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**Could a Common Currency Have
Prevented the Asian Crisis?**

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ABSTRACT

Recently currency instability and its economic and social consequences prompt the question whether and to what extent a common currency could have served to prevent or meliorate the Asian crisis. This paper examines the advantages and costs of such a proposal, using the experience and institutions of European monetary union as a starting point. It concludes that while the technical economic obstacles are not insurmountable, the political and social factors presupposed in a union are more important in explaining the region's lukewarm reception of the proposal.

COULD A COMMON CURRENCY HAVE PREVENTED THE CRISIS IN ASIA?

*Maria Claret M. Mapalad and Emmanuel S. de Dios**

Introduction

In the midst of the Asian currency and financial crisis, the question has been raised whether and to what extent its worst aspects may have been meliorated, if not altogether avoided, if the region instead had a common currency. The idea is not new. Earlier albeit less definitely, Malaysian prime minister Mahathir Mohammed went on record as saying the region should ultimately think about using its own currency. The executive director of the Hong Kong Monetary Authority has only been the most recent source of the proposal.¹

On the one hand, the practicability of a common currency has certainly gained in plausibility from the proximity of the remarkable European experiment of monetary union, is due to be completed in 1999. On the other hand the outbreak of the crisis saw the economies of the region effectively being treated by global hedge funds and portfolio investors as if they were a homogeneous group. To be sure, among the strategies pursued by some countries, notably Malaysia and the Philippines, was the effort to *differentiate* themselves from the rest of the region by emphasizing that their “fundamentals” were markedly unlike those of the other countries hit by the crisis. Experience has subsequently shown, however, that such efforts have met with limited success.

This paper takes the problem raised by the contagion-effect by the horns and follows it to its logical conclusion by asking what would have been involved if the countries of the region had indeed been bound together by a common currency. It explores an intriguing albeit conjectural suggestion that the on-going financial and currency crisis in Asia could have been prevented or mitigated if a common currency had been adopted by a number of countries in the region prior to the crisis. It asks what the requirements of a common currency would have been, as well as the extent to which the region's economies are in the appropriate position to fulfill those requirements. Finally, a number of hypotheses are proposed as to why the region's enthusiasm for a single currency is subdued.

A common currency and the crisis

Whether and how a common currency could have prevented or ameliorated the currency and financial crisis that began in July 1997 depends on what one regards as the origins of

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¹ Mr. Joseph Yam, speaking in Manila on 5 January 1999 on the occasion of the 50th year of central banking in the Philippines.

the crisis. Two related but distinct views exist. One view of the crisis attributes its occurrence to weak fundamentals in a number of countries of the region², including a deterioration of international competitiveness. Over long periods, nominal exchange rates were adjusted only minimally, while domestic prices rose faster than those of trading partners and competitors. The result was declining competitiveness, widening current account deficits, as well as an excessive recourse and exposure to foreign borrowing.³ Granting this was the case, a common currency arrangement may be argued as possibly lessening the chances of a crisis, since – as will be discussed below – the conservative monetary and fiscal policies required to make the monetary union work in the first place were also those needed to prevent macroeconomic aggregates and fundamentals from deteriorating.

On the other hand, an increasingly influential view places the greater share of the blame on speculative movements of capital and a subsequent financial panic.⁴ In this case, it may be argued, monetary union could have prevented the crisis, since it would have placed the (common) monetary authority in a better position to defend the common exchange rate, if it so decided. Under such a system, the monetary authority would have had access to a much larger amount of reserves, pooled from the reserves of all the union members. Speculative attacks would have been less successful in causing the common currency to depreciate and would not have caused a crisis similar to that which actually occurred in 1997. A related point, discussed further below, is that the common currency of a sufficiently “large” Asian monetary union would have come to hold more of it, while the members of the union would have needed to hold less non-union reserves, since their own currency would have functioned as such a reserve.

None of this implies that speculative attacks would never have succeeded. It could be argued nonetheless that both the severity and duration of speculative attacks would have been much reduced. This is because the necessary adjustment, if any were needed, could have been undertaken by the union in the form of a one-time depreciation of the common currency. The contrast is obvious between this state of affairs and the several rounds of competitive devaluation that actually occurred in the course of the crisis, with over- and under-shooting of individual currencies contributing to uncertainty. Uncoordinated efforts to shield each domestic economy from the crisis sent strong signals of uncertainty and policy inconsistencies, which further weakened investor confidence and failed to arrest the outflow of short-term capital.

From this one concludes that regardless of the preferred explanation of the crisis, a common currency would have played *some* role in either preventing or at least

² This was the position of the International Monetary Fund, at least during the initial stages of the crisis.

³ As applied to the Philippines, some writers have pointed to the long-standing problem of exchange-rate misalignment as an important source of the problem (see, e.g., de Dios, Diokno, Fabella, Medalla and Monsod [1997]).

⁴ This view, which emphasizes the role of the instability of capital flows, has obtained influential support from Joseph Stiglitz (e.g., Stiglitz [1998]), the chief World Bank economist, and even from such free-trade advocates as Jagdish Bhagwati [1998]

minimizing exchange-rate volatility that was the most visible manifestation and occasion for the crisis. On the other hand, it must be noted that the manner in which a common currency would have helped the situation differs. In particular, the argument is weaker and indirect if one accepts the second or "fundamentals"-viewpoint. Policy measures that are thought needed to have averted the crisis, such as fiscal discipline and conservative monetary policy, are not unique to a monetary union but would have presumably been effective even without it. It is another thing to say, however, that the emergence or sustainability of such conservative fiscal and monetary policies would have been difficult or impossible except in the context of a convergence to monetary union.

Costs and benefits of a common currency

A monetary union would require each member to give up independent control of its monetary and exchange rate policies as well as to co-ordinate its fiscal policies with those of other members. This implies foregoing the ability to use monetary policy to affect the level of domestic output and employment, and the deliberate use of exchange rate changes to affect international competitiveness. At the very least among union members, capital markets would be liberalized. A common currency, combined with a high degree of capital mobility among members, would mean that national authorities effectively lose control of money supply, which would henceforth be in the hands of a common monetary authority. It is conceivable in principle -- though perhaps impracticable -- for capital movements to be liberalized among members but to be restricted for nonmembers.

Whether the *union* as a whole has monetary autonomy depends on whether the currency union adopts a floating or fixed foreign exchange regime. In the case of European monetary union, capital markets are liberalized for both members and nonmembers, even as the euro floats against other currencies. The float ensues monetary autonomy of the European Central Bank, since capital flows would reflect themselves not primarily in changes in the supply of euros but in its exchange rate relative to the other world currencies.

With nominal exchange-rate adjustments ruled out, each member must then pay particular attention to maintaining or enhancing its competitiveness as a production and investment location first through the moderation of inflation (including the rate of growth of nominal wages) to a rate that keeps pace with those of other union members and of the main trading partners, and secondly through productivity growth. To the extent that these channels for gaining competitiveness are more restricted, then the leeway otherwise afforded by depreciation would be sorely missed.

Without monetary and exchange-rate autonomy, only fiscal policy remains available to national authorities in their attempts to affect domestic output and employment levels. For this reason, the temptation is great to use fiscal policy in ways that could threaten the success and stability of monetary union. Large fiscal deficits in one member country -- say, in response to unemployment -- would cause an incipient rise in interest rates,

causing capital inflows and an appreciation of the common currency. The appreciating common currency penalizes other members, whose export competitiveness, and hence output, are affected. In the meantime, output in the fiscally profligate country rises. Such a "beggar-thy-neighbour" policy would be bound to threaten the stability of the union.⁵ Consequently, great importance has been placed on "tying the hands" of members' fiscal authorities.

The loss of control over monetary and exchange rate policy and the implicit constraints placed on fiscal policies are the most important costs incurred in a country's decision to join a monetary union.

On the other hand the benefits of joining such a union must also be considered. The principal ones are regarded as gains in microeconomic efficiency arising from the reduction in transactions costs as the common currency unit is used to denominate trade and investment transactions. Uncertainty is also reduced as intra-union nominal exchange are permanently fixed. Transactions costs would be eliminated in wholesale and retail payments, as well as both within and across companies. Gains to end-users or consumers (owing to elimination of information costs and price-discrimination across different suppliers) are given prominence in the media but are difficult to quantify. The bottom line, however, is that most of these gains will be proportional to trade, investment, and mobility of persons. Of course, having a common currency would in addition enhance both trade and investment among union members, just as potential gains from it would be larger as the trade and investment relations among members were already high to begin with.

At the level of the macroeconomy, potential gains from adopting a common currency include those resulting from the tendency of policies towards low inflation, as earlier noted. Others are consequences of the inability of members to engage in competitive devaluation, or beggar-thy-neighbour policies, already as discussed above in connection with the financial crisis.

A gain that is less often noted is that from seigniorage and savings due to lower foreign reserves. As already mentioned, the emergence of a common Asian currency would result in seigniorage effects (see e.g., Hansen, Heinrich, and Nielsen [1991:171]). Seigniorage is the gain to a monetary authority that derives from its right to issue money. To the extent the new currency is accepted as a new reserve (which would require that the union be large and "important" enough), the common monetary authority needs to hold less of other types of reserves, while the rest of the world may hold more of the new one. Individual countries also dispense with the need to hold foreign reserves of their own. The result in both instances is saving or revenue, since the assets that would have been held in foreign currencies may now be held in the form of interest-bearing assets. For the European Union, these gains are thought not to be very large,⁶ but this circumstance is

⁵ For a fuller discussion, see Hansen, Heinrich, and Nielsen [1991: 119-177].

⁶ Studies reported by Pelkmans [1997:294] estimate seigniorage gains to be ECU 2.4 billion, or less than a

partly due to the fact that many pre-union currencies (e.g., the DM or franc) were themselves already being used as reserve currencies. In the case of Asia, however, few if any of the present currencies are widely accepted as reserves; hence the additional gains from seigniorage are likely to be more significant.

Defining an optimal currency area

Whether ASEAN is an optimal currency area or a subset of a larger area (e.g., ASEAN plus Japan) depends on a number of considerations.⁷ The argument for a common currency is particularly strong if it can be shown that potential union members do not lose much from giving up the independent use of their domestic policies, such as for example in absorbing the impacts of an external shock. Equivalently, if it can be argued that potential union members respond more or less similarly to common external shocks, then one member will have less need to resort to its own policy tools to counteract the impact of such a shock or than another member. In this case, a common or co-ordinated policy (whether monetary, fiscal, or exchange-rate) will be expansionary in nature. In contrast, if union members respond differently to a common shock (i.e., if some experience a recession while others enjoy a boom), then it is less clear how common policy might be designed to benefit all union members, since some would lose and others gain from policy action with a single direction.

Second, if policy preferences of potential union members tend to be convergent, as shown for instance in a common preference for low inflation, then there is likely to be less resistance to constrained or co-ordinated policies, placing less obstacles to adopting a common currency. For the same reason, countries that are less reliant on monetary and fiscal instruments to affect output to begin with are also less likely to oppose union.

Third, the adoption of a common currency depends on the speed at which wages and prices adjust. The importance of this criterion pertains once more to each member's need to use domestic policies to expedite (or hinder) needed market adjustments. When wage and price adjustments can occur fairly rapidly, union members will find that the cost of giving up policy autonomy (at least for this purpose) will be low, making membership in a monetary union less objectionable.

Fourth, the greater is intra-union trade and investment, the stronger is the argument for a common currency. This follows from the microeconomic gains of monetary union, whose magnitude depends on the volume of the trade and investment affected.

The previous discussion suggests the importance of the behaviour of the domestic economies and the similarity of countries' responses to external shocks. In this section, we attempt to assess the feasibility of adopting a common currency among five ASEAN

fifth of the minimum estimates of transactions cost gains (ca. ECU 13 billion).

⁷ Mundell [1961] is the *locus classicus*.

countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) or among these countries and Japan. The choice is dictated primarily by the availability of comparable data and the fact that these countries were among the most severely affected by the Asian financial turmoil, which is this paper's main concern.

To attempt an answer to this question, we use a procedure similar to one used by Gros [1996], as described by Pelkmans [1998: 292], which tests the correlation between export changes and unemployment as a demonstration of how external shocks (such as export changes) affect domestic unemployment. Pooled annual data for the period 1986-1996 for all six economies were taken, and output (GNP) growth was regressed against the growth of exports of goods and services, percentage changes in fiscal balances, and annual growth of money supply (M_2). The results are shown in Table 1.

Taking export growth as a proxy for external shocks and the GNP growth as a representation of the domestic economy's behaviour, we find that output growth increases by approximately 0.2 owing to a one percentage-point increase in export growth, i.e., this is the elasticity of output with respect to exports. This estimate is to be interpreted as representing the "average" behaviour of the union.

Table 1. Regression: GNP growth, ASEAN 5 and Japan
(pooled annual data, 1986-1996, 54 data points)

Dependent variable: Annual GNP growth	Coefficient	t-statistic	Probability
Constant	0.030	3.29	0.0019
Annual growth of exports of goods and services	0.196	4.46	0.0000
Percentage change in national government budget	0.002	1.18	0.2450
Annual growth of money supply (M_2)	0.032	0.73	0.4680
Adjusted R-squared	0.309659		
S.E. of regression	0.026243		
Durbin-Watson statistic	1.159508		
Log likelihood	122.0337		
F-statistic	8.924562		0.00008
Akaike info criterion	-7.209497		
Schwartz criterion	-7.062065		

To test whether some countries "deviate" significantly from average all-union behavior, we compare alternative regressions which exclude one or another country from the sample. If the exclusion of one country leaves the "average" behaviour of the remaining largely unchanged (with a deviation in the range of 10-30 percent), then one may conclude that the remaining members respond to a common external shock in a manner similar to that of the entire "union". More importantly, it would also mean that the excluded country itself is not significantly different from the rest, since its addition does

not materially alter the all-union behavior, compared to when it was excluded.⁸ If, furthermore, as a result of dropping countries successively from the regression, one *always* obtains coefficients which are not significantly different from the all-union regression, then one can conclude that *no country* behaves significantly differently from the average.

For present purposes, the coefficient of interest is that of export growth, which is a proxy for external shocks. The question is whether the coefficients shown in the various union-minus-one regressions are significantly different from 0.2. To answer this question, a Wald coefficient test⁹ is constructed to test the null hypothesis that the true output-export elasticity of each union-minus-one regression is statistically significantly equal to that of the union (i.e., approximately 0.20). The results are reported below.

Table 2: Wald test results

Country excluded	Export growth coefficient estimate	Wald test* <i>F</i> or χ^2	Probability (<i>F</i> -statistic)
Singapore	0.184441	0.085577	0.771353
Malaysia	0.207683	0.026148	0.872333
Thailand	0.191278	0.025245	0.874558
Philippines	0.187958	0.094705	0.759837
Indonesia	0.202317	0.002379	0.960341
Japan	0.177624	0.209574	0.649406

*null hypothesis: Coefficient equals 0.20

Source: Appendix Table; authors' computations

All the Wald tests suggest that the null hypothesis cannot be rejected, i.e., one cannot reject the hypothesis that the output response of a union-minus-one is similar to that of the entire union. Since the exclusion of one member does not change the behavior of the entire union, it can be deduced that the behavior of that member is similar to that of the union. In short, there is no potential union member whose economy responds to external shocks differently from how a union would respond on average.

Second, each member's need to resort to monetary or fiscal policy to address domestic needs (e.g., output and employment levels or changes) may also be assessed. The low *t*-statistics for fiscal and monetary policy in Table 1 suggest that neither type of policy is in fact effective (or actively used), at least over the period 1986-1996.¹⁰ The regressions in

⁸In short, we have indirectly tried to infer the behaviour of one country relative to the union by doing a union vs. union-minus-one comparison. A more direct test would have compared a union-minus-one regression with a regression equation explaining the behavior of *x* alone. This was not possible owing to data insufficiency: each country has at most only 11 annual data points (from 1986-96). Unfortunately, quarterly or more frequent data series were unavailable. Pooling at most 11 data points per country over six countries yielded a total of 54 observations.

⁹The Wald test effectively distinguishes whether the similarity of coefficients is intrinsic or is due to averaging out otherwise distinct relationships.

¹⁰Our results indicate that Malaysia tends to use pro-cyclical monetary policy, while Japan uses counter-cyclical fiscal policy.

Table 1 which exclude individual countries in turn also revealed no significant effect of growth in fiscal or monetary variables in output growth. Hence these findings suggest a weak argument in favour of leaving the control of fiscal and monetary policies for the purpose of achieving output targets in the hands of individual member governments. As such, loss of control of these policies as required by the adoption of a common currency does not prove to be costly (at least in terms of output growth to each union member.

Third, on the speed of adjustment in factor markets and of wages and prices. Capital market adjustments tend to occur more rapidly than those in the labour market, owing to greater capital market integration, as is largely the case in the ASEAN-Japan region. Most countries stepped up their efforts to liberalize their capital accounts by the late 1980s and more significantly in the 1990s. In contrast, labour-market adjustments do not often take place beyond national borders. As regards wages and prices, adjustments do occur but asymmetrically, i.e., adjusting upwards but not downwards. On this basis, it is not clear whether adoption of a common currency is an appropriate policy alternative. It must be pointed out, however, that the greater capital market integration noted above, coupled with the tendency of central banks to adhere to fixed (or narrow band managed float) exchange rate regimes would require members to give up only one thing, namely monetary autonomy, in order to push through with a common currency.

Fourth, a common currency becomes more attractive when the volume of trade and investment among union members is significant. It is on this criterion, however, perhaps the most crucial, that ASEAN does least well as a potential currency union. This is seen in the small share of trade within the potential union, as measured by the share of each country's exports to the union to its total exports (Table 3). Unlike Europe, the ASEAN members are not their own most important trading partners. The most ASEAN trade-oriented countries are Singapore and Malaysia, and much of this trade is between the two alone. The Philippines, on the other hand, exports the least to the region.

Including Japan in a potential monetary union improves the picture significantly. Measuring the volume of trade by individual members in terms of the share of its exports to the union out of its total exports, one finds large potential microeconomic efficiency gains for Indonesia, which would have exported an average of 52 percent of its total exports to the union between 1980 and 1996. This is followed by Malaysia, Singapore, and Thailand. Even on this basis, however, the Philippines is still among those likely to benefit the least, since the share of its exports to ASEAN-plus-Japan is the lowest among the five ASEAN countries included. The smaller share of Japan's exports to the region is due to its more diverse export markets, which include the U.S., Europe, and China. Excluding Japan from the union reduces the potential microeconomic gains for all countries by more than half, except Singapore. The greatest impact would be on Indonesia, followed by the Philippines.

Table 3: Exports to ASEAN (Exports to ASEAN-plus-Japan)
(as percent of total exports)

Period	Singapore	Malaysia	Thailand	Philippines	Indonesia	Japan*
1980-1996	22.86 (31.52)	26.37 (44.15)	14.59 (30.30)	8.13 (27.39)	11.32 (51.78)	10.86
1980-1985	22.59 (32.10)	26.46 (48.34)	15.04 (29.11)	8.17 (29.79)	13.11 (60.89)	9.26
1986-1990	21.53 (30.24)	24.72 (42.95)	12.36 (28.23)	7.38 (26.43)	10.36 (53.45)	8.29
1991-1996	24.23 (32.01)	27.65 (40.97)	16.00 (33.22)	8.72 (25.80)	10.33 (41.29)	14.59

Source: International Monetary Fund, *Direction of Trade Statistics*, various issues

Notes: Figures in parentheses represent share of exports to ASEAN and Japan combined.

*Figures for Japan represent exports to ASEAN as percent of total exports.

Convergence criteria: how close?

The further question arises how close the ASEAN economies are (or were) to fulfilling conditions for a monetary union if they should decide to form one. In principle, the prerequisites for monetary union would involve proto-members demonstrating a high degree of exchange rate stability over a period of time, and a willingness to co-ordinate their fiscal and monetary policies. The Maastricht Treaty elaborates these conditions as "convergence criteria" consisting of: exchange rate stability (within the context of fixed exchange rates under the former European Monetary System), a high degree of price stability, sustainable fiscal positions on the part of would-be members, and convergence in long-term interest rates. These criteria in turn were specified to mean that: (a) inflation in any country should not exceed 1.5 percentage points more than inflation in the best-performing three members (i.e., the three with the lowest inflation rates); (b) fiscal deficits should not exceed 3 percent of GNP (or GDP); (c) interest rates (specifically long-term interest rates) are to be no more than 2 percentage points above the average levels of those prevailing in the three countries with the lowest inflation¹¹; and (d) the public debt is not to exceed 60 percent of GNP or GDP. While convergence criteria are for the most part arbitrary, a useful starting point would be to ask to what extent the countries of the region might fulfill criteria similar to the Maastricht convergence criteria.

At the outset, it should be noted that the purpose of such criteria has much less to do with the technical requirements of currency union, and much more with establishing credible commitment on the part of the would-be members once they have joined. Nothing in principle prevents a high inflation country from joining a low-inflation union -- it does so, after all, at its own peril. Pelkmans [1996:301] regards the inflation and interest-rate criteria as being "clear, though perhaps arbitrary measures of nominal convergence". As for interest rates, it is far from clear, first of all, that they should even tend to equality before and after monetary union actually takes place. The extent to which that happens

¹¹ Note that the reference is to the three countries with the lowest inflation, not those with the lowest interest rates.

would depend rather on the degree of capital mobility among union members and the differences in premia for inherent risk among issuers of debt. What would fall out would be exchange-rate risk, as a result of the fixing of exchange rates, as well as the transaction costs differential, once it becomes unnecessary to convert from one currency to the next. Indeed the Maastricht criteria themselves recognize this and do not impose this but rather an "average" of the interest rates of low-inflation countries.

The fiscal criteria, on the other hand, are regarded as more problematic. The debt-ceiling is "controversial", owing to the lack of any clear standard for what is a "sustainable" level of public debt.¹² The deficit threshold, on the other hand, is regarded as insensitive to the business cycle and as unduly restricting the competence of national authorities to respond with fiscal measures to economy-specific shocks. Nonetheless, as part of credible commitment, adherence to the fiscal-deficit criterion is especially significant for the sustainability of a single-currency project. Monetary union by definition removes discretion over monetary and exchange rate policy from national authorities. As previously discussed, fiscal policy remains a national prerogative and may be used to redistribute demand, output, and employment from one union partner to another. As an indicator of commitment before a union, therefore, the fulfillment of the fiscal-deficit criterion is possibly more important than that for public debt. Levels of debt are cumulative and historical rather than reflecting existing policy priorities or preferences, so that trends rather than current levels hold more significance.

The state of things in the region before the crisis is shown in Figures 1 to 4, which in turn are based on Appendix Tables 2 to 5. ~~It is evident first of all that levels of inflation varied widely among countries of the region, with the Philippines and Indonesia having the highest and Singapore and Malaysia having the lowest rates of inflation over the period.~~ Thailand's performance is somewhere in between. Nonetheless, the gaps between rates have narrowed significantly through time. The same trend and pattern among countries is evident for interest rates, a process that was undoubtedly helped along by the fact that this period also coincided with the partial or complete opening of the capital account for these countries. Strictly speaking, however, only Singapore and Malaysia would have actually fulfilled the inflation and interest rate convergence criteria as defined by the Maastricht Treaty if these were applied.

Before drawing any conclusions on the basis of this performance, however, the important qualification must be made that -- unlike the European Union -- the ASEAN countries still have *not* made any commitment to monetary union, or to fixed exchange rates, for that matter. Hence no coordination, whether open or tacit, ever existed among these countries. Interest rates, for example, would certainly have bundled up more closely if the protomembers had been bound to one another by fixed exchange rates (resulting in, among other things, a removal of the exchange-rate differential). In the same manner,

¹² Textbook theory defines an "unsustainable" ratio of public debt to GDP simply as one that increases without bound. For the same reason, a "sustainable" debt-income ratio is simply one with bounds, regardless of its level.

fixed exchange rates would have led to a closer coordination of monetary policy, with possible consequences for the inflation differentials. When this is taken into consideration, the results achieved appear less insignificant.

It is in convergence in the size of fiscal deficits where the ASEAN record appears more promising (Figure 3). All the ASEAN-5 have pursued conservative fiscal policies throughout the decade, with most actually running surpluses by the mid-1990s. This includes the Philippines, which initially had to struggle with deficit-to-GDP ratios of 5 percent in the early 1990s. As for the ratio of public debt to income, Indonesia remains the distant outlier (a public debt to GNP ratio of more than 300 percent), while others make, or are close to, the 60 percent limit. For reasons already discussed, however, no hard and fast rule applies in these matters: a trend to reduction, combined with consistent fiscal surpluses would be a more telling indicator of credible commitment than the debt-to-income ratio at any moment. And indeed, the trend in Indonesia's debt-income ratio was one of decline, while its fiscal record showed surpluses.

Why not, indeed?

This paper has sought to give a dispassionate assessment of the potential for monetary union in the ASEAN region, one that possibly includes Japan. The most important objection interposed by the literature is the small amount of trade done by these countries with one another, which has traditionally been regarded as the principal source of (both static and dynamic) gains to such a union.

On the other hand, there are weighty reasons to think a union could have played a positive role in a nontraditional area: the closer macroeconomic coordination and reserve-pooling among these economies that would have been enforced in the drive towards monetary union may conceivably have led to a situation that could have averted if not meliorated the outbreak of the financial crisis, as well as its far-reaching economic and social consequences. In addition, the gains from seigniorage – unlike those for the European Union – are likely to be larger. Even the so-called “convergence conditions,” as set out under Maastricht, are not entirely beyond reach.

From this, one concludes that the purely technical objections to prevent a monetary union being concluded in the region are less daunting than they might seem at first. Nonetheless, technical criteria cannot be taken in isolation, and there are good grounds why – even if it might have held promise – a monetary union was not likely to have arisen.

Ultimately, the more important obstacles to monetary union in the region, probably have much less to do with technical reasons or pre-requisites for what constitute “optimal currency areas.” It has been observed, after all, that neither Europe, nor for that matter even the U.S., is an optimal currency area, a fact that has not prevented them from going ahead and electing single currencies. The real difficulties must be sought instead in the

political sphere. The question is when the point will be reached that sovereign national governments and their constituencies feel themselves secure enough to turn over certain competencies to supranational authorities, a circumstance that must depend in part on the architecture and qualities of those supranational institutions themselves.

The point is best made by considering the behaviour of exchange rates in the past decade. Before the crisis, nominal exchange rates have in fact been rather stable against the U.S. dollar. (Indeed, a good deal of opinion would cite that stability as one of the triggers for the crisis.) From this one might argue that the authorities would have lost little if they had indeed earlier abdicated their right to change their currencies' values to a supranational monetary authority, since in practice they were observed to have made little use of this opportunity anyway.

This and similar economic arguments are beside the point, however, since sovereignty involves rights rather than results. For governments, it is often the size of the (national) opportunity set itself rather than the ultimately chosen point that matters.¹³ The same argument may be made with respect to potential versus actual use of monetary policy and fiscal policy. Monetary union – which involves a surrender of some sovereignty – must therefore be perceived as expanding national opportunities through the replacement of autonomous policy levers with others. This requirement is often more complex than it seems.

There are, of course, alternatives to country-specific monetary and exchange-rate intervention even after monetary union has occurred (e.g., interventions in productivity improvements, discretionary fiscal policy over a limited range). But replacing the flexibility afforded by having several rather than fewer policy instruments requires compensations in *other* respects. In Europe, this has taken the form of the removal of barriers to trade, factor mobility, movement of persons, as well as various supranational social safety nets. Most important, although virtually impossible to quantify, is the change in the perception of what constitutes “us” versus “them” involved in the gradual development of a European identity. This is another sense in which the gradualism in the well-known sequence of economic integration (i.e., from customs union to monetary and hence to full political union) may be understood. All these factors ensure that the loss of national policy-levers is sufficiently compensated for by an expansion of opportunities in other respects.

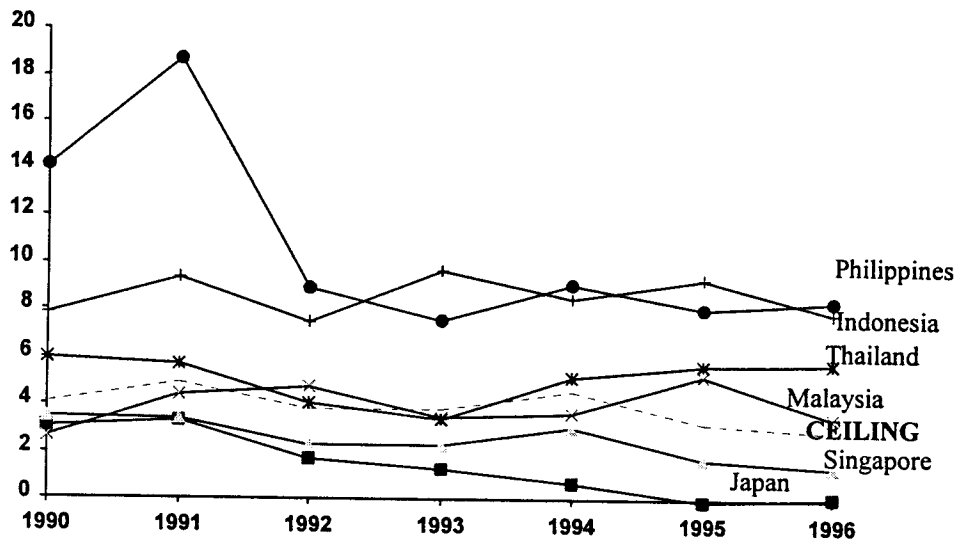
By contrast, governments and national constituencies in Asia are by and large cast in the role of competitors for trade and investment, and continue to perceive themselves to be so. (The major direction of trade flows away from the region is only one manifestation.) Differences in political systems and social ideologies also stand in the way of agreement over the design of what may be considered a fair and equitable regime of transfers and compensation from supranational institutions. Where trust and solidarity are in short

¹³ This phenomenon of context- or menu-dependent choice was noted, among others by A.K. Sen to explain the value of freedom of choice.

supply (as well as the mechanisms to foster them), separate currencies and monetary and fiscal autonomy are unlikely to be surrendered.

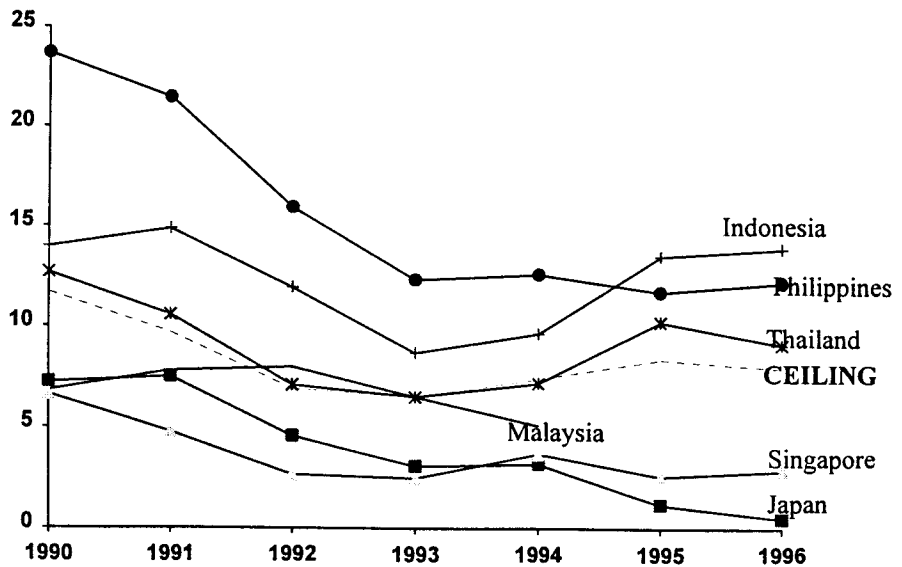
To return then to the original question whether a common currency could have saved Asia, the answer is probably a cautious "yes" in principle. Unfortunately, however, the conditions needed to turn principle into reality are more complex and are unlikely to emerge for some time.

Figure 1
Inflation rates
(in percent)



Note: Inflation ceiling is 1.5 percentage points above inflation in the three best-performing ASEAN members (Singapore, Malaysia, Thailand).

Figure 2
Interest rates
(in percent)



Note: Interest rate ceiling is two percentage points above the average of interest rates in Singapore and Thailand.

Figure 3
Ratios of fiscal deficits to GNP
(in percent)

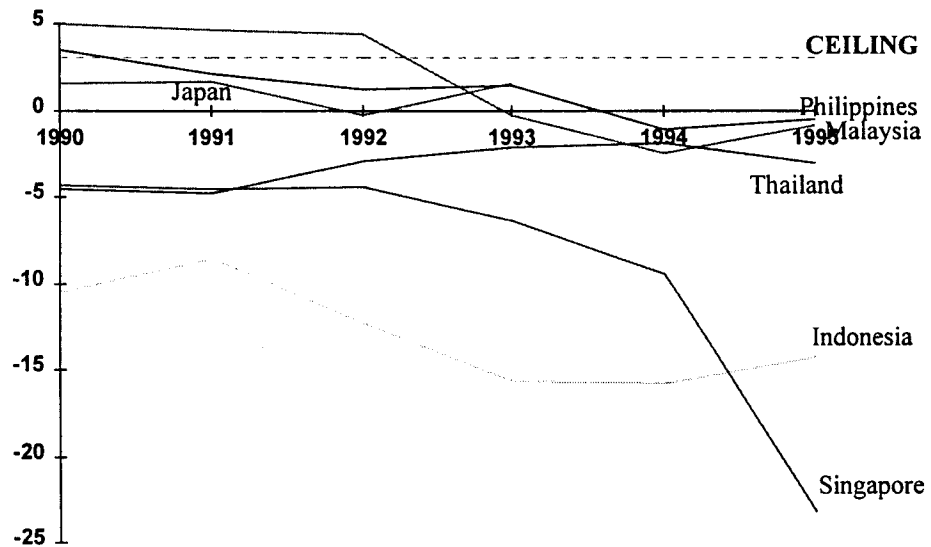
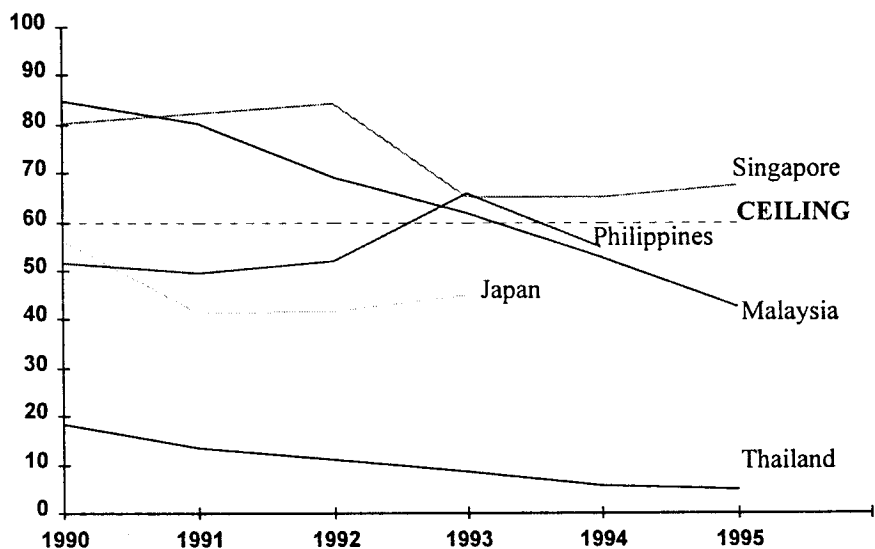


Figure 4
Ratios of public debt to GNP
(in percent)



Note: Figures for Indonesia are out of range and are not displayed. Please refer to Appendix Table 5 for actual figures.

Appendix Table 1

Regression Results:
Dependent Variable: Output (GDP) Growth
(t-statistics in parentheses)

	Minus- Singapore	Minus-Malaysia	Minus-Thailand	Minus- Philippines	Minus-Indonesia	Minus Japan
Constant	0.029465 (2.768049)	0.032602 (3.109910)	0.027989 (2.440810)	0.035883 (4.168208)	0.032315 (2.919986)	0.041877 (3.274925)
Annual growth of exports of goods and services	0.184441 (3.467910)	0.207683 (4.371218)	0.191278 (3.484425)	0.187958 (4.803249)	0.202317 (4.258793)	0.177624 (3.634011)
Percentage change in national government budget	0.001948 (1.053034)	0.003905 (1.422372)	0.001646 (0.868079)	0.001568 (1.065748)	0.003214 (1.681644)	0.000840 (0.426884)
Annual growth of money supply (M_2)	0.043465 (0.874233)	0.011535 (0.234313)	0.042003 (0.908363)	0.065263 (1.663582)	0.019188 (0.350684)	0.004809 (0.096935)
R-squared	0.313919	0.395005	0.299281	0.458496	0.407031	0.248118
Adj. R-sq.	0.263718	0.350737	0.246727	0.418874	0.362558	0.195661
S.E. of regression	0.027434	0.026684	0.026703	0.021508	0.026619	0.026901
Log likelihood	100.0607	101.3090	99.07456	111.0121	99.21401	105.3330
D.W. stat	1.080048	1.144424	1.080973	1.518367	1.130717	1.037280
Akaike info criterion	-7.107241	-7.162724	-7.159448	-7.593971	-7.165786	-7.149920
Schwartz criterion	-6.946649	-7.002131	-6.997249	-7.433379	-7.003587	-6.992460
F-statistic	6.253242	8.923054	5.694748	11.57169	9.152372	4.729945
Prob(F-statistic)	0.001352	0.000114	0.002412	0.000013	0.000098	0.006130

Source: IMF, IFSY 1997
Econometric Program: Eviews v. 1.1c (1994)

Appendix Table 2
Progress towards hypothetical inflation convergence
(in percent)

Year	Target	Japan	Singapore	Malaysia	Thailand	Philippines	Indonesia
1990	4.1	3.1	3.5	2.6	6.0	14.1	7.8
1991	4.9	3.3	3.4	4.4	5.7	18/7	9.4
1992	3.8	1.7	2.3	4.8	4.1	8.9	7.5
1993	3.8	1.3	2.3	3.5	3.4	7.6	9.7
1994	4.6	0.7	3.1	3.7	5.2	9.1	8.5
1995	3.2	-0.1	1.7	5.3	5.7	8.1	9.4
1996	2.9	0.1	1.4	3.5	5.8	8.4	7.9

Appendix Table 3
Progress towards hypothetical interest-rate convergence
(in percent)

Year	Target	Japan	Singapore	Malaysia	Thailand	Philippines	Indonesia
1990	8.81	7.24	6.61	6.81	12.73	23.67	13.97
1991	6.76	7.46	4.76	7.83	10.58	21.48	14.91
1992	4.74	4.58	2.74	8.01	7.06	16.02	11.99
1993	4.50	3.06	2.50	6.53	6.49	12.45	8.66
1994	5.68	3.20	3.68	5.07	7.17	12.71	9.74
1995	4.56	1.21	2.56	--	10.28	11.76	13.64
1996	4.93	0.47	2.93	--	9.16	12.34	13.96

Appendix Table 4
Progress towards hypothetical fiscal deficit-GNP criterion
(in percent)

Year	Target	Japan	Singapore	Malaysia	Thailand	Philippines	Indonesia
1990	3.0	1.57	-10.53	4.98	-4.59	3.47	-4.29
1991	3.0	1.71	-8.58	4.60	-4.77	2.10	-4.53
1992	3.0	-0.32	-12.35	4.47	-2.88	1.16	-4.43
1993	3.0	1.56	-15.67	-0.23	-2.12	1.46	-6.36
1994	3.0	--	-15.81	-2.50	-1.89	-1.04	-9.53
1995	3.0	--	-14.26	-0.87	-3.04	-0.52	-23.30
1996	3.0	--	--	--	--	-0.29	--

Note: Negative entries denote surpluses.

Appendix Table 5
Progress towards public debt-GNP criterion
(in percent)

Year	Target	Japan	Singapore	Malaysia	Thailand	Philippines	Indonesia
1990	60	56.13	80.35	85.02	18.62	51.58	481.1
1991	60	41.29	82.41	80.48	13.50	49.44	423.0
1992	60	41.87	84.41	69.40	11.07	51.88	448.6
1993	60	45.17	65.06	61.95	8.53	65.97	379.9
1994	60	--	65.17	52.81	5.90	55.00	323.5
1995	60	--	67.72	42.77	4.82	--	--

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