A Single Currency for Asia?

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Background

Asia's efforts to move toward a common regional currency appear to have stalled. Although the Asian financial crisis of 1997 created the tempo for greater monetary policy and exchange rate coordination in the region, large heterogeneities in economic structures, policies, and institutions among regional economies have prevented decisive moves to a common currency. Asia lacks appropriate institutions for adopting common monetary policies and moving to a single currency. The problems faced by the euro have further diminished the prospects for a single currency in the region.

The key challenges facing implementation of a single currency for Asia are:

the Asian financial crisis of 1997, the need for greater policy coordination, the Chiang Mai Initiative, and the Asian Currency Unit (ACU);
ASEAN's centrality in a common Asian currency and its lack of enabling conditions;
the difference in exchange rate arrangements in the region;
the question as to whether Asia could even contemplate a single currency, when the euro faces crisis despite covering a more homogeneous economic region.

One of the consequences of the prolonged economic contraction and financial downturn in Europe is the skepticism it has engendered about the prospects of a unified regional currency in Asia. There was a time when Asia was seriously considering the prospect of adopting a common currency. But the troubles of the euro have made the South East Asian economies wary of currency unification. South East Asia, or more specifically the ASEAN group of economies, is central to moves toward a single Asian currency. The lack of enthusiasm of the ASEAN on a common legal tender for the region underscores the erosion in credibility that the concept of a single regional currency has suffered following the European crisis.

The 1997 Asian Financial Crisis and the Birth of the Chiang Mai Initiative

The beginnings of a common currency in Asia can be traced to the Asian financial crisis of 1997. The crisis drove home the importance of greater policy coordination among the regional economies, particularly the large economies of North East, South East and South Asia. These regions comprise several large economies such as Japan, South Korea, China, Taiwan, Hong Kong, Singapore, Malaysia, Indonesia, Thailand, and India. Most of these countries were affected by the crisis of 1997, though not in equal measure. Economies like China and India suffered relatively less because of their limited integration with the global financial system. Nonetheless, the urgency of policy coordination was realized by all the economies notwithstanding the difference in the degree of the difficulty they encountered.

A major driver of greater policy and institutional coordination among the regional economies was their disappointment with the policy responses of the IMF during the crisis. The crisis highlighted the importance of the region being self-sufficient in warding off contagion-type situations precipitated by speculative attacks on national currencies. This realization gave birth to the Chiang Mai Initiative (CMI). The CMI created a pool of reserve currency and extended bilateral credit swaps to participating members. The reserve pool and the swaps are intended to help regional central banks to maintain the stability of their currencies in the event of speculative attacks. The CMI has 13 participating economies, which include the 10 ASEAN members (Brunei, Cambodia, Laos, Malaysia, Myanmar, Indonesia, the Philippines, Singapore, Thailand, and Vietnam), China (including the Hong Kong Monetary Authority), Japan, and South Korea. It has been decided that the current corpus of the CMI should be doubled, from US$120 billion to US$240 billion.

The move on the CMI was accompanied by the first steps for forming an Asian currency unit (ACU) in the middle of the last decade. Following the interest expressed by China, Japan, and South Korea in greater coordination of their currencies at the annual meeting of the Asian Development Bank in May 2006, the idea of an ACU was formally floated. The ACU is statistically conceptualized as a basket of currencies reflecting the movements of various national currencies against a numeraire currency. This was expected to be a precursor to an eventual common currency in Asia. However, the move to a common currency has been sluggish for several reasons. Many of these relate to typical features of the region and its economies.

Is Asia Ready?

On paper, a common currency has several benefits for Asia. These include more seamless integration of trade and capital flows within the region. This follows from avoiding costs of invoicing products and services in different currencies when they cross borders. Apart from cutting transaction costs of paperwork and procedures, a single currency also helps traders to avoid the risks of exchange rate fluctuations. These risks often force traders to hedge against fluctuations by entering into futures contracts. More predictability and less uncertainty are clear benefits of a common currency. Given that the region has extensive intraregional trade, a common currency should ideally be a welcome option.

The early moves toward the ARU involved China, Japan, South Korea, and the 10 ASEAN economies. This is the ASEAN+3 grouping that spans across South East Asia and North East Asia. How feasible is it for the group to work toward a common currency?

The ASEAN is the most cohesive regional grouping in Asia. But it is different from the European Union in several respects. The most important difference, perhaps, is the lack of regional institutions with the capacity to serve as overarching regulators. The ASEAN secretariat is hardly equivalent to the European Commission. More importantly, ASEAN does not have the equivalent of a European Central Bank. Individual ASEAN members continue to retain sovereignty over their monetary policies. Such sovereignty must be sacrificed if the move to a common currency is to be made.

Progress on a common currency is inseparable from progress on regional integration. The conditions for moving to a common currency must take shape within the ASEAN, which is the most visible structure of a regional bloc in Asia. If ASEAN cannot produce the enabling conditions for a common currency, it is difficult to perceive how the ASEAN+3 can do so. This appears all the more difficult given that South Korea, Japan, and China are unlikely to agree easily on various aspects of convergence of their monetary policies and exchange rate management.

The EU experience shows that some members can retain their individual currencies. Those EU members outside the Eurozone, such as the United Kingdom, Denmark, Switzerland, and Sweden, have different currencies. Can Asia adopt such a system? Reproducing the current EU structure with similar features would require creating a “eurozone” within Asia. More specifically, in the context of the ASEAN+3, either the ASEAN or a subgroup within ASEAN needs to replicate the “eurozone” by giving up sovereignties on monetary and exchange rate policies and establishing a supranational regulator to manage the group collectively. Such a scenario appears distant within the ASEAN.

The milestones that have been mentioned to achieve the ASEAN Economic Community (AEC) by 2015 do not include steps for moving to a single currency. The plan proposes the establishment of a regional economic zone enabling free flows of goods, services, capital, investment, and labor. But it refrains from proposing more ambitious plans of monetary policy convergence or establishing a regional regulator for managing monetary policy and moving toward a common currency. Indeed, it does not even propose the establishment of a parallel currency on the lines of the ACU. Similarly, the idea of a common currency does not find mention in other regional economic integration initiatives, such as the one being pursued by the East Asia Summit.

It appears that ASEAN and the Asian region are not yet ready to embrace the notion of a common currency. One of the main reasons for the unwillingness is the heterogeneity among the economies. There are considerable differences within the ASEAN economies in the degree of economic development and in their economic structures. The relative differences increase if the pool is enlarged to include China, Japan, South Korea, India, Australia, and New Zealand. Apart from the obvious differences in economic features and the nature of economic institutions, there are noticeable differences in the economic policy management systems as well.

One of the best examples of the heterogeneity in the region in the context of a single currency is the difference between the exchange rate systems of the various economies. While most economies follow the floating exchange rate system, there are variations in the nature of the float. Many prefer the “managed” float where, despite allowing the exchange rates of national currencies to be market-determined, central banks intervene at periodic intervals to influence the values of the currencies through their sales and purchases. The interventions are usually influenced by the desire to control large appreciations of currencies, which can erode the competitiveness of a country's goods and services.

Indonesia, Malaysia, Thailand, and India are examples of managed floats, while Japan and South Korea have more free floats, in contrast to the "peg" arrangements of China and Vietnam. In several countries of South East Asia, such as Cambodia, Myanmar, Indonesia, and Vietnam, the US dollar is unquestionably accepted as the legal tender. With such wide differences in exchange rate regimes and monetary policy frameworks, moving to a common currency through convergence of institutions and systems is seemingly difficult.

The Effects of the Euro Crisis

The prospects for a common Asian currency have received a considerable setback after the problems experienced by the euro. The financial crisis in the Eurozone—particularly the difficulties suffered by relatively smaller euro economies like Greece, Portugal, and Ireland—has raised serious doubts over the effectiveness of currency integration in facilitating greater integration of trade and investment within a region. If the Eurozone and the euro, with the Eurozone's much greater institutional, systemic, social, and political similarities than the ASEAN+3, could not avoid a financial catastrophe, then the possibility of any such arrangement in Asia is far less likely.

Indeed, common currencies can probably work only if member countries have a lot in common. There is no denying that noncommonalities among the ASEAN+3, and among the even greater Asian region that includes India, Australia, and New Zealand, are too much to even contemplate formal and common exchange management structures. Apart from economic dissimilarities, matters are further complicated by delicate political and strategic dynamics. The China–Japan–South Korea grouping, for example, harbors considerable political volatility. The Eurozone was free from such pressures. Even then, the members' economies are finding it difficult to stick to the euro.

The euro crisis also reveals the importance of institutional support in times of trouble. The European Central Bank has tried its best to support the affected countries. But probably that is not enough. It will be unwise of Asia to contemplate a common currency unless the regional institutions are strong enough to sustain multiple bailouts. This will require the growth of contingency measures far larger than the current Chiang Mai corpus.

Final Thoughts

The outbreak of the global financial crisis and the troubles faced by the euro initially raised hopes for the emergence of a common currency in Asia and its gradual growth as a global reserve currency. However, Asia does not appear to be ready for currency integration. Several limitations are hampering a regional currency union, including the large economic, social, and institutional heterogeneities in the region. Countries seem unprepared to converge on common exchange rate management systems and monetary policy frameworks. The region also lacks strong institutions for coordinating monetary and exchange rate policies. The failure of several Eurozone economies to manage their monetary and fiscal health, despite operating in a far more homogeneous region than Asia, has made the already remote possibility of a single Asian currency even more distant.

More Info

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See Also

Viewpoints

- The Tragedy of the Euro

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