**Document Title:**

Report to ABAC — BUILDING A STABLE CURRENCY REGIME.

**Purpose:**

For consideration.

**Issue:**

Whether ABAC should consider promoting the creation of an APEC currency, which might be called the APECCU.

**Submitted by:**

ABAC New Zealand.

**Background**

1 The first paper on this topic[[1]](#footnote-1) was presented in Taipei when FEWG decided the matter should be the subject of further consideration. A further paper was presented in Yokohama[[2]](#footnote-2). It proposed that ABAC consider promoting the creation of an APEC reserve/trading currency, an APEC CUrrency, which might be called the APECCU. This paper discusses further matters relevant to the issue including addressing comments made in Yokohama.

2 The USD as the primary trading currency, the global financial crisis (GFC), the GFC's impact on the US economy and measures being taken by the US to deal with the downturn in the US economy have increased exchange rate volatility. The topic was brought forward within the FEWG work program because of members' concerns that exchange-rate volatility was having a serious impact on trade.

3 The proposal is that the APECCU's value could be fixed in a similar way to the way in which IMF Special Drawing Rights (SDRs) are fixed but would be based on a basket of the 21 APEC currencies[[3]](#footnote-3). The value of the APECCU would fluctuate according to the fluctuation of the currencies in the basket. This means movements in the exchange rates of the larger economies would have greater influence than movements in the smaller economies, but the impact would be indirect and fluctuations might tend to cancel each other out. Even if that did not occur, there would be diversification unlike the present situation where changes in monetary conditions in the US have an immediate and direct impact on exchange rates.

4 The APECCU would not replace domestic currencies – it would not be a single currency for the region like the Euro is for the Eurozone economies. Economies would not be prevented from having exchange rate arrangements considered to be necessary or desirable for their own economies' monetary or other economic conditions. Their domestic currencies would adjust against the APECCU according to the arrangements they have in place.

5 Refer to the Yokohama paper for more details of the proposal and the Taipei paper for detailed background.

**Proposal/recommendation**

6 ABAC should consider the issue in greater depth with a view to deciding at the third 2011 meeting whether to advance a proposal to Leaders. At the same time ABAC should carefully monitor any steps which may be taken within the G 20 framework.

**PAPER**

**Comments made in Yokohama**

**Will the APECCU reduce volatility?**

7 The question was asked whether the APECCU would in fact reduce volatility. This question was answered to some extent in paragraph 41 of the Yokohama paper where it was said that the value of the APECCU would fluctuate according to the fluctuation of the currencies in the basket. This means movements in the exchange rates of the larger economies would have greater influence than movements in the smaller economies, but the impact would be indirect and fluctuations might tend to cancel each other out. Even if that did not occur, there would be diversification unlike the present situation where changes in monetary conditions in the US have an immediate and direct impact on exchange rates with the USD.

8 Coincidentally a paper has recently been published by the New Zealand Treasury which although not directly addressing the issue does contain relevant material[[4]](#footnote-4). The paper says

A significant portion of New Zealand's trade is denominated in US dollars. When this occurs, short-term movements in the NZD/USD exchange rate are likely to have a significant impact on New Zealand dollar export receipts. However, in the medium term the exchange rate that actually matters is that between New Zealand and the regions that ultimately concern the traded goods.[[5]](#footnote-5)

9 This confirms the impact on New Zealand’s trade of short-term movements. There is no reason to think the outcome would be any different for other APEC economies. Then it notes that in the medium term short-term movements in the NZD/USD exchange rate do not actually matter. That may be so from an econometric view of what is important to monetary conditions but the medium term is not what is important to traders. Traders must deal with the here and now where they must try to live with short-term movements, incurring the risks and costs associated with this volatility. If volatility can be smoothed trading conditions become easier.

10 It is common experience that diversification reduces volatility. There is no reason to think that currency diversification would be any different. But it could be tested by constructing a model of how the APECCU would have behaved over an historical period and comparing it with the NZD/USD exchange rate during the same period. ABAC New Zealand may need to consider asking the New Zealand Treasury to undertake that exercise.

**Attempting to reduce volatility could have undesirable consequences**

11 The question was asked whether it was desirable to try to stamp out volatility. The answer is that volatility may be an unavoidable consequence of economic conditions in a particular economy and it may be undesirable to try to prevent exchange rate adjustments. A fixed exchange rate makes exchange-rate movements unavailable as an adjustment mechanism responding to economic conditions arising within a particular economy. Recent experience with the euro highlights potential difficulties arising from a single currency. For example, Germany benefits from weakness in other Eurozone economies tending to keep the euro low giving Germany a competitive advantage in export markets. Conversely weaker economies such as Ireland which would benefit from a lower exchange rate are deprived of that possibility.

12 The APECCU proposal would not have that undesirable effect for the reasons explained in paragraph 39 of the Yokohama paper. In short, it is not part of the APECCU proposal for there to be a single currency for the APEC region. The APECCU would not replace domestic currencies – it would not be a single currency for the region like the Euro is for the Eurozone economies. Economies would not be prevented from having exchange rate arrangements considered to be necessary or desirable for their own economies' monetary or other economic conditions. Their domestic currencies would adjust against the APECCU (and against other currencies) according to the arrangements they have in place.

**Should it be left to the G 20?**

13 This question was addressed to some extent in the Yokohama paper. See paragraphs 24-26, supplemented by paragraphs 27 and 28.

14 The G 20 in Seoul did not advance any concrete proposals. Indications are that with France in the chair international monetary reform may be promoted through the G 20 during 2011. However, it is by no means clear that the sort of monetary reform which France has in mind is reform which would be supported by ABAC. Indications are that it may well be a heavily regulated approach and actually inimical to free and open trade, including regulations in relation to food prices.

15 Although the APECCU proposal would not prevent individual economies deciding their own exchange rate policies vis-a-vis the APECCU as well as other currencies, the APECCU proposal is market-driven. It seeks to facilitate free and open trade, not to regulate it.

16 We cannot tell how G 20 proposals may develop. They may not develop at all or they may develop in ways which ABAC would not support. It is accordingly suggested that ABAC continue trying to develop the APECCU proposal whilst carefully monitoring proposals emerging from France and elsewhere. For reasons explained in paragraphs 28-37 of the Yokohama paper, APEC may have a unique opportunity to advance something which could be of crucial importance in promoting regional economic integration. That makes this a proposal which, although it should be advanced carefully, should nevertheless be taken further.

**A similar proposal**

17 In Fostering Monetary & Financial Cooperation in East Asia, edited by Duck-Koo Chung and Barry Eichengreen, numerous aspects relevant to the issue are considered. Of specific relevance to the APECCU proposal is Chapter 2 by Barry Eichengreen "Fostering Monetary and Exchange-Rate Cooperation in East Asia" which discusses the creation of a "parallel regional currency". Eichengreen says this idea has been pushed by the Asian Development Bank and its president, Haruhiko Kuroda. "As described by Kuroda (2006), the Asian Currency Unit (ACU), defined as a weighted average of the 13 ASEAN +3 currencies, might start as a convenient summary indicator of the strength of Asian currencies vis-a-vis those of the rest of the world. But it also could be a convenient unit in which to denominate bonds for Asian investors seeking currency diversification and for issuers wishing to hedge the currency risk of receivables denominated in regional currencies. The ADB and other official institutions could jump-start the market in the instrument by issuing their own ACU-denominated bonds."[[6]](#footnote-6)

18 In his conclusion, he says "A parallel regional currency provides a stable unit for intra-regional trade and investment…. But the parallel-currency approach is unproven. There are few historical examples of synthetic, basket-based parallel currencies that have gained significant market share. And the fact that the market in the parallel currency will start out small and that liquidity will be limited will mean significant transaction costs for those using it in intra-regional trade and investment."[[7]](#footnote-7)

19 The APECCU proposal is a proposal for a parallel regional currency, but a currency created within the institution of APEC and for the economies within APEC and, most importantly, including the US. For these reasons the opportunity exists to avoid or overcome the problems Eichengreen describes.

**Conclusion**

20 ABAC should consider the issue in greater depth with a view to deciding at the third 2011 meeting whether to advance a proposal to Leaders.

21 At the same time ABAC should carefully monitor any steps which may be taken within the G 20 framework. A better solution could be supported. Dangerous proposals should be resisted.

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1. Document: FEWG 30-017A. [↑](#footnote-ref-1)
2. Document FEWG 30-041. [↑](#footnote-ref-2)
3. QFINANCE Dictionary Finance and Business Dictionary definition of basket of currencies: a group of currencies, each of which is weighted, calculated together as a single unit in establishing a standard of value for another unit of currency. [↑](#footnote-ref-3)
4. Gemma Mabin, New Zealand 's Exchange Rate Cycles: Evidence and Drivers <http://www.treasury.govt.nz/publications/research-policy/wp/2010/10-10>. [↑](#footnote-ref-4)
5. Page 11, Box 2: The importance of the currency of denomination. [↑](#footnote-ref-5)
6. Page 18. [↑](#footnote-ref-6)
7. Page 28. [↑](#footnote-ref-7)