Currency Cooperation in the Global Economy
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Ricardo Hausmann, formerly chief economist of the Inter-American Development Bank: “National currencies are a phenomenon of the twentieth century, supranational currencies are the solution of the future”.

Since the dissolution of Bretton Woods in 1971/73, the global economy has experienced many dramatic swings in the exchange rates of the main global economies. The exchange rate movements pose enormous problems for a sustainable global economy, generate economic and social costs. The US currency as the dominating currency in the global economy played a pivotal role in these episodes.

The current downswing of the US dollar against most of the important currencies weakened its positions and the creation of the euro seems to have established a serious competitor to dollar’s monopoly. All in all, it is fair to describe the global currency structure in the early 21st century as a game with new actors and new cards.

One of the most remarkable developments in the world economy at the dawn of the new millennium is the rapid acceleration of cross-border competition among currencies. Circulation of national currencies no longer coincides with the territorial frontiers of nation-states. A few popular monies, most notably the U.S. dollar and the euro have come to be widely used outside their country of origin, competing directly with local rivals for both transactions and investment purposes. The origins of this development, which economists call currency substitution, may be understood to refer to economic integration at the global level. Many scientists predict that in future national currencies will disappear, leading to an increasing number of regional currencies of one kind or another - a distinctly new geography of money.

Currency regionalization occurs when two or more states formally share a single money or equivalent. Broadly speaking, two main variants are possible. First, countries can agree to merge their separate currencies into a new joint money, as members of Europe’s Economic and Monetary Union (EMU) have done with the euro. This is *currency unification*, a strategy of alliance. Alternatively, any single country can unilaterally or by agreement replace its own currency with an already existing money of another, an approach typically described as full or formal *dollarization*. This variant, a more subordinate strategy of followership, has long been official policy in a miscellany of tiny enclaves or microstates around the world, from Monaco to the Marshall Islands, as well as in Panama and, for many years, Liberia; and was more recently adopted by Ecuador and El Salvador, each of which now uses America’s greenback in place of its own former currency.

So, in the process of regionalization monetary sovereignty is either *pooled* in a partnership of some sort, shifting authority to a joint institution, or else *surrendered* wholly or in part to a dominant foreign power.

EMU is clearly viewed as a test case for a strategy of pooling rather than surrendering monetary sovereignty. If Europe’s experiment comes to be seen as a success, it could have a powerful demonstration effect, encouraging similar initiatives in other countries.

Although the integration processes of the EU and East Asia differ, globalization and the increasing importance of cross-border externalities will cause East Asia to give consideration to the currency union strategies used by the EU to increase the effectiveness of integration.

In many ways East Asia is a natural hub for currency integration:

- East Asia has a huge domestic market of nearly 2 billion people – about three times EU market;
- East Asia is the fastest growing region in the world. Over the last two decades we have seen average annual growth rates of about 7% -far outstripping the 4-5% growth in the rest of the world;
- East Asia also has a high domestic savings rate of about 20-45% depending on the country. This compares well with the EU's average of about 20%;
- Finally, East Asia holds over half the world's foreign exchange reserves.

But the decision on currency arrangements will necessarily be a political decision and given that this decision calls for strong consensus among a number of countries it has to be clear from the start that common currency is a long term goal –talking of decades and not years, for the real exchange rate adjustment process to be sufficiently aligned for a common currency.

Progress will need to be backed by solid institutional arrangements including a suitable monetary coordination mechanism, regional surveillance activities, and a regional liquidity facility.

Even those who think preconditions are not right for a common currency, agree that East Asia has made a good beginning towards regional financial cooperation. To move forward, it is crucial for the region to establish a strong institution for monetary and exchange rate coordination. This will set the stage for a currency area or the eventual adoption of a single currency. The following steps are a pre-requisite:

- To establish a more credible defense mechanism against excessive currency fluctuations.
- To establish a regional reserve pooling mechanism, or other regional borrowing arrangements as a precursor to a possible centralized monetary arrangement, such as an Asian Monetary Fund.
- To establish a credible regional surveillance mechanism that limits moral hazard and provides robust financial surveillance.
- To drill down to the national level to strengthen and harmonize the regional financial architecture by adopting consistent international regulatory and supervisory frameworks.

As a starting point, one or more groups of countries within East Asia with some degree of real exchange rate comparability should shift from explicit or implicit dollar anchors to an agreed basket of currencies. Of course with the flexibility of a crawling band exchange rate regime. This flexibility is needed to provide lead-time for currencies with hard pegs and fragile financial systems to effectively manage the shift to the new anchor. It would also allow real exchange rates to adjust over time as the region's economies develop.

By 2030 the world will have three major currency zones - one European, the other American and third - Asian. These regional currencies will form the bedrock of the next century's financial stability. A new geography of regional currencies is beginning to emerge as a byproduct of globalization.