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**Comment on: "Chances and Limits of South-South
Monetary Coordination" by Jan Kregel**

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Peter Nunnenkamp

**Comments on: Chances and Limits of South-South Monetary Coordination
by Jan Kregel**

The paper is quite surprising in several respects. The first half of the paper provides short summaries of existing mechanisms of South-South monetary cooperation. But the author goes rarely beyond describing what the objectives of these mechanisms are and what instruments are applied. Kregel is fairly reluctant to critically assess and evaluate the reasonability of objectives and the appropriateness of instruments. For example, he simply notes that a common currency has been proposed by some authors for MERCOSUR, without taking clear position. The same applies to initiatives such as the Roadmap for the Integration of ASEAN in Finance and possible exchange-rate arrangements for this group of countries.

By contrast, the second half of the paper offers some unconventional arguments, instead of dealing with more familiar OCA criteria. Possibly, I am so obsessed with the standard line of reasoning that I find it sometimes difficult to grasp Kregel's approach. For instance, the section on "Coordination and the Problem of Monetary Sovereignty" starts with the assertion that "the basic difficulty hindering coordination is the lack of domestic monetary sovereignty". This appears to be in conflict with the traditional line of reasoning according to which coordination comes at the cost of national sovereignty. However, what follows is a discussion of how governments make the public accept the money they issue, which does not seem to be specific to the South. It remains open to question why many countries face external financing constraints and suffer from "original sin", whereas some countries such as Australia successfully escaped this uncomfortable situation.

The paper is more or less silent on conventional issues, including the symmetry or asymmetry of shocks, trade intensity among participating countries, factor mobility within the group of countries under consideration, structural similarities or divergence. Likewise, the question of whether these OCA criteria are endogenous, an issue which figures prominently in the contribution of Fritz and Metzger to this volume, is hardly addressed in Kregel's paper. I am not sure whether Kregel considers all this to be irrelevant. In any case, it is mildly surprising to me that a paper on South-South monetary cooperation can do without any reference to Mundell, Eichengreen, Hausmann, John Williamson, Frankel and Rose, and other celebrities in the field.

It would be interesting to learn whether the presenters we have heard so far would agree on what they perceive to be the major problem of the South. From Fritz and Metzger I got the message that net external debt in foreign currency is the key problem of the South, as it involves serious mismatches and "original sin" increases volatility. Kregel seems to agree in the first part of his paper where he considers South-South cooperation schemes as a means to reduce dependence on external borrowing. In subsequent sections of the paper, however, external financing constraints are said to be the major impediment to economic development of the South. Both aspects of external financing of the South may well have common roots, namely institutional deficiencies at both the international and national level which many development economists consider to be the fundamental reason for persistent underdevelopment. Yet, the notion of external financing constraints seems to imply that "too little" is the major problem related to foreign capital imports of the South, whereas the notion of "original sin", by stressing the risk involved for the South, suggests that the problem is "too much" or "too volatile" (see Nunnenkamp 2001).

The next issue that may deserve some more attention concerns the various types of South-South monetary cooperation and the different objectives underlying these types of cooperation. In a recent paper on regional monetary arrangements for developing countries, Chang (2000) draws on Sebastian Edwards in separating three broad types of arrangements: regional agreements for the settlement of payments, agreements for balance of payments support, and monetary unions:

- It would be interesting to learn whether Kregel would agree with Chang (2000) who argues that the popularity of regional payments agreements (such as the one operated by ALADI in Latin America) is likely to decline. This may be because the rapid development of financial technology and the increased integration of international financial markets have as a consequence that regional cooperation of this type has less to offer in terms of reduced transaction costs.
- By contrast, regional agreements for balance of payments support are on the rise, mainly because of recent developments in the ASEAN+3 group. Yet, earlier agreements such as the Latin American Reserve Fund as well as the original ASEAN Swap Arrangement may indicate the limits of this approach, unless the potential “war chest” is as large as in the case of ASEAN+3. It is interesting to note that the symmetry of shocks, which is typically considered a “plus” when a regional group aims at monetary union, may turn out to be a “minus” when a group subject to contagion aims at self-protection against financial crises. Hence, depending on the characteristics of shocks, a regional group may be well suited for a common currency, but badly suited to ward off financial crises, or vice versa. At the same time, it may be open to question to which extent monetary cooperation can really reduce the cost of the accumulation of reserves observed by Kregel. UNCTAD (2001: 111) may be quite right in stating that “regional arrangements among developing countries may need to involve major reserve-currency countries ... in order to achieve stability and avoid costly crises”.
- As concerns monetary unions between developing countries, the question is whether exchange-rate risk *within* the regional group represents the major problem. According to Levy-Yeyati (2002), the – flawed – logic in part of the literature runs as follows: (i) nominal volatility has negative real effects; (ii) monetary union reduces nominal volatility; hence, (iii) monetary union has positive real effects. However, if it is mainly volatility of the local currency vis-à-vis the US\$ which harms developing countries, the positive real effects of a monetary union among developing countries will probably remain marginal. This reasoning also invites the question of whether the European model is of much use for South-South cooperation. Developing countries regarding the European experience as a model should not forget the EMS crisis of the early 1990s, which, according to UNCTAD (2001), was similar in many respects to emerging-market crises, even though supporting institutions were fairly advanced at that time already. Furthermore, Eichengreen (1998: 22 f.) posits that “no EMS-style arrangement will be viable elsewhere in today’s world of high capital mobility.” In any case, the road to monetary union has many traps. Transitional issues include technical challenges such as finding optimal weights for a common currency basket (Dobson 2002; Schweickert 2000). More importantly, a common basket peg may well lead to higher intra-regional volatility in real, effective terms when, as in Southeast Asia, the geographical structure of trade and the structure of foreign debt differ considerably within the region.

Against this backdrop, I am curious about what we can reasonably expect from South-South monetary cooperation. Kregel raises a similar question on the first page of his paper about the degree of South-South coordination that is possible without cooperation from the North. As indicated before, the general message of the paper is not completely clear to me. But it does not seem quite as simple as the UN Under-Secretary-General for Economic and Social Affairs, J.E. Ocampo (2003), would like to have it; he noted recently: “The small size of existing financial arrangements among developing countries indicates that there is ample room for aggressive South-South cooperation”. Alternatively, the small size of existing arrangements may indicate that there is less to gain than we might wish, because otherwise governments would not have missed the opportunities of South-South cooperation in the first place.

My reading is that much of the relevant literature invites the conclusion that monetary union is neither necessary nor sufficient for developing countries to achieve closer integration in terms of trade, FDI, etc. The experience of the West African Economic and Monetary Union, even though not a pure South-South scheme, illustrates that monetary union is not sufficient. It may not even be necessary if, as Bayoumi and Mauro (2001) as well as Schweickert (2000) observed for the *de facto* US\$ orientation of large parts of Southeast Asia, the individual optimisation of currency baskets implies fairly stable intra-regional exchange rates. Schweickert (2000) argues that it is difficult to conceive suboptimal intra-regional exchange rates as long as all countries optimise their exchange-rate relations vis-à-vis a few anchor currencies.

The next question is which type of cooperation, and in which policy area regional cooperation is most likely to deliver. In Asia, for example, monetary and exchange-rate cooperation may be inferior (the wrong project, according to Eichengreen 2002), at the present time at least, to regional projects focusing on the deepening and strengthening of regional financial and capital markets. In that regard, the final section in Kregel’s paper may come fairly close to suggestions made by Eichengreen and others on how ASEAN should proceed. Eichengreen (2002) suggests that the Chiang Mai Initiative should be clearly defined as fostering financial stability, not stabilizing exchange rates.

More generally, it is probably for good reasons that UNCTAD (2001: 127) notes that “regional arrangements could fail in the absence of sound domestic institutions and policies”. Dobson (2002) goes one step further: She regards domestic reforms as the most important line of defence; her concern is that the current focus on monetary cooperation, notably in East Asia, may divert attention and resources from reforms of domestic financial institutions, even though financial systems in this region still trail best international practice. Hopefully, she is wrong and her concern will prove unfounded!

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