



Prospects for Asian Currency Unit (ACU)

Section One

The Experience of Europe by 1999 and its Lessons

Presenter

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Outline

- The effects and limitations of ECU for progressing European monetary integration
- The effects and limitations of ECU for promoting intra-regional trade and investment
- The lessons

The Effects and Limitations of ECU to European Monetary Integration

- Monetary integration: Defined by the irrevocable fixing exchange rates (or a single currency) and the highly coordinated monetary and fiscal policies among members.
- The birth of ECU: The EMS and its success in stabilizing the exchange rates
- The EMS: (1) bilateral obligation to sustain any parity, with a small range of fluctuation. (2) Unlimited duty of governmental intervention. (3) A consensus-based realignment. (4) The ECU as the anchor of the parity system.



- **The merits:**

- (1) A more symmetric design.
- (2) A strong mutual commitment

- **The Achievements:**

- (1) The convergence of inflation rates.
- (2) No realignment from 1987 to 1992.

- **The shadow:**

The convergences made the DM, rather than ECU, the substantial anchor

The causes of the 1992 crisis

- 1) The uncompleted convergence of inflation rates
- 2) The German austerity program after the reunification of East and West Germany
- 3) The liberalization of capital control in Europe
- 4) The global recession during the early 1990s
- 5) The voted down of the Maastricht Treaty by Denmark in 1992
- 6) Germany's retreat from its unlimited commitment to intervention

What lay behind the failure:

the lack of a proper coordination over monetary and fiscal policies, the lost of symmetry, and the burst of crisis

The Effects and Limitations of ECU for Promoting Intra-regional Trade and Investment

- Difficult to determine precisely to what extent the ECU had benefited the development of intra-regional trade and investment
- The adoption of ECU in the public and private sectors
- In general, the private ECU developed much better than its adoption in the public sector, however, the proportions of ECU denominated transactions in the private sector were relatively small

The passive role of ECU in the public sector

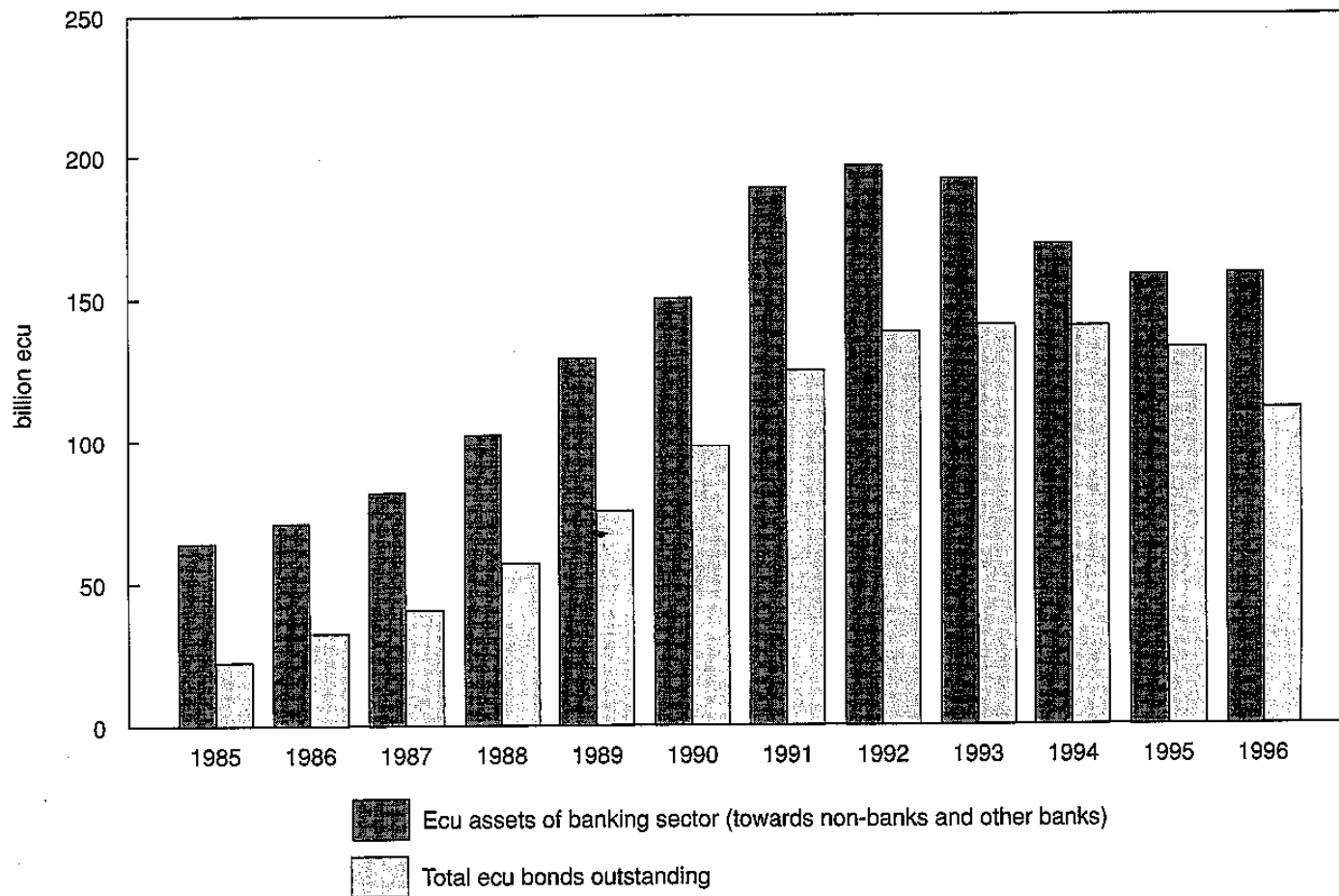
- 1) Far from a real currency of a monetary union.
- 2) The limited use of ECU in transactions by the central banks
- 3) Market conditions and regulatory concerns impeded the expansion of official ECU's role

The private ECU

- 1) Compositions: exactly the same with the official ECU
- 2) A considerable growth during the first decade: The third biggest one in the European bond market among all European national currencies



The ECU in International Finance



Note: Data for 1996, end of March.

Source: BIS. Adapted from Gros and Thygesen 1998: 246.

What drove the expansion?

- 1) A good choice for diversifying exchange-rate risk.
- 2) To gain more yield by eluding the national regulations.
- 3) Political considerations.
- 4) Commitment to a more integrated Europe of certain European giant financial institutions
- 5) The anticipated 'through-train relationship' between the ECU and the coming European single currency

The limited market share in general

- 1) Only one percent of trade in the Community
- 2) 10 percent of the nondollar foreign currency claims of banks
- 3) Not more than 20 percent of all nondollar Eurobonds
- 4) 15 percent of the non-US dollar Medium-term notes
- 5) 10 percent of all euro commercial papers

Two-side competitions with European national currencies and the US dollar

- 1) Competing with the ‘network externalities’ of national currencies in a lack of legal tender status
- 2) The ‘advantage of incumbency’ of the US dollar in global finance



Lessons

- 1) In an era of global finance where capital control is dismantled, the stable currency parities could not be maintained without a proper framework of coordination between national monetary and fiscal policies of member states.
- 2) The absence of this framework for policy coordination is inclined to lead to a dominance of the strongest currency. This dominance might lead the stabilized currency parities to crisis when the relevant conditions are ready.

Lessons

- 3) The 'network externalities' of the national currencies and the hegemony of the US dollar have to be put into considerations.
- 4) A proper coordination over fiscal and monetary policies among members requires strong political wills. Are Asian countries ready in this sense?

Thanks for your attention

