

Future Currency Arrangements in the Asia Pacific Region

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Introduction

It was in 1995 when I first put forward a proposal on Asian Currency Unit (ACU), in the name of “APEC common currency unit”.

I presented my idea at the meeting of the 1995 Europe/East Asia Economic Summit held in Singapore on September 20-22, under the auspices of the World Economic Forum (Geneva based institute, known as the organizer of the annual Davos meeting). The report of the meeting of the year recorded:

“Takehiko Kondo proposed an APEC common currency unit (CCU) defined as a monetary cocktail including the US dollar, Japanese yen, Chinese renminbi, Korean won and Thai baht. Kondo said: If the current yen-dollar exchange rate instability continues, and G7 (Group of Ministers of Finance and Central Bank Governors of the seven industrial countries) has no effective measures to counter this situation, they could

disturb trade and investment flow and because of this, decelerate the economic growth in the region...

The CCU would not be so controversial because it does not aim at excluding the US dollar, nor establishing a yen zone, and recognizing the potential and influence of China in the region, includes the Chinese renminbi, according to Mr. Kondo”.

The Asian press reported the meeting more in detail.

The Nation Review, a Thai daily, dated 23 September 1995, quoted me as follows:

“Takehiko Kondo put forward the controversial proposal at the World Economic Forum...

“We should prepare a receptor’ as the APEC CCU that is more independent either from the dollar or the yen. The CCU will be, by definition, more stable in value than any particular currency, as is well demonstrated by the experiences of the SDR (the Special

Drawing Right of the IMF) and ECU (European Currency Unit), Kondo said.

“However, Kondo’s proposal immediately received a cool response from critics.

Makoto Utsumi, a professor at Keio University of Japan, did not see the logic of having a new currency for APEC when already the SDR or EMU do not function at all in commercial transaction.

Manu Bhaskaran, economist of Crosby Research Pte Ltd also said the lack of political will and institutional arrangements will prevent the materialization of a regional currency”.

The Star, a Malaysian daily, dated 23 September 1995, reported :

“Kondo said the composition share of the CCU could be decided by the APEC finance minister’s meeting with the APEC secretariat publishing daily calculated CCU rate against the US dollar and yen and others.

“The CCU will also be used, for the time being, as a pure calculation unit and it will have no substance as an asset. In this respect, the CCU will be different in feature from either the SDR or the ECU. The CCU will be used in APEC as a denomination unit for trade and investment, he added.

“Monetary authorities will promote but not force the use of the CCU. Its use will be left totally up to the initiative of private parties involved in trade and direct investment.

“To justify his proposal, Kondo said the Americanization of the financial business in the Asia-Pacific had been in progress with American standards predominant.

Moreover, he said monetary authorities in

the region were not prepared to advance European-type cooperation in the monetary field”.

The Indonesian Observer dated 23 September also reported my proposal :

“Under my concept of CCU, the US dollar will continue to play a very important role, Kondo said.

“However, having in mind the existing institutional or de facto link with the US dollar throughout the region, the CCU implies a mild shift from the dollar, thus easing somewhat the excessive burden of the dollar as a key currency in this region, Kondo said.

“He said the CCU could lead to an APEC monetary system in the future...”

The two Taiwan newspapers dated 23 September 1995 reported my proposal as well.

In retrospect, the year 1995, when I put forward the ACU of my style, was the year in which the dollar fell below ¥80 at one point. It was a period when the high yen was carrying all before it, and exchange rates were extraordinarily unstable. It was the feeling that if the situation were left as it was, the Asian economy would not fare well. That was the genesis of my proposal. It was not for preparing the lack of the liquidity in case of currency crisis, but simply to cushion against excessive foreign exchange rate fluctuations in the region.

I always predict that the future main problem in our region is not the insufficiency of the dollar liquidity, but rather currency exchange risk. We have a lot of liquidity in the region, starting with the Chinese foreign

reserve, exceeding 1 trillion dollars. But we will not see the stability of exchange rate among the Asian currencies, particularly in the eventual surroundings of more flexible exchange rate formation of the Chinese renminbi.

I also draw your attention that my ACU idea was not proposed before the definitive creation of the single European currency euro. Many were still skeptical on its successful launch, in the aftermath of European currency crisis of 1992-93.

In the intervening years, Asia suffered a regional currency crisis in 1997-98 and witnessed the advent of the euro in 1999. Calls gain momentum for the region to set its own direction toward a future currency regime.

Why need we create ACU? We have no Asian currency to compare to US dollar or European euro. Asian countries use US dollar in many of their international transactions. But it certainly incurs economic and financial cost in Asia. We are exposed day after day to foreign exchange risks. We are not in the level playing field with the United States and Europe, in mega-competitions under the globalization. That is the reason why we have to do our best to minimize the risks compared to other regions. ACU will lessen the risks, although it will not completely eliminate them.

Having presented these in general, I would like to enumerate the core features of my idea.

Features of my ACU concept

1. APEC currency unit.

My concept is to formulate ACU at the APEC (Asia Pacific Economic Cooperation) level. The task of constructing a common currency for Asia (the Asia-Pacific region) is a big challenge ahead of us in the region of the 21st century, and I think, always under your control and criticism, it most appropriate to mandate this important job to APEC which is fostering closer economic and trade ties between the Asians and the Americans, with both the victors and vanquished of World War II, and with the structured informal meeting of the leaders as well as the institutionalized Finance ministers' level meeting.

The core of my proposal is both US and China should join from the start of ACU. I firmly believe that ACU cannot effectively move forward in lack of either US or China.

However, as for China, I hope not, but some believe that it may choose to distance itself from ACU and instead, to seek a "greater Chinese currency zone" including Hong Kong and Taiwan. They consider that Chinese renminbi is an up-and-coming currency to counter a dominance of US dollar in the region. This will go along with the Asianization of renminbi. This is a similar thinking to what some Japanese scholars advocated in the past in their zeal to create a yen zone.

One advantage of APEC-based ACU is, I hope, to facilitate the US participation into the ACU scheme. Whether to include US

dollar in the currency basket of ACU is without doubt an important question.

Contrary to many, my view is that US dollar should constitute an essential part for the success of the undertaking of ACU.

In this respect, former US Deputy Secretary of State warned us on the possible integration of Asia without US :

“The United States, as a member of the Asia Pacific community, has a major interest in East Asia. It cannot accept an East Asian Community which excludes the United States. If East Asia is keen to establish an East Asian Community, why can it be formed with APEC as its basis? “(Richard Armitage, “Is Participating in an East Asian Community in the National Interest”, Wedge, May 2005, quoted by Tadahiro Asami in his article of KOKUSAI-KINYUU, dated August 1, 2005).

On the Asian side, every effort should be exerted to avoid a political impasse over the treatment of US dollar, especially the kind that eventually discouraged the initiative in 1997 to create the Asian Monetary Fund to rescue countries hit by currency crisis in Asia.

US might as well maintain the current system based on dollar. But the US international balance of payments is in deficit. This is because US continues to be a spender. It is highly unlikely US will suddenly turn into a saver. The US deficit is financed by capital inflow from abroad, but there is no guarantee that this will be sustained. If the current situation prolongs, I think US will have no choice but to take up the kind of ACU idea,

which means to share exchange risks proportionally between Asia and US.

However, noteworthy enough, the Financial Times dated June 16, 2006 reported :

The US yesterday signaled it would not fight efforts to create an Asian currency unit, turning the page on more than a decade of largely consistent opposition to Asian monetary integration...

The signal was given by Tim Adams, the under-secretary for international affairs at the US Treasury, in a closed session of the World Economic Forum in Tokyo.

While Mr Adams spoke in general terms, a copy of his prepared remarks, obtained by the Financial Times, spells out clearly the US position on the Asian currency unit. The remarks say the US believes there has been “some confusion” about its attitude on the ACU. They say : “We do not see the ACU as a competitor to the dollar.”

They go on to say that the US is “open minded” on this issue and add : “We view proposals for Asian currency co-operation with interest.”

Mr Adams presented his remarks as a clarification rather than a shift in US policy. However US officials admit that the US is seen in Asia as being hostile to regional monetary and financial integration in principle, and wants to change that view”.

The article commented :

“The green light from the US is a big fillip for Japan, which has been pushing the idea of an Asian currency unit loosely modelled on the European currency unit, the precursor to the euro, in face of considerable regional

scepticism. It comes at a time of growing diplomatic closeness between Washington and Tokyo.

While formidable obstacles remain to the creation of an Asian currency unit, with Asian countries to agree on weightings or on the inclusion of Taiwan, the US decision and the broader evolution of US Asia policy it represents may in time be seen highly significant”.

At any rate, the involvement of the US on ACU is certainly a highly delicate political question.

Way back to my original proposal, Manuel F. Montes commented :

“It is illustrative that Kondo Takehiko... took great pains to swear that the U.S. dollar would be part of the basket...just so that the proposal would not provoke U.S. resistance.”

Though it may seem like something of a digression, I sounded out the opinions of a few Western experts before and after presenting it at the Europe/East Asia Economic Summit in Singapore in the autumn of 1995. I paid particular attention to see the Americans would react to my concept as being “anti-American.”

One American I asked, Mr. Edward M. Graham of Institute for International Economics wrote to me :

“I do not find this proposal to be as controversial as you might think. After all exchange rate volatility does pose significant risk and such risk can dampen trade, which is not in anyone’s interest except perhaps the financial institutions that profit from selling risk reduction instruments such as futures

and forward hedges, forex options, and such. And, so, any reasonable proposal to reduce this volatility is welcome...”

On the other hand, Klaus Regling, then Ministerialdirector im Bundesministerium der Finanzen, wrote to me :

“On the way back to Germany I read your paper on a possible APEC common currency unit. Working on European monetary union, I know how difficult it is and how long it takes to achieve progress towards monetary integration. But it is important to develop visions”.

In January 1999, Jacques Attali, who served adviser to President Francois Mitterand wrote a comment in *Le Monde* that setting up an integrated Asian currency was premature, saying that it was like “trying to set up a monetary union in the Balkans”. At the same time, in his book “*Fraternité : Une nouvelle utopie (1999)*”, he suggested that it might be possible to create a single currency centered on the Chinese renminbi.

Many argue that in Europe the monetary union was preceded by the trade harmonization, and that it took 40 years for the realization of euro. So it will take more time in Asia, they say. I am not fully convinced with this argument for several reasons.

First of all, the time is different. The global financing would never cease to grow. We have to face it. As the Asian currency crisis of 1997-98 demonstrated, large-scale capital movements can quickly reverse decades of economy building efforts by Asia. Under these circumstances, the Asian economies cannot develop with sustainability in

the future without currency stability. So in my view, we have to work not only for FTA, but also simultaneously for currency as well.

We can learn from the experience of Europe. We have the “late comer’s advantage”, thus we can shortcut the process.

In this respect, the “snake” system, which limited the margin of the fluctuation of participating currencies within the internationally agreed margin, seems to have been a painstaking and time consuming process in the experience of Europe. The Europeans were finally forced to enlarge substantially the margin of fluctuation after the European currency crisis of 1992-93. The lesson is we Asians have to be more prudent for the adoption of such a system of the confrontation with the markets. We might rather proceed directly to ACU.

2. A numeraire currency.

At the inaugural stage, ACU should be created as a “numeraire” currency, that is, a currency unit serving as a standard of value. So it would be constituted as a unit of denomination and would not be given the substance of assets.

Generally, an international currency has at least some of the following five attributes; first, numeraire, second, means of payment for international private transactions, third, store of value of private assets, fourth, reserve currency, and fifth, currency for intervention.

“Numeraire,” was first introduced by French economist Léon Walras in 1870 (*Éléments d'économie politique pure*) to refer to the representation of the value of other goods. It

became a word in the international monetary field since 1971.

Under the Bretton Woods system, the formal numeraire was gold. It gave U.S. dollar an equivalent role. The original Articles of Agreement of the International Monetary Fund, Article 4, Section 1 provided that the par values of currencies would be expressed “in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.” Eventually the convertibility between the dollar and gold came under doubt; the solution chosen was to banish gold from its role as a numeraire.

The attributes shared by many international currencies are those of numeraire and foreign reserve currency. These two attributes existed in ECU as well. My innovation in the concept of ACU compared to ECU is to constitute ACU with the pure attribute of numeraire, even without the aspect of the foreign reserve currency. I believe further progress in the globalization of the economy and the electronization of currency in the 21st century could permit us the birth of an international currency only with the attribute of numeraire.

This concept might be criticised. The above quoted Edward Graham commented on my original proposal of 1995:

“The one element of criticism that I have of your proposal is that while ACU might sense as a medium of exchange, so that trading contracts might be written in ACU, the ACU could not be fully useful unless it were also a store of value. In order for this latter

to happen, in the absence of any sort of APEC official international financial intermediary (i.e., there is no APEC-level IMF), there would have to be some willingness of private financial intermediaries to issue instruments denominated in ACU. Does such a willingness exist? Even as a trading medium, the ACU would be of limited value until financial intermediaries were willing to develop markets for forward and futures in ACU, so that normal hedging could take place.”

But he added :

“Maybe it could be argued, however, that if the CCU were launched, these markets would develop quite normally”.

3. A common currency, but not yet a single currency.

ACU would be a common Asian currency. In other words, it is a parallel currency. So it is supposed to coexist with existing Asia Pacific national currencies, such as US dollar, Chinese renminbi, Japanese yen, Korean won and so on.

I am not thinking of a single currency on the lines of euro.

In this sense, ACU is nothing to interfere with the sovereignty of the participating countries in the area of monetary policy at the present stage.

Given the diversity of the region, the task of coordinating macroeconomic policy should be left to be pursued gradually, but at a steady pace.

4. A common capital currency, maybe not a common trade currency.

The aim of creating ACU is, by its use, to stabilize trade and investment transactions within the Asia Pacific region. But ACU might not be necessarily needed to start its use with denomination of trade transaction. It would probably be more practical to begin its use with denomination of capital transactions in the Asian capital markets.

I will be justified for two reasons.

First, my argument corresponds to the historical experience in Europe. ECU was more used for denomination purpose in the capital markets, but used very poorly for trade denomination purpose.

Second, in today's global economy, capital transactions are more dominant in size than trade transactions.

Maybe, a reasonable starting point would be to use ACU as the unit of denomination of bonds issued in the capital markets of the Asia Pacific region. This goes along with 'the Asian Bond Market Initiative', which allows channel directly abundant saving of Asia, into businesses in need in our region, without the intermediation of Western capital markets.

5. Simplicity

As is explained above, my ACU concept is a very simplified scheme. I think it is essential not to complicate the matter, having in mind the Asian diversity.

Currency basket, numeraire, common capital currency and simple model, those are the core features of my ACU concept.

Who will define ACU?

My original proposal was that ACU would be defined by the APEC Finance Ministers meeting. But, since, the trend has been going to the direction of defining ACU by the ASEAN plus 3 meeting, which comprises the Association of Southeast Asian nations, Japan, China and South Korea.

In the 2001 Report of the East Asia Vision Group set up in 1998 by the proposal of Korean President, monetary integration was included as one of the agenda items, by the insistence of the Japanese expert.

In May 2006, Finance Ministers from China, Japan and Korea agreed to study ACU, in the meeting held at Hyderabad of India, on the sidelines of the Asian Development Bank annual meeting. Although the trajectory seemed not to be so simple, I appreciate the agreement in a sense that the theme of ACU finally reached the ministerial-level agenda, as was confirmed in the joint communiqué. This represents a shift of the discussion of ACU, from the world of mere ideas by academicians to that of reality “with friction and resistance” in French economist Jacques Rueff’s terminology.

Reportedly this ministerial agreement was triggered by the ADB which spearheaded an initiative to define ACU. The ADB seems to have failed to complete the job by the resistance of its member governments. Many wondered if the definition of ACU was in the ADB’s jurisdiction.

The definition of ACU depends without doubt on political leadership of the region,

but, once defined, whether or not ACU becomes viable in the region hinges on how well it will be received on the market as a useful instrument. In this connection, I do hope, the ADB will play a positive role as a promoter of ACU usage, from the viewpoint of general interest in the region.

The first East Asian summit took place in Kuala Lumpur in December 2006 with 16 countries, ASEAN+6 (ASEAN+3, plus India, Australia and New Zealand). The East Asian Summit has not yet mentioned anything about Asian currency future.

In a word, the future process for defining ACU will be; first, to confirm the usefulness and the necessity of launching ACU, and next to decide the composition and the weighting of ACU. Many consider that the exercise is still premature and point out the difficulties of the decision of the relative weighting.

In this respect, a practical solution would be to fully use the methodology of the already existing Chinese currency basket, introduced in July 2005, on the occasion of the reform of the exchange rate formation of renminbi, as a reference material. It is reportedly composed of 11 currencies, including US dollar, Japanese yen and Korean won but, quite naturally, as it is a basket for Chinese use, it does not include renminbi itself. But I think it could be modified for Asian use, without changing the basic thinking. We can work out the distribution of weighting of ACU, by adopting the methodology of China for the measurement of each participating country’s economic power based on gross domestic product, trade and other factors, but, of

course with necessary modification to enlarge the Chinese national currency basket into an Asia Pacific version.

I am a University professor. A difficulty for professors of International Economics is to explain the concept of the currency basket, to young students. They are in general not willing to understand, partly because they consider it is a mere fictive concept by academic scholars. China changed the situation. Since 2005, students have to understand it, because it is part of the Chinese international monetary policy. So the Chinese monetary authorities in a way facilitated the job of the University professors. As one of them, I have to say thanks to the Chinese authorities for their contribution to our education purpose.

In any way I think we should not exaggerate the difficulty in technical modality.

Jean Monnet once said :

“If everything had been difficult, nothing had been impossible once the political will to reach existed. The technicians had realized a turn of force in many fields...That is their job. The solutions unconceivable before became natural to them in the coherent context which one had traced to them. In my knowledge, things can not be otherwise, and I have never overestimated the technical obstacles.”

In my view how to prepare a workable answer by defining objectively a formula for weighting, taking into account different economic data in the region may be far less tricky than deciding which currencies to be included in ACU.

Conclusion

In concluding, the current situation is that no one doubt about the conceptual usefulness of ACU. It is a progress we attained through our discussions in the past 10 years. The next step is how to translate the notion into practicality.

I would quote once again my favorite Jean Monnet from his Memoires (1976) :

“Men, when they are placed in certain conditions, see that their interest is common and then are carried to start to agree. These conditions are that one speaks of the same problem, with the will and even the obligation to give it a solution acceptable to all.”

I am convinced that in near future the Asia Pacific region will surely fulfill these conditions.

First, in near future, the exchange rate of Chinese renminbi will become to move more freely according to the market conditions. In the present trend towards more integrated global financing, China will abolish gradually capital restrictions. Then inevitably the time will come mutually volatile exchange rate movements among dollar, renminbi, yen, won and other currencies. One has to smooth them out. If not, Asia will risk of becoming a high cost region, because of the exchange rate instability.

Second, in the Asia Pacific region, I firmly believe that, no matter how powerful one particular country may be, no single currency in the region can achieve hegemony. It is not desirable either.

If my assessment has any validity, then we

have no choice but closer cooperation among major currencies in the region. ACU is the crystallization of these considerations of the Asian people in one concrete and simple concept.

The least we can say is that the question of ACU will test the collective wisdom of Asia and its political will in the 21st century.

The central underpinning of the current discussion about creating ACU is the conviction that a stable regional currency regime will not only bring greater economic stability, but also contribute in the long term to the peace of the Asia Pacific region in the 21st century.