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Mit czy rzeczywistość?

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MONETARY INTEGRATION OF EAST ASIA STATES

1. Introduction

Establishment of the Economic and Monetary Union as well as replacement of national currencies with euro in still growing number of European Union's states resulted in situation, when many regions of the world start thinking of, or intensify works over regionalization process. According to D. Rodrik,[1] states in which total adjustment on the goods markets, service markets and productive inputs occurs should consider the opportunity for international economic integration. In S.M. Hashim's[2] opinion the above declaration was inspiring enough to try to integrate the East Asia region. Previously, this region was characterized by an absolute separation of states belonging to this area, in particular, in terms of multiplicity of cultures and ideologies, but also because of different economic interest and their economic policies. It was really hard to observe cooperation between states of the region in terms of goods and services trade, investments or in financial sector. These factors constituted a natural barrier for economic integration of the East Asia. The financial recession 1997-1998 resulted in a situation, where authorities of the region noticed a need for economic integration which would enable solving current problems the states of East Asia must face as well as to prevent or reduce problems in the future. It is worth showing that the contemplated area is in possession of natural resources, capital and human resources necessary for economic development. Moreover, particular markets are close to each other while the region itself has similar traditions, accepted norms and culture, which makes the states of the

[1] D. Rodrik, *How Far Will International Economic Integration Go?*, "Journal of Economic Perspectives" 2000, Vol. 14, No. 1, p. 180.

[2] S.H. Sharim, *Towards East Asian Economic Integration*, "European Journal of Economics, Finance and Administrative Sciences" 2008, Issue 12, p. 116.

region to head for strong cooperation and exchange. However, it does concern not only the economic and political sphere, but also mutual safety, education, environment and culture. A significant factor deciding on the willingness of integration between the states of the East Asia region were different economic relations between states from other continents, such as NAFTA, European Union or African Union.

The purpose of this article is to characterize the integration process of states of the East Asia region, in particular, monetary integration. The author uses commonly used convergence criteria, analyses the economic situation of the region's states and rates the preparation level and opportunities for introduction of common currency in these states.

2. East Asia integration efforts

The first organization called into being for regional cooperation was Association of South East Asia (ASA), established in 1961 by the Philippines, Malaysia and Thailand. Unfortunately, the conflict for Sabath[3] caused the failure of perspective for cooperation and suspension of all operations. In 1966 a group much larger than the ASA was established, called Asian and Pacific Council – ASPAC. Accession of China to the organization resulted in its collapse in 1975. Similarly unsuccessful initiative was MAPHILINDO, an organization set up by Malaysia, Philippines and Indonesia, which promoted the idea of Malaysian Union.[4] A good step towards the integration was, set up in 1967 by five states, political and economic organization ASEAN (Association of South East Asian Nations), whose goal is acceleration of economic, social and culture growth in the region and promotion of peace and stabilization in the territory of associated states. Currently, the number of members amounts to ten. First commercial agreements among Asia states entered into force in 1980. However, by ASEAN's initiative in 1992 the Asian Free Trade Agreement (AFTA) was signed. Since that time the states have started liberalization of the international trade, reducing barriers for import and lowering amounts of duties.

Another form of cooperation of Asia and Pacific states can be observed within APEC (Asia-Pacific Economic Cooperation). The organization was set up in 1989, to eliminate customs-barriers, to promote technological cooperation and to head for more tight economic integration as well as to support economic growth and a square share.

Asia follows Europe and the European Union in terms of its integration. However, it faces a lot of obstacles which European economy did not have to face. For instance, Europe is more "compact" in size and states which want to integrate usually border each other. It makes the distances between member states short and, in

[3] North-East area of Borneo Island.

[4] K.A. Nawrot, *Determinanty rozwoju gospodarczego państw ASEAN*, Scholar, Warszawa 2008, p. 76.

turn, it makes import and export of goods between member states simpler. Next problem there is political system and economic situation of many Asian states. At the moment the European Union was set up and in the years following its extension, member states and states-candidates could be called free-market economies or transforming economies. In case of Asian states there is a large incoherence between economies. There are typical open economies, communism economies, transforming economies as well as economies which must "fight" against geographical isolation and limited market. Taking the above-mentioned differences into account, more and more often it is said that Asian integration is performed in sub-regions. Three main regions, called sub-regions, are distinguished: East Asia, South Asia and Middle Asia, from which the most integrated economies are East Asia.[5] Concept of the cooperation on the sub-regional level seems to be the most logical and possible to achieve because of the above-described diversification of economies of the region. Therefore, economies may integrate with different speed, realizing other adjustment programmes.

Asian Development Bank (ADB) is an institution directly engaged into the integration of Asian states, whose superior task is creation of new ways for regional cooperation and being a financial partner for states of the region. In 1994 this bank has started a realization of a regional strategy for cooperation and integration (RCI)[6] in Asian states. Tasks to be completed within described strategy focus on four priority fields:[7]

- creation of regional/sub-regional economic programmes, directed into infrastructure,
- development of trade and cooperation in terms of investments as well as Asian states integration,
- financial cooperation and monetary integration,
- RPG – cooperation within regional public utilities, that is taking care for environment, natural disasters management, use of "green" energy and increase of its share, arrangement of informative campaigns about HIV and drugs.

The above described fields for activity constitute four basic columns for activity within the realization of the RCI strategy. RCI superior goal is reaching satisfying results for all Asian states. Making the cooperation between the states more tight will enable the realization of the tasks, which for single economic units would not be possible to complete. Further analysis made by the author shall concern the third column which focuses on tasks related to financial and monetary cooperation.

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[5] H. Kuroda, *Developing through Cooperation. Perspectives on Economic Cooperation and Integration in Asia*, Integrating Asia, Winter 2007, p. 33.

[6] *The Regional Cooperation and Integration (RCI) Strategy.*

[7] *Regional Cooperation and Integration Strategy*, Asian Development Bank, July 2006, p. 11.

3. Monetary and financial integration of East Asia

Despite the fact that East Asia is recognized to be the most integrated region in terms of economy in the whole Asia, this region has just started the cooperation within monetary policy and the financial sector. The RCI third column assumes – in Asian states – integration and development of financial states, achievement of regional macroeconomic and financial stability and stabilization of currency exchange rates. In the recent years it has been observed that the access to financial markets of the East Asia is simpler, just because of deregulation on the financial market, liberalization of law concerning the capital inflow as well as restriction on control over currency issues. Foreign financial operations made by commercial banks of developed states and portfolio investments made the regional cooperation on financial markets tighter. However, when comparing the financial cooperation in the field of the portfolio investments in East Asia and in other regions of the world, it can be stated it is quite limited. Internal flow of the portfolio investments in the East Asia region in 2007 amounted to just 7% of total world flows. To compare, the same index for European Union amounted to nearly 70%.[8] Consequently, one can declare that despite the fact that barriers for investments in the financial sector of Asian economies have been reduced recently, there still are difficulties in terms of financial capital flows. In particular, the situation concerns ASEAN states with low revenues, in which there are valid rigorous provisions. The controls are conducted quite often, what discourages potential investors. Developed states do not consider these economies to be attractive in terms of capital investments, since they are still recognized to be poorly developed. Asian investors locate their capital in North America and in Europe mostly, and they rarely invest in East Asia.

In the opinion of many economists a turning point for creation of the integration of Asian states, in particular in terms of finances, was the Asian recession which occurred between 1997 and 1998, and the implementation of common currency in the member states of the European Union. Since that moment there have been commenced intensive works over Asian Monetary Union (AMU) with common currency. Another recession in 2007 proved again that such cooperation must be provided in order to protect these states from future recessions. It was found out that there must be used European sample which is the model of the Economic and Monetary Union since the Union resulted in European success and enabled implementation of the common currency in many member states. There was invented an idea of creation of AMU central bank there, which would be an independent institution watching for price stability in Asian economies. Moreover, monetary policy should stimulate economic growth of states and assure stability on financial markets. Similarly, like in the case of the European Economic and Monetary Union,

[8] *Coordinated Portfolio Investment Survey*, International Monetary Fund, December 2007.

there should be implemented convergence criteria, on the basis of which decision would be made whether a state can join AMU or not. Such criteria would concern fiscal sphere, monetary and economic spheres of economies-candidates. Asian ASEAN states assumed creation of a unified market by 2015, which will be an important phase of Asian Monetary Union[9] creation process.

4. Convergence criteria for East Asia

Convergence criteria established in Maastricht Treaty for states-candidates for Economic and Monetary Union show macroeconomic convergence of economies. However, they do not constitute a part of criteria specified in the theory of optimal currency area – OCA – invented by R. Mundell, R.J. Kinnon and P.B. Kennen in 1960s. Their creators separated criteria which should be met in order to treat an area as OCA. These criteria are:[10] low asymmetry of shocks suffered by regions of a particular zone, flexibility and mobility of workforce, rigid exchange rates, which are favourable for states characterized by mutual openness, diversification of production and export structure; similar rate of prices growth in states which belong to a monetary union, high level of financial integration and low inconstancy of real currency exchange rate. Despite the fact that the level of macroeconomic convergence of economies, which are willing to create a monetary union, is not obligatory condition according to Mundell's theory, meeting these criteria is of significant meaning when states want to join one monetary area such as the Economic and Monetary Union in Europe. This opinion is also supported by the fact that it will be difficult to create one currency and implement it into states, where there are different inflation rates, levels of budget deficit and economies are different in terms of the economic growth rate.

Table 1 presents macroeconomic indices for regions of East Asia verified by Economic and Monetary Union. Convergence criteria established in Maastricht, in terms of the inflation rate, interest rate, budget deficit and public debt reflect the level of convergence between states and other members of the Economic and Monetary Union. Analyzing the presented data one can conclude that states of the East Asia region, at the end of 2007, are not characterized by macroeconomic convergence. Analyzing required inflation criterion, due to which the inflation rate should not exceed 1.5 percentage point from the average of three states with the lowest inflation rate, it can be calculated that this average in 2007 amounted to

[9] *EMU: A role model for an Asian Monetary Union?*, Deutsche Bank Research, Financial Market Special, EU Monitor 61, November 28, 2008, p. 1.

[10] E. Wojnicka, *Spory wokół teorii optymalnych obszarów walutowych*, "Ekonomista" 2001, No. 1, and K. Biegun, *Kryteria optymalnego obszaru walutowego w rozszerzonej Unii Europejskiej*, [in:] A. Manikowski, A. Psyk (eds.), *Unifikacja gospodarek europejskich: szanse i zagrożenia*, Wydawnictwo Naukowe Wydziału Zarządzania UW, Warszawa 2004.

0.73% and, consequently, 9 of 16 states would not meet this criterion. Also in case of interest rates there are noticeable differences between states of the region. Because of the lack of complete data from all states, running the simulation for convergence is impossible. However, level of interest rates for long-term deposits fluctuates from 0.38% up to 8.80% which proves large variability.

Table 1. Macroeconomic indices for states of East Asia in 2007 (in %)

Country	Public sector debt % of GDP ($P < 60\%$ GDP)	Fiscal balance general government % of GDP ($F < 3\%$ GDP)	CPI inflation rate % ($I < 2.23\%$)	Interest rate	
				rate on time deposit of 12 months %	lending rate %
Japan	162.5	–3.2	0.1	0.38	1.88
China	17.3	0.7	4.8	3.29	7.47
Hong Kong	1.7	7.2	2.0	2.80	6.75
Korea	33.3	3.8	2.5	5.17	6.55
Taipei, China	34.9	–0.3	1.8	2.40	4.31
Singapore	–	9.0	2.1	0.83	5.33
Brunei Darussalam	–	12.8	0.3	1.14	5.50
Cambodia	–	–1.2	5.9	7.05	16.18
Indonesia	35.7	–1.2	6.2	8.20	13.86
Lao PDR	–	–2.7	4.5	–	30.00
Malaysia	55.6	–3.2	2.0	3.70	6.41
Myanmar	–	–	33.9	–	17.00
Philippines	62.3	–0.2	2.8	3.10	8.69
Thailand	37.5	–1.7	2.2	2.32	7.05
Vietnam	43.0	–5.4	8.3	8.80	11.18
India	–	–2.9	6.3	8.40	13.02

Public sector debt refers to consolidated government debt except for Indonesia and Korea, while the Philippines refer to non-financial public sector debt.

Sources: *International Financial Statistics*, ADB, Key Indicators, IMF, 2008.

Stability of public finances of the East Asia region can be checked using two other convergence criteria which are: the budget deficit rate and the public debt. Value of the first mentioned criterion should not exceed 3% of GDP. The states of the contemplated region mostly have budget excess. Only Vietnam, Malaysia and Japan would not meet this condition at the end of 2007. The rate of the public debt – as the second criterion for public finances – should not exceed the 60% of GDP level. From available data for Asian states presented in Table 1 it results that the largest debt rate in 2007 was assigned to Japan (162.5%), above the required norm were Philippines and Malaysia. Unfortunately, 6 states of this region do not make such data available and consequently, objective assessment is very difficult in this case. Moreover, none of exchange rate is a stabilizing mechanism in the region, which confirms the conviction that these states do not show macroeconomic convergence necessary to commence a construction of common monetary union.

Taking into consideration the structural convergence of states of the East Asia region to which there can be included similarity of states in terms of industry's structure, development of financial sector, openness for foreign capital or reached GDP level *per capita*, it can be concluded that, despite the fact that criteria are not met for optimal monetary areas, a state without strong structures and solid economic basis cannot specify its exchange rate in relation to a currency of a state with strong structures and foundations. Thus, states of the East Asia region should – firstly – complete necessary structural and institutional reforms, which will strengthen economic and structural basis and will result in macroeconomic states' convergence in the future.

5. Conclusions

The above analysis showed that the East Asia region's states have not reached macroeconomic convergence so far, at least, not so significant which would enable creation of an economic and monetary union. Obviously, there are made efforts in order to create Asian Monetary Union, however, forecasts say the creation of such a union is quite distant. Referring once again to criteria for an optimal monetary area it can be stated that these criteria assure easy functioning of a monetary union, they level occurrence of asymmetric shocks, even if it is not possible to be met totally and simultaneously. That is why creation of a monetary union and implementation of common currency is different from the theory of monetary area in some fields and ways of realization. Moreover, in Frankel's[11] opinion, creation of a monetary union with one currency stimulates the trade integration of states. In practice, it usually means that states integrated within trade and other relations have better chance to create a monetary union.

More and more often five ASEAN states' cooperation is discussed. These states are: Indonesia, Malaysia, Philippines, Singapore and Thailand. In 2007 these states were the most dynamic economies in the region and forecasts show that in these states the economic growth will amount to 4-6%. However, there is no convergence at the inflation rate level, which is very different between these economies, and there are no perspectives for stabilization in the nearest future. These states also suffer from lack of mobility of productive inputs, either to other states of the world or between them. Economic Union of ASEAN promotes mobility of capital and workforce, however, the intended purpose in practice is possible to be

[11] J.A. Frankel, *On the euro – the first eighteen months*, Deutsche Bank Research, EMU Watch No. 87, Frankfurt am Main 2000.

reached in 2015. An obstacle to integrate the states is constituted by size of the states (large Indonesia and small Singapore), or wealth of society (the largest for Singapore). For a change, Indonesia and Philippines are attractive in terms of work costs, while Malaysia and Thailand are characterized by educated work force and relatively high remuneration, because of significant input of these states into the world industry, in particular, electronic equipment industry and automotive industry. Because of severe law and high standard for governing, Singapore is associated with a world financial centre.

Cursory review of the basis criteria for creation of an optimal monetary area and negative assessment of the East Asia states in terms of convergence criteria derived from Economic and Monetary Union of Europe makes basis for opinion that it is too early for monetary union for Asian states. These states are on a good way heading for meeting requirements and should use trade integration at first as well as make cooperation tight. It will be a first step towards integration, also monetary. It is also important to perform reforms, in China and in ASEAN states. Averagely wealthy states of the region must reform their economies quickly and face growing world-competition from the side of other states, in particular China. When these tasks will have been completed, creation of AMU – Asian monetary union can be commenced.

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INTEGRACJA MONETARNA KRAJÓW AZJI WSCHODNIEJ

Streszczenie

Azja wzoruje się w swojej integracji na Europie i tworzeniu przez nią Unii Europejskiej. Napotyka jednak w swoich działaniach wiele przeszkód, z którymi nie miała do czynienia gospodarka europejska. Celem artykułu jest próba scharakteryzowania procesu integracyjnego państw regionu Azji Wschodniej, ze szczególnym uwzględnieniem integracji monetarnej. Autorka, wykorzystując powszechnie stosowane kryteria zbieżności, analizuje sytuację gospodarczą krajów regionu i ocenia przygotowanie oraz możliwości wprowadzenia w tych państwach jednej wspólnej waluty.