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Asian Monetary Integration in Recent Economic Debates

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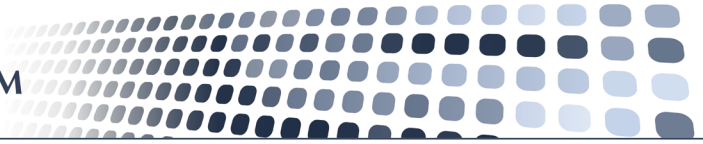


Abstract

The articles analyses the issue of monetary integration in Asia taking into account the most recent literature and the main contributes of the last decades both in economics and IR. It locates the debate within regional integration theory and federalism, taking into account the relationship between economics and politics, market and institutions.

Key-words:

Asia, Optimum Currency Areas, monetary integration, economic debate



1. Introduction

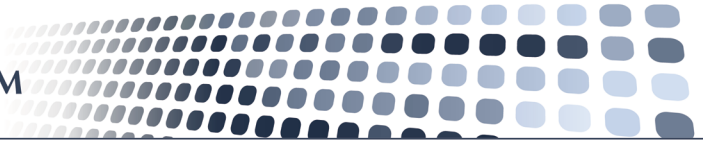
In 1992 an interesting paper by M. Dutta on *Economic Regionalization in Western Europe: Asia-Pacific Economies (Macroeconomic Core: Microeconomic Optimization)*, published in *The American Economic Review*, pointed out that two waves of interest in both the economic literature and international diplomacy had considered the opportunity to replicate the European integration process in some Asian countries. The first wave was before and during the Seventies, which saw an increasing interest from Japan and the United States to foster integration in the area; the second in the Eighties, after the 1980 Canberra meeting were the *Pacific Economic Cooperation Conference* was established.

Recently, after the financial and currency crises that hit Asian economies at the end of last millennium and the foundation in Europe of the single currency, a renewed interest towards integration processes in Asia has grown (Whyplosz 2001). In the last four years a vivid scientific debate on such topic has taken place on the main international economic journals.

Such debates are relevant to the theory of federalism for at least two reasons. First, in the theory and history of federalisation processes, monetary integration plays an important role as money is often considered a public good which has to be provided and safeguarded by a public institution representing a collective sovereignty and legitimated through democratic citizenship.

Federalism is based on the struggle against the absoluteness and exclusiveness of national sovereignty and monetary integration provides an institutional economic tool to overcome exclusive national sovereignty and foster political integration.

The second reason is that from a strategic point of view, active political federalism has always advocated the creation of continental groups of countries in order to better and more realistically struggle for greater democratic legitimacy in the world. Asian monetary integration may therefore represent a further step towards this scenario of a multi-polar geography of power worldwide.



But the *institutional approach*, where the process is guided by political institutions to provide a collective public good is not the only approach to monetary integration. Integration has been (Vaubel 1984a; b) - and still is (Buchanan 2004) - considered also as a (more or less) spontaneous process whereby markets attempt to gain greater efficiency, through the decrease of transaction costs and policy costs associated with different currencies. In this case the *institutional content* of the integration process can be minimized (in some cases to zero, in others to a very broad constitutional arrangement).

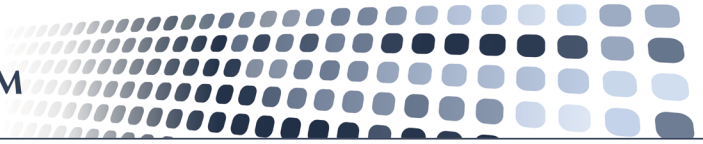
Three main questions have historically emerged in this field: a) how to cut the world in order to create optimum currency areas and, in the specific case we are examining, which countries to “invite” into a monetary integration process in Asia; b) what model of integration is most suitable for the selected countries and what institutions are required; c) how to manage the transition towards the target.

2. Searching for Optimum Currency Areas (OCA) in Asia

In the debates on Asian integration processes two main questions were on the stage until less than two decades ago: the first was that such process was mainly meant to concern trade agreements; the second that almost all proposals included the United States. Nowadays, trade interdependence among Asian states is a historically consolidated evidence and the debate is concentrating on the need to assist such real side economic interdependence with a sound monetary arrangement aimed at smoothing exchange rates volatility.

On the second point, until very recently some Authors (Mundell 2002; Tae-Joon, Jai-Won, Shinji 2005) considered as a basic need to take into account (if not explicitly as members) the United States as path-making monetary authority in the area. Only in the last few years such a hypothesis has been completely put aside. Today, the question concerning the United States is whether and how urgently Asian countries, and in particular China, should abandon their (almost exclusive) peg with the dollar.

The decision by Japan to officially propose the creation of an Asian Monetary Fund to challenge the Washington Consensus strategy (through the IMF) in 1997 (Lipsy 2003; Amyx 2002), was a testimony of a forthcoming radical change of attitude towards Asian



integration (Wook 2006). Recently, the proposal found new supporters and is now being widely discussed.

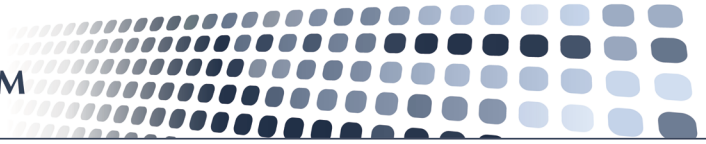
As to the question of the territorial-political demarcation for an exchange-rates agreement and a monetary integration process, it is evident how the classical OCA theories (Mundell 1961; McKinnon 1963; Kenen 1969), are still very much used. Many Authors still pretend they can minimize currency union costs through an optimal process to single out the national economic systems that most match the several OCA criteria.

But it is evident how political considerations and geographical proximity are prevalent. A first proposal concerns in fact Pacific Island countries (Browne, Orsmond 2006), where small, open economies seem to meet McKinnon's criteria (trade openness), but the geographical distance shrinks the effective role of Mundell's ones and monocultures definitely run against the capacity to minimize the impact of asymmetric shocks (Kenen's criterion).

Furthermore, for this group of countries, Beeson (2006) considers this solution politically outdated, in favour of a second one, which regards a wider group named "East-Asian countries" as the engine of future integration.

The most likely proposal seems to be for the so-called ASEAN+3 which includes the countries participating in the Association of Southeast Asian Nations (ASEAN: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) plus China, Japan and Korea (Kawai 2008). This was also the territorial basis on which the well known Chiang Mai Initiative (CMI) was put forward for bilateral reserve pooling (Eichengreen 2003) and which has recently (may 2007) reached an agreement on a multi-lateral currency-swap scheme to face financial crises. Some variations of this pattern include Australia, India, New Zealand and Taiwan (Gudmundssen 2008). The extraordinary growth of India, together with China, in the last few years is bound to change the integration perspectives but nobody seems now to be able to predict the direction it will take.

Another interesting process is taking place among the Arab countries of the Gulf, where the member states of the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) are trying to agree on the terms and schedule of a common market and a monetary union (Al-Mansouri, Dziobek 2006). This area seems to be far ahead in the integration process but is not very much considered by the economic



literature worldwide. It is anyway a further testimony of the fact that economic interdependence has increased also in that area, as well as internal trade, financial transactions and direct investments, leading to a greater and greater quest for monetary stability, especially on the currencies market.

As it is clear from the discussion, the attempts to push on the accelerator of “regional” integration in Asia all envisage delimitations that are founded more on political homogeneity rather than on OCA theory criteria. And the degree of political “sympathy” is likely to affect the success of economic and monetary integration more than macroeconomic performances and convergence. Several Authors (Yetman 2007; Gudmundsson 2008) seem in fact to be well aware of the conclusions of Frankel and Rose (1998) about the endogeneity of optimum currency areas criteria: once a monetary union is established, even automatic, market mechanisms start operating which ease the fulfilment of the various criteria proposed to test the efficiency of the area.

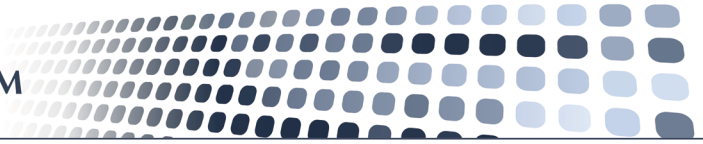
This brings back to the question of the degree of political commitment to start a monetary integration process and the degree of institutional *thickness* it is given.

3. Monetary integration between markets and institutions

Is there any need for a (and what kind of) mechanism to govern the integration process? Should it be the market forces alone or some kind of formalized institutional framework?

Mundell (2002) and Eichengreen (2006) have authoritatively suggested a parallel currency approach to Asian monetary integration. They argue against a *single* currency and in favour of a *common* currency that should be issued along the national ones to ease trade *within* and *outside* the area. It should therefore serve a twofold purpose. The first is internal, i.e. to reduce transaction costs and possibly the volatility of exchange rate expectations. The second is to act as a reference currency for the regional area in a multi-polar world monetary system.

The parallel currency approach is typically a market-oriented approach to monetary integration. But many different kind of parallel currencies may be envisaged. An extreme version of it is the *currency competition*, where a public action is required only at the start to



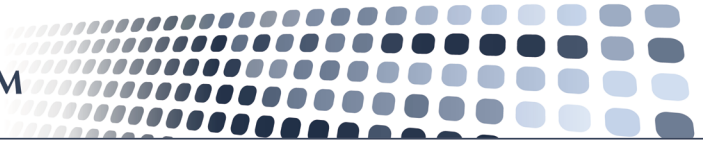
issue a new currency which is then left to freely compete with the existing ones in the market and possibly increase its appeal through agents' preferences. Also in this case, however, the issuance and control over the quantity of this new additional money is to be attributed to some Monetary Fund, thus requiring some kind of institutional commitment from the participating countries.

Some Authors have argued in favour of a *basket* version of the parallel currency (Kawasaki, Ogawa 2006) where it is considered only as a reference-monetary-sign composed of existing currencies. But even the basket solution is open to many different devices. There are two main possible choices. The first is a common peg towards an external basket, possibly based on a weighted average of some leading international currencies. But as Gudmundsson (2008) underlines, this would mean to give up the final responsibility of monetary policy, as this would be decided by the anchoring currencies. The alternative solution is an internal one, but this poses the usual $n-1$ problem which requires a hegemonic stability or a strong commitment to monetary policy coordination.

4. Some critical transitional elements

Focusing on East-Asia, a seminal article by Kuroda (2004) has attempted to set a five-steps road-map to monetary union, based on the Balassa (1961) scheme for economic integration and on the European experience. First a free trade area should be created, later evolving in a custom union and then a single market for production inputs and final goods. In the meanwhile a currency agreement could reasonably support such transformation and be finally give way to a monetary union.

This is obviously a typical European road-map to monetary integration. But most commentators underline the need to stress the differences rather than the similarities of both processes and "regions". Asian countries, whatever group is considered, have not undergone any of the political commitments to build a super-national institutional system to guarantee peace as happened to Europe after the second world war. And no institutional arrangement has been set up to give democratic legitimacy to the ongoing trade integration process.



This means that the very final target of non-European integration processes is unknown. The political commitment that guided the European integration process is not replicable on the world scale.

In the absence of a specific political aim, only intermediate economic goals can be targeted, such as domestic business cycle smoothing, greater coordinated response to asymmetric shocks, higher specialization of labour and high rates of growth with minor gaps among commercial partners.

In this respect, it is obviously doubtful whether the countries should commit to any rigid exchange rate regime, even though with a “band” mechanism like the European Erm. Gudmundsson (2008: 81), for example, points out how in this peculiar period of high and divergent growth rates in the area, flexible exchange rates might be necessary to accelerate unsynchronised business cycles and therefore best prepare the conditions for subsequent commitments for a monetary union. Instead of stabilizing exchange rates, Asian countries are invited, under this respect, to promote greater integration of financial markets to absorb the negative effects of exchange rates volatility upon trade. Whatever group should be founded appropriate for monetary integration, the differences in the economic and financial dimension of the participating countries seem to suggest, under this viewpoint, that they would better avoid searching for exchange rates stabilization.

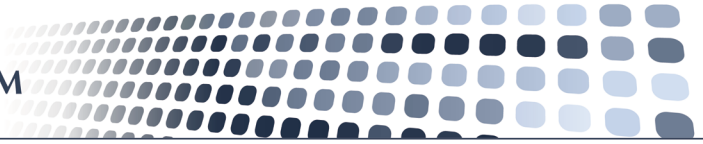
But this strategy will not jeopardize trade integration only if the possible increasing exchange volatility is well absorbed by a mature and integrated financial system, which would probably require many years to grow.

5. Concluding remarks

In the last decade, increasing attention has been placed on the acceleration of regional integration processes aiming at a new international order based on “continental” regional powers.

Monetary integration in Asia is, in this respect, on the agenda of international diplomacies and has become a subject-matter of enquiries in economic theory and policy.

Many attempts are being made to single out optimum currency areas from both economic fundamentals and political considerations. The extraordinary growth of India and China in the last decade has completely changed the scenario. From a loose

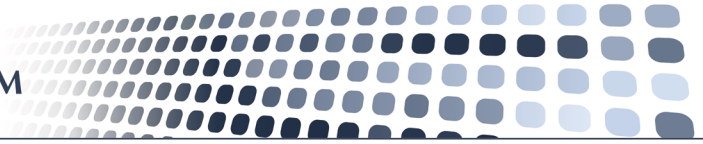


aggregation of small or medium economies where Japan and the United States could play a hegemonic role providing a collective public good named “monetary stability” we are now moving to consider stronger integration processes where China’s role is fundamental and the increased interdependence requires an acceleration of the integration process.

Monetary integration needs to assist such process and is in fact a more and more debated question both in diplomatic meetings and in scientific literature. Many enquiries try to pick from the European experience to stress the analogies and (mainly) differences. The divergence in macroeconomic performances of the countries involved in the aggregation processes let many commentators be cautious about the type and speed of monetary integration and we may expect further empirical studies to be published in the next years.

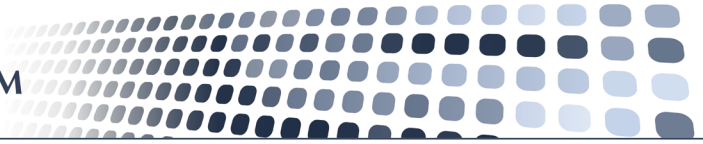
Most likely, a more comprehensive approach to the question is needed, where economic theory considerations are assisted by political scenarios for the future evolving situation in Asia and in the whole world. The steps towards some “regional” common monetary arrangement may still represent the most effective strategy to foster greater political integration at a supranational level and this may help accelerate the process of a more legitimate and efficient multi-polar world. But this discussion should not be kept detached from the reform of the international monetary system on the whole.

In synthesis, we believe that some heed should be paid to Mundell’s (2002: 9) words: “Does Asia need a common currency? The answer depends on what the alternative to it is. If the alternative is the present system then my answer is ‘yes, Asia needs a common currency’. The present system has serious flaws. If, however, the alternative to it is a global currency, which I think would be the best solution, then my answer is Asia does not need a separate common currency”.



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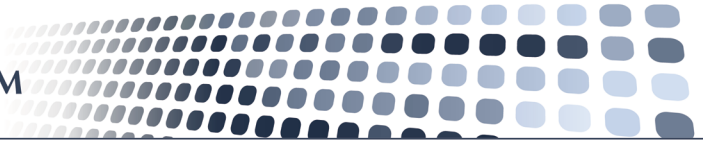
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