# Is an East Asian Currency Feasible?

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# Introduction

- Relative exchange rate stability facilitates cross-border trade and direct investment, both of which are beneficial to the respective real economies: exporters, importers, direct investors and direct investees.
- An "East Asian Currency Bloc" is much more feasible than a single East Asian Currency like the Euro.
- An "East Asian Currency Bloc" can be defined as a group of East Asian economies that agree to maintain their relative exchange rates at stable (real) parities, like the pre-Euro European monetary snake.

# Coordination of Real Exchange Rate Parities

- There is already sufficient trade and investment integration within the East Asia itself.  Maintenance of relative real exchange parities among East Asian economies further facilitates long-term trade and direct and portfolio investment flows among them.
- An agreement among participating economies helps to avoid "beggaring thy neighbour" policies, which ultimately do more harm than good to the economies themselves.
- Maintenance of relative real exchange parities enables collective adjustment en bloc to changes in the exchange rate values of major currencies outside of East Asia such as the U.S. Dollar and the Euro.

# Coordination of Real Exchange Rate Parities

- In order to discourage hot money inflow and outflow, a Tabin tax of say 0.5% or 1% can be imposed on any capital account currency conversion between a currency in the bloc and a currency outside the bloc.  For long-term cross-border investments, the Tobin tax is immaterial.  For short-term capital flows, the Tobin tax can be an effective deterrent.

# An East Asian Monetary Fund

- The maintenance of relative real exchange parities can be administered and monitored by an East Asian Monetary Fund, which can be regarded as a logical continuation and expansion of the multilateral Chiangmai initiative of providing mutual assistance in the event of need.
- The adjustment of the relative real parities will be made periodically under Bretton-Woods-like (or International Monetary Fund prior to 1971) rules, except that it will be in real terms rather than in nominal terms, taking into account the balance payment surpluses or deficits of an economy.

# An East Asian Monetary Fund

- Moreover, the East Asian Monetary Fund can also assume the function of settlement of cross-border transactions in the respective local currencies (much like what the Bank for International Settlements did for the European economies in the 1950s) and thus avoiding dependence on a single major reserve currency either within or outside of the currency bloc.
- With the possibility of settlement of some international transactions in the local currency, the need for official foreign exchange reserves can be significantly reduced.

# Development of a Bond Market in Local Currencies

- The economies in the "East Asian Currency Bloc" can also cooperate in the development of a bond market in local currencies. If governments can borrow in their own local currencies, the risks of currency mis-match and possibly maturity mis-match, which are typical causes of financial crises, will be significantly reduced.
- To encourage the holding of these local currency government bonds by both domestic and foreign investors for the medium and long terms, it may be necessary for them to be indexed to the rates of local inflation.
- These inflation-indexed bonds can also be held as part of the foreign exchange reserves of the central banks of the different economies within the currency bloc.
- These bonds should also be available within the issuing economies themselves to all the local citizens . This will lessen the probability of potential default than if they are only available to foreign holders.

# Concluding Remarks

- An "East Asian Currency Bloc" is completely feasible. All it needs is some political will. It can start with the coordination of the relative real exchange rates of the Yuan, the New Taiwan Dollar and the South Korean Won on the one hand and the Indonesian Rupiah, Malaysia Ringgit, Filipino Peso, Singapore Dollar and the Thai Baht on the other. Eventually these two groups can also agree on their relative exchange rate parities.
- Japan, Vietnam, Cambodia, Laos, Myanmar and perhaps Brunei may follow.
- With an "East Asian Currency Bloc", adjustment of exchange rates between it and the other major currencies such as the U.S. Dollar and the Euro will be greatly facilitated as no individual East Asian economy will be relatively advantaged or disadvantaged with coordinated real parities.

# Concluding Remarks

- However, periodic adjustments of the relative exchange rate parities of countries within the "East Asian Currency Bloc" in response to persistent balance of payments surplus or deficit and to differential rates of inflation.  This possibility of adjustments makes it possible to have relatively loose coordination of fiscal and monetary policies across countries and incomplete factor, especially labour, mobility.
- An "East Asian Currency Bloc" is the logical pre-cursor to a single East Asian Currency.