

CHAPTER 5

CONCLUSION

5.1 Conclusion

As the world is moving into the new Millenium of Globalization, regional economic blocs become more important than it had ever been in the past. The European Union has already reached a milestone in 1999 as currency union, NAFTA seems to be on the right track, and ASEAN is making some progress on the long road to an economic integration. However, an economic integration is not such as easy thing to achieve. It involves a lot of countries, with common goals coming together and trying to pool their resources, and muscle up to the big powers of the world. Small countries, on their own are rarely given any attention, or voice in the world arena, and under the umbrella of an economic integration, it is a chance for their voice to be heard, take for example Greece - a member of the European Union, and among one of the 15 members country to start using the Euro Currency in 1999. Greece could never have made herself heard on the world stage, but as a member of the European Union, although it is not her own voice, she has a say in the European Union world policies. This chance to be heard is very appealing to the small countries of the world.

But is an economic integration all that it has been said to be? There are many types of economic integration and a form that works for a particular region does not necessarily means it will succeed in other regions. However, all the economic integration does have a common goal, and it is to achieve a political union. The process towards political union is a long and tiring one, and it is so easy for the participating countries to loose sight of their progress. From the start, with Preferential trade agreement, Free Trade area, Custom Union, Common Market to the Economic and Monetary Union to a Political Union, each steps have to be taken very, very carefully. In the beginning, the potential member countries have to be chosen very carefully. The importance of the characteristics of the members can be seen through the European Union's delicacy in choosing and admitting new members. The NAFTA has the luxury of having only 3 members, whose economy are quite convertible, and whose economic natures are quite similar, although the GDP gap between the United States and both Canada and Mexico are quite large.

In Asia, ASEAN had been one of the main regional organizations. The main aim of ASEAN was to counter Communism threat, and deals

with security issue during the Cold War years, and maybe that is the reason why it has been as yet unsuccessful in transforming into an economic grouping. Asia is also very interesting in that all the members of the ASEAN have similar economic features, all had performed well economically right up to the financial crisis in 1997, and all have been seriously talking about the possibility of an ASEAN economic integration for a long time, but nothing had ever been achieved yet.

This study aims to examine the formation of both economic and monetary integration through the Optimum-Currency-Area theory and the study of trade interdependency. The first part of chapter 2, the overview of selected nine East Asian countries are analyzed. Then, Trade Interdependency through Trade Matrix (Export - Import Matrix) among selected 9 countries are analyzed. The result shows that over the last 15 years, there has been an increased in the intra-regional trade in the East Asia region. It can also be observed that during the financial crisis outbreak in 1997, most of the trade statistics for most of the country shows a declining trend. The overall picture of the trade matrix in Asia show that there have been strong trade relations between the selected Asian countries, which is a good sign for a solid foundation for an Asian economic integration. And that although the figures suffered a setback in 1997, during the Asian financial crisis, the region look strong enough to be able to bounce back. The monetary integration through Optimum Currency Area -- the pre-conditional characteristic -- is discussed.

The next section covers the issue of East Asian Crises. The collapse of the Thai baht in July 1997 marked the beginning of Asia's financial crisis. After a series of speculative attacks, Thailand was forced to float her currency on 2nd July, but within a couple weeks local financial crisis becomes a regional problem. Indonesia, Korea, Malaysia, Philippines, and Thailand suffered the most severe adverse impacts as a result of the crisis. While other countries in the region also suffered in varying degrees because of the spillover effects of the crises. Intra-regional trade in this region declines in this period of time. It was clearly seen that the crisis caused an obstacle to the formation of Asian monetary and economic integration even just in the period of economy stagnant. Anyhow, for further and stronger economic and monetary cooperation in this region, it need to have more forum, negotiation, cooperation, and practice in order to provide the smooth road to the light of trading and monetary block.

The last section is the core of this study, which provides the statistical analysis of Optimum-Currency-Area theory in East Asia. The estimated regression is formed according to the characteristics of pre-conditions for participating in a currency area. The economic disturbance to output, dissimilarity of economic structure, the relative sizes of the

candidate countries, trade linkage, and price disturbance are taken into account in the determining exchange rate stability.

The selected nine East Asian countries-- China, Indonesia, Japan, South Korea, Malaysia, The Philippines, Singapore, Taiwan, and Thailand -- are observed. Japanese Yen is chosen to be the leading currency of the currency block. The cross-country data between 1989-1998 is used to construct the observations and to estimate the equation determining the OCA index of each country vis-à-vis Japan. The anticipated coefficient sign from the estimation turn out to be as expected. The first output parameter, standard deviation of the differences in output growth, which represent asymmetry in output disturbances tends to have a positive relationship with volatility in exchange rate. Asymmetric shocks in inflation have positive effect on exchange rate. The size of the economies also have a positive relationship with volatility in exchange rate, that is smaller countries are likely to benefit from joining a currency area. Dissimilarity has a positive relationship with volatility in exchange rate. High bilateral trade has proved to lessen the exchange rate variability (negative relationship to the volatility in exchange rate).

By observing the OCA index in 1994, 1996, and 1998, the finding suggests that Indonesia is not ready for participating in the currency block. The result suggests that before the financial and economic crisis; China, Korea, Malaysia, The Philippines, Singapore, Taiwan, and Thailand can be candidates for participating in the currency union vis-à-vis Japanese Yen. However, due to the financial and economic crises, every country except China shows no sign of convergence towards the exchange rate stability within the Japanese Yen block. This is because this crises mainly occurred in the financial sector, which have the strongly effect to the exchange rate stability.

Though the economic desirability of a trading bloc in East Asia is difficult to assess, its feasibility is more predictable. It is more likely to have economic integration in East Asia. The Asian share of trade is growing quickly. In terms of East Asian trade flows, the growing importance of intra-regional trade is evident. Taking Japan, China, the newly industrializing economies (NIEs) -- South Korea, Hong Kong, Taiwan and Singapore -- and the ASEAN countries -- The Philippines, Indonesia, Thailand, Malaysia, Singapore, and Brunei -- as a group, export growth was fastest in the first half of the 1980s. Investment both within and into Asia is expanding more rapidly than in any other region. But once they were hit by financial and economic crises since 1997, the miracle turns to be the nightmare to the region. Their economies are instability. Hence, it can be concluded that the formation of a currency block or union in East Asia can not be easily reached. It will take a long time to recover from the crises and begin to realize the regional economic

and trade agreement again. If the currency block is put into practice in East Asia, first suitable stage to begin should be the Free Trade Area and then move to deeper integration until reach the highest stage -- Supranationality, which might take number of years. Hence, the institutional arrangement should be more concerned in this region. Countries should take a serious practice and give more cooperation. Harmonized fiscal and monetary policy is preferred in order to solve the problem and limitations in this region. This will lead to the opportunity in the formation of economic and monetary integration. The miracle in this region will happen again with the stronger economic fundamental.

In conclusion, I believe that an Asian Economic and Monetary Integration is an achievable concept. By observing the trade relations and economic interdependency in the region, it reveals that there is a strong enough base on which to build an economic and monetary integration upon. The foundation lays in the region's unity in diversity, meaning that although each of the potential member countries in Asia have different economic systems and structures but with some work, the strength of each can be brought forward and mold together to create a deeper and more sophisticated level of an integration. Furthermore, by examining the theory of the Optimum Currency Area, eventhough the results are not so encouraging, due to economic structural differences among the targeted countries, and the economic growth of each showed differing trends. But there is still a potential for an integration to be realized, as serious steps have been taken in the region in recent years, to work towards a deeper integration. The interests of the Asian countries were on different agendas, prior to the financial crisis, with each being more concerned about the state of their own economic well being, but now it seems that the crisis had given a rude awakening to these countries. The lesson learnt is what had always been known but ignored; more effective international economic and financial systems were needed to protect and prevent against economic backlashes such as the financial crisis. Now that most of the Asian countries are on the road of recovery, the issue of a regional economic and financial integration is of utmost importance, as protections are needed to prevent future crises, and safeguard the interests of each country. It seems that the interest of all the Asian countries have converged further, as a result of the crisis, and this is the best opportunity to set the movement in motion. There is more chance for success when all the potential members share a common goal, and the protection against further crises is as good a goal as any. Working on that small goal, the potential members can then progress onto bigger things, but something need to be done, and it has to be sooner than later, for an Asian Economic and Monetary Integration to be realized. It might not be an easy task, and may take up a number of years to pursue the dream, but where there is

will, there is always a way. It might be 20 or 30 years before the dream comes true, but an Asian Economic and Monetary Integration will be accomplished, and it will stand proudly beside the likes of the EU, and NAFTA. Then, the process will have come a full cycle, and the Asian miracle will take place again.

5.2 Limitation of the study and Suggestion for further study

1. This study emphasizes on both economic and monetary integration. The economic integration is studied through the study of Interdependency, which mainly cover in the trade (export-import) space in descriptive term. Hence, further study should be more concentrated on econometric aspect for each variable of each country in order to have a clearer picture of its relationship. Furthermore, Intra-Industry Trade should be studied and analyzed in order to give a clearer picture of each sector in the subject country.
2. The monetary integration is studied through the theory of Optimum-Currency-Area. This study put more attention to output disturbance, economic size, trade linkage, price disturbance, economic dissimilarity, and volatility of exchange rate. For further study, investment term is an interesting variable to be analyzed. Foreign direct investment in bilateral term should be analyzed in order to cover both trade and investment space in the estimated regression model. This will give wider vision and conclusion to the formation of currency union in East Asia.