HONG KONG INSTITUTE FOR MONETARY RESEARCH

Asian Monetary Union – Where Do We Go from Here?

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HKIMR Occasional Paper No.2

June 2005

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Final manuscript received February 2005.

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* Hong Kong Institute for Monetary Research and The University of Hong Kong. The author is grateful to the HKIMR for sponsoring this project, but the views expressed are those of the author and do not necessarily reflect those of the HKIMR, its Council of Advisers or Board of Directors. The author has benefitted from discussion with Michael Chui, Joanne Cutler, Michael Devereux, Hans Genberg and Stefan Gerlach, and comments from an anonymous referee. He acknowledges invaluable assistance from Steven Chan Wai Wah in the preparation of statistics.

Chapter 1. Executive Summary

This paper aims to move the debate on Asian monetary union forward towards concrete exploratory work.

The arguments in favour of monetary union – which is taken to mean, in its ultimate form, a unified currency – have been well rehearsed in the academic literature on optimum currency areas. In Asia, in addition to the microeconomic benefits of reducing transaction costs, improving price transparency and deepening financial markets, there would appear to be advantages in macroeconomic terms, especially to smaller economies, in arrangements which would enhance monetary stability in the region by reducing or eliminating the vulnerability of currencies to speculative attacks or which would impose some collective peer discipline on monetary policy.

On the other hand, there may be compelling reasons for individual economies to retain autonomy in monetary policy, especially as an instrument for responding to country-specific shocks.

Empirically, despite a considerable body of research, the economic case for Asian monetary union remains unproven. Anyway, because of the rapid pace of economic development in Asia, conclusions from past research may quickly become obsolete. The arguments for and against are subject to continual modification. The balance may be shifting more towards union than away from it. Even so, this paper remains agnostic as to where that balance lies, and sceptical as to whether the two largest economies in the region – China and Japan – would see enough advantage in the idea to make it worth their while becoming involved. But those uncertainties do not justify simply shelving the subject.

Asia can draw on the experience of Europe, both in its preparations for the euro and in living with the currency since its launch at the start of 1999. The euro has plainly been successful in technical and operational terms. Benefits have also been apparent at the microeconomic level. However, the balance of costs and benefits at the macroeconomic level is, as yet, less clear. Moreover, the pre-entry convergence criteria were, arguably, more rigid than was strictly necessary; and the design of continuing fiscal rules under the Stability and Growth Pact has presented problems – although it is perhaps significant that breaches of those rules have not created any noticeable problems on the monetary front.

In a number of important respects, however, Asia differs markedly from Europe. It has nothing of the political vision which drove Europe towards a single currency, and little to match the institutional structures which have existed in Europe, first to guide the preparations for the euro and subsequently to operate the system.

In order to progress the topic of Asian monetary union beyond generalities, it is desirable to build some concrete proposals on which policy makers can focus.

It is suggested, therefore, that exploratory work should be commissioned, prospectively, though not necessarily, through the forum of EMEAP (the Executives' Meeting of East Asia Pacific Central Banks), under three main headings:

- establishment of an Asian currency unit, and arrangements for central banks in due course to operate central rates and bands relative to it;
- the structure and functions of an Asian central bank;
- the goals and instruments of a common monetary policy.

These topics are elaborated in chapter 8.

Although at present the prospect of a monetary union anywhere in Asia may seem very remote, it is worthwhile embarking on such work, simply in order to be in a better state of readiness when the time for such a union may appear riper. Given that even the limited amount of preparatory work mooted here could itself take a considerable time to complete, it is not too silly to suggest that such work should begin now. There need be no commitment for the time being by any party to join such a union, but simply a willingness to discuss the possibilities and develop a practical blueprint in good faith.

Chapter 2. Introduction

2.1 Purpose and outline

Asian monetary union (AMU) is a subject that has received increasing attention in recent years, notably since the successful launch of the euro, but there has been little substantive progress in the direction of such a union.

This paper reviews and discusses a range of issues relating to the question of whether some group of Asian economies should move towards monetary union and a common currency.[1] It aims, in particular, to identify key areas where further study could now usefully be undertaken.

The paper is organised as follows. After this introductory chapter, which sets out the background to the study, chapter 3 provides a short account of the case for and against monetary union, in mainly theoretical terms. Chapter 4 discusses the background to and implementation of the euro. Chapter 5 examines, in the Asian context, the various economic issues that might be relevant to any decision on monetary union; it finds that there is no definitive answer as to the balance of costs and benefits. Chapter 6 considers the political and institutional aspects, noting how in this regard the Asian landscape differs greatly to that of Europe even during the earliest steps towards the euro. Chapter 7 embarks on a discussion of how Asia might in practice proceed in addressing the issue, proposing that a central bankers' forum, such as EMEAP,[2] should take the lead. Chapter 8 goes on to propose concrete preparatory work under three headings: devising the framework for an Asian monetary system, which would be the necessary precursor to any eventual monetary union; considering how an Asian central bank might be structured; and exploring how a common monetary policy might operate. Chapter 9 refers briefly to questions of preconditions and continuing obligations, which would need to be addressed at some stage. Chapter 10 draws together some conclusions, suggesting that, if central banks or governments are the slightest bit interested in the idea of eventual monetary union, work could usefully start now, albeit without any obligations beyond a willingness to explore the issues in good faith.

2.2 History, meaning and coverage

In macroeconomic terms a common currency regime in many respects resembles the situation where economies maintain fixed rates of exchange, via the gold standard, a currency board or discretionary intervention. The crucial differences, however, are that the common currency does not permit any autonomy at all in monetary policy, as would be possible under a fixed exchange rate regime with the assistance of exchange controls; and that, even though it might in principle be possible to unscramble the arrangements and revert to a separate currency,[3] a currency union would generally be regarded as an irrevocable choice.

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1 Various sources provide reviews of the subject, to varying degrees of detail, and some rather dated by now. See, for example, Fabella (2000), Kawai and Takagi (2000) and Wyplosz (2001).

2 The Executives' Meeting of East Asia Pacific Central Banks, established in 1991; membership comprises the central banks of Australia, China, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Philippines, Singapore, South Korea and Thailand.

3 As following the dissolution of the Austro-Hungarian currency union after the first world war, or with the creation of new separate currencies in the early 1990s in the countries of the former Soviet Union.

For the purposes of this paper, AMU is taken to mean, in its ultimate manifestation, a unified currency for a group of Asian economies, to replace their separate national currencies. It would constitute the final step along any path of monetary cooperation in Asia, but it should be noted that cooperation in monetary matters is often discussed without the wish or presumption that it would necessarily proceed so far as a common currency.

Different observers may have different ideas as to the exact geographic coverage of the proposal, but it is generally taken to embrace, at most, economies in south-east and east Asia, but not south Asia or Australasia, even though Australia and New Zealand are in many respects quite closely linked to the region.[4] For the purposes of this paper it is therefore assumed that the maximum extent of AMU would be the members of the Association of Southeast Asian Nations (ASEAN), plus those with observer status there (East Timor and Papua New Guinea), plus greater China,[5] Japan and South Korea. Thus the full list of potential candidate members is: Brunei, Cambodia, China, East Timor, Hong Kong, Indonesia, Japan, Laos, Macau, Malaysia, Myanmar, Papua New Guinea, Philippines, Singapore, South Korea, Taiwan, Thailand, Vietnam. In practical terms it would be immaterial if some of the smaller economies on the list were in or out, or if any other small peripheral economies were included. On the other hand, the omission of either of the two largest economies, China or Japan, might have major repercussions for the design or viability of the arrangement.

2.3 Current arrangements

Brunei and Macau, although they possess formally independent currencies, each operates a currency board based on another currency within the group – Brunei on the Singapore dollar and Macau on the Hong Kong dollar. Hong Kong has a currency board based on an outside currency, the US dollar. East Timor does not have a currency of its own but uses the US dollar; this does not necessarily preclude the possibility of it altering its arrangements in the future. China and Malaysia operate *de facto* pegs to the US dollar. Japan, Papua New Guinea, Philippines and South Korea have “independently floating” currencies. The remainder practise “managed floating with no pre-announced path”.[6]

It should be noted that all of the economies with the exception of Hong Kong and Japan operate capital controls, albeit to widely varying degrees of intensity.

The region has long had a US dollar focus. Table 2.1 shows a measure of the variability of regional currencies against the dollar and against the yen over the last ten years. Over the full period, the majority of currencies recorded greater variability against the dollar than against the yen, but this was largely because of big adjustments against the dollar during the 1997 Asian financial crisis, which broke a number of *de facto* dollar pegs. Since then, there has been notably less variation against the dollar, with some currencies continuing to shadow the dollar either formally or informally. In the period since September 1998 only Indonesia and South Korea have shown more stability against the yen than against the dollar.

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4 Via common membership of APEC and EMEAP, for instance. India has also been mentioned as a possible member of any union in the longer term; see Kuroda (2004).

5 *i.e.* China, Hong Kong, Taiwan and implicitly, though it is seldom mentioned, Macau.

6 These regime classifications are taken from the IMF’s *Annual Report* 2004, except for Taiwan which is not covered there but is observed to follow a managed float. Cambodia, Laos and Myanmar each operate more than one exchange rate; the reference here is to the major market.

Table 2.1 Variability of Asian Currencies Against Dollar and Yen

Coefficient of variation (100*SD/mean), based on end-quarter exchange rates

	March 1994 - June 2004		September 1998 - June 2004	
	relative to US dollar	relative to yen	relative to US dollar	relative to yen
Cambodia	18.2	15.6	1.9	8.2
China	1.2	11.8	0.0	7.8
Hong Kong	0.4	11.1	0.3	7.8
Indonesia	52.5	48.2	12.1	9.5
Japan	10.8		7.9	
Laos	73.4	73.4	23.1	23.8
Malaysia	17.9	15.2	0.0	7.8
Myanmar	5.6	7.5	4.9	6.2
Philippines	28.1	25.8	12.4	14.2
Singapore	9.0	9.5	2.9	6.4
South Korea	21.1	15.1	6.3	4.4
Taiwan	10.4	8.4	4.2	5.8
Thailand	21.9	17.7	6.3	7.3
Vietnam	13.4	12.8	4.5	8.6

Meanwhile, the region's economies account for over half of the world's official holdings of foreign exchange reserves (Table 2.2), and continue to amass them, mainly, it seems, in US dollars. According to IMF figures, some two-thirds of global foreign exchange reserves at end-2003 were held in dollars.[7] During 2002 and 2003 over 80% of the new accumulations of reserves comprised dollars, and, despite anecdotal evidence of increased diversification since then, the proportion being accumulated in dollars is still likely to be quite high. The valuation effect of the dollar's depreciation may, however, cause the overall dollar proportion to stabilise, or even decline. Meanwhile the proportion held in yen remains at around 5%. The euro proportion has been the principal beneficiary of any active diversification away from the dollar, and of valuation effects.

[7] IMF *Annual Report* 2004.

Table 2.2 Foreign Exchange Reserves

end-2003, US$ billion	
Brunei	0.5
Cambodia	0.8
China	403.3
Hong Kong	118.4
Indonesia	34.7
Japan	652.8
Laos	0.2
Macau	4.3
Malaysia	43.5
Myanmar	0.6
Papua New Guinea	0.5
Philippines	13.3
Singapore	95.0
South Korea	154.5
Taiwan	206.6
Thailand	41.0
Vietnam	6.2
Total of above	1776.2
Total as percentage of worldwide official foreign exchange reserves	*53.7*

Sources: For Brunei, IMF Public Information Notice (PIN) No. 04/107 September 23, 2004; for Taiwan, CEIC *Asia Database*; for others, IMF's *International Financial Statistics* September 2004 (IFS).

2.4 Official efforts towards closer ties

At times over the years, in accordance with its desire to "internationalise" the yen, Japan has attempted to persuade others in the region to peg their currencies to the yen or at least afford the yen a sizeable weight in any basket which guides exchange rate policy. It has tried to make yen instruments, or procedures for the trading thereof, more attractive to foreigners; and it has sketched an action plan for internationalisation of the yen.[8]

But none of these moves has been particularly successful. The monetary authorities in the rest of the region persist with a much stronger focus on the dollar than anything else.

This dollar focus may at least partly be motivated by trade considerations – the fact, or belief, that a stable or relatively stable rate against the world's main trading currency best suits those involved in international trade. This would imply a belief also that, to the extent that the nominal exchange rate

[8] Ministry of Finance (2003). For earlier discussions see Ministry of Finance (1999) and Latter (2000). Kwan (1994) examined more specifically the case for other economies anchoring to the yen.

is anchored, any necessary adjustments to the real exchange rate can be satisfactorily achieved by variations in domestic cost and price levels. If that is the case, there may be little incentive to vary existing exchange rate regimes. It is possible, however, that, for some at least, the target has increasingly become stability against the renminbi, but that this motivation is obscured because of the stability of the dollar/renminbi rate for the past ten years.[9] In such cases, by implication, some move towards a broader or more formal AMU may be attractive. If or when China adjusts the renminbi against the dollar, the reaction of others in the region will provide useful insights into attitudes in this regard.

In 1997 Japan floated the idea of an Asian Monetary Fund, but this came to nought because of political opposition elsewhere.[10] Next, ASEAN leaders, meeting in Hanoi in December 1998, endorsed a project to study the feasibility of a common currency, but little progress has been recorded there. The subject was more recently boosted by being debated in the margins of the annual general meeting of the Asian Development Bank in May 2004, although no consensus seemed to emerge.[11]

Most recently, the chief executive of the Hong Kong Monetary Authority noted the possible advantages of Asian monetary union in terms of fostering financial stability, but raised a number of questions which would need to be answered before the economic justification for such a union could be decided. He confessed that, to his knowledge, monetary union was not yet formally on the agenda in any official Asian forum.[12]

Thus, in contrast to the considerable discussion of the prospects for AMU that has taken place in some academic circles, on the official side there has been little practical progress in deliberations, still less with actions. The only areas where concrete steps have been taken which may be deemed in any sense relevant are swap networks and bond markets. A set of bilateral swap agreements among EMEAP members was established in 1995, albeit only providing US dollar liquidity against US treasury securities. Then, since 2000 a series of bilateral swaps between US dollars and domestic currencies among ASEAN+3 countries[13] has been developed under the Chiang Mai initiative.[14] Meanwhile, a number of initiatives have been launched through EMEAP, ASEAN+3 and APEC (the Asia-Pacific Economic Cooperation forum) to develop regional bond markets, but in terms of currency focus none has yet yielded any significant diversion of attention away from the US dollar.[15]

9 However, as shown in the first column of table 5.1, for some of the economies China is still only a rather modest trading partner.

10 As mentioned by Yam (2004).

11 See, for example, Chino (2004) and Rowley (2004).

12 Yam (2004).

13 The ASEAN members together with China, Japan and South Korea.

14 These are mostly conditional on compliance with IMF programmes – which is somewhat ironic in view of the disdain sometimes shown in the region for the IMF

15 A modest effort to shift attention away from the dollar was the second stage of EMEAP's Asian bond fund – so-called ABF2 – which was announced in December 2004 and provides for, initially, investment of up to US$2 billion equivalent in bonds denominated in the region's currencies.

Chapter 3. Monetary Union

3.1 General considerations

In assessing the merits of monetary union at the economic level, there must first be agreement as to the purpose of monetary policy itself. Current conventional wisdom is that its purpose is to maintain a stable monetary environment, in which economic welfare objectives – such as low inflation and growth, including the ability to absorb or adjust to external shocks with the minimum of welfare loss – can be best satisfied, but where monetary policy supplies the facilitative environment and, although possibly serving as a short-term instrument of demand management, is not regarded as a means for directly influencing the economy's underlying productive potential. However, in the context of monetary union, the nature of the objectives which may be agreed is less important than the fact of agreement itself, since, if central banks are not in agreement on basic objectives, whatever they may be, there is absolutely no point in seeking to unify the monetary systems.

In practice, the operation of a monetary union would require not just consensus on those general objectives, but also more specific agreement on details of the unified policy focus, and the development of a single decision-making and operational framework.

But, while a viable framework for a common monetary policy is a necessary requirement of a monetary union, it is not a sufficient reason for adopting one. Currency union should not be an end in itself but only a means towards better economic performance. The challenge for each prospective member of the union is to determine whether or not it would actually be better off for having surrendered monetary autonomy.

There is also a question of whether such a union, however desirable in economic terms, would be politically achievable. It necessarily involves surrender of sovereignty and, in substitution, an agreement on common goals. In Europe, monetary union was driven, to a large extent, by political considerations and would almost certainly not have materialised, had it not been for the powerful political momentum behind it.

3.2 The broad economic case

Mundell has come to be regarded as the father of the modern academic debate on the optimum currency area (OCA), while, a little later and in a separate context, Werner was perhaps the first to deliver some practical and political impetus to the subject.[16]

The OCA literature has focused on articulating the economic conditions for successful currency union, identifying what is the best set of criteria by which to judge whether two or more economies would be better served by having a single currency, and carrying out associated empirical investigations.

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[16] Mundell (1961). The Werner report (1970) was the first substantive step on the road to monetary union in Europe. Kenen (2002) reminds us that Mundell was dealing only with the macroeconomic aspects, and was writing in an era of mainly low capital and labour mobility between countries.

The arguments in favour of a unified currency may be summarised as follows:

- savings from not having to hedge currency exposures;
- savings on the shoe-leather costs of shopping around to find the best exchange deals;
- no longer being deterred from a transaction altogether merely because of risk aversion to exchange rate uncertainty;
- improved cross-border price transparency, leading to more intense competition;
- benefits from deeper and more homogeneous financial markets;
- avoidance of the damage inflicted by exchange rate misalignment,[17] such as mistaken investment appraisals or hysteresis effects;
- benefits which may arise from coordination of policies designed to achieve a common goal of monetary stability;
- reduced need to maintain national foreign exchange reserves;
- possible benefits from role as international reserve currency.

Through these various channels welfare may be enhanced, most visibly, perhaps, if trade expands. There is a body of empirical work attesting to the trade benefits of a stable exchange rate or *a fortiori* a common currency.[18]

Against these arguments must be put the costs of losing monetary autonomy and, in particular, the costs of adjusting to country-specific shocks when monetary policy is no longer an available instrument.

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17 Misalignment in the sense of movement that is not based on economic fundamentals; Buiter and Grafe (2003), for example, point out that the existence of technically efficient foreign exchange markets, supported by high capital mobility, does not necessarily imply that those markets are informationally and allocatively efficient.

18 Most famously by Rose (2000) from his ‘gravity’ model research, from which he concluded that membership of a currency union might account for a tripling or more of trade between members. Others have challenged the findings, for instance by pointing to endogeneities in the process. Rose has conceded some of these points but the general conclusion, that there is a significant positive impact on trade, appears indestructible. See, for example, Melitz (2001).

Chapter 4. The European Experience

4.1 History

For many years the OCA debate was largely confined to examining hypothetical situations, since there was no sufficiently recent case of deliberate election for currency union among economies with previously separate currencies that could serve as a relevant empirical test-bed. That has now changed with the adoption in 1999 of the euro by eleven European countries (joined by a twelfth, Greece, in 2001). The following paragraphs review the path to European monetary union (EMU), with a view to informing the discussion of AMU.

The road to the euro was a long one.[19] Visionary statements about possible monetary union had been made as early as the 1950s. The first moves of any substance came following the Werner Report of 1970, with the instigation in 1972 of the "snake in the tunnel" – an arrangement aimed at limiting fluctuations in exchange rates between members. Although its success was shortlived, it laid the foundation for a more concerted effort to contain fluctuations in exchange rates with the inception of the European Monetary System (EMS) in 1979.

There were three elements to the EMS: a new unit of account, the European Currency Unit (ecu) based on a basket of member currencies; a European Monetary Cooperation Fund (EMCF) to provide balance-of-payments assistance; and the Exchange Rate Mechanism (ERM) under which national currencies set central rates against the ecu and maintained their rates within standard margins on either side of the central rates, initially set at 2.25% (though 6% for some).

The ecu became the unit of account for the European Union, being used formally in budgetary calculations etc., and there was a pool of "official" ecu created by central banks swapping part of their foreign exchange reserves and gold. These official ecu could be transferred between central banks only. But a private ecu market also developed, with bond issuance and exchange market activity taking place – initially on only a modest scale, but growing as the ecu became accepted and as it was eventually earmarked for transition into the euro.

Despite various realignments of central rates subsequently, and despite the fact that, after the 1992-93 crisis precipitated a widening of the bands to 15%, the system for a while resembled more a floating regime, the ERM provided the framework within which the convergence process operated for the currencies which were in due course to merge into the euro.

The starting point of the final push towards the euro was the establishment of the Delors committee in 1989, charged with formulating specific plans. This was followed by completion in 1992 of the internal market programme – with free trade, substantial dismantlement of non-tariff barriers and full liberalisation of capital flows – as envisaged under the Single European Act of 1986; the Maastricht treaty, also of 1992, setting out the definitive path to the euro; the establishment of the European Monetary Institute (EMI) in 1994, which transformed into the European Central Bank (ECB) in 1998; and, ultimately, the launch of the euro at the start of 1999. Throughout this history there was a strong underlying political determination among the core eurozone countries to reach the eventual goal.

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19 Recounted in, *inter alia*, Portes (2001) and Chiu, Morris and Pineau (2002).

Six years on since its inception, it is clear that the fusion of currencies into the euro has been successful as a technical and operational exercise. On the economic front, there are signs of trade among members having been significantly enhanced,[20] but the evidence of economic performance more generally is more mixed, with some countries such as Ireland, Greece and Spain appearing to flourish, while others such as Germany and Italy have languished somewhat. No firm conclusions have been reached as to how much these developments may be attributable to monetary union itself, but there is a suspicion that the laggards have been suffering because of inflexibility in their internal economic structures and labour markets, which have come under the spotlight partly because the instrument of unilateral monetary policy is no longer available.

The passage of time also allows for an appraisal of the convergence programme, both as to how it was observed, what it may have contributed to the overall success, and how, in retrospect, it might have been better or differently designed.

4.2 The convergence process in Europe

Under the Maastricht treaty, candidate countries had to fulfil a number of conditions, mostly related to achieving convergence with one another. Each currency had to have been fully convertible for at least two years, and the exchange rate must have been functioning satisfactorily in the ERM within margins of 2.5% and without any devaluation against other members; the rate of inflation must have converged to close to the area's average; long-term interest rates must also have converged to close to the average; the fiscal deficit must have been at or below 3% of GDP; and the outstanding amount of government debt no more than 60% of GDP – or moving towards that figure at a satisfactory pace. In the event, all the criteria were judged to have been satisfied by all the eleven candidates.[21]

4.3 Inflation

For inflation, the criterion was set at achieving a rate of increase in consumer prices (on the harmonised EU measure) no more than 1.5% above the average of the three lowest inflation countries. While it was clearly desirable – albeit, arguably, not essential – that inflation should be under control before the euro was launched, and to be in line with prevailing economic wisdom around the world this would have meant a rate of no more than 2-3% across the EU, it seems with hindsight that a 1.5% range between highest and lowest may have been unnecessarily tight, leaving insufficient room for the differentials which one might expect, and indeed require, to accommodate structural adjustments. It is noteworthy that by 2003 there were five eurozone countries which would have been in breach of this criterion if it had been kept as a continuing obligation.

One of the reasons why overall inflation in the eurozone remained above the ECB's target ceiling of 2% in the early years of the euro was the fact that inflation was obstinate and would not, largely because of structural rigidities in the labour market, go below zero in any participating state. There is debate as to whether the current dispersion of inflation rates is merely a reflection of the necessary adjustment of competitiveness in consequence of structural differences, or a more sinister sign of strain within the euro system.[22] However, given

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20 As concluded by Micco *et al.* (2002) and Barr *et al.* (2003).

21 See the 1998 *Convergence Report* for the final appraisal of adherence to the criteria by the initial eleven currencies.

22 European Central Bank (2003).

that, ahead of the euro's launch, all candidates were satisfying the criterion of exchange rate stability, it was perhaps unnecessary to impose quite such a rigid view of inflation convergence.

An OECD study[23] found that, historically, internal migration has played a more significant role in equilibrating regional imbalances in the United States than it has in Europe, leading to the conclusion that relative wages (and hence prices) would need to bear more of the adjustment in Europe. It cites research on the US indicating that a spread of 3-4% between the highest and lowest inflation rates among the states was needed, implying that at least as large a spread might be needed across the eurozone. It is not clear whether the ECB's desired ceiling of 2% on EU average inflation is sufficient to accommodate the spread between member states which may be necessary for macroeconomic equilibrium, given that there appears to be institutional resistance to actual deflation in individual members. If 2% proves too restrictive, migration may need to be more elastic in order for macroeconomic equilibrium to be assured.

4.4 Fiscal policy

The fiscal criteria have created the biggest problems for the eurozone, not only regarding initial compliance but also because they were subsequently consolidated into the Stability and Growth Pact (SGP) as a continuing obligation. All eleven founder members were judged in 1998 to have satisfied the criteria, although a few only after applying permitted flexibility in terms of making satisfactory progress towards the 60% debt ratio. But, because some countries only just managed to meet the pre-entry criteria in fairly benign economic circumstances, it was scarcely surprising that budget deficits came to overshoot the 3% ceiling during a subsequent economic downturn. This highlights flaws in the design of the SGP rather than necessarily calling into question the philosophy on which it is based.[24]

There is nevertheless scope to dispute that philosophy. It is based on the view that within a currency area a certain degree of collective fiscal discipline is required to safeguard the common monetary policy from being placed under undue pressure from irresponsible fiscal policy among a minority – the free-rider problem. The fear is not only that governments may crowd out other borrowers from financial markets, but also that the very existence of a sizeable borrowing requirement may engender fears of inflation – because of the lurking threat of monetary financing, even if formally proscribed – and so drive up interest rates zone-wide.

The alternative view is that, since the monetary rules prohibit central banks from directly financing government deficits, there is no more serious monetary impact from government running a deficit than from the corporate sector doing so, at least not when the economy is operating below productive potential, and that individual governments should therefore be left alone to use fiscal policy for counter-cyclical correction and to make the political/social choice as to the nature and scale of the public sector's role in their respective economies. In support of this view it is noted that the deficit overruns to date do not appear to have had any significantly harmful effects on interest rates, nor hence on the conduct of

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[23] OECD (2002).

[24] See Allsopp and Artis (2003) for a useful survey of this field: they argue for a coherent set of fiscal rules, but with sufficient flexibility to accommodate the cycle and asymmetric shocks. See also Buiter (2003) for a critique of the fiscal rules of the SGP and a suggested framework for any such rules.

monetary policy or the relationship of the euro to other currencies. The growing credibility of the ECB diminishes fears that fiscal profligacy might culminate in some sort of inflationary bail-out. Further support for this general point derives from the observation that in the United States long-term interest rates have remained low in the face of large and growing budget deficits.[25]

In essence, therefore, the received wisdom that high fiscal deficits will necessarily involve high interest rates has been called into question in recent years as a result of the clear separation of monetary from fiscal responsibilities in most jurisdictions.

4.5 Central bank autonomy

In addition to these economic criteria, there was a requirement that national central banks and their governors, who would be their countries' representatives on the ECB's decision-making committee, should be adequately independent from finance ministries and parliaments, in order to ensure that the ECB would resolutely give priority to its inflation objective, and so as to insulate monetary policy from any opportunistic political interference.

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25 Eichengreen (2004), for example, is sceptical of arguments concerning free-riders and collective damage, noting that breaches of SGP have had no adverse consequences for monetary conditions in the eurozone.

Chapter 5. Considerations For Asia

5.1 General

The broad consensus from the academic literature over a period of more than forty years is that an economy is likely to be more suited to monetary union -

- the more open it is;
- the greater the product diversity of its trade;
- the less likely it is to suffer idiosyncratic shocks; in other words, the more likely it is that shocks affect members of a union symmetrically;
- the greater the flexibility of its labour markets, particularly in respect of real wages.

The following paragraphs examine these and other factors which may be considered relevant to determining the readiness of Asia for a common currency.

5.2 Openness and trade integration

The utility of an independent currency tends to be less, the more open is the economy, and the more dependent it is on any one dominant trading or financial partner.[26] However, the case for some sort of fixed rate or currency union would always be dependent on the currency to which one is pegged, or the unified currency, itself being soundly managed and possessing other desirable attributes such as convertibility.

By way of illustration, the openness and trade-links arguments may be persuasive in suggesting that Hong Kong and Macau should adopt the currency of mainland China, but the renminbi lacks convertibility and Beijing has yet to establish any sort of track record in managing a convertible currency. Even if such conditions were satisfied, one could appeal to the examples of such countries as Canada, Mexico or Switzerland to show that a unified currency with a dominant neighbour is by no means a necessary condition for prosperity.

The degree of trade integration among the Asian economies is considerable and growing rapidly, although some will, of course, always be more dependent than others on neighbours in the region. Some past research suggested that integration within Asia fell short of that among the eurozone countries immediately prior to the launch of the euro, but that comparison may be changing with time.[27] Table 5.1 shows that trade integration in 2003 ranged from 43% to 70% among a core group of the Asian region's economies.[28]

Typically, trade integration would be seen as providing the basis for a successful monetary union. On the other hand, to the extent that trade has already flourished in the absence of currency union, the potential further benefits from such a union are diminished.

26 McKinnon (1963) was among the first to specifically suggest that it was inappropriate of a small open economy to maintain an independent currency.

27 Trade integration has been measured by a number of researchers, for example, Chui, Morris and Pineau (2002) and Xu (2003). Wyplosz (2001) actually found stronger residual integration in Asia, compared to Europe, after allowing for gravity factors.

28 It should be borne in mind that linkages in the field of services are also very important, but there is no readily available bilateral data.

Table 5.1 Trade with Asian Economies as a Percentage of Total Trade (Imports + Exports) in 2003

*Each cell measures the percentage of A's total trade that is represented by trade with B, as recorded by A**

A \ B	CHI	HK	IND	JAP	KOR	MAL	PHI	SING	THAI	TW	Total of group
China		10.3	1.2	15.7	7.4	2.4	1.1	2.3	1.5	3.8	45.7
Hong Kong	43.1		0.6	8.7	3.5	1.7	1.3	3.6	1.4	6.6	70.5
Indonesia	7.2	1.5		19.1	6.3	3.7	1.2	10.2	3.3	4.7	57.2
Japan	15.5	3.7	2.7		6.2	2.8	1.0	2.4	3.3	5.2	42.8
Korea	15.3	4.7	2.3	14.4		2.2	1.3	2.4	1.2	3.6	47.4
Malaysia	7.5	4.8	2.7	13.6	4.0		2.4	14.0	4.5	4.1	57.6
Philippines	5.3	6.4	1.5	18.2	5.0	5.2		6.7	3.5	7.3	59.1
Singapore	7.8	6.4	3.5	9.2	4.1	16.3	2.2		4.3	3.3	57.1
Thailand	7.5	3.5	2.6	19.0	2.9	5.4	1.9	5.9		3.1	51.8
Taiwan	11.9	11.1	1.6	16.4	4.9	2.0	2.0	3.3	1.8		55.0

* Except that Singapore data for its trade with Indonesia in 2003 is unavailable, so the figures reported by Indonesia are used.
Sources: IFS for all except Taiwan. *CEIC Asia Database* for Taiwan. Exports are on FOB basis, imports CIF.
Note: The IMF cautions that China may classify as trade with Hong Kong some of its trade with other, particularly industrial countries, if it passes through Hong Kong ports.

5.3 Mutual capital flows

Intra-regional capital flows are on the increase, notably in respect of direct investment.[29] Portfolio flows may be less significant, in many cases because deliberate controls are still in operation. One would expect there to be potential efficiency gains in finance as a consequence of unifying currencies. On the other hand, as with trade, if financial integration has progressed well under separate currencies, or is deemed capable of progressing well subject to controls being lifted, it may be argued that potential benefits from currency union will be limited.

5.4 Disparities in living standards

Income disparities are substantially greater across the Asian region than Europe. For example, GDP per head in Japan is some 100 times larger, at market exchange rates, than in Laos and Cambodia, and some 40 times above Indonesia (table 5.2), whereas at the launch of the euro the maximum divergence between member countries was a factor of $4^1/_2$, or only $2^1/_2$ if Luxembourg, a very small but wealthy country, is excluded (table 5.3). The sharper dispersion would tend to make the Asian region less suited to monetary union, if it implied that the types of shocks likely to hit the countries, or their reactions to particular shocks, were likely be to more diverse. Income disparities might also mean that quite large shifts in real exchange rates would be required over time; within a monetary union that adjustment would need to occur wholly through differential inflation – a factor which might, depending on internal structural flexibility, affect the design of the collective monetary policy within a union.

[29] See, for example, Xu (2003), p. 6.

Table 5.2 Asian Economies: Gross Domestic Product

	Year	GDP, US$ billion	GDP per capita, US$
Brunei	*2003*	4.5	13,000
Cambodia	*2002*	4.0	303
China	*2003*	1409.9	1,068
East-Timor	*2003*	0.3	415
Hong Kong	*2003*	156.6	22,286
Indonesia	*2002*	173.3	797
Japan	*2002*	3979.4	31,253
Laos	*2003*	1.9	340
Macau	*2003*	7.9	17,025
Malaysia	*2003*	103.2	4,204
Myanmar	*1999*	352.0	7,510
Papua New Guinea	*1999*	3.5	664
Philippines	*2003*	79.3	983
Singapore	*2002*	87.0	20,928
South Korea	*2003*	605.6	12,611
Taiwan	*2003*	286.4	12,735
Thailand	*2003*	143.3	2,280
Vietnam	*2003*	39.0	480

Sources:
GDP For Brunei, IMF PIN 04/107; for East Timor, IMF PIN 04/118; for others, IFS.
Population United Nations *2003 ESCAP Population Data Sheet* for Brunei, China, East Timor, Hong Kong, Laos, Macau, Malaysia, Philippines, South Korea, Taiwan, Thailand, and Vietnam; *Population and Development Indicators for Asia and the Pacific 2002* for Cambodia, Indonesia, Japan, and Singapore; IFS for Myanmar and Papua New Guinea.

Table 5.3 Eurozone, Original Eleven Members: Gross Domestic Product 1998 (*ie* prior to launch of euro)

	GDP, US$ billion	GDP per capita, US $
Austria	211.2	26,079
Belgium	250.5	24,538
Finland	129.0	25,032
France	1452.5	24,692
Germany	2142.4	26,076
Ireland	86.3	23,141
Italy	1196.5	20,807
Luxemburg	18.9	44,671
Netherlands	391.3	24,877
Portugal	106.9	10,714
Spain	588.0	14,540

Source: IFS; GDP is converted to US$ at period-average exchange rates; year-end population figures for 1998 are used in the per capita calculation.

Neither of these considerations should necessarily rule out the possibility of monetary union. The fact that some of the new EU members which are regarded as candidates to join the euro in the not-too-distant future are substantially poorer than existing members has not been seen as a stumbling block to joining the euro provided that other criteria can be met. Even so, the largest divergence within the enlarged EU (table 5.4), at a multiple of 13 (or 9 if Luxembourg is excluded), is still very much smaller than that in Asia.

5.5 Exchange rate variability and focus

The historical variability of exchange rates has already been discussed. However, given shifting economic and political circumstances, this cannot be taken as much of a guide to future variability. It is widely presumed that, as with Europe, there would need to be a prior period of stability between the currencies in order to make a currency union credible, but there are examples of economies in

Table 5.4 Enlarged European Union, Gross Domestic Product

	GDP, US$ billion	GDP per capita, US$
Austria	253.5	31,248
Belgium	302.3	29,364
Cyprus	12.9	16,161
Czech Republic	85.4	8,339
Denmark	212.3	39,665
Estonia	9.1	6,787
Finland	162.2	31,205
France	1762.4	29,447
Germany	2407.8	29,215
Greece	173.5	15,820
Hungary	82.8	8,345
Malta	4.5	11,559
Ireland	152.4	38,974
Italy	1471.1	25,593
Latvia	10.3	4,412
Lithuania	18.2	5,255
Luxemburg	26.3	58,875
Netherlands	513.2	31,941
Poland	198.3	5,134
Portugal	147.5	14,680
Slovakia	32.5	6,024
Slovenia	15.7	7,897
Spain	840.3	20,505
Sweden	301.6	34,013
United Kingdom	1795.8	30,403

Source: IFS; GDP is for 2003 except for Poland, which is 2002; GDP is converted to US$ at period-average exchange rates; year-end population figures for 2002 are used in the per capita calculation.

the past succeeding in stabilising or fixing their exchange rates quite abruptly, without a track record of convergence – most notably the Hong Kong dollar in fixing to the US dollar in 1983. During much of the period when Europe was discussing and negotiating union, the member currencies were exhibiting considerably volatility. This did not prevent the eventual union. Existing variability should not, therefore, be taken as a signal that monetary union could not be achieved.

5.6 Inflation disparities

Disparities in inflation rates exist across Asia, but some are explained by currently differing monetary regimes. Inflation has subsided in recent years in the key Asian economies (table 5.5), with deflation emerging in some. There is little reason to doubt candidate economies' ability to achieve whatever degree of convergence may be deemed necessary as a condition for AMU. But, to the extent that divergences arise from structural diversity across Asia, quite wide disparities – wider, at any rate, than in Europe – may not be inconsistent with exchange rate stability. And exchange rate discipline, if followed in accordance with a prescribed preparatory path to union, or as ultimately cemented by the union itself, will anyway deliver the necessary degree of convergence in inflation rates.

Table 5.5 Selected Asian Economies: Consumer Price Inflation

	2001	2002	2003
China	0.5	-0.8	1.2
Hong Kong	-1.6	-3.0	-2.6
Indonesia	12.5	10.0	2.4
Japan	-0.7	-0.9	-0.2
Malaysia	1.4	1.8	1.1
Philippines	6.1	3.0	3.0
Singapore	1.0	-0.4	0.5
South Korea	4.1	2.7	3.6
Taiwan	0.0	-0.2	-0.3
Thailand	1.7	0.6	1.8

Sources: CEIC *Asia Database* for Thailand and Taiwan; otherwise IFS..

5.7 Structural homogeneity

Structural differences, associated with factor or cultural endowments or with different stages of economic development, are likely to be greater across any prospective Asian group than they were in Europe.[30] This suggests that, in order to accommodate the differential impact of shocks and the evolution of structural changes (such as the Balassa-Samuelson effect), considerable flexibility in real exchange rates may be needed. If nominal flexibility is ruled out by currency union, greater reliance would need to be placed on internal price level flexibility, with allowance for wider disparities in national rates of inflation.

5.8 Experience with shocks

Empirical research has produced mixed results.[31] Taking the widest range of Asian countries, shocks may certainly be less homogeneous than across the eurozone, for reasons relating to economic structure, political eventualities and, to some extent, geography. But even in Europe there have been one or two outliers such as Finland and Ireland. And, within certain subgroups of Asian economies, there is a high degree of uniformity. The Asians tend to adjust to shocks more readily. And currency union might itself lessen some of the differences that contribute to the variability of shocks. Thus, on this score the Asian economies may not necessarily be any less suited to currency union, compared with Europe.

It is presumed that Asian economies would be unlikely to operate, on a significant scale, any network of mutual fiscal support (such as the EU's centralised budget) that might compensate for the differential impact of shocks. In fact, however, within the eurozone the scope for discretionary fiscal transfers to offset asymmetric shocks is less than is popularly presumed, and very much less than, for example, among regions of the United States.[32]

5.9 Flexibility

It is widely acknowledged that the Asian economies possess much more flexibility in cost-price structures than is found in Europe. This stems essentially from labour markets, which are less rigid[33] and subject to comparatively little minimum wage legislation. There are also instances of quite high labour mobility across frontiers in some parts of the region, although this tends to be on the basis of specified, officially regulated contracts rather than entire freedom of movement of labour.

5.10 Financial robustness

As noted already, the existence of capital controls of varying incidence is an absolute impediment to monetary union. These may disguise or protect financial fragility, such as weak banks; and those countries with fragile financial systems may not anyway be welcome into a monetary union,

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30 A point stressed by Grenville (2004).

31 See, for instance, Eichengreen and Bayoumi (1996), Chow and Kim (2000). But note that their empirical work excludes China because of data constraints.

32 See Allsopp and Artis (2003).

33 Eichengreen and Bayoumi (1999).

especially if this suggests that the central bank may be tempted to bail out banks. Moreover, weaknesses in financial systems may generate unhelpful attitudes towards inflation and monetary discipline more generally.

5.11 Monetary competence

The monetary union debate is usually conducted on the presumption of optimising behaviour by the monetary authorities in all circumstances.[34] If, however, there exist weak central banks – perhaps because they are subject to too much political influence – the case for surrendering monetary policy, to a presumably more disciplined regional central bank, is stronger. This may encourage the thought that some of the institutionally weaker countries would be ideal candidates for AMU, but in practice the others are likely to be deeply – and perhaps rightly – suspicious of admitting them to the club on such motives. Those who regard themselves as practising successful monetary policies may anyway not be particularly enthusiastic about AMU. In Europe, the requirements that all national central banks should have a sufficient degree of independence from their respective governments was an important factor in achieving the necessary convergence of central bank attitudes. All of this highlights the question of whether central banks are likely to strike a sufficient consensus to proceed.

5.12 Fiscal discipline

It is popularly presumed that some evidence of fiscal prudence, if not actual convergence, would be a prerequisite for proceeding towards AMU, despite the queries raised above as to the necessity for such criteria. In fact the core candidate countries do already exercise a reasonable degree of discipline (tables 5.6 and 5.7).[35] It does not look as if they would have any more of a struggle than did the euro candidates in meeting criteria of a similar nature to those used in Europe, if such were deemed appropriate.

5.13 Empirical findings

A number of studies have been performed to ascertain how well particular groups of Asian economies would be suited to monetary union, particularly by comparison to the European experience. A common but not universal finding in the past has been that the Asian countries are less inter-dependent in trade than were the members of the euro prior to its launch. But, even if such findings still hold, their interpretation is ambiguous. It could either be taken to indicate that Asia would acclimatise less well to a single currency, or that the single currency should be encouraged because the potential trade gains are that much greater.

With regard to OCA criteria more generally, Goto and Hamada, writing in 1992, found that, after analysing data on trade, investment, labour mobility, prices and GDP, Asia was as ready for a single currency as Europe had been in 1990; they suggested that a reasonable case could be made for AMU.[36] Eichengreen and Bayoumi also concluded, some ten years ago, that a group of east Asian economies satisfied the economic criteria for monetary union about as well as did countries scheduled to join the euro.[37] In another paper they found ASEAN less suited than was the

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[34] As noted by Melitz (2002).

[35] See also Chui, Morris and Pineau (2002).

[36] The publication of their paper is dated a couple of years later – Goto and Hamada (1994).

[37] Eichengreen and Bayoumi (1996).

eurozone before the Maastricht treaty, but that the differences were not large.[38]

Even if countries do not appear to satisfy OCA criteria *ex ante*, membership of a currency union may itself induce changes which bring them into stronger conformity with the criteria.[39] In other words, the problems which may have been presumed to arise because of lack of close integration or homogeneity may dissipate over time. One may note, for example, that, within Europe, the United Kingdom, Ireland, Finland and Sweden were found to be relatively idiosyncratic in terms of the business cycle.[40] This may, in some eyes, have been reason enough not to join the euro. In the event, Ireland and Finland did join, and their economies appear to have done well, and may have become more synchronised with the rest of the eurozone. Sweden and the UK stayed out, but there is no evidence of either having suffered from its decision.[41] For Asia, the flexibility factor could be sufficient to outweigh many of the factors indicative against monetary union.

All of those empirical findings should, however, be treated with some caution, for two reasons. First, the selection of Asian economies for inclusion varies and is to some extent arbitrary – depending on such factors as data availability or the researchers' political perspectives. Second, much of the work is now rather dated. Asia is a fast changing environment, notably because of the rapid growth of China and its trading relationships; thus, conclusions reached on the basis of careful empirical work during the 1990s or even more recently may to varying degrees have been overtaken by events. If anything, recent events will have tended to strengthen the evidence in favour of AMU.

Finally, it should be noted that the evolution of monetary union in Europe actually owed very little to the application of OCA criteria. The project had its own political momentum and the goal was almost certain to be reached, whether or not OCA-type analysis indicated that it was a good idea.

5.14 The economic case summarised

In the absence of any overriding political motivation, the economic case for AMU would itself need to be convincing. However, the most one can say is that the economic case is unproven. The textbook arguments for currency union have already been recited. The benefits which might most specifically be of appeal in Asia are:

- the trade effect, as predicted *inter alia* by Rose (2000), although it is not clear to what extent trade is actually impeded by existing currency arrangements;
- the benefit from more stable relative prices between countries, not arbitrarily driven by asset markets; the associated benefit, to smaller economies in particular, of being insulated from speculative attacks on the currency;

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38 Bayoumi, Eichengreen and Mauro (2000).

39 Frankel and Rose (1998) argue that OCA criteria are (at least partly) endogenous, citing trade expansion and increased business cycle synchronisation, in particular. Artis (2003) remarks that, because of endogeneities, it might be easier to satisfy OCA criteria after entry than before.

40 Artis (2003).

41 See Barr *et al.* (2003) for a comparison of economic performance between 'in' and 'out' countries.

- benefits from developing a collective discipline towards monetary stability, open capital markets, fiscal prudence, etc.;
- benefits from eliminating any scope for competitive depreciation within the region;
- benefits from an enlarged, unified financial market;
- contributing to a better global payments balance by eliminating or curtailing the mercantilist urge to accumulate foreign reserves which is at present prevalent in Asia;
- possible welfare gains for AMU members from an international reserve currency role, and for the rest of the world from the availability of a new reserve currency, ranking alongside the dollar and euro.[42]

The arguments against AMU are:

- loss of monetary autonomy and, in particular, of the exchange rate as a mechanism for adjusting to idiosyncratic shocks – arguably necessary given the diversity of economies in terms of stage of development, resource endowments, social policies etc.;
- higher risk of contagion from financial fragility and associated crises within any prospective currency area;
- loss of autonomy to operate capital controls, which are nowadays not seen as so objectionable or inappropriate as in years past.

Different weights may apply to these various arguments for different economies. And some may decline in significance or relevance over time. There will always be enormous scope for debate as to where the overall balance rests. Even in Europe, six years on from the adoption of the euro, no conclusive empirical work has emerged concerning the overall balance of costs and benefits of joining or not. For Asia, *a fortiori*, the question therefore remains open.

[42] A reserve currency role may confer benefits in terms of seigniorage and a liquidity premium. On the other hand, the currency may be more vulnerable to destabilising capital movements – a consideration which explains why Germany, Japan and the United Kingdom each sought, at different times during the second half of the last century, to prevent their currencies from acquiring that role. For relevant discussion, see Portes and Rey (1998).

Table 5.6 Fiscal Balance as Percentage of GDP

	2001	2002	2003
China	-4.4	-3.0	-2.5
Hong Kong	-3.0	-6.4	-4.5
Indonesia	-3.7	-1.8	-2.3
Japan	0.8	0.4	0.7
Malaysia	-5.5	-5.6	-5.4
Philippines	-4.1	-5.3	-4.7
Singapore	3.5	4.3	1.0
South Korea	0.6	2.7	2.7
Taiwan	-1.5	-2.5	-3.1
Thailand	-2.4	-1.4	0.4

Sources: For Korea, IMF PIN 04/11; for Indonesia IMF PIN 04/51; for Malaysia, IMF PIN 04/27; for Singapore, IMF PIN 04/41; for Taiwan, Asian Development Bank "Asian Development Outlook 2004", table 2.5; for others, IFS.

Table 5.7 Government Debt as Percentage of GDP

China	*2003-Dec*	5.3
Hong Kong	*2004-July*	0.4
Indonesia	*2003-Dec*	66.5
Japan	*2004-July*	146.8
Malaysia	*2003-Dec*	67.0
Philippines	*2004-June*	61.5
Singapore	*2003-Dec*	106.4
South Korea	*2004-June*	25.2
Taiwan	*2002-Dec*	20.0
Thailand	*2004-Sept*	27.9

Sources: For Indonesia and Malaysia, IMF PIN 04/51 and 04/27, respectively. For others: GDP data as for table 5.2; government debt figures from IFS for Singapore, and from *CEIC Asia Database* for the remainder.

Chapter 6. Political and Institutional Aspects

6.1 European experience

Monetary union would require appropriate institutions both for the analysis and negotiation prior to any decision and for the implementation thereafter. It is here, perhaps, that the biggest distinction between Europe and Asia lies.

Europe had a strong institutional structure, dating from the founding of the European Economic Community by the Treaty of Rome in 1957, through to the formation of the European Communities in 1967[43] and ultimately the European Union in 1993,[44] which followed on from the completion of the internal market in 1992. This progression was at each key stage backed by treaty, and was continuously, indeed fervently, supported by EC/EU officials in Brussels and by most leading political figures. Within this framework there was no serious difficulty in developing the network of finance ministers and central bank governors, and others designated by them, to study the monetary union proposal and eventually establish the EMI as precursor to the ECB.

As well as possessing the institutional structure, Europe had a powerful political motivation for a single currency, as a symbol of a strong and united Europe. The economic case was perhaps secondary, but was argued strongly and appeared to be sufficiently convincing. A single currency was also regarded by many as the obvious and logical culmination to the vision of the single internal market. By contrast, Asia lacks any such collective will at present, either between the big two countries,[45] or even among sub-groups which are superficially the most suited to closer monetary ties – such Japan and Korea, Singapore and Malaysia, or greater China.[46]

6.2 Asian institutions

Thus, a forum would need to be established. ASEAN perhaps comes closest in structure – though still far away – to the institutions of the European Union as an inter-governmental forum. Some of its achievements, in terms of free trade for example, are similar to those of the EU. It also pursues various initiatives for financial cooperation and monetary and financial integration. But none of the largest three economies of the region – China, Japan or Korea – is a member, nor is Hong Kong or Taiwan. However, China, Japan and Korea do work alongside ASEAN in the so-called ASEAN-plus-three forum, which has established a continuing dialogue on economic issues of mutual concern.

Other regional forums include EMEAP and the Asian Consultative Council of the Bank for International Settlements, based on its regional

43 By formally merging the European Economic Community, the European Coal and Steel Community, and the European Atomic Energy Authority.

44 Resulting from the 1992 Treaty on European Union, commonly known as the Maastricht treaty.

45 Xu (2003) perceives, however, increased open-mindedness on China's part towards matters of economic integration – albeit not specifically in monetary policy – and calls for political wisdom from Japan and China in order to move towards greater mutual understanding and trust.

46 As discussed by Tan (2003). Lin (2001) argues that greater China would be suited to a single currency and suggests that this could be a starting point for a broader union. Cheung and Yuen (2004) also present the case for a greater China zone.

office in Hong Kong – both being groupings of regional central bankers. These two stage a proliferation of meetings, but core questions on monetary union have not been visibly addressed.[47]

Thus, not only does Asia lack at present the necessary supranational institutional framework, but one also senses that, in stark contrast to the political agenda which drove EMU forward, there is as yet no force from on top to catalyse any discussion of the possible path to monetary union.

A certain degree of political consensus would clearly be a precondition for any steps towards AMU, and further down the road there would have to be homogeneity, or at least tolerated diversity, in such matters as the standing of national central banks and the nature of the appointment of national officials to serve in any prospective Asian Central Bank (ACB). Given the diverse political philosophies across the region, Asia might not expect to achieve such a high degree of concord in these matters as has been achieved in Europe (e.g. regarding independence of the national central banks). It would be important for the architects of AMU to decide what would be the minimum acceptable level of political convergence necessary to make AMU feasible and credible.

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[47] A view echoed from Chui, Morris and Pineau (2002).

Chapter 7. Procedural Considerations

7.1 Choice of forum

In Europe the euro was almost 30 years in gestation. In Asia a lot could change over the next 30 years. What if people then decide that it would be desirable to be in a monetary union, but realise that no groundwork has been laid? They would have to wait, not necessarily a further 30 years but probably 10. There is little or nothing to lose by proceeding with some definite work now to explore and prepare for AMU, even if it is subsequently decided not to proceed.

Most of the groundwork would involve technical analysis of economic issues and central banking functions and operations. This would probably be best performed within the central banking fraternity, although, to varying degrees, individual central banks might feel obliged to involve their finance ministries. At this exploratory stage it should not be necessary to create a completely new institutional framework; it would be preferable to use existing ones. There are three choices.

The first would be ASEAN or, necessarily, the ASEAN-plus-three forum. But, if ASEAN took the lead, the exercise would immediately take on the mantle of a major political initiative. And the core ASEAN members might be reluctant to cede the necessary influence to the other three, dominant economies, which the latter's position would effectively demand. It would anyway be better to proceed, at least initially, in a lower-profile environment, involving technical experts free, so far as possible, of political obligations.

The second possibility would be to proceed under the auspices of the BIS Asian Consultative Council of central bank governors. It may be recalled that much of the early discussion of EMU, and preparatory work for the EMI, took place among European central bankers meeting at the BIS headquarters in Basel. The drawback in the AMU context is that the BIS Asian office is ultimately answerable to Basel, where Asia does not have a particularly powerful voice. The BIS is still regarded, at core, as being the preserve of the 'Group of Ten' developed nations.[48] The authorities in Asia would probably be reluctant to accept the BIS in a leading role in discussions about a prospective AMU.

The third candidate would be EMEAP, which already includes most of the central banks which would be key to any AMU exercise, namely those of China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore and Thailand. The other two EMEAP members, Australia and New Zealand, might agree to move to the back row for this particular project. Taiwan might be granted observer status. Although seemingly quite well suited to the task, EMEAP has a track record mainly as a collator and disseminator of information, and organiser of meetings, rather than in original analysis or policy implementation. However, given adequate leadership and imagination, and a collective will for the exercise to make progress, there is no obvious reason why it could not rise to the occasion.

The choice of forum would depend to some extent on which countries were interested in exploring the

[48] The Group of Ten actually comprises eleven: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

issues further. If it transpired that EMEAP was adequately representative of the potential participants in AMU, or at least the key ones, then it would on balance be preferable for the planning to be taken forward initially in that forum, by establishing one or more appropriate working groups.

7.2 Participation

A prior question is of course whether there would be a critical mass of economies wishing to pursue the AMU idea. The attitudes of China and Japan would be crucial. If one of these were to join, then the other, faced with a bloc that would inevitably be its major trading partner, might see a compelling economic argument for it to join too. Japan has been trying for the past decade or so to establish a fuller international and regional role for the yen, but without much success. In 10-20 years from now, smaller economies in the region are even less likely to consider a link directly to the yen than they are now. Attention will probably have shifted further to the renminbi. If the renminbi looked set to emerge as the focal point, the Japanese authorities would more likely seek a major role on the inside than stay on the outside.

However, if China and Japan are satisfied with their own present monetary arrangements, there may be little attraction for either of them to surrender any autonomy. After all, in Europe it was the political vision which drew Germany into the eurozone, not the belief that it would enjoy a superior macro-monetary environment, even though it accepted that there were advantages in a single currency at the microeconomic level.

While acknowledging such provisos, for the purposes of the discussion that follows it is assumed that both China and Japan would wish to be part of AMU. This does not mean that currency union would be infeasible unless they both joined. It might even be easier, in strictly practical terms, to create some sort of union with only one leading currency; but in that case both the new currency and its central bank would be a less potent force on the world stage.

7.3 Preparatory work

Some might argue that any designated working group should start by examining, in detail, trade and financial linkages, the nature and incidence of shocks, and so on, in an effort to ascertain whether the OCA criteria were satisfied in respect of different combinations of Asian economies. It is the contention of this paper that this would be wasteful, since the results would almost certainly be inconclusive. Moreover, the economic situation, and hence the force of different arguments about the costs and benefits, will continually evolve over the coming years. Individual central banks could, and no doubt should, carry out such examinations for their own economies so as to inform their eventual choices, but the central working group should concentrate on other things.

Among all official commentators, Kuroda (2004) has perhaps gone the furthest in elaborating a specific plan of action. He has suggested that five issues should be tackled:

- strengthening the 2000 Chiang Mai swap network;
- developing further the bond markets in the region;
- extending free trade agreements;
- cooperating in the pursuit of exchange rate stability;
- developing concrete convergence criteria for any eventual path to a single currency – a goal which would, in his view, necessarily depend on attaining a certain degree of integration of markets for goods, services, labour and capital.

While these may be desirable elements in any progression towards monetary union, it is important to identify where the priorities lie and what the key points are on the critical path. The first three may not be essential; the fourth and some aspects of the fifth may be, but they are not necessarily the only or the most important issues to address.[49]

[49] Another Japanese proposal, from the Japan Center for International Finance, envisages pursuit of closer ties and policy coordination within subgroups of economies in the region, with the aim of achieving substantial currency convergence within each group before embarking on wider union.

Chapter 8. Three Points To Address

The approach

It is recommended that the work should proceed initially with a focus on just three issues. One is to construct the operating framework for exchange rates – an Asian monetary system (AMS), modelled to some extent on the EMS – which could be implemented as a first practical step and provide for subsequent progress towards AMU. The second is to make institutional preparations for the creation of a supranational monetary institution. The third is to examine what sort of monetary regime might prevail within an eventual monetary union. All of this presupposes, of course, that there is a willingness among a core group of economies at the very least to discuss these issues.

8.1 Asian monetary system

This task is to establish a mechanism to bring about convergence of exchange rates, capable of evolving smoothly into a single currency regime. The aim is to have what may initially be a fairly loose and flexible arrangement. The experience of individual economies in participating in this mechanism will provide practical evidence as to whether they are suited to ever closer currency ties.

In its early stages the arrangements need to allow sufficient flexibility for individual participants to be confident that -

- they are not compromising their own monetary stability;
- they are not surrendering monetary sovereignty prematurely or irrevocably;
- they will not suffer volatility from any less disciplined neighbouring currencies – as may arise, in particular, in the earlier stages of the arrangement.

The starting point for this arrangement is to design a benchmark currency basket, with reference to which each central bank will monitor and prospectively target, even if only very loosely at first, its exchange rate. Three different approaches may be considered:

(a) *An 'outside' currency basket*
This basket comprises major currencies that are not participating in the AMS. Assuming that the yen is participating, this means essentially the dollar and euro, although, in principle, others, such as sterling, Australian dollar or Swiss franc, could be included too. The advantages of this option are simplicity and a significant degree of continuity, insofar as some countries already implicitly target a major currency basket, while others operate *de facto* fixed rates to the dollar which could, with a minimum of practical difficulty, be replaced with the basket, even in the case of a currency board. A further advantage is that there will be no immediate need for a collective monetary policy, nor any immediate encroachment on the autonomy of individual central banks. However, this option does not yield any material progress towards establishing a common currency unit, and the continuing substantial allegiance to the dollar may make the new system look too much like the one it is replacing.

(b) *A 'major' currency basket*
In this option, the basket comprises the world's major currencies, regardless of whether participating in the AMS. This is taken to mean the dollar, euro and yen (although again, in principle, others could be included too). Such an arrangement has been proposed from time to time as a means of

weaning Asian economies away from the dollar.[50] It shares with (a) above the advantages of relative simplicity and continuity. However, the inclusion of one of the inside currencies, the yen, in the reference basket means that, in effect, the system is a hybrid; the benchmark itself could become hostage to the domestic fortunes of one of the member currencies of the AMS. If that issue is to be confronted, then arguably one should move directly to (c) below, especially since sooner or later the renminbi may have a claim for inclusion in the major currency basket.

(c) *An 'internal' currency basket*
Under this option, an Asian currency unit (acu) is devised at the outset, being a basket of the currencies participating in the AMS – and them only. The acu is similar to the ecu in Europe, which served as the numeraire for operating the exchange rate mechanism, and subsequently became the euro. This could be seen as a more positive step towards an eventual single currency, and would steer the attention of the authorities and the markets towards the stability of each currency relative to other currencies in the region, rather than relative to outside currencies. The disadvantage or, more correctly perhaps, the challenge arises from the fact that the exchange rate of the acu against the rest of the world will be dictated by the behaviour of the dominant regional economies (as with the deutschemark effect in Europe). There would be a consequential need for peer reviews of monetary policy, and to develop collective policies. But this should be seen as a positive factor towards the establishment of the necessary machinery for operating a single currency in the longer term.

Given that the underlying purpose of the entire exercise would be to explore the conditions pertaining to currency union and prepare for that as a possible ultimate goal, it seems clear that option (c) – the acu route – should be chosen.

As regards the precise composition of the acu, since it would be the channel through which the region's exchange rates with the outside world are determined, it might be argued that the weights should reflect each economy's interaction with the rest of the world in terms of trade. However, the only available statistics on the required geographic basis relate to trade in goods, whereas trade in services is also hugely important. So too are capital flows. Alternatively, the weights could be based on GDP, as possibly a more accurate measure of the relative monetary importance of each economy within the region. Or some hybrid formula could be used. This would be a technical matter on which the proposed working group would advise. The table shows the approximate percentage weights which would ensue from a GDP approach if all the Asian EMEAP economies, plus Taiwan, joined in. It also shows the units of currency which would combine to form the acu, on the assumption that, in the interests of political neutrality, the acu at day one was scaled to equal one SDR.

50 The proposal for a dollar-euro-yen basket was elaborated in particular by Williamson (2001), who suggested respective weights, based on trade patterns, of 35-40%, 30% and 30-35%.

Table 8.1 Illustrative composition of Asian currency unit

	Percentage weights			composition of acu based on weights C (one acu equals sum of these components)[51]
	A: based on $GDP (as in table 5.2)	B: based on GDP at purchasing power parity[52]	C: average of A and B	
Japan	56.5	26.9	41.7	67 yen
China	20.0	48.4	34.2	4.4 renminbi
Korea	8.6	6.4	7.5	122 won
Indonesia	2.5	5.4	4.0	571 rupiah
Taiwan	4.1	2.6	3.4	1.7 NT$
Thailand	2.0	3.5	2.8	1.7 baht
Philippines	1.1	2.6	2.0	1.7 peso
Hong Kong	2.2	1.4	1.8	0.22 HK$
Malaysia	1.5	1.8	1.6	0.09 ringgit
Singapore	1.2	0.8	1.0	0.025 S$

As exchange rates between the currencies fluctuated, the actual weights would shift somewhat over time. As with the ecu, there would be provision for periodic review of the basket to reflect changing economic circumstances. If new countries joined the exchange rate arrangements, it would not be necessary on technical or, assuming they would be relatively small, economic grounds, for their currencies to be included in the acu; nor, indeed, would it be essential for any of the lower weighted currencies to be included in the first place. However, in terms of politics it might be hard to exclude any. In Europe, new members in the ERM were factored into the ecu.

In Europe the weights in the ecu, before it finally transformed into the euro, ranged from 31.9% for the deutschemark to 0.44% for the Greek drachma. The range suggested for the acu is broadly similar. But it would be dominated by the yen and renminbi. In one sense this would be appropriate, given the importance of those economies to the region. The attraction to others of stabilising their currencies against the acu would depend crucially on those two countries pursuing steady and responsible monetary policies.

Both in political terms and to give recognition to the high degree of openness of some of the smaller economies, there might be merit in leveling up the proportions somewhat. Any proposal would be to some extent arbitrary; by way of illustration one might fix the weights at 30% each for China and Japan, 8% each for Korea and Indonesia, and 4% each for the remainder.

The initial aim of the AMS would be to stabilise what are already, for the most part, fairly stable cross-rates between the currencies of the region. Countries would be permitted to join if they had a

[51] One acu is scaled to equal one special drawing right (SDR) at exchange rates of 14 December 2004.

[52] World Development Indicators database, World Bank, September 2004.

commitment to that goal. Once the acu was implemented, each central bank would be presumed to regard this as the main yardstick by which to judge its currency's behaviour, and might aim to achieve a measure of stability in its exchange rate against the new unit. At first, this could be informal and unannounced, but in due course the central bank might set a central rate and band. As part of any eventual move towards monetary union, and in order to make the ultimate goal of a unified currency credible, a process of convergence would probably need to be initiated which would oblige central banks to observe bands progressively more strictly and require them to intervene or take remedial actions as necessary. The existing central bank swap network could be used and extended to that end, but this would probably be more a symbol of solidarity than make a material contribution. Several of the economies anyway possess huge reserves, so would not need a swap network, while those with few reserves might not be able to muster resources from swaps on a sufficient scale if a severe speculative crisis hit them.

With regard to the size of any bands, it might be sensible to start with a quite wide range, such as 10% on either side of the central rates, with the prospect of narrowing them at some future date, rather than commence with something too ambitious – bearing in mind that Europe started with 2.25% but was forced to widen them when pressures became too great.

Inevitably, as was the case in Europe, tensions may develop if the acu moves significantly against the major outside currencies – the euro or dollar. If this reflects factors peculiar to the euro or dollar, it may not call for any action within the acu area, or it may warrant some general adjustment of monetary policy – if, for example, in the circumstance of a dollar depreciation there would otherwise be a danger of importing deflation. If, however, the move reflected singular developments in a leading member economy, such as the acu being forced up in the exchange market by the strength of Chinese exports, then consideration would need to be given to a realignment within the AMS.

Though by no means essential, governments or central banks might assist the development of the acu by issuing acu denominated bonds. These would help publicise the unit and help it gain wider acceptance. Such bonds might be regarded as a natural progression from the multi-currency Asian bond fund which the central banks have recently announced; instead of pooling a series of bonds in the different currencies by different issuers, the issuers themselves would now issue in the pooled denomination.

Finally, if participants were serious about progression to a single currency, a programme for capital account liberalisation would need to be agreed and factored into the AMS timetable.

The foregoing is a fairly rudimentary account of the preparatory work which might be undertaken, but it could serve as a basis for working out more detailed plans. The EMS provides many lessons to draw upon, both positive and cautionary. It should be noted, in particular, that the currencies participating in the EMS suffered occasional crises, and Asian currencies may be equally or even more vulnerable. Ultimately a commitment to monetary union requires a willingness to subordinate other policies to exchange rate stability. Until a final and irrevocable step is seen to have been taken, financial markets are likely to test the commitment. It would be important for the AMS regime to provide the flexibility for economies to cope with any crises, while maintaining the momentum of the process of convergence to eventual monetary union. It would be equally important for the leading economies, China and Japan, to be pursuing policies which would create a monetary environment that others would be content progressively to latch onto.

8.2 Institutional development

In the transitional phase, when national currencies continue in existence, the acu system could be monitored through the working group framework, since all actions would be largely voluntary for national administrations. Even so, participants would want to monitor the monetary policies of one other, particularly of the largest economies, and, as the system progressed towards the convergence of exchange rates, to exert increasing peer influence. The institutional framework would need to adapt and, at some point, an Asian central bank would need to be established, which would, after the final step to currency union, take over the conduct of monetary and exchange rate policy for the entire region.[53]

In discussing the structure and functions of the ACB, the following points in particular would need to be considered.

- *Timing and participation*. The ACB would need to be established sometime in advance of the launch of a common currency. Plainly, all those economies whose currencies would be merging would need to participate in the ACB, but that list might not be definitive at the time of the bank's formation. There would anyway need to be provision for participation by aspiring members of the currency union. Eventually there might need to be two-tier participation in the bank – one tier for members of the common currency and one for those involved in the AMS but not yet ready for complete currency union.

- *Structure and governance*. Under this heading come a wide range of issues that would require attention, the detail of which is beyond the scope of the present paper. They include legal construction, capitalisation and shareholdings, composition of board, composition of executive, voting arrangements, independence, sharing arrangements for seigniorage on central bank money and pooling of some national foreign currency reserves. The ECB model might be a sensible starting point, and its experience to date would be invaluable, but, especially given the different political circumstances, it is unlikely the ACB would emerge as a carbon copy.

- *Accountability.* This might be an especially difficult issue. Except in the unlikely event of parallel moves in the direction of political union, there would be no equivalent to the European Council of Ministers, the European Parliament or the European Court of Justice. The ACB, which would, ideally, be a non-political institution, would need to be answerable in political terms, but to whom? It would be impracticable to be accountable separately to governments or parliaments in every participant economy. It might be necessary to establish an overseeing ministerial committee, but this would presuppose a degree of co-operation in economic policy that is, as yet, unprecedented in the region. Of current institutions, ASEAN perhaps provides a framework which is the closest to what would be needed, but its membership is not the same as that of the prospective currency union.

- *Financial relationship with government and with banks.* This refers to rules about financing the government, where the convention nowadays is to prohibit direct central bank funding of government; and about bailing out troubled banks, where it might be recommended to ban any ACB involvement, leaving the matter to national authorities.

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[53] The political challenge of getting governments to surrender monetary policy and building the appropriate transparent and accountable framework is discussed by Eichengreen (2004).

8.3 Monetary policy

AMU would require, ultimately, a common monetary policy. The task here would be to discuss how the present objectives of monetary policy, which vary across the economies, might be steered towards necessary convergence, and to design a monetary mandate for the ACB. Although the actual creation of the ACB would be many years away, the preparatory work could usefully commence sooner rather than later. Points to cover would include:

- inflation targeting as a possible framework – if so, in what range, particularly to allow for structural differences and the Balassa–Samuelson effect, but also allowing for the fact that AMU would not be realised for many years;
- possible alternative or addition of an exchange rate target or range vis-à-vis the rest of the world;
- monetary policy instruments and operations; some might see a mature debt market as a precondition for monetary operations, but foreign exchange swaps may serve as an effective substitute, at least in the early stages, especially in view of the likely scale of foreign exchange resources and the existing experience of using that market;
- strategies on reserve accumulation;
- consideration of the implications of the removal of capital controls, bearing in mind that all participants would need to operate the same monetary regime – assumed to be free of any such controls.

Chapter 9. Preconditions and Continuing Obligations

As an adjunct to those suggested three areas of action, consideration would need to be given to the mechanism of admission to the AMS and, ultimately, to the single currency. Membership of either would involve open commitment and implicit acknowledgement of the benefits. Some more specific evidence of suitability, at least in the final stages, through conformity with convergence criteria of the sort employed in Europe, might be required. This would be a matter for the working group to discuss. But it is the view of this paper that in Europe the preconditions for the euro were unnecessarily specific. Provided that the new central bank is adequately committed to monetary stability and enjoys autonomy in pursuit of that, participants will be forced to an adequate measure of convergence – or suffer accordingly. In other words, the system can, to a considerable degree, be self-policing.

Even in the earlier stages, when currencies are set with central rates and bands around the acu, the system will stand or fall depending on the commitment of individual countries. In practical terms, because their weights in the acu will be by far the largest, the system will depend on China and/or Japan pursuing monetary policies that are sufficiently stable to allow others to live comfortably with broadly stable rates against the acu.

In a similar vein, if and when the final stages of union are reached, it is for consideration whether any separate, continuing, non-monetary disciplines would need to be imposed – for example, to restrain fiscal policy along the lines of the eurozone's stability and growth pact.

Chapter 10. Conclusions

Academics find AMU fertile ground for research and conference agendas. Politicians and officials in the region from time to time express general interest in the idea, although this may relate as much to its symbolism for a stronger Asian identity (there may even be a tinge of euro envy at work) as to any acknowledgement of the technical or political feasibility of AMU. Central bankers, who would surely be the ones charged to take the matter forward, also display interest, but have appeared reluctant to move ahead, possibly not wishing to commit resources without at least some signal of support from the political level. The challenge is to find some way of progressing the discussion.

The reality is that the economic debate on whether Asian countries would benefit from AMU is inconclusive, and likely to remain so for a long time. On the one hand, in addition to the microeconomic benefits of reducing transaction costs, improving price transparency and deepening financial markets, there would appear to be advantages in macroeconomic terms, especially to smaller economies, in arrangements which would enhance monetary stability in the region by reducing or eliminating the vulnerability of currencies to speculative attacks or which would impose some collective peer discipline on monetary policy. On the other hand, there may be compelling reasons for wishing to retain individual autonomy in monetary policy.

While Asian economies are probably more suited than European ones to achieving adjustments to their real exchange rates without necessarily adjusting nominal rates, there is no conclusive evidence that they would actually benefit from currency union. Asia may be judged to be performing well enough as it is.

As to whether a country would, on economic grounds, want to join such a union, one can do worse than refer to the UK finance minister's approach to deciding whether sterling should give way to the euro. Although he has presented a famous list of five tests, there is one that overrides all the others – namely whether such a move will be good in the long term for growth, stability and jobs. [54] Few would argue with that. In Asia it would be for individual governments to make that judgement.

Although the development of the euro provides invaluable experience on which Asia could draw, the procedures followed in Europe would need to be critically reviewed rather than too hastily replicated. For example, a qualification system which includes both exchange rate stability and tight convergence of inflation rates may be over-identified and would hence, given the structural diversity across Asian economies, risk being unattainable in practice. Anyway, a union, once formed, would deliver the appropriate degree of inflation convergence endogenously, whatever the prior situation may have been. Meanwhile, given that the European approach to fiscal convergence and continuing fiscal discipline plainly contained a number of weaknesses, it would be desirable to re-examine from first principles the case for fiscal rules, and their design.

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[54] The other four tests are: (i) that business cycles and economic structures are sufficiently compatible between the UK and the eurozone to justify common interest rates; (ii) that there is sufficient flexibility to deal with problems; (iii) that entry will make conditions better for firms making long-term decisions to invest in the UK; and (iv) that entry will not impair the competitive position of the UK financial services industry.

More generally, it should be remembered that, although the final steps towards the euro involved quite strict discipline in adhering to various criteria, and eventual admission to membership was presented as being more a hard-earned privilege than an automatic right, in the earlier stages of the EMS, participation in the ERM was on a looser basis and the ERM itself adapted to circumstances - as with the widening of bands in 1992. Countries participated if they were genuinely interested in pursuing greater exchange rate stability and were prepared to suffer any associated pain; there was little, if anything, by way of free-rider opportunities to exploit, so those who did join tended to be serious about the aims. In the same vein, Asia could start off with a not too rigid or ambitious AMS; only those with a commitment to making it a success would anyway choose to join.

Even on the most optimistic assumptions, however, a single Asian currency would be years or even decades away. Among the many preconditions would be further ideological convergence at the political-economic level, and, assuming that China would be integral to any single currency plan, a track record of a well-managed, fully convertible renminbi. And economies which already enjoy exchange rate stability, notably Hong Kong, would need to be convinced that a switch to what might in some ways be a slightly less stable exchange rate would indeed be in their best interests.

Overall, this paper is agnostic as to the likely balance between costs and benefits from monetary union in Asia, and sceptical as to whether the two largest economies in the region would see enough advantage in the idea to make it worth their while becoming involved. But it argues that there is no harm in launching some specific exploratory work. If it comes to nought, so be it. But, if the subject is ever to progress beyond generalities, there must be something concrete for leading central bankers and government officials to chew upon.

It is proposed, therefore, that the discussion should move on from the inevitably inconclusive area of the OCA debate towards the formulation of some practical blueprints. It may be noted, in passing, that OCA considerations played little or no part in decisions on joining the euro. It is suggested, therefore, that work could be commissioned, prospectively, though not necessarily, through the EMEAP forum, under three main headings:

- establishment of an Asian currency unit, and arrangements for central banks in due course to operate central rates and bands relative to the acu;
- the structure and functions of an Asian central bank;
- the goals and instruments of a common monetary policy.

Each of these topics could be addressed simultaneously by separate working groups, involving different mixes of expertise in such fields as law, markets and economics. People with appropriate expertise from within or outside EMEAP could be invited to participate. Participation by any of the economies which might be prospective candidates for the AMS or AMU would not constitute a commitment to proceed in that direction; it would signify merely an interest, and a willingness to discuss the possibilities in good faith.

There would be no presumption that these studies would necessarily lead to the introduction of a new currency scheme. But, unless purposeful work of this sort is undertaken, no one in the region will ever be ready to move forward, even when the time may be obviously riper than it is now. Realistically, the conditions necessary for even the first suggested operational step towards AMU, namely the adoption of central rates and bands relative to the postulated acu, are unlikely to obtain until at least five years from now, but the preparatory exercises mooted here would themselves take a considerable time to complete. It is not too silly to suggest that they should begin now.

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