Asian Monetary Union – Where Do We Go from Here?

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June 2005

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 section 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 few years 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.