A Long Haul to A Single Currency in East Asia

By

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Free flow of capital and the collapsed of financial institutions during East Asian financial crisis offer evidence to suggest that liberalisation is sensitive and could be harmful. However, many hold a more moderate view and believe that a more careful and gradual approach towards globalisation would minimize the risk of instability to the economy. While developing countries are still debating the issue of globalisation agenda, European countries have made a major step forward by fully implementing a single currency called, EURO.

This single currency will be absorbed by free market mechanism, making it necessary to dismantle remaining market impediments, unite and enhance market integration and ride on liberalisation and globalisation so as to generate immense benefits to the European economy.

Similar to the pessimistic view on the EURO some 30 years ago, many economists see that it is rather too early to seriously talk about a single currency for East Asia. One clear obstacle to the proposal is the large gap in the stage of economic development and inflation rate which reflect vast differences in living standards within the region. A single currency will lead to transparent pricing and smooth flow of resources across borders. This will raise prices in lower income countries and lower them in higher income countries. While consumers in richer countries would enjoy benefit of lower prices, consumers in low income countries may have to suffer the price rise. Thus, if large price adjustments are required, a single currency will be painful for lower income countries. Thus, arguably, it is not a viable exchange rate proposal.

Painful adjustment during economic and political union in Germany is one recent example pointing to the importance of narrow economic gap before implement a single currency. However, the adjustment period during that unification has been smoothly shortened by free mobility of labour and resources, thanks to the elimination of borders. It is worth noting that smooth and quick economic convergence was not the main factor contributing to the success of this unification. In this case, the strong desire for political unification among Germans was far more important than economic factors in the unification process.

Political and economic unification in the early days of the creation of the United States of America and United kingdom are two examples where complete political and economic unification had played an important role in implementing single currency. Except for Korea, China, Taiwan and Hong Kong, there is no historical basis to suggest that such a political unification will be repeated in East Asia. Even for European countries, such an unification any time soon is far fetched. Thus achieving a certain level of economic development and narrowing down the gap among countries in East Asia is very crucial for introduction of a single currency.

One appealing feature of a single currency to East Asian countries is the removal exchange rate risks in cross-border investments. Investors will have more flexibility in their investment decisions because they can move their capital within the currency area without having to hedge for exchange rate risk.

Although there are points in favour of a single currency to avoid future exchange rates collapse and financial crisis, it is quite misleading to believe that a single currency will always be more stable and stronger than national currencies. Perhaps, a single currency can ensure greater efficiency which would make it a strong currency. However, in the final analysis, the value of any currency will depend on the economic fundamentals of a country or region. A single currency cannot eliminate speculative activities that would destabilise the currency. Definitely, there is room for much speculation with regards to member countries economic, social and political conditions.

To a certain extent, the benefits of a single currency depends on the efficiency of the financial market and information technology. Financial market and information sector in many Asian countries are still too underdeveloped to enhance the effectiveness of a single currency policy.

The scope for a counter-cyclical macroeconomic maneuvers is limited under a single currency. In the open and competitive environment, central bank can only play a guiding role in a very transparent manner. A highly disciplined monetary and fiscal policy has to be consistently applied to give a clear signal to the market. It is likely that this mechanism will keep the inflation rate stable without any substantial fine-tuning.

Thus implementing a single currency requires dynamism and flexibility to withstand various external shocks on the regional economy. To maintain the value of the currency, member countries must be highly integrated, not only, economically but also socially. For instance, economic slowdown in one member country may require painful adjustments in other countries to maintain the external value of currency.

A single currency for ASEAN (Association of Southeast Asian Nations) will expedite the economic integration of the region. Although, there is a considerable economic gap, the process of tariff reduction in AFTA and harmonisation of policies will induce convergence. Similar to European community, the creation of ASEAN and the cooperation of member countries in international forum on various issues has engendered social integration among ASEAN population. This element, if strengthened, could be a driving force for a successful implementation of a single currency.

Adopting a single currency goes beyond harmonisation of trade barriers. It is about substituting one aspect of national sovereignty with economic efficiency or removing one aspect of country's independence with market freedom. Thus, indirectly, a single currency would mean allowing other countries to be part of the conduct of domestic economic policies, particularly on matters regarding to fiscal and monetary policy which has impinge on exchange rate movements. So, unless we have a strong social integration, a single currency will not be a viable proposition.

Although the size of ASEAN market is too small to achieve a sufficient level of intra-regional trade to generate a series of economic benefits arising from increased competition, ASEAN has many positive elements for a successful implementation of a single currency proposal.

Japan is still struggling with its economic problems. China, too, has its own limitation to be an effective leader for the single currency proposal. As a new market economy, China's economy is still beset with market impediments and a lot more needs to be done. Furthermore, to maximise output, a single currency needs a mature financial system, a well developed information technology (IT) sector and a well establish legal system. China's economy is still far away from fulfilling these conditions.

A single currency proposal caries both risks and benefits. Most of the risks, however, are immediate occuring during the transition. Whereas, the benefits are long-term in nature, since social integration requires a long gestation period. It will take quite a while before East Asian could arrive at a single currency.