A SINGLE CURRENCY FOR ASIA: IS IT TIME?

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The 1997 Asian financial crisis may be said to have been the most traumatic experience in the region in recent times. It gave rise to much soul-searching and led to several initiatives along several fronts, among the most important of which were concerns related to regional and financial cooperation in East Asia. The crisis highlighted the need to address some major structural and policy weaknesses, especially in the financial and corporate sectors. The crisis put at the forefront of the regional cooperation agenda the need to focus on one important dimension – monetary and financial cooperation – with a view to enhancing East Asia's resilience to future shocks.

Background to Resurgence of Interest in a Regional Currency

Suddenly, interest in the possibility of an Asian Monetary Union resurfaced, having been mulled off and on over the years, as part of continuing dialogues on regional economic cooperation. I might note, however, that the desire to develop our financial markets did not arise exclusively in the aftermath of the Asian crisis. For indeed, in the first half of 1997, among the major agreements reached during the APEC Finance Ministers Meeting which I had the honor of chairing was the adoption of a 5-point agenda for promoting the development of the regional financial and capital market. An unfortunate consequence of the crisis was to stymie the reform agenda, and to put the region on a defensive stance rather than the pro-active position that characterized the Finance Ministers' 1997 consensus.

The role played by the multilateral agencies – the IMF, World Bank, and even the ADB – was perceived by some to be wanting in those traumatic moments, and indeed gave rise to the idea of a more focused Asian Monetary Fund. But being early days, what actually happened was the rise of bilateral swap arrangements, gradually increasing in size and coverage to generate what we now see as multilateral swap arrangements or the creation of an Asian fund. The ASEAN also weighed in with its proposal to settle intra-regional net trade payments in local currency, asserting that this would reduce the volatility of our respective exchange rates with the US dollar.

Further along the road, the ASEAN + 3 Summit in Manila in November 1999 officially supported efforts to develop new forms of cooperation among the 13 member countries represented. East Asia's post-crisis initiatives at regional and financial cooperation stemmed from the realization that the unexpected cross-country contagion that occurred in the aftermath of the crisis could not be a matter of indifference among individual countries in the region. It was seen that the crisis had its origins in common weaknesses in the financial and corporate sectors among several countries, and so cross-country cooperation on financial reform issues would be beneficial to all. Over-all, it was recognized that countries needed to cooperate in monetary and financial spheres to provide a mechanism for crisis-prevention and crisis-management.

The post-crisis initiatives may be seen as proceeding in four areas:

- regional information exchange and surveillance (at its lowest and more doable level)
- regional resource pooling (which resulted in the ASEAN swap arrangement and bilateral swaps)
- financial sector development (which gave rise to networking arrangements among bank regulators and domestic credit agencies and the ASEAN + 3 Asian Bond Market Initiative), and
- exchange rate coordination (which gave rise to the setting up of an ASEAN Currency and Exchange Rate Mechanism Task Force in 2001 to examine the desirability and feasibility of regional exchange rate coordination).

A Regional Currency for Asia?

Even as these initiatives are now making encouraging progress, the Asian region, and more particularly, East Asia, is now at the critical cross-roads in its initiatives towards regional monetary and financial cooperation. In this post-crisis period, it is increasingly being examined that intra-regional exchange rate stability is a desirable objective. There is a wide range of options in the menu being proposed, among them a common basket pegging of regional currencies and the adoption of a single regional currency in the long run. The European experience is seen as a model for the way forward. The question that of course arises is whether such a model would apply to East Asia, given the diversity of the economies that comprise it, and given that time – which

Europe had – is a luxury that countries in the region can no longer afford in this fast-moving century. And if such a model were to be adopted – or a better word perhaps is adapted – by Asia, what kind of a road map is the region going to use, and would the individual countries be happy to use the same map in moving towards such a common destination?

The Euro as a Model for an Asian Currency

To see if the European model can serve as the template for the development of a single Asian currency, a quick review of how the European Monetary Union evolved might be worth repeating. Definitely, the euro did not spring forth full-blown on January 1, 2002. While it would seem that since its introduction, the euro may now be considered a success, having already assumed the role of the world's second leading currency (albeit some way behind the US dollar), the highway that led to it was not without its difficulties. Inspiring as the European experiment might be, it is well to remember that it was a long, erratic, and often laborious process. It took 30 years to gestate, and integration was hampered along the way by several international crises and also by internal divergences, which aspiring Asia may do well to remember.

An ADB paper on the European Monetary Union described the path to monetary integration as being comprised of three distinct steps:

- the Werner Plan
- the European monetary system (EMS), and
- the EMU

Although the steps differed, they were rooted on common grounds. First, monetary integration is achieved through the introduction of a single common currency.

Second, this introduction relies on a common policy managed by common institutions. And third, a high degree of convergence among the participants is a prerequisite for monetary integration. The paper stated that the third condition was crucial in the EMU process, since it determined the speed of integration.

The Werner Plan was the first attempt to achieve monetary union within ten years from 1969, but it failed to bring about coordination among the six European governments in periods of important international turmoil, among them the first oil crisis and the wave of instability in the foreign exchanges that followed the US decision to float the dollar in 1971. The situation emphasized the need for deeper monetary coordination between the member states, and in response the European Monetary System (EMS) was created.

The EMS had three main components: the European currency unit (ECU), the exchange rate mechanism (ERM), and financial support. The ECU (which was a basket of currencies of the European states) was the numeraire for currency parities in the EMS. According to the ERM, each currency had a central exchange rate linked to the ECU, the latter being used as a basis for a bilateral divergence indicator. Monetary authorities had to intervene once the bilateral market exchange rate crossed the divergence threshold. Financial support for interventions was based on three credit facilities, the most important being the very short-term facility whereby central banks were able to rely on an unlimited amount of foreign reserves which had to be settled 45 days later. The short-term facility provided automatic access for a longer period, while the medium term facility consisted of loans with conditionalities and reimbursements in tranches.

Over a ten-year period, the EMS helped to reduce exchange rate variability – the flexibility of the system combined with the political resolve to bring about economic convergence achieved sustainable currency stability. However, there was a growing feeling that the completion of the Single Market called for deeper monetary integration. It was also felt that the potential of the internal market could not be fully exploited because of what economists considered the "impossible trinity" – free movements of capital, exchange rate stability, and independent monetary policies which could not co-exist in the long-term. Thus the path towards full monetary integration was firmly laid out in three stages:

- 1990-1883 (diagnostic stage) during which period progress made with regard to economic and monetary convergence was assessed while member states were to adopt appropriate measures to comply with certain prohibitions in the Treaty on the European Union (signed in 1991).
- 1994-1998 (convergence stage) during which member states were to prepare towards adopting the euro and were expected to make significant progress towards economic policy convergence (through precise but nonbonding rules on public financing and the introduction of monitoring of public financing). The European Monetary Institute (EMI) was established for the purpose of institutionalizing coordinated monetary policies. The EMI was meant to be only a transitory monetary institution, and would be the forerunner of the European Central Bank (ECB) which was established in June1998.
- 1999-2002 or the period of implementation of the monetary union, during which conversion rates between the euro and national currency units were

irrevocably fixed, and the euro was to become the currency of the participating countries and was to be used in the foreign exchange markets. It replaced the ECU, and the ECB used the euro for drawing up the monetary policy of the participating countries. By January 2002, national currencies were withdrawn, and new euro banknotes and coins were put into circulation.

Towards a Single Asian Currency

The creation of the European Monetary Union had a long history of cooperation. In the early 1950's the European Payments Union provided the first framework for cooperation, exchange of information, peer monitoring and trust building. The move towards the EMU was made possible by (1) high trade interdependencies, (2) common acceptance of basic political and social values (democracy, a market economy with a strong welfare state) – though we might mention that the UK did not consider democracy to be as strongly anchored in the Continent nor did it share a welfare state commitment) – (3) fairly even economic development and comparable living standards, despite divergences among its poorest members, and (4) a strong commitment to solidarity.

Nonetheless, not all countries participated in the EMU. This was because of the stringent requirements of policy coordination and institution building, which, when it came to the crunch, involved the renunciation of national sovereignty. The question of whether Asia is ready to embrace the strict requirements and follow the path carved by the EMU remains to be seen. Or is there an alternative that fits the culture, political history, and a shared sense of urgency that would unerringly move Asia towards regional integration? More to the point, towards a unitary currency for the region?

Moving Towards Asian Regional Monetary Integration

After the crisis, Asian countries experimented with different exchange rate regimes – mostly in the form of flexible exchange rates, where central banks however intervened extensively to build up foreign reserves. The challenge before them is to decide how much flexibility is best in the future, while avoiding too much de facto pegging to the dollar (for most of Asia) if a repeat of the mistakes of the precrisis policy is to be avoided. Capital controls is of course an option, but with financial markets becoming more and more integrated, the impossible trinity provides only one of two choices – exchange rate stability or monetary independence.

Arguments for a monetary union in fact center on what is perceived to be its most important benefit – exchange rate stability. As exemplified by the European model, exchange rate stability would promote trade and investment, and give rise to peer pressure for macroeconomic coordination. The downside is that central bank autonomy in the participating economies would be lost, except in the leading country's central bank. Another cost is that asymmetric shocks could cause difficulties without capital mobility and fiscal cross-border transfers. Another consideration for Asia, as it mulls the idea of its own monetary union is that certain preconditions were present when the EMU finally came into being: there was high intraunion trade, factor mobility, price and wage flexibility, policy coordination, and for the most part, shocks were symmetric.

In the case of Asia, the concept of "region" is premised on geographical reasons. The economic reality however is that there is substantial diversity in the economies, each with its on idiosyncracies. This heterogeneity is clear from a perusal of ADB key indicators which show that the highest per capita income is about 140 times that of the lowest as of 2001, in contrast for example with Europe where standards of living across countries were for the most part on par with each other. Moreover, Asian economies trade less with one another than European countries did among themselves. Likewise, in contrast to Europe, Asia does not have a similar integrationist tradition. This diversity makes the task of regional integration more challenging. This is not to say that the task is impossible. Allow me to express my thoughts on how Asia might trek towards this notional destination.

First I would say that instead of looking immediately outward toward the region, what if we first build inwards from each respective economy? As I stated earlier, to reach that convergence point, there may be a road map, but there could be several routes all leading there. In last year's Bo'ao forum I indicated that such a customized way by which each economy could mark its place in the continuum of the development agenda and proceed from there may be more doable. Agreement on a timetable and drawing up of milestones would help each economy to set and execute reforms according to local conditions and its commitment to the development agenda. The key challenge facing the move towards greater cooperation and integration within the region is to find a way forward, that is, set priorities and sequence activities.

Steps Towards Achieving Monetary Integration

Let me go back to the post-crisis initiatives that I mentioned earlier.

- First, the regional information exchange and policy dialogue on surveillance is easily the most doable and consistent with a variety of possible institutional arrangements including, if need be, the launching of an Asian Monetary Fund in the medium term. Since sharing already existing information entails little additional cost, the improved sharing of economic information and macroeconomic monitoring is desirable, particularly in view of the general tendency for contagion to be regional. Similarities in economic and financial structures as well as in macroeconomic policy regimes suggest that countries can learn from each other's experiences. Moreover, regional trade interdependencies are now increasing, signifying that macroeconomic and financial sector policies can be expected to have progressively larger economic spillovers within the region (as for example was shown in a sample of European countries). Further to this, the question of whether an independent regional monitoring system over and above global information and monitoring systems may need to be addressed. In fact regional level initiatives at economic monitoring have been undertaken, post-crisis, including the setting of a Regional Econoic Monitoring Unit (REMU) in ADB. Another issue is: what is to be done with the information? Are Asian countries ready to move from information sharing to surveillance? Effective surveillance may require the willingness to surrender some degree of sovereignty over macroeconomic policies as well as to exercise peer pressure on other countries to modify their policies. As long as it is based on an accurate diagnosis of macroeconomic problems, such discipline may in principle be considered beneficial to both those exerting the pressure and the country that is subject to the discipline.

There is thus a strong case for coordination within Asia to be extended beyond mere information sharing to the level of regional surveillance. I would say that taking this step is the most doable, albeit it entails some surrender of what we call "amor propio" in my country.

- Second, earmarking a portion of foreign exchange reserves for financing the short-term liquidity needs of member countries, or resource pooling would be a logical next step. This could lead to the eventual establishment of a centralized reserve pool with a mandate for crisis-prevention and crisis-management. The Manila Framework actually included among the required initiatives both regional surveillance and a contingent financing mechanism for Asian currency stabilization.
- The third step is financial sector reform and development. The recently announced Asian Bond Market initiatives is one such contributory step. Moreover, regulators are now paving the way to give consumers a variety of products that could address their diverse and hybrid needs. This of course is a challenge to regulators to make judgments on risks that both takers and providers of products that local market might evolve, and ensure that appropriate safeguards are instituted. Moreover, the development of the local capital market rests a great deal on the role played by government, which as we know is the one that can create the benchmark of a risk-free yield curve. Cooperation in developing effective mechanisms for regulation and supervision is essential. This would involve setting up general regional guidelines for prudential regulation (to be adapted in accordance with individual needs) as well as the extension of the supervisory function within each country to all institutions that engage in financing activities.

- Fourth, and we go back to the issue of whether Asia is ready for regional exchange rate coordination. The question that comes to the fore is what form is it to take – a regional basket peg, an Asian Monetary Union, or full monetary unification. A fundamental difficulty in our part of the world is that there is really no consensus on where the common regional currency arrangement is headed for. The various options that have been suggested are: (1) a monetary union among ASEAN countries only; (2) a Greater China or RMB monetary union; and (3) a monetary union between Japan and Korea. At the Bo'ao forum last year, Professor Robert Mundell suggested that a wider area, such as an APEC currency area, rather than an Asian currency area would be easier to begin with, because in an Asian currency area, it would require a decision to use a major currency, in this case, the RMB or the Yen. Moreover, he extensively discussed the issue of RMB's role in an Asian currency area, concluding that for China's own sake, it should keep the RMB fixed, shouldn't appreciate, depreciate or float. He also said that Japan should concentrate on saving the life of the Yen. As has been pointed out by many analysts, Asia at present does not satisfy many of the economic criteria for a successful currency union. While there is a growing consensus that exchange rate stability is a desirable objective, it is clear that the East Asian countries have a long way to go before adopting a common currency. The European experience does suggest that the adoption of a common currency is the last step in the process of regional economic integration, and hence takes a long time.

Final Comment

So where does that leave us? We go back to recalling the fact that East Asia has suffered a painful and costly financial crisis. This suggests to me that the East Asian countries, most especially, may now be prepared to set aside their differences and work together to develop a region-wide self-help system to prevent future crisis. It has been said that more than economic will, political will is what will in the end bring about a convergence similar to that accomplished in Europe. The number of initiatives taken – the Manila Framework, Chiang Mai Initiative, ASEAN+ 3 efforts – are proof of the sincere desire to move the region to convergence. I believe that our discussions at this seminar will provide us with a clearer view of the way forward. Asian culture has always emphasized consensus building rather than a confrontational approach. Such an approach has its upside and downside, but let it not be said that we are less than willing to take the necessary steps. Asia after all, has had a far longer history of civilization than most, and a patience bred through the ages..