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**A New Monetary Arrangement for Asia?  
A Political Critique**

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***Abstract***

There has been a recent interest on the idea of deeper monetary interaction in Asia, particularly in the context of a potential monetary union in East Asia. Such an interaction is also articulated keeping in mind the recurrence of regional financial crises and the absence of any mechanism to cope up with the monetary disturbances that they may result in. The renewed interest in the creation of an Asian Currency Union, bringing greater convergence in the East Asian currencies is an example in this direction. Most of the literature on the subject however has overemphasised on the economic feasibility of such a project while giving marginal focus to the political imperatives. The present paper provides a broad survey of the debate by highlighting both the economic and political imperatives which point to a not so optimistic future of monetary union in Asia. By tracing the evolution of the idea of monetary cooperation in Asia from the early 1950s, the paper argues that the likely contemporary political impediments to the project may not necessarily come from internal factors, but there may be extra-regional constraints as well, which may work to the detriment of the idea. Asia therefore would be more ideally suited for strengthening the existing mechanism for facilitating monetary cooperation rather than creating new ones for monetary integration.

## **Interpreting Contemporary Regionalism**

While Regionalism as an idea in the contemporary global political economy has firmly established itself as one of its constitutive elements, the scope and spread of the same has varied across regions and continents. It has often been expressed as a factor which optimises the existing complementarities across the region thereby maximizing collective welfare of the member nations. Besides, regionalism also is seen as providing the much needed stepping stone for larger global integration which provides the reluctant new entrants a testing ground- the building bloc thesis. Finally regional option, seen from a contemporary perspective, can also be envisaged as providing the necessary cushion which enables absorption of the adverse outcomes of certain global factors.

As the global community accepts regionalism as one of its key factors, its location and depth has often been determined by political as well as economic stakes that nations are collectively able to put together in the regional project. Thus while in Europe, the creation of the European Union and its ongoing attempts at further expansion express one of relatively successful instances of regional community creation, its variants in Asia and Latin America have been rather episodic and disparate. Infact given the varying form and content of regionalism across Asia itself has been dependent on the extent to which nations are willing to supplement the idea of the regional over national policy autonomy. Thus while 'trade regionalism' has precluded greater inclination for nations to move on the fast track of tariff liberalization and market access, 'monetary regionalism' is an idea which is still subject to over caution and serious deliberation in Asia.

Monetary regionalism in fact has remained subservient to the idea of trade regionalism in Asia, recent interest on the theme notwithstanding. It is therefore pertinent to give a brief conceptual overview of the same before exploring why inhibitions regarding the former have had a rather historical antecedence.

## Conceptualising Monetary Regionalism

Regional Monetary institutions have generally bordered along two key functional paradigms- *monetary cooperation* and *monetary integration*. Monetary cooperation essentially entails a basic level of coordination in the area of finance and currency between nations where the basic objective is more to seek complementarities and linkages that could help the member economies 'facilitate' cooperation in the wider sphere of trade and investment. Thus monetary cooperation may include institutional mechanisms such as Clearing and Payments Arrangements (CPAs), Reserve Funds and Project Financing Facilities. Such arrangements while requiring policy coordination among member nations may not require extensive policy convergence and therefore are the more easily executed instruments as they entail negligible national policy surrender. Monetary cooperation arrangements worldwide therefore are often seen as a logical and necessary next step of cooperation in the trade sphere. Regional groupings are perceived as better candidates for such cooperation as monetary cooperation at global level is considered to be a difficult thing to sustain, mainly because of the three key elements of governments: exchange rate stability, capital mobility and national policy autonomy, thereby constituting an incompatible 'Unholy Trinity'.<sup>1</sup>

Clearing Arrangements which acquired greater prominence in the post world war II economic reconstruction were seen as useful instruments to facilitate payments and progressive liberalisation of trade by creating conditions for intra-regional trade expansion. Conventionally, a multilateral clearing arrangement seeks to clear current transactions, primarily comprising of goods and services, without using convertible

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<sup>1</sup> Benjamin Cohen, 'The Triad and the Unholy Trinity: Problems of International Monetary Cooperation,' in Jeffrey A Frieden and David A Lake (eds) *International Political Economy: Perspectives on Power and Wealth* (London, 1995).p.257.

currencies except for settling the net balance resulting from periodic settlements.<sup>2</sup> Thus there is a precise advantage of economising the precious foreign exchange as the hard currency is to be used only for settling the net balances. The main benefit of an international clearing arrangement is also described as deriving from their impact on reducing restrictions on trade and on the use of foreign payments instruments in times of overvaluation.<sup>3</sup> Among some of the major instances of clearing arrangements have included the Asian Clearing Union (est.1974), West African Clearing House (1976), Caribbean Community Multilateral Clearing Facility ((1977) and Clearing House of Preferential Trade Area for Eastern and Southern Africa (1984).

Reserve Funds have a larger scope and context as they provide the member countries the facility to address their balance of payments deficits as generated by their extra-regional or global trade transactions rather than the intra-regional deficits. Such a fund could consist of a capital fund or reserve assets built from the monetary reserves from the member countries which are transferred to the fund. Such reserves pools are conceptualised on the basis of variability of the payments to be made, whether they are to be made by one country or many countries, the potential being greater the larger the membership of the grouping.<sup>4</sup> Besides, a regional reserve fund could also enable a better bargaining on behalf of individual members with regard to probable investment options and could give greater strength to regional currencies collectively.<sup>5</sup> Some of past instances of reserve Funds have included Arab Monetary Fund and the Andean Reserve Fund. Both Clearing Unions and reserve Funds entail a certain policy complementarity and coordination and therefore make limited demands on national policy autonomy.

Monetary Integration initiatives on the other hand call for a far deeper harmonization and convergence of monetary and exchange rate policy, which entail greater adjustments of

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<sup>2</sup> United Nations Conference on Trade and Development, A Review of the Main Features of Clearing Arrangements of Developing Countries (UNCTAD/ECDC/128), 22 November 1982, p.2

<sup>3</sup> Byron Auguste, The Economics of International Payments Unions and Clearing Houses : Theory and Measurement (London, 1997) p.18.

<sup>4</sup> J R Dodsworth and J Diamon, 'Monetary Cooperation as a source of development Finance : The ASEAN Case', Journal of Developing Economics, vol.7, 1980 p.410

<sup>5</sup> Charan D Wadhwa, 'Reserve Pooling in Asia and the Far East', The Pakistan Development Review, Vol IX No.3 Autumn, 1969, p.310.

the national policy. The steps towards monetary integration could begin with a certain currency union- indicating the linking of the regional currencies to a common peg such as CFA- Franc Zone or currencies could be allowed to fluctuate within a fixed band as was done in the initial Exchange rate management under European Monetary system. At a more advanced level, there is the feasibility of complete monetary union enabling complete integration of monetary and exchange rate policy with the eventual creation of a common central bank and a common currency, such as the one prescribed by the European Monetary Union with the launch of Euro in 1999. The theoretical premise for monetary union, given by the optimal currency area (OCA) hypothesis provides the operating environment where a common currency is a feasible proposition. According to the OCA principle, if the world can be divided into different regions within which there is factor mobility and between which there is factor immobility then each of these regions should be assigned a separate currency which fluctuates relative to all other currencies.<sup>6</sup> Mobility of labour helps achievement of both external and internal equilibrium within a region without the need to bring about monetary and fiscal adjustments among the member countries. The process also helps achieve deeper integration of the financial market in the region, as evident in the euro-zone, where the 'depth and breadth of market have increased as the elimination of exchange rate risk and elimination of hindrances to cross border trading have attracted more investors in the euro area.'<sup>7</sup>

### **Asian Monetary Initiatives: From one ACU to another**

Asia has been no exception to the diverse experiences in regional monetary interaction that have been practiced elsewhere, though such efforts have been manifest at different times and spaces. Even though the diversity of the Asian economies ranging from the oil producing middle –east, agrarian South Asia and the manufacturing and export oriented East Asia has precluded a unified-commonly acceptable idea of regionalism, the same

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<sup>6</sup> Robert Mundell, ' A Theory of Optimum Currency Areas' American Economic Review, September 1961, p.664.

<sup>7</sup> R Kannan and Atri Mukherjee, Is East and South East Asia Including India an Optimum Currency Area? Economic and Political Weekly, March 17-23 2007, Vol XLII No.11, p.954.

has evolved in a sub-regional contexts interspersed with select trans-regional examples as well. Even though there has been a renewed talk of an 'Asian Economic Community', which countries are to be included and which to be excluded has not yet been thought of. The story of the Emerging Asia or the coming Asian century are more reflective of a certain coming together of the South East and East Asian seaboard with the probable inclusion of the upcoming economic giants in India and China rather than Asia as a whole which is too diverse and differentiated to qualify for a regional bloc. But more on that a little later.

The initial efforts at initiating regional cooperation efforts in Asia date back to the 1950s with the establishment of the then Economic Commission for Asia and Far East (ECAFE) under the auspices of United Nations, which mandated a study as early as 1948 on the necessity of a regional monetary and payments arrangement in Asia. An International Monetary Fund assisted study on a similar theme concluded on the basis of inadequate evidence that a regional clearing union was impractical.<sup>8</sup> It was only in the early sixties that the possibility of a clearing and payment arrangement irrespective of regional trade liberalisation measures was conceived mainly with a view to counter the imbalances that were emerging out of expanding intra-regional trade.<sup>9</sup> A series of consultations thereafter laid the blue print for what was to become the Asian Clearing Union (hitherto ACU-1) in 1974 with its secretariat located at Tehran with the initial membership of seven Asian countries.<sup>10</sup>

The ACU 1 has been operational till date with the express mandate of (1) To provide a facility to settle payments, on a multilateral basis, for current international transactions among the territories of participants;(2) To promote the use of participants' currencies in current transactions between their respective territories and thereby effect economies in the use of the participants' exchange reserves;(3) To promote monetary cooperation

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<sup>8</sup> I N Mukherjee, *Towards Economic Integration in Asia : An Evaluation of Trade Expansion Programme of Developing Countries in Asia and Pacific* (New Delhi, 1978) p.2

<sup>9</sup> United Nations, 'The Asian Development Bank and Trade Liberalisation', REC Series number 2, ECAFE, (NEW York,1965),p.90

<sup>10</sup> The members included Bangladesh, Nepal, India, Iran, Myanmar, Pakistan and Sri Lanka.

among the participants and closer relations among the banking systems in their territories and thereby contribute to the expansion of trade and economic activity among the countries of the ESCAP region; and(4) To provide for currency SWAP arrangement among the participants so as to make Asian Monetary Units (AMUs) available to them temporarily. To its credit, the ACU, transactions experienced a remarkable growth and remained one of the few clearing unions never experiencing a default. In 2007, volume of transactions (one way plus accrued interest) amounted to USD 15,830.5 million depicting 31.4 percent growth compared to the preceding year. On a monthly basis, the average transactions stood at USD 1,319.2 million compared to USD 1,004.2 million during the previous year.<sup>11</sup> However, ACU remained a grouping which was often found lacking in its appeal, particularly with eventual convertibility of currency in member countries and conversion to dollar denominated transactions not projecting as a viable instrument of intraregional trade expansion. Besides, the grouping remained more of a procedural mechanism which could not really do much to foster a greater monetary interaction and harmonization among the member countries, leave aside attracting new members. Another lacuna perhaps could be its lack of congruence with an overlapping regional trade cooperation initiative which could have provided it a greater supplementary role.<sup>12</sup>

The other parallel initiative, though linked more closely with a particular regional cooperation initiative was the Association of South East Asian Nation (ASEAN) SWAP arrangement which was more in the form of a regional credit facility that could use the SWAP facilities to finance temporary international liquidity problems of ASEAN members.<sup>13</sup> Besides the Economic Cooperation Organization (ECO) conceived its own mutual payments arrangement on lines of the former Regional Cooperation for Development (RCD) Union for Multilateral Payments Arrangement. But all these initiatives were rather isolated without there being an incremental and cumulative effort to put all together as part of some systematic whole.

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<sup>11</sup> See Asian Clearing Union homepage [www.asianclearingunion.org/ACU-introduction.htm](http://www.asianclearingunion.org/ACU-introduction.htm)

<sup>12</sup> Rahul Tripathi , Monetary and Payments Cooperation in South Asia : A Case Study of the Asian Clearing Union, Unpublished PhD thesis, School of International Studies, Jawaharlal Nehru University, 2000,p.192

<sup>13</sup> Article I of the ASEAN SWAP Arrangement in Michael T Skully, ASEAN Financial Cooperation Development in Banking, Finance and Insurance (London, 1985)

With a greater trend towards liberalization of hitherto closed economies and simultaneous reforms in the trade and the financial regimes governing most of Asian countries in the 1990s, it appeared that any movement towards monetary regionalism would appear to be redundant when the dominant trends were towards globalism and global financial integration. Countries would hardly appear to be having the need for clearing arrangements when currencies were becoming freely convertible and reserve funds would appear futile when foreign exchange inflows were booming. The Asian Financial crisis beginning in 1997 and the contagious collapse of hitherto inflated Asian economies eventually gave a wake up call- a call for reinventing monetary regionalism in Asia, which was to pave the way for a potential ACU -2.

### **A New Monetary Architecture for Asia**

Asian financial crisis led to an immediate desire and demand for a regional reserve facility to provide for the short term liquidity problems of the member nations in the form of an Asian version of IMF, the Asian Monetary Fund, which was immediately rejected by the US led Western combine, on the grounds that it may add to financial recklessness at a time when the need was for greater regulation and supervision. As the Asian recovery gradually picked up and the global attention again shifted towards the rising Asia (with the booming markets of India and China) the voices on creation of an Asian Economic Community gained further momentum.<sup>14</sup> At the core of the efforts were the expansion of ASEAN membership from six to ten, its initiation of ASEAN sectoral and dialogue partnership, ASEAN plus 3 (Including China, Japan and South Korea) and the identification of a future East Asia Summit which would include apart from ASEAN, all its dialogue partners.

In the midst of these growing voices for greater economic interaction in Asia, came the proposal for creation of an Asian Currency Unit (ACU 2) by Asian Development Bank (ADB) based on a basket of 13 Asian currencies (ASEAN plus 3) as a yardstick to

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<sup>14</sup> Nagesh Kumar 'A Broader Asian Community and a Possible Roadmap', Economic and Political Weekly, September 3-9, VolXL no 36,p.3926

measure currency variations. It was expected to monitor both the collective and the individual movement of the currencies against both the dollar and Euro and the regional average given by ACU 2. It was also envisioned as enabling economic interdependence in Asia, cooperation on exchange rate stability and at a later stage ‘convergence of monetary policy and introduction of a monetary union.’<sup>15</sup> This expectedly generated a lot of interest in academic and policy circles and led to the initiation of a number of studies which focussed extensively on theoretical- economic feasibility of such an undertaking and to a lesser extent the political impediments to the same.

In one of the most comprehensive scenarios analysing a potential Asian Currency Union (ACU 3) it has been pointed out that ‘some Asian countries exhibit almost the same level of external openness, intra-regional trade and symmetry in macroeconomic shocks as their European counterparts did in the pre-euro period. Thus some subsets of Asian countries are ideal candidates for a currency union. It has however pointed out that there are other factors that affect the successful establishment of an Asian currency union, such as the historical and political backgrounds, institutional set-ups, regional convergence in developmental stages, and track-record of sound macro-economic policy.’<sup>16</sup> It is felt that the level of political commitment to further regional integration is a major impediment and will take years if not decades to evolve.

According to another study, loss of national policy autonomy especially in the context of unforeseen shocks and instability may engender political opposition to any such monetary integration. Currency often becomes symbolic of national identity and prestige and could well become an issue of concern when it comes to electoral politics. Besides there is a greater need for political proximity between member nations so that currency union may lead to other related cooperative mechanisms such as ‘seignorage sharing, intercountry fiscal transfers when needed and eventual delegation of monetary policy to a

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<sup>15</sup> R Kannan and Atri Mukherjee, no.7, p.955.

<sup>16</sup> Shingo Watanabe and Masanobu Ogura How Far Apart Are Two ACUs from Each Other? : Asian Currency Unit and Asian Currency Union , Bank of Japan Working Paper Series No.6-E-20 November 2006, p.4

common central bank.<sup>17</sup> Further, the study makes a very interesting comparison of political proximity between regional member nations based on the pattern of voting decisions taken at the United Nations and concludes that countries in the East Asian region exhibit a very low level of political proximity as compared to other regions such as European Union. Besides, Japan and South Korea are expressed as having least political proximity vis a vis other South East Asian countries, thereby questioning Japan's leadership of a potential East Asian Currency union. On the other hand, political proximity is much more with regard to sub group of ASEAN countries along with China.<sup>18</sup> It concludes by saying that given the present economic and political contexts, East Asia may not be an ideal optimum currency area.

Furthermore, in one of the most comprehensive political economy analysis of east Asian monetary regionalism in the recent times, it has been pointed out that East Asia as a whole may still not be an ideal candidate for monetary integration because a) None of the regional countries would be inclined to accept the leadership role of either Japan (which is seen reluctant to resolve its long pending disputes with east Asian neighbours) or China (which is very often seen as a potential political threat) b) Community identity in the whole of East Asia is still to take a firm shape despite the ASEAN plus 3 and the EAS models c) Absence of *linkage politics* which means the lack of other regional issues of common concern which could be used by some countries as a bargaining point in return for monetary integration and d) The role of external players such as United States which have traditionally been opposed to the idea of strong east Asian regionalism and accordingly were one of the strongest opponents of the idea of Asian Monetary Fund that was mooted in the wake of Asian financial crisis of late 1990s.<sup>19</sup>

The prospects before deeper monetary regionalism in Asia therefore appear to be bleak in sharp contrast to the other regional cooperation initiatives relative to trade and investment

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<sup>17</sup> Jong Wha Lee and Robert J Barro ' East Asian Currency Union  
[http://www.es.re.kr/asapro/board/download.htm?f\\_name=1181626468.pdf&r\\_name=Jong-Wha%20Lee-plenary.pdf](http://www.es.re.kr/asapro/board/download.htm?f_name=1181626468.pdf&r_name=Jong-Wha%20Lee-plenary.pdf)

<sup>18</sup> Ibid. p.24

<sup>19</sup> Hyoung Kyu Chey, 'The Political Economic Critique of the theory of Optimum Currency Areas and its implications for East Asia, The World Economy, Blackwell 2009  
accessed at <http://www3.interscience.wiley.com/cgi-bin/fulltext/122595394/PDFSTART>

as the necessary political impulses still remain weak for greater strides in that direction. Monetary regionalism can at best continue in the form of 'cooperation' rather than potential 'integration' as the available literature on the area suggests.

## **Conclusion**

Given the broad outline of the evolution, conceptualisation and experience of monetary regionalism in Asia, it is quite clear that there cannot be one single model of monetary cooperation in the whole of Asia which is quite diverse and disparate. Smaller sub regions within Asia may be better candidates for greater monetary interaction rather than Asia as a whole. Secondly, limited feasibility of 'integration' should not rule out maximizing the potential benefits of 'cooperation' that Asian economies can still achieve, particularly by way of having better payments procedures and a viable reserve fund especially in the context of financial crises. Thirdly, Asia has to reinvigorate and redefine the existing institutional Arrangements such as the ACU-1 for the potential role they can play in mitigating the crisis. Finally, Asia as a whole will have to rediscover the essence of an Asian identity by defining it in contemporary political language if it has to make any meaningful impact on the global economic scene.