1. Introduction

1.1 PURPOSE AND SCOPE OF THE BOOK

East Asian economies have been growing rapidly and are likely to lead the world economy as the new locomotives, replacing the US and EU, two regions which are still suffering from the fallout from the global financial crisis. Greater economic openness and globalization are the key factors in the rise of the East Asian economy as a pole of economic growth. Despite this remarkable performance, however, East Asian economies are not immune from economic turbulence caused by global and regional financial crises. This has led many East Asian countries to search for collective remedial solutions and to intensify regional economic cooperation. Along with globalization, there is increasing regionalization in East Asia. East Asian economies are currently facing three challenges.

The first challenge is to construct a zone of sustained economic growth, amid the long and gradual decline of the US economy. The US has been the main East Asian export market and has played a dominant role in the ‘East Asian miracle’, headed by Japan and followed by the Asian tigers (Korea, Taiwan, Singapore and Hong Kong), then by the ASEAN economies, Malaysia, Thailand, Indonesia, and the Philippines, and finally by China. Compared to the past when the US absorbed more than half of East Asian countries’ exports, however, the influence of the US on the East Asian economy has been declining rapidly and it currently absorbs only 15 per cent of East Asian countries’ exports. Considering the recurring huge trade imbalances of the US economy, it is clear that the US will no longer be a main engine for the growth of the East Asian economy. The East Asian region itself will be a new pole of economic growth and this will lead East Asian economies to strengthen their economic ties among themselves and, in particular, with China. Increasing regional economic integration in East Asia will inevitably contribute to a significant reshaping of the global economic and monetary order.

The second challenge is to prevent financial crises and ensure economic stability. East Asian economies have an inherent weakness of being overly exposed to external shocks, because their growth is based on an export-oriented strategy. This weakness was demonstrated by two recent
Asian monetary integration

financial crises. When the Asian financial crisis occurred in 1997, East Asian countries recorded negative economic growth and experienced severe social problems. This painful memory is still vivid in the minds of many East Asians. For them, the crisis was triggered by a sudden outflow of volatile short-term capital and the consequences were compounded by the large sums owed to creditors and the inappropriate rescue policies of the international organizations such as the IMF. This led to the first strong awareness of the need for regional monetary and financial cooperation. In 2008, when the America-born global financial crisis spread throughout the world, the region was again very severely stricken by the crisis, experiencing a big drop in growth rates. The global financial crisis shows that East Asian countries can suffer from a financial crisis regardless of its origin, and that unless the risk of volatile capital flows is resolved, they can be victims of an international financial crisis at any time. To protect themselves from these recurring financial crises, many East Asian countries made strenuous attempts to acquire resilient and high-performing economic structures. Individual efforts are insufficient, however, because no matter how well East Asian countries are internally prepared, they are not strong enough to be able to stand alone against global shocks in the globally-integrated world. Many commentators were led to conclude that East Asian governments should take steps to create a zone of monetary stability to insulate them better from these extraneous influences.

The third challenge is the necessity to share the fruit of economic growth and prosperity. A pessimistic view seems to prevail to-date in relation to the possibility of regional cooperation in East Asia (e.g. Eichengreen, 2002). The reason given is that East Asian economies are too diverse and different in their degrees of development and income levels. The wide income divergences, for instance, can generate political tensions among East Asian countries, leading to the isolation of the economically-depressed regions or countries from the prosperous ones. This will thwart all attempts to further regional economic integration and construct a zone of monetary stability. Thus, East Asian countries will have to endeavour to reduce the regional economic and social disparities that exist among them and thereby nurture regional cohesion and solidarity.

This book attempts to examine how East Asian economies could establish their own zone of monetary stability. It is clear, however, that monetary stability cannot be addressed separately from the issues of economic growth and solidarity. Without economic growth and solidarity, there would be no purpose in pursuing monetary integration. All three challenges should be simultaneously addressed. Against this backdrop, this
Introduction

book tries to address the issues of East Asian monetary integration in the broad framework of economic growth and solidarity.

Many proposals of varying scope and ambition for monetary and financial cooperation have been put forward both inside and outside the region. In particular, as the issue of East Asian monetary cooperation became urgent after the 1997 currency crisis, there have been many studies conducted in this regard (for instance, by Park and Wyplocz, 2010; Ito, 2009; Henning, 2002; and de Brouwer, 1999). Despite such an increase in interest, however, these studies were fragmentary and incomplete. They are not comprehensive enough to address all aspects of Asian monetary integration covering its history and future outlook. This book thus tries to seek, from a broader historical perspective, a feasible way for East Asian monetary and financial integration to occur that would fit well with the present and future circumstances of the region. Specifically, this book examines past East Asian monetary integration experiences, analyses and reviews the current conditions and ongoing efforts for monetary integration, and proposes some ideas towards achieving eventual Asian monetary union.

The main arguments of this book are as follows. First, the book emphasizes that history is important. In fact, monetary integration in East Asia is not unprecedented. Historically, East Asian countries belonged to a large natural monetary union linked by silver currencies, in particular the Spanish and Mexican silver dollars. This proves that East Asian monetary integration is not too unrealistic a project. Monetary integration can be realized, once the necessary economic and political preconditions are met.

Second, this book focuses on the endogeneity of the monetary integration process. As Frankel and Rose (1998) argued, the conditions required for monetary integration do not always exist at the beginning of the integration process, but may subsequently come into existence; that is higher monetary integration may improve the integration conditions, and in turn make regional countries more suitable for monetary integration. Thus, although the conditions for monetary integration are relatively unfavourable in East Asia compared to the EU, it does not necessarily mean that East Asia is less suitable for collective monetary arrangements, because those criteria evolve over time with the process of monetary integration. It is likely that the integration process itself will turn the region into an optimum currency area. Of course, there are many barriers to East Asian monetary integration which still persist. However, they are barriers that could be reduced with East Asian economic integration, depending upon how East Asian countries react in relation to a regional arrangement. Thus, the important issue is not how monetary integration will fit in with the current conditions but how to make the process move forward.
Asian monetary integration

Third, this book reviews current efforts at East Asian monetary and financial integration. Although progress is rather slow, there have been some remarkable achievements. In particular, the multilateralization of the Chiang Mai Initiative (CMI) currency swap facility is one important step toward the creation of an Asian Monetary Fund (AMF). To evaluate these achievements and proposals properly, it would be helpful to compare the similarities and differences between East Asia and Europe. Clearly, there are many European achievements that East Asia can emulate. The replication of the successful European Monetary System can be one such goal. Of course, East Asia is not Europe, and many people think that East Asian monetary integration will be very difficult to achieve. For instance, while the process of European integration deepens because of the highly interdependent structure of European economies, the push for an East Asian monetary and financial arrangement is less likely to do so because of the relatively lower degree of intraregional transactions among East Asian countries. Furthermore, while the process of European integration was propelled forward through the creation of strong supranational institutions, there are no equivalent institutions in East Asia because East Asian governments are reluctant to delegate power to supranational bodies (Eichengreen, 2002; Yoon, 1999). However, East Asia is changing and ‘East Asia may be on the brink of a historical evolution’ in integrationist thought and policy, not unlike that of Europe half a century ago (Bergsten, 2000).

Finally, the book highlights some challenges to be overcome if East Asian countries are to realize monetary and financial integration. As pointed out, East Asian economies face three challenges: economic growth, monetary stability and regional solidarity. This book emphasizes that monetary integration cannot be achieved without strengthening the other two pillars of integration. Thus, to realize a zone of monetary stability in East Asia, East Asian economies should first of all deepen their institutional cooperation structures in order to further their real regionalization and economic growth. Second and more importantly, East Asian economies should pay attention to regional cohesion, because the eventual goal of East Asian monetary integration should be to share in the prosperity of the region through establishing a zone of economic growth and monetary stability. Indeed, this lack of solidarity explains why the Japanese attempt to integrate Asian economies under the auspices of the yen bloc before and during the Second World War was bound to fail. Last, but not least, this book ends up by highlighting the importance of political leaders having vision and will, and of the existence of a regional identity as essential ingredients in framing a successful East Asian monetary integration.
1.2 ORGANIZATION OF THE BOOK

This book is divided into four parts, even though the individual parts are not specifically numbered. The first part consists of two chapters and introduces the historical experience of currency blocs in East Asia. Chapter 2 shows that silver currencies circulated as the main media of exchange in all parts of Asia, and that thus there was already a natural currency zone in East Asia with the silver dollar as a unit of account even before the nineteenth century. In contrast, Chapter 3 gives a case study of the past experience of monetary integration in East Asia, implemented by Japan from 1937–45. This experience suggests that when a leading country acts in a predatory, self-interested manner, regional economies disintegrate and the integration moves against the endogeneity process.

The second part consists of three chapters and addresses the background to the issue of monetary integration in East Asia. Chapter 4 provides an overview of the East Asian economy since the 1980s and identifies key factors that have changed its landscape. A clear understanding of the development of the East Asian economy is important in order to figure out how it has been transformed along with its rapid expansion and its severe crises. In Chapter 5, the suitability of conditions for monetary integration in East Asia is evaluated, basically in terms of countries’ economic prospects, and it shows that despite some barriers, there are good reasons for promoting East Asian monetary integration on economic grounds. Chapter 6 explains what forces drive the necessity for a regional collective monetary arrangement in East Asia. The chapter highlights that monetary cooperation is needed not only to cope with external challenges but also to resolve internal problems in East Asian countries and conflicts among them.

The third part critically evaluates existing proposals regarding East Asian monetary and financial integration. Chapter 7 examines the main features of these proposals and compares their strong and weak points. When proposals are evaluated, particular focus is placed on two aspects: whether they fit the current status of the East Asian economy, and also, whether they fit the future path of monetary integration by promoting endogeneity. Chapter 8 changes the focus of interest from the monetary side to the financial side, and demonstrates how financial cooperation can be utilized as an alternative strategy for circumventing deadlocks in monetary and exchange rate cooperation and thus facilitating continuing regional cooperation. Chapter 9 explores the idea of a regional currency unit (RCU), what form it should take and how it should be utilized to promote regional monetary and financial integration.

Finally, the last part discusses the prospects for East Asian monetary
integration and the barriers that need to be overcome to realize it. Chapter 10 provides some lessons for East Asian monetary integration, relying on the European experience. Considering the many barriers remaining, it is essential for East Asian to have a buffer period of an Asian Monetary System before moving to a Monetary Union. Chapter 11 ends the book with a discussion of what East Asian countries should do to overcome the barriers and to achieve successful monetary arrangements in the region.