

Printing Instructions: Select **File** and then **Print** from your browser's menu

--- Article Information ---

This article was printed from [www.theedgedaily.com](http://www.theedgedaily.com).

Article's URL: [http://www.theedgedaily.com/cms/content.jsp?id=com.tms.cms.article.Article\\_bed095db-cb73c03a-16a7c990-ed4de068](http://www.theedgedaily.com/cms/content.jsp?id=com.tms.cms.article.Article_bed095db-cb73c03a-16a7c990-ed4de068),

## My Say: Long road to Asian Monetary Union

By Saravanan Ramasamy

"A hen and a pig are negotiating to solve the food shortage. The hen makes a suggestion: 'I will supply the eggs if you will supply the bacon.' The pig ponders this for a moment and replies: 'But yours is a contribution, mine is a total commitment.'" (Kofi Annan)

The idea of an Asian Monetary Union in the foreseeable future may be absurd and, to a certain degree, echoes the sentiment of United Nations secretary-general Kofi Annan's allegory above.

Essentially, the Asian Monetary Union would require member nations to give up their unilateral monetary and exchange rate mechanisms for a common monetary and exchange rate mechanism.

But signs of Asian monetary and exchange rate cooperation are intensifying day by day.

Ironically, the Asian financial crisis increased economic disparities in the region, thus making monetary integration more difficult, but it also rekindled political interest in Asian monetary and exchange rate cooperation.

The apparent failures of international organisations such as the International Monetary Fund (IMF) to foresee the crisis and deal effectively with it led to renewed calls for some sort of regional monetary fund.

It is for this reason that leaders of Asian countries like Thailand's Prime Minister Thaksin Shinawatra and former Malaysian Prime Minister Tun Dr Mahathir Mohamad have always advocated some sort of regional mechanism of crisis management.

As a result, there has been a spate of post-crisis initiatives to explore monetary and exchange rate cooperation. In September 1997, much to everyone's surprise, Japan proposed an Asian Monetary Fund (AMF) to pool regional funds for quick disbursement in an emergency.

This proposal did indeed receive support from other potential creditor countries, such as Singapore and Taiwan. The idea was also welcomed at the political level by Malaysia and Indonesia.

However, the Japanese proposal was met with strong resistance from both Washington and the IMF. The latter, which is not very much independent of the former, objected on grounds that such a fund would merely duplicate the facilities available at the Fund itself. In addition, IMF claimed that the setting up of AMF would exacerbate the moral hazard problem as a regional lender of last resort.

"An Asian Monetary Fund would be a threat to the authority and the effectiveness of the IMF," said IMF's Stanley Fisher. US and IMF pressure prevailed and the idea of AMF was shelved.

The idea of an AMF may have been lost, but in what subsequently became known as the "Chiang Mai Initiative", the Asean+3 (China, Japan and Korea) agreed in principle to establish a pool of hard currency to be used in times of crisis and to explore the possibility of setting up surveillance machinery to anticipate future crisis.

The "Chiang Mai Initiative" took place on the sidelines of the Annual Meeting of the Asian Development Board (ADB) in Chiang Mai in May 2000. This initiative culminated in May 2001 at the ADB meeting in Honolulu, which dropped the idea of a pool of hard currencies but expanded the existing Asean repos (repurchase agreements) and swap arrangements to Asean+3.

To illustrate the mechanics of repos, if an Asean central bank which has signed a repo agreement with Japan wants to intervene to prevent depreciation of its currency, it can acquire US dollars from Japan to support its currency by selling US Treasury securities, with an agreement to reverse the transaction (repurchase the security) at a mutually agreed price and date. These repos enable the central bank to obtain US dollar liquidity at short notice.

Alternatively, the swap arrangement is essentially a spot sale/purchase of a currency and a simultaneous forward purchase/sale of the same currency. This enables countries to swap "soft" for hard currencies if the home currency is under attack.

In fact, it would not be far-fetched to state that the repos and swap arrangements consolidated in Honolulu constitute the beginning of a regional financing facility and is indeed a form of "embryonic" AMF.

The Asian monetary and exchange rate cooperation was taken to greater heights with the establishment of an Asian Bond Fund (ABF) which was initially proposed by Thaksin.

ABF came into force in June 2003 when 11 Asia-Pacific central banks created a regional fund of US\$1 billion by pooling a small portion of their foreign exchange reserves. The countries involved are Australia, China, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Singapore, Thailand, the Philippines and South Korea — all of which are members of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP).

In addition, India has confirmed its participation with an investment of US\$1 billion of its own reserves.

Unlike the AMF, why hasn't ABF met with any strong resistance from either Washington or the IMF? Is it because of the fact that ABF's investment is denominated in US dollars?

As a matter of fact, ABF is a passively managed fund by the investment management unit of the Swiss-based Bank of International Settlements (BIS Asset Management).

Its mandate is to invest in a basket of liquid US dollar sovereign and quasi-sovereign debt issued by major member economies (excluding Australia, Japan and New Zealand).

According to Ramkishan Rajan, Visiting Senior Fellow at Singapore's Institute of Policy Studies, the ABF could work as an insurance against another Asian crisis.

By and large, ABF promotes greater intra-regional financing and this ought to reduce the region's exposure to mass international "hot" capital outflow.

Furthermore, ABF essentially facilitates the diversification of financing from bank lending to bonds.

Bond financing is always considered to be relatively more stable than bank financing since the former is primarily more illiquid. Such diversification is essential for Asian economies which predominantly rely heavily on bank financing.

It may not be that rosy after all. ABF, in the current form, has got a major limitation. It deals with regional bonds in US dollar denominations. How would this help to reduce the region's vulnerability to uncovered US dollar borrowing?

A sharp depreciation in the US dollar will lead to a sharp decline in the country's net worth, argues Ramkishan.

In this vein, industry experts argue that it would be more relevant for ABF to invest in regional bonds issued in domestic currencies although such bonds have to offer higher yields to compensate for the currency risk.

If the primary motive of establishing the ABF is to act as an insurance against another Asian crisis, the higher yield should not be a major concern. Asia remains open to currency and liquidity risks that could cause a repeat of the currency crises of 1997.

The ABF is useless as a shield for Asian markets as long as it remains dollar-denominated and a passive investor.

Moving forward, Asian countries have to develop harmonised standards and practices to integrate the current fragmented national bond markets in the region.

"The region would not be able to reap the full benefits of efficient and vibrant bond markets as long as Asian bond markets remain fragmented," said Malaysia's Second Finance Minister Tan Sri Nor Mohamed Yakcop at the Kuala Lumpur International Bond Conference held last week.

In tandem with the abovementioned aspiration, Nor Mohamed said Malaysia intends to lengthen the bond yield curve towards 20 years in order to develop a deep, liquid and efficient domestic bond market.

However, this boils down to one important question. Will ABF, like AMF, face strong resistance from both Washington and the IMF if regional bonds in US dollar denominations are replaced with domestic currency denominated bonds?

Today, Asian central banks hold about 1.7 trillion in US dollar-denominated reserve assets.

Most of the world's international reserves come into existence as a result of the US' current account deficit.

Take that money away, and the US government may have problems financing its debt.

---

*Saravanan Ramasamy, on sabbatical from his job as a consultant, is currently pursuing his post-graduate studies at the National University of Singapore*

--- end ---