NATIONAL CURRENCIES IN MUTUAL PAYMENTS WITHIN THE EAEU: BARRIERS AND PROSPECTS

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Summary

The purpose of this research project is to identify regulatory, institutional, economic, and other restrictions impeding the use of EAEU national currencies in settlements, and to prepare, based on research findings, proposals regarding the steps that can be jointly taken by the EDB, the EEC, and the central (national) banks of EAEU member states over the midterm horizon to strengthen the role of national currencies in mutual settlements within the EAEU. The authors conducted a series of in-depth interviews with businessmen, national and supranational regulators, and representatives of the expert community. There were 42 respondents from Russia, Kazakhstan, Belarus, Armenia, Kyrgyzstan, and Tajikistan, including representatives of international organizations and large businesses.

The authors would like to express their sincere gratitude to all interviewees for their contribution to attainment of research objectives. In the findings, opinions voiced by individual respondents will be shown as italicized quotes in inverted commas.

The use of EAEU national currencies instead of reserve currencies in mutual transactions eliminates undesirable FX exposures affecting numerous entrepreneurs, reduces economic and regulatory barriers hampering involvement in foreign economic operations, and promotes macroeconomic stability and development of national financial markets and intermediaries.

Over the last several years, there has been an increase in the share of national currencies (particularly, the Russian rouble) in operations between EAEU member states. Still, reserve currencies (the US dollar and the euro) account for about one-quarter of aggregate foreign trade turnover (see Table A1).

The same is true for the currency structure of individual cash transfers, where the natural transactional advantages of the rouble and other national currencies come to the forefront as the macroeconomic situation begins to stabilize. Degree of integration is an important factor: in terms of its share in aggregate payments in Russia, the rouble is behind the dollar,

<table>
<thead>
<tr>
<th>Mutual Payments by EAEU Member States</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>in Armenian Drams (AMD)</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>in Belarusian Roubles (BYN)</td>
<td>0.4</td>
<td>0.3</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>in Kazakh Tenges (KZT)</td>
<td>0.4</td>
<td>0.5</td>
<td>1.1</td>
<td>0.7</td>
</tr>
<tr>
<td>in Kyrgyz Soms (KGS)</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>in Russian Roubles (RUB)</td>
<td>61.8</td>
<td>67.4</td>
<td>68.0</td>
<td>74.1</td>
</tr>
<tr>
<td>in US Dollars (USD)</td>
<td>30.3</td>
<td>26.3</td>
<td>25.0</td>
<td>19.3</td>
</tr>
<tr>
<td>in Euros (EUR)</td>
<td>6.8</td>
<td>5.2</td>
<td>5.1</td>
<td>5.2</td>
</tr>
<tr>
<td>in Other Currencies</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Table A1. Currency Structure of Payments for Exported and Imported Goods and Services between EAEU Member States (for the period, %)

Source: Eurasian Economic Commission.
and is more or less on a par with the euro; in the CIS zone, there is a stable parity between the rouble and the dollar; and in the EAEU, the rouble has already captured two-thirds of the market (in Tajikistan, more than 80%).

Still, the US dollar remains the dominant currency in payments for goods and services among EAEU member states, excluding Russia. For example, the US dollar accounts for about 50% of total settlements between the Republic of Belarus and EAEU countries (with the exception of Russia), and for about 80% of total settlements between the Republic of Kazakhstan and the Kyrgyz Republic. This represents a major reserve that can be tapped to increase the share of national currencies in mutual settlements, and any relevant program should make ample use of that reserve.

According to the poll, major obstacles to increasing the share of local currencies in settlements include low liquidity of the market for conversion operations in local currency pairs; lack of currency risk-hedging instruments; and lack of trade finance loans denominated in local currencies, which results in foreign trade participants incurring additional costs and becoming exposed to additional uncontrolled risks.

Currently, most national financial markets are characterized by low capacity and liquidity; in a number of cases, they also lack critical segments required to efficiently increase the role of national currencies (Figure A1).

Figure A1. Structure of Exchange Turnover in EAEU Countries in 2016, %
Of all EAEU countries, Russia, Armenia, and Kazakhstan have derivative markets which could theoretically be used to implement currency hedges covering operations with the use of EAEU national currencies. However, even in Russia and Armenia, derivative markets do not offer instruments that could be used to hedge risks associated with exchanging EAEU national currencies without an intermediate reserve currency. In the relatively large Russian FX derivatives market, almost the entire turnover is represented by USD and EUR futures, while futures or options based on EAEU national currencies are non-existent. The minuscule Armenian derivatives market trades only USD futures, and transactions with that instrument are few and far between.

Unlike derivatives markets, spot currency markets in all EAEU countries account for a significant part of the exchange market (predominant in three countries out of five). However, trades in EAEU national currency pairs represent merely a fraction of all spot currency deals. The key reason for that is that transaction costs are exorbitant due to extremely low demand for EAEU national currencies even in the neighbouring countries.

Besides, those markets are characterized by instability, pronounced structural disproportions, and by such negative factors as the dominance of the Russian market.

At the same time, the high volatility of hard currencies, as observed over the last several years in global financial markets, has spurred interest in the rouble as the settlement currency in foreign trade operations within the EAEU. This conclusion is supported both by the growing share of the rouble in the currency structure of export/import payments, and by the findings of the EDB research. According to the survey results, more than half of respondents from business and expert communities anticipate the strengthening of the role played by national currencies in mutual settlements. Only 17.4% of the respondents believe that it will decline (Figure A2). These results have been obtained despite the fact that, in the opinion of the majority of respondents, the consequences of the currency crisis in Russia in late 2014 to early 2015 have not been fully overcome, and there remains a high probability that such crises will emerge again in the future.

**Figure A2.**
Distribution of Responses to the Question: “How Will the Share of National Currencies in EAEU Payments Change over the Mid-Term Horizon?”, %

Source: EDB.
The recommendation is clear: “evolution is better than revolution”. “Organic growth” is preferred. Monetary integration should follow economic integration: removal of numerous exceptions and restrictions in mutual trade turnover, creation of links between economic agents and logistical and transportation ties between countries, development of common labour and capital markets. Respondents agree that, subject to the foregoing, any attempt to put the currency integration cart before the economic integration horse will not accelerate development of common markets, but will, on the contrary, give rise to additional risk. Employment of administrative methods to stimulate settlements in national currencies may undermine any attempts at their wider use.

“A direct path to national currencies: lift mutual trade barriers, examine non-tariff barriers between countries, attempt to lift those, then examine currency restrictions, capital movement restrictions, restrictions imposed not only on portfolio investments, but also on direct investments, and then consistently work with that agenda. This will do more to promote sustainable use of national currencies than any technological solutions”.

“The creation of an integrated EAEU currency market—easier access to each other’s financial markets, more financial instruments denominated in national currencies”.

“The creation in currency markets of market-maker pools for EAEU national currencies—higher liquidity of national currency sectors in exchange markets”.

In the opinion of the respondents, at the current stage, a special role is played by ongoing development of investment, industrial and technological cooperation, joint investment projects within the EAEU. Accordingly, removal of obstacles in the way of investment flows is regarded by respondents as the key integration vector. Development of small and medium-sized businesses and cross-border cooperation are also viewed as national currency “growth points”.

“In the integration process, there is a bias in favour of attempts to expand trade, while investments are left on the back burner. But in our regional context, removal of barriers in the way of investment flows is perceived as less painful than liberalization of trade. Integration in that area would probably be associated with lower costs in macroeconomic terms. And there would be considerably more political opportunities for liberalization of investments”.

Respondents also noted that it would be expedient to increase the role of joint financial institutions, in particular, the Eurasian Development Bank, in developing cooperation projects for EAEU member states, stimulating export potential, financing, hedging, and diversifying foreign-trade operations among EAEU residents. The Bank could also provide loans denominated in national currencies, and implement a multilateral clearing mechanism.
For reference: One of the stated objectives of the EDB is to increase the attractiveness of settlements in local currencies. In 2016, after the Bank had joined the FX sections at Moscow Exchange PJSC and Kazakhstan Stock Exchange JSC, it began to offer market-making services for the RUB/KZT pair, seeking to minimize the spread and boost the pair’s liquidity, which eventually resulted in a reduction of the costs incurred by foreign trade participants. The EDB, within its trade finance support program, also offers to the financial institutions of its member countries loans denominated in local currencies to finance their clients’ foreign trade contracts. Over the last year, the Bank has opened credit lines for financial institutions with a total principal amount equivalent to $200 million. By way of currency risk hedging, the Bank also quotes, for the benefit of its counterparties, a RUB/KZT swap with an effective term of up to nine months. In the immediate future, the Bank also intends to do the same (offer hedging instruments, reduce currency pair costs and spreads) for the Armenian dram and the Belarusian rouble. Provision of assistance to EAEU issuers seeking to enter financial markets of other EAEU member states is another important area.

Discussing the obstacles that impede wider use of national currencies, respondents spoke of combined operation of multiple adverse factors. The top three constraints are high currency risks, existing business practices, and lack of economic incentives for the use of national currencies instead of reserve currencies (Figure A3). Answering the question regarding regulatory and supervisory barriers that need to be removed to increase the

![Figure A3. Distribution of Responses to the Question on the Main Obstacles to Increasing the Role of EAEU National Currencies, %](image)

Source: in-house calculations based on processed poll data.
role of national currencies, respondents usually do not mention any specific restrictions, which, together with low factor relevance, implies that their impact is quite insignificant. Among the steps that need to be taken to strengthen the role of national currencies, respondents mention development of capital market, better accessibility of loans denominated in national currencies, and availability of joint projects in industry, agriculture, and infrastructure (Figure A4). Subject to the priority of development of investment cooperation, they further note the need to assure symmetrical protection of property rights and to streamline operations of executive and judicial bodies in that area.

Obstacles to increasing the role of EAEU national currencies can be economic, political, or legal in nature.

**Economic obstacles** include high transaction costs associated with the use of such currencies, due to the small size of national economies and financial markets, their insufficient development and diversification, the lack of a macroeconomic stability track record, prevailing market standards dictating the need to quote transactions in reserve currencies, the lack of market mechanisms that could be used to hedge currency risks, and the use of offshore arrangements in foreign trade. It is possible to overcome these obstacles by progressive development of EAEU national economies and integration processes, improvement of the investment climate, deeper division of labour and economic diversification, creation of transnational corporations operating in the Eurasian space, development and implementation of joint investment projects, development of a common financial market, and designation of integration priorities for small- and medium-sized businesses.

**Political obstacles** include lack of long-term strategic integration development plans, insufficient harmonization of economic policies, and the unpreparedness of EAEU
member states to give priority to their national currencies (in particular, when making contributions to joint-entity charter capital and extending loans). Inasmuch as government transfers between EAEU member states account for a considerable part of cross-border payments, this has a material impact on the structure of such payments and, accordingly, on the scope of national currency flows entering any particular EAEU member state. Extension of government loans denominated in national currencies deserves special mention. In this case, a certain balance of risks and benefits is associated with a possible decision to extend intergovernmental loans within the EAEU in national currencies. Naturally, the only viable option is when such loans are extended in the currency of the creditor country; otherwise, the creditor country is exposed to excessive risk.

However, extension of intergovernmental loans in the currency of the creditor country meets with objections from some high-ranking strategic experts.

“The ‘let’s do rouble lending’ thing doesn’t work, because Russia will be the first to suffer. EAEU countries are still prepared to take rouble loans, but the risks to the Russian budget (especially if we’re talking about intergovernmental loans) are just too high”.

“Governmental (intergovernmental) loans in EAEU member states are recorded in dollars; commercial loans are recorded in dollars. And the primary reason for that is that export contracts are recorded in dollars. In this situation, it would be strange to encourage anybody to use roubles, while both the state and corporations prefer dollars.... Offering rouble loans would send a powerful signal, but we are afraid to do that, as we do not trust the rouble ourselves”.

Yet, risks associated with extension by Russia of governmental loans denominated in roubles emerge only when such loans are financed with dollar-denominated assets. In all other cases (if the source of the loan is denominated in roubles), there are no such risks.

The identified legal obstacles are associated primarily with the status of EAEU national currencies (which at this time do not have statutory priority over reserve currencies) and removal of barriers to development of the national financial markets of integration-association members and the future common capital market.

The research findings make it possible to formulate the following proposals to strengthen the role played by national currencies in mutual settlements between EAEU member states:

• accelerate development and implementation of measures designed to enhance the financial markets of EAEU member states, to deepen their integration, to harmonize and liberalize relevant regulatory regimes;

• create conditions conducive to full or partial conversion of mutual obligations and payments within the EAEU into national currencies, including development of standard practices for extension of intergovernmental (sovereign) loans in the national currency of the creditor country;
• develop a program that will better protect the rights of entrepreneurs, shareholders, and other investors in all EAEU member states and, possibly, envisage creation of special arbitration institutions to settle disputes between economic agents registered in different jurisdictions;

• consider implementation of mechanisms reducing transaction costs associated with the use of national currencies in mutual settlements within the EAEU, including multilateral clearing and FX risk-hedging mechanisms, and make a decision regarding the possible creation of such mechanisms subject to the results of assessment of their effectiveness;

• implement measures designed to improve alignment of macroeconomic policies pursued by EAEU member states and the sustainability of their national economies;

• develop a cross-border cooperation development program;

• assure the use of national currencies in all cross-border budget transfers (payments to residents outside the country);

• accelerate implementation of the Agreement on Common Approaches to Regulation of Currency Legal Relations and Implementation of Liberalization Measures in EAEU Member States;

• strengthen the role played by the EDB and EAEU national banks in boosting the importance of national currencies, in particular, by expansion of lending in national currencies.

It is not possible to increase the share of national currencies in operations among EAEU residents by directive measures. Some of the steps proposed in the report may be implemented in the short term, while other transformations will require long-term, fundamental changes. The best foundation to underpin all efforts related to strengthening the role of national currencies in mutual settlements between EAEU member states is dynamic development of the national economies composing the association, and tangible progress in the integration processes.