Create a Common Asian Currency by 2025

By Norbert Walter

After the roller coaster ride of the 1990s, Asia has receded from the headlines. Most of the countries in the region have largely recovered from the 1997 financial crisis-and a number have made credible efforts in trying to convert their societies to consumer-led demand. Now, when things are more quiet than before, is an opportune time to ask ``what next?" The surprising answer is that Asia is a logical candidate to take a leadership role in the reform of global currency markets-by creating a common Asian currency.

Asia would seem to be a strange candidate for such a radical step at first blush. After all, the key nations in the region each have separate strong identities and have developed on separate, parallel tracks. Until recently, countries such as Japan, China and South Korea seemed to place more importance on their relations with countries outside the region than with each other. Thus it is not surprising that Asia is a patchwork of different economic systems that interact in a highly unsystematic way. The effects are often extremely unwelcome.

Growing intra-Asian trade

In recent years, East Asian countries have begun to recognize this problem. To attack it, they have pursued a clear-cut strategy to open their markets to each other and intensify their division of labor. As a result, intra-Asian trade has grown faster than the region's trade with the rest of the world, and more than half of Asian trade today is among countries within the region.

To some degree, this also reflects the orientation of Japan's foreign direct investment-as well as the regional biases of the overseas Chinese in the region. But official policy shows a marked change from the past-and sets the stage for even more cooperation.

While trade and capital flows stay within Asia more often than before, these transactions are-curiously enough-generally denominated in a third party's currency-the U.S. dollar. This exposes Asian companies to unnecessary risks.
It is well known that the U.S. monetary authorities rarely accommodate the needs of the ``other side" (in this case, the economic conditions in Asian countries). For short time-horizon transactions, there are unwelcome hedging costs. And for longer-term investments, there is unwelcome exposure to substantial exchange rate fluctuations. The current state of affairs effectively obstructs the emergence of deeper and more efficient financial cooperation in Asia-and this raises the cost of capital for borrowers in the region.

Currencies are a natural place, therefore, to focus future cooperation. In addition, nobody needs a reminder that this is where the last big crisis started. The currency relationships of East Asia are therefore a key piece of the economic policy puzzle in the region.

Currently, confusion reigns when it comes to exchange rate regimes. To peg or not to peg? Fixed or floating? The language may be colorful, but the arguments are endless. The experts are divided. But, no matter what the exchange rate arrangement, currency crises occur too frequently. They result in wide and often lasting swings of exchange rates well off their equilibrium values.

Many of the Asian countries moved from a system of pegs to controlled floating in the wake of the 1997 currency crisis. But this is not a matter of carefully chosen policy. Now, however, the Asian countries have a chance to consciously choose to eliminate the many problems associated with separate currencies.

Now, I am the first to admit that Europe is not a perfect role model for Asia on these issues. But what is certain is that similar economic trends evolved there-intensification of intra-European trade for example, and growing intra-European direct investment. And those trends demanded eliminating exchange rate volatility.

Viewed from today's perspective, no existing Asian currency truly fulfills the role of international currency. In a formal way, of course, the yen-since it is convertible and used internationally-comes closest to embodying the characteristics desired in a future Asian currency. However, the consistent unwillingness of the Japanese government over many years to invite real international participation in that country's financial market-and their skepticism that the Japanese currency would be used for international purposes-spoiled the chance to assume a major role when Japan was economically strong in the 1980s.

On the other hand, the candidate for a leading role over the next generation, Not a `currency hegemon'China, still does not possess a fully convertible currency. And it has a financial sector that is still not emancipated from state planning-and not yet equipped with mature financial markets. That suggests that Asia might well move in the direction of Europe creating a common currency-rather than simply choosing a ``currency hegemon'' (and following its lead).

The euro-and EMU - did not spring up, full-grown, from an empty field. In Asia, as well, existing institutions will almost certainly play a role in the creation of a common currency. APEC could be one key, but ASEAN would be much more appropriate as the lead body for developing the concept. Of course, it would be highly welcome if the heavyweights of the region pulled their own weight. Therefore, ASEAN+3 (Japan, China and South Korea)-or, preferably ASEAN+4 (including India)-would become the sounding board for this idea.

The institutional elements of such an organization would most probably have to be strengthened and clear tasks assigned to it, like mutual support projects for clearly defined cases (for example in a financial crisis). However, until such a grand project gets off the ground it would be highly welcome if institutions with a special interest in the issues were to promote related debate, study and exchanges.

Interestingly, it was the Malaysian Central Bank which led the way recently with two series of conferences on the topic. Universities and research institutes should take up the issue. Lively debate about advantages of a common currency should be initiated. European scholars could contribute their observations about the experience of getting the EMU started. Such measures will begin the process of familiarizing the Asian public with the need for currency union-and will help shape the final result to Asia's particular needs.

There is no reason that, by 2025, Asia should not have a single internal market-and a single currency. The result would help Asia continue its impressive development and remove an unnecessary additional cost of cross-border trade and investment.

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