

A Single Currency for South Asia: A Rejoinder

Author(s): Rahul Tripathi

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## A Single Currency for South Asia

### A Rejoinder

RAHUL TRIPATHI

The article 'A Single Currency for South Asia: Economics and Politics of Monetary Integration' by Sisira Jayasuriya et al (*EPW*, July 16, 2005) is a welcome addition to the growing literature on the political economy of regional cooperation in south Asia. It not only defines the broad contours around which any discussion on deeper integration within south Asia should take place, but also brings into focus an area which has till recently received a marginal attention in the regional cooperation literature. As the South Asian Association for Regional Cooperation (SAARC) enters the second decade of its existence, there has been a growing frustration among the strongest votaries of the organisation on the widening gap between the reality and the promise. The anxiety has been further compounded by its inability to focus on certain key drivers in economic cooperation (notwithstanding the recent attempts at South Asian Free Trade Area). This article, by highlighting the political logic of economic cooperation and analysing the ramifications of a foreseeable monetary integration in the region, tries to address both.

#### Politics and Economics

By pointing out that a deeper integration forged by a common currency has the ability to bring peace, political stability and huge 'peace dividend' in its wake, the authors are rightly able to tell us the promise. At the same time, they caution against any overestimation of the benefits given the reality of barriers to movement of goods, capital and people [Jayasuriya 2005: 3165]. The underlying message clearly is in favour of raising the stakes in regional cooperation to such an extent that a conducive climate for discussion, if not resolution of pending political issues is

created. The politics and economics of SAARC cannot be separated from each other and should not be seen as sequential. The case with regard to monetary cooperation in the region is no exception.

The SAARC Eminent Persons Group (EPG) established by the Male Summit in 1997 provided a roadmap in this direction. Probably the time has come to revisit the critical points of the report, which were never given a serious thought by the political leadership that instituted it. The report lays down the steps which would be necessary to attain the Economic Union and very rightly put the onus on the governments, academic community and civil society to initiate research and discussion at national and regional level on different aspects of the proposal [SAARC 1999: 57].

The proposed South Asian Economic Union is intended to be a logical culmination of the South Asian Free Trade Area and a South Asian Customs Union, which are envisaged over a specific time frame. One of the critical components of an Economic Union is the harmonisation of monetary and fiscal policy among the member countries which leads to a greater policy coordination in exchange rates, interest rates and inflation [Sobhan 2005: 12]. Such macroeconomic policy coordination, if practised perfectly prepares an appropriate ground for the eventual monetary union, which would include a common currency within the region. Available literature shows, however, that opinion is divided on whether south Asia does provide the appropriate environment for a full-fledged monetary union.

#### Whither Monetary Union

The issues at stake are both theoretical as well as practical. For a region to be suitable for experimenting with common currency and therefore, a common monetary policy it should satisfy the Optimum

Currency Area (OCA) criteria which presupposes a free mobility of labour and inflexibility of wages in the region. Some empirical studies conducted earlier on SAARC as an OCA have shown negative results which suggest that it should not pursue monetary integration immediately as that might lead to a crisis of adjustment and an increase in economic costs [Maskay 2001: 217]. It has been suggested that a slow, but sure path as pursued in Europe should be followed with the initial focus being on meeting the convergence criteria on broad macroeconomic indicators. Other studies, which are less empirical and more policy-prescriptive refer to the desirability of monetary cooperation in successive stages that could lead to an eventual monetary union which may not entail individual countries surrendering their monetary sovereignty. Such studies talk of greater political cooperation and confidence building among the member nations in order to move towards a monetary cooperation [Saxena and Baig 2004: 23]. There has also been a logical extension of the idea at the broader Asian level, particularly in meeting the challenges similar to the Asian financial crisis of late 1990s. This includes creation of a parallel currency, which could be used by all Asian countries, which may retain their individual currencies, yet, link it to the former. Under this dispensation, individual currencies could vary in relation to parallel currency within a broad band depending on the circumstances prevailing [Agarwala 2002: 25].

#### Future Course

The principal question, therefore, is how should south Asia place itself in the midst of these theoretical and practical formulations relating to monetary cooperation. Given the fundamental reality that any regional cooperation initiative has to pass the political test before it fulfils the economic logic in south Asia, the realm of monetary cooperation has to be no different. A critical concern, therefore, would be how the broad contours of monetary cooperation are to be outlined in a manner that they satisfy the binding constraints that exist.

First and the foremost, a clear distinction has to be made between the monetary cooperation and the monetary integration.

The former may be seen as a precursor to the latter where a substantial monetary policy autonomy may be retained. There should be cooperation, harmonisation and integration of monetary policy, spaced out sequentially, to achieve slow but steady gains in the larger direction.

Second, the monetary cooperation should not be seen in isolation with the other regional cooperation initiatives, but rather in tandem with each other. For example, the monetary and financial cooperation should supplement others in the arena of industrial, investment and trade cooperation. At present there appears to be a greater focus on trade liberalisation alone – ignoring the basic wisdom that a trade expansion in the regional context can occur only when there is an enabling environment provided by a conducive investment climate and a supportive monetary and financial package. The efforts in all the three areas have to be simultaneous and not sequential as it appears at present.

Third, in any scheme of regional financial coordination, existing institutional arrangements should be consolidated and modified rather than new ones being identified. A case in the point is the Asian Clearing Union (ACU), the only clearing facility of its kind in Asia which has been providing a clearing arrangement for multilateral payments settlement and also a temporary credit facility for the member nations for almost three decades. The union was created in 1975 under the auspices of United Nations Economic and Social Commission for Asia and Pacific as a mechanism to make use of local currencies in the settlement of regional transactions, thereby economising on the use of foreign exchange. Even as drastic changes were made in the operational mechanism with the onset of liberalisation of exchange rates among the member countries, ACU has continued to function without there being a default in members' payment obligations. As the union covers almost all the SAARC countries except one, a strong case has been made to integrate the efforts of the two groupings [Tripathi 2000: 194].

Besides, there is a need for a greater mandate to SAARCFINANCE which is an organisation of governors of central banks of SAARC's member countries. If given a political mandate, the forum could do more than just discussing and sharing monetary and exchange rate developments in the region and come out with some action plan with regard to achieving greater

harmonisation of policy and creating reserve facilities that meet the short-term requirements of member nations. It has been noted that the existing facility in form of South Asian Development Fund (SADF) has been languishing in the absence of adequate resources and leadership [Dubey 2005: 29].

It is, therefore, the basic contention of this paper that if at all SAARC has to give a greater meaning to regional integration efforts, there have to be movements on parallel fronts gradually but systematically. While the relative merits or demerits of an eventual monetary union may still be debated, it should not preclude whatever small gains that have already been made in the area of monetary cooperation within or outside the framework of SAARC. The real challenge would be in how these initiatives are made part of or made to supplement the larger goal of regional integration. It seems that there has been a significant, if not sufficient, economic thought given to the desirability and feasibility of greater monetary interaction within SAARC, the need is to give it the political backing at the highest levels. [37]

[Some of the arguments in this paper were earlier presented at a seminar on 'New Life within SAARC' organised by the Institute of Foreign Affairs, Kathmandu recently. The author has benefited from the comments by the participants.]

Email: rahul@southasiatogther.org

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