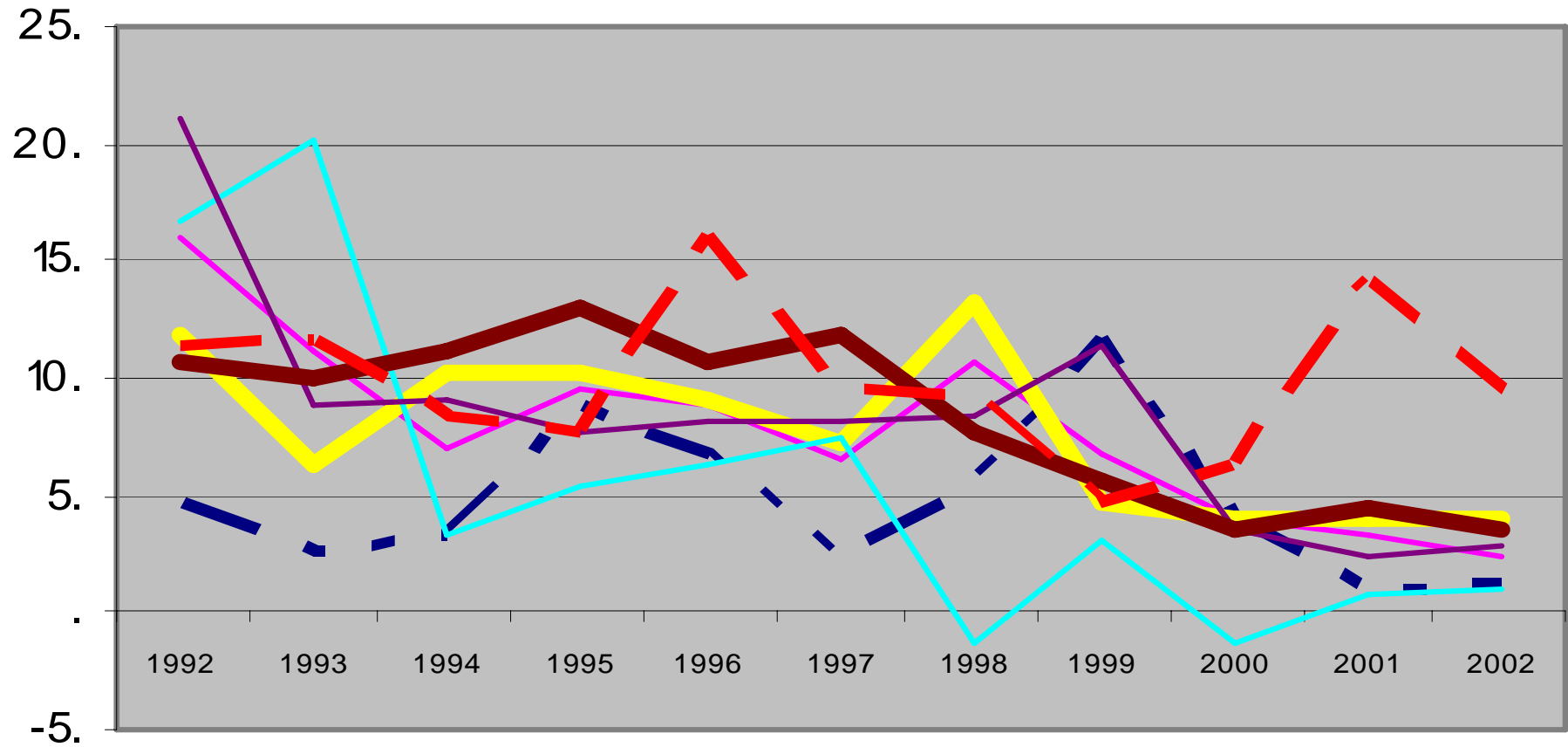
\*\*\* Data of 1997.

# 1. SAARC Region Debt vs. Deficit Plot



Data Source: Asian Development Bank Key Economic Indicators 2003, Reserve bank

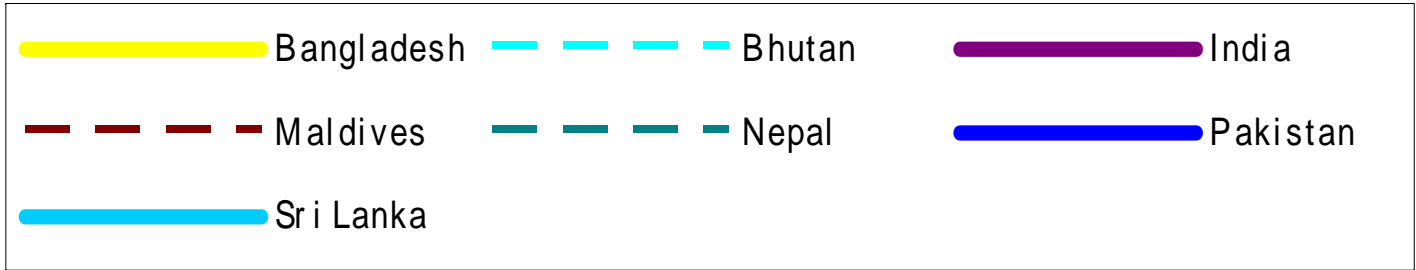
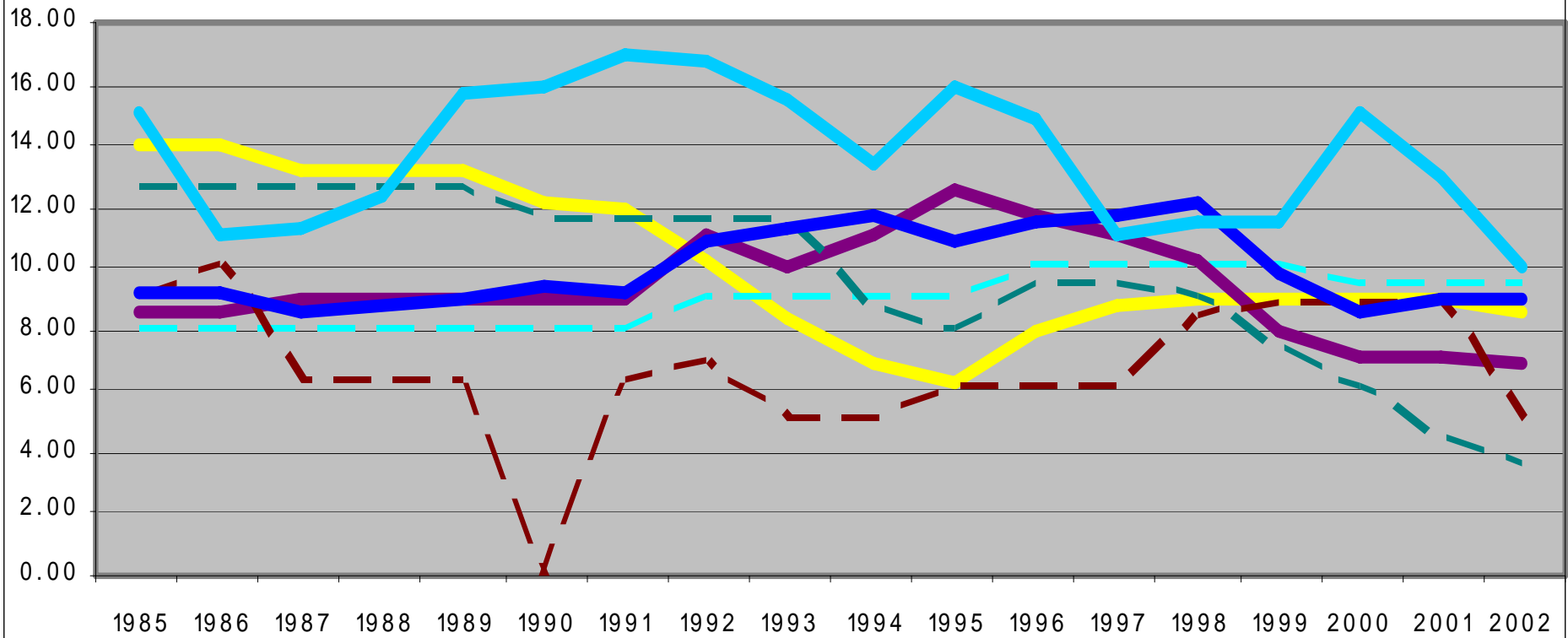
# Inflation Rate (Percent) in South Asia



## SAARC Correlation of Inflation (1992-2002)

	<i>Bangladesh</i>	<i>Bhutan</i>	<i>India</i>	<i>Maldives</i>	<i>Nepal</i>	<i>Pakistan</i>	<i>Sri Lanka</i>
Bangladesh	1						
Bhutan	0.289257	1					
India	0.222355	<b>0.765405</b>	1				
Maldives	-0.06512	<b>0.707411</b>	0.215344	1			
Nepal	0.351445	<b>0.865242</b>	<b>0.592273</b>	<b>0.63184</b>	1		
Pakistan	0.217325	<b>0.643343</b>	<b>0.694584</b>	<b>0.54031</b>	<b>0.50487</b>	1	
Sri Lanka	<b>-0.43997</b>	0.175658	0.124542	0.31155	-	0.1775	1

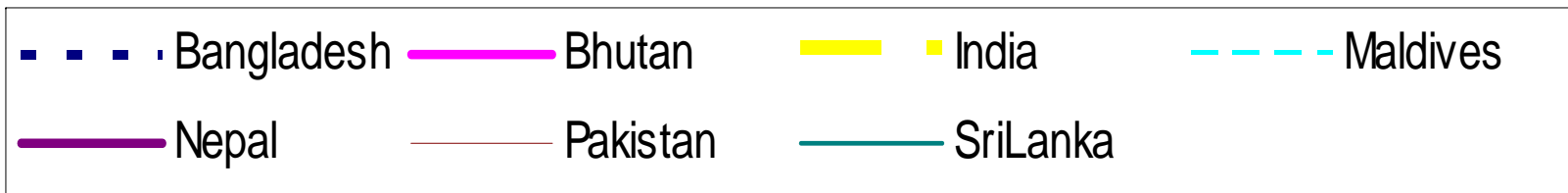
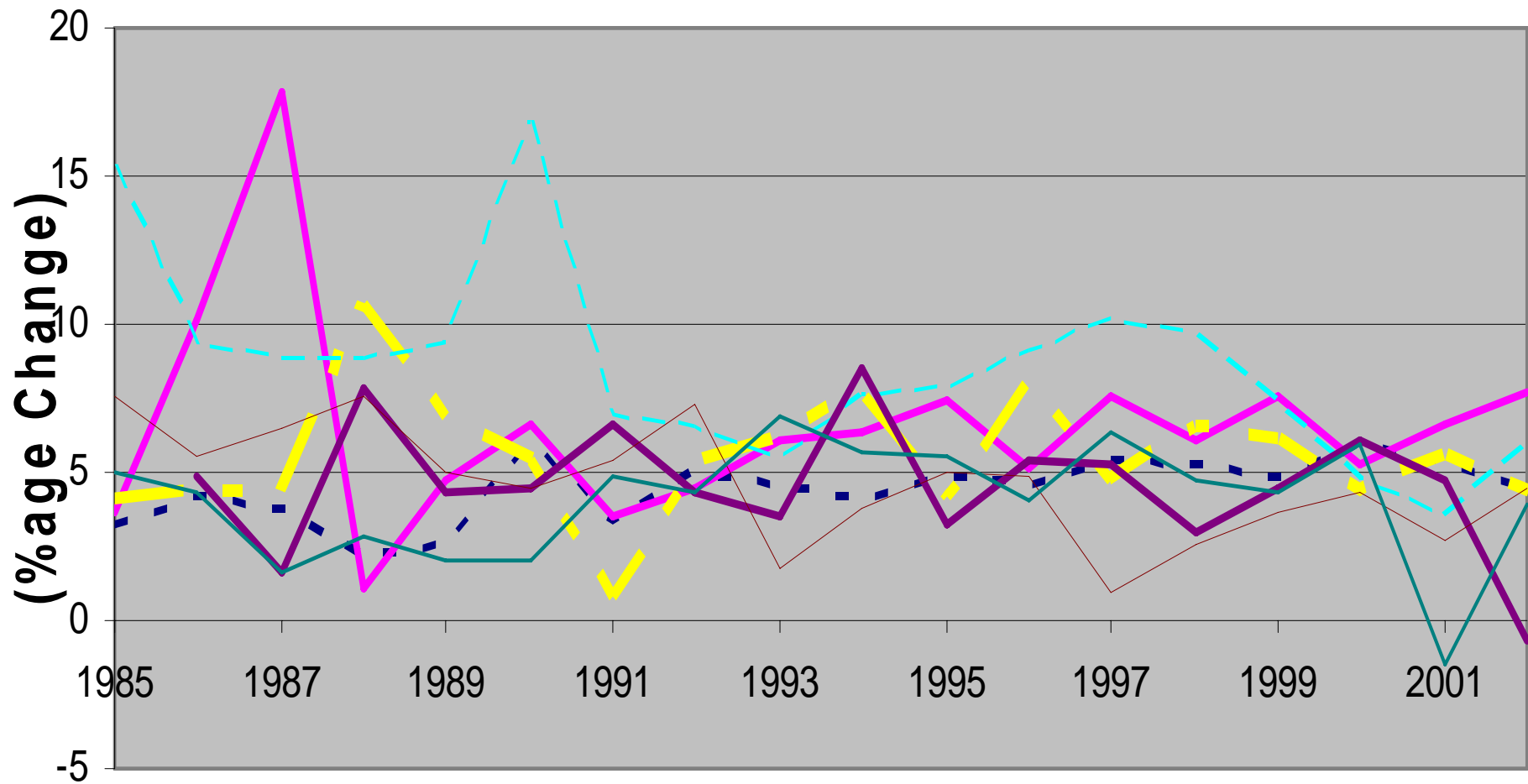
# Interest Rates (12 Months Deposits)



## SAARC Correlation of Interest Rates (12 months savings deposits)

	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Bangladesh	1						
Bhutan	-0.795	1					
India	-0.3888	0.1551	1				
Maldives	0.3614	-0.0052	<b>-0.4469</b>	1			
Nepal	<b>0.6898</b>	<b>-0.6987</b>	0.3172	-0.0163	1		
Pakistan	<b>-0.6341</b>	<b>0.5615</b>	<b>0.7993</b>	-0.3172	-0.002	1	
Sri Lanka	-0.0398	-0.2561	0.3358	-0.1561	0.2884	0.096	1

# SAARC: GDP Growth Rate



## Correlation of GDP Growth of SAARC Region (1985-2002)

	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Bangladesh	1						
Bhutan	0.1435	1					
India	-0.2954	-0.3412	1				
Maldives	0.0597	0.0995	0.125	1			
Nepal	-0.2136	<b>-0.5305</b>	0.3296	0.0268	1		
Pakistan	<b>-0.5178</b>	-0.0274	0.0868	0.0826	0.1018	1	
Sri Lanka	0.1759	-0.1655	-0.1399	-0.0831	0.1295	-0.271	1

**Table 07: SAARC: Exchange Rate Correlation (1992-2002)**

	<i>Bangladesh</i>	<i>Bhutan</i>	<i>India</i>	<i>Maldives</i>	<i>Nepal</i>	<i>Pakistan</i>	<i>Sri Lanka</i>
<b>Bangladesh</b>	1						
<b>Bhutan</b>	<b>0.96420202</b>	1					
<b>India</b>	<b>0.96420202</b>	1	1				
<b>Maldives</b>	<b>0.79923481</b>	<b>0.84569</b>	<b>0.84569</b>	1			
<b>Nepal</b>	<b>0.96926459</b>	<b>0.99908</b>	<b>0.99908</b>	<b>0.843926</b>	1		
<b>Pakistan</b>	<b>0.98295065</b>	<b>0.98534</b>	<b>0.98534</b>	<b>0.81884</b>	<b>0.98669</b>	1	
<b>Sri Lanka</b>	<b>0.99556455</b>	<b>0.96267</b>	<b>0.96267</b>	<b>0.838725</b>	<b>0.96747</b>	<b>0.97934</b>	1

# Recommendations

- Pakistan - MFN status to India by the July 2004;
- India to remove non-tariff barriers implement MFN for Pakistan Jan 05;
- SAFTA implementation (2010) by India, Pakistan and Sri Lanka;
- Less Developed countries of the region by 2015;
- Customs Union by 2017;
- Monetary union (SAARC MU) by 2020;
- Countries to meet the criteria of deficit (4%) and Debt (50%) or close;
- SAARC Rupee for implementation by the year 2025.
- National currency notes & coins should then be replaced.

# Conclusion

- Single Currency proposal needs more than Economic Yardstick;
- Single Currency for South Asia is possible in the long run;
- Political will, vision and proper strategy;
- Openness, Intra regional trade, SAFTA, Factor Mobility, SAARC MU;
- Convergence requirements;
- Benefits
  - Less Transportation Costs;
  - Cross holding of assets and liabilities;
  - Peace and prosperity;
  - Fiscal Discipline;
- Costs
  - Loss of Exchange Rate Adjustment;
  - Loss of Monetary Policy

Questions

