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A currency union is not what Asia needs
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A steady stream of European politicians and bureaucrats has flowed into east Asia to extol the virtues of European economic integration, with the strong implication that Asia should follow suit. Indeed, currency unification has become a central issue in economic discussions in the region. However, this seems an inappropriate and unhelpful distortion of priorities.

European economic integration might be seen in terms of three elements: the unified exchange rate; elements of supranational sovereignty; and a complex network of uniform rules.

It is understandable that east Asian policymakers should focus on the exchange rate component, given the failure of their exchange rate regimes in the crisis of 1997. Japan's attempt to promote the yen as an international currency has reinforced the idea. But this seems the wrong regional priority. In evaluating the euro, we might recall the judgment of Chou En-lai, the Chinese revolutionary, on the success of the French revolution: "Too early to tell." More substantively, the unified exchange rate certainly did not come quickly or easily.

At a more theoretical level, Europe is a better fit than east Asia to the economists' "optimal currency area", with more similar economic structures and resource endowments. In Asia, countries as intrinsically diverse as Japan and Indonesia seem unlikely candidates for currency union on any economic criterion. Exchange rate flexibility is not available to countries within a currency union. Yet it is one way to buffer against trade shocks, helping each country absorb these shocks as the terms of trade between industrial goods and resources shift. Finally, the failure in 1997 of quasi-fixed rates does not mean a unified exchange rate would be the solution.

If currency unification is not the logical basis of east Asian integration, then what is? Clearly the substantial passing of economic sovereignty to a central body is not on the agenda. What about the third element - the harmonisation of regulations to create a unified market in a more fundamental sense than simply removing tariff barriers?

Without wishing on Asia the pervasive rule-making of Europe, broad-brush rules convergence would seem a more fruitful source of co-operation than currency unity. We know from domestic experience that even free-market economies are not remotely like the economy of Adam Smith's invisible hand. At the domestic level, there are pervasive rules that govern economic relationships and without these, transactions would be complex, uncertain, and unenforceable. International transactions happen within a much lighter institutional framework, and are consequently more risky. How will an exporter enforce a transaction, or the importer know the quality of goods being delivered? Who will ensure that markets remain competitive?

Much remains to be done in setting down the global rules of international economic relationships. Some of these rules can be written in multilateral forums - such as the Basel rules for banking. But the need for a high degree of unanimity among a large number of players limits what can be done multilaterally, and agreement will be more feasible either bilaterally or, better still, regionally.

East Asia could benefit from common (or at least co-ordinated) rule-making in many areas such as investment, consumer protection and intellectual property. These rules will sometimes be codes of behaviour, agreed between the parties; sometimes the rules will be incorporated into the laws and regulations of the participating countries. This would not only support greater global integration, but would upgrade Asia's domestic regulatory infrastructure, with "best practice" rules drawn from international experience replacing inadequate home-grown ones.

Does this infringe domestic sovereignty? No doubt it would require domestic legislation in some cases, but this is not so much a case of diminished sovereignty as of adopting a set of superior rules.

It might seem bold to offer the Australian/New Zealand experience as being more relevant to east Asia than the European model, but it may at least provide a counter-weight example. These two economies have become, essentially, fully integrated, without currency union and without loss of sovereignty or national character. No single model will suit the unique circumstances of east Asia, but a focus on developing a region-wide framework of rules covering trade and investment would seem a more promising endeavour than currency unification.

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