

**TOWARD A COMMON CURRENCY FOR THE ASIA-PACIFIC REGION**

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**I. Initial Proposal for an “APEC Common Currency Unit”**

In 1995 I published a proposal for an “APEC common currency unit” that set off the discussion that has been going on over the past several years concerning the possibility of an Asian common currency unit. It appeared in the journal *Kin’yu Zaisei Jijo* (Financial and Fiscal Affairs) under the title “Proposing an ‘APEC Common Currency Unit’—and Rejecting “Yen Zone” Talk That Fails to Discuss the Costs.”<sup>1</sup> The proposal was made at a juncture when the yen was exceedingly strong, and it was not something advanced after witnessing the Asian currency crisis; in addition, it was advanced at a time when the course to the launching of the euro, Europe’s integrated currency, was still unclear.

In July 1997 the Asian currency crisis struck, and then in January 1999 the euro was launched. Some people have taken these developments as the basis for suggesting that Asia needs a key currency of its own in line with the European model.

In 1996 Toyoo Gyohten wrote: “Twenty-five years have passed since the ‘Nixon shock’ [when the United States ended the convertibility of the dollar into gold, marking the beginning of the end of the post–World War II system of fixed exchange rates], and the time has come to turn our thoughts to Asia’s monetary system. In 1999 an integrated European currency, the euro, will take its place alongside the U.S. dollar, but Asia’s currencies remain unintegrated. Is there not a need for a key currency in the Asian region to accompany [the region’s] economic development?”<sup>2</sup>

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<sup>1</sup>*Kin’yu Zaisei Jijo*, vol. 46, no. 24 (June 26, 1995), pp. 32–35.

<sup>2</sup>*Nikkei Kin’yu Shimbun*, August 21, 1996.

Then, on February 20, 1998, the Provisional Economic Countermeasures Council of the Liberal Democratic Party (LDP) issued its fourth set of “Emergency Countermeasures for the National Economy,” containing an item “Consideration of Creation of a Common Currency System”; this referred to “the creation of a common currency system to be used jointly by the Asian economic zone.”

These documents did not include concrete proposals like mine for a common Asian currency unit.

In 1999, Tadao Chino, president of the Asian Development Bank (ADB), came out with the following comment: “With the yen, alongside the euro, supplementing the dollar, the United States, Europe, and Japan should seek global economic and financial stability through responsible fiscal and monetary policies. In concrete terms this means creating a basket centered on the dollar, the euro, and the yen. Depending on the circumstances, it might also be appropriate to include Asian currencies. Though it will probably be a while before the Japanese yen becomes a key currency, at least we can consider a setup in which the yen would have a weight in a currency basket commensurate with its national strength and Asian currencies would be pegged to this basket. The Chinese yuan might also be included a little bit later, with a large weighting like the yen’s.”<sup>3</sup> This comment, worded with extreme sensitivity, seems to encompass the points of discussion at this juncture.

Why, fundamentally, does the birth of a common currency in Europe mean that we need to think about a common currency in Asia as well? This is because we are in an age of global competition, and if Asia does not have a common currency, it will be at a competitive disadvantage against the United States and Europe, which conduct international transactions using their own national or common currency; we will face foreign exchange risks, and so our transaction costs will not be the same as theirs.

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<sup>3</sup>*Asahi Shimbun*, April 27, 1999.

At the same time, however, having advanced my proposal in 1995 while observing the yen's strength at the time, I do think that Asia (or the Asia-Pacific region) is one place and Europe another, that its currency system should be constructed in line with its own circumstances, not as a copy of the European model. Of course it is highly meaningful to make comparisons with Europe and draw lessons, and in this essay I will refer to the European experience, but I am not proposing that we simply imitate. To make this clear, let me here present a digest version of my original proposal for an "APEC common currency unit":

The sharp rise of the yen [in 1995] has caused considerable clamor for the internationalization of the Japanese currency, meaning the creation of a "yen zone." But the discussion, which seems to have become somewhat overheated, appears to consist only of abstract arguments without either discussion of the specific way in which a yen zone would be created or consideration of the issue of whether Japan is ready to bear the attendant costs. What I wish to put forward is not this sort of overblown plan for a yen zone but a proposal to create an "APEC common currency unit."

On March 12, 1995, the daily *Asahi Shimbun* carried an editorial titled "Independent Yen Essential to Stable Monetary System" that stated (as translated in the *Asahi Evening News* on March 19):

"The United States as a country of a global key currency, has the special privilege of making payments to foreign countries in its own currency, the dollar, instead of in foreign currencies. Even if it does nothing to reduce its deficits, all it has to do is to print more dollar bills. That is why it is not using moderation to maintain the international balance of payments.

"In order to stabilize the dollar, it is necessary to create a system for the United States to use foreign currencies in settling international payments just as other countries do. But the United States will not readily give up its special privilege to use the dollar because of its convenience. . . .

"It is desirable to make the yen into an independent currency on par with the mark.<sup>4</sup> . . . It is not an easy task to spread yen-based transactions in Asian countries, which are, in effect, dollar markets. . . . The

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<sup>4</sup>At the time I made my original proposal, as seen in this *Asahi Shimbun* editorial, people did not have the birth of the euro in mind. This was the general state of affairs then.

independence of the yen not only creates a Japanese economy that can withstand the fluctuation of the dollar. If the yen shows a move to separate itself from the dollar, the United States is likely to seriously tackle the problem of reducing its deficits. Only then can we expect to see prospects for a stable international currency system supported by the dollar, mark and yen.”

In addition, Toshihiko Yoshino, who uncovered the history of the events leading to the setting of the yen-dollar rate at ¥360 in the postwar period, offered the following comment in a piece titled “The Yen’s Rise is a Labor Pain in the Transition to a Trilateral Currency System”:<sup>5</sup>

“It is essential to create a situation in which the United States itself cannot avoid feeling that it will be hurt if the dollar depreciates against the mark and the yen. . . . At this juncture we should stop intervention to buy up dollars, and we should switch Japan’s foreign currency reserves from their excessive reliance on dollars by diversifying into other assets, such as the mark and gold. This should be done gradually, however, since selling huge amounts of dollars all at once would cause the dollar to crash. If possible, Japan might consider buying some of the United States’ gold reserves at the current market price. It would also be desirable to raise the share of yen-denominated trade and facilitate the issuance of yen-denominated bonds, building up a system centered on the Asian region that would not be affected by sudden sharp movements in the value of the dollar.”

The two arguments that I have quoted above share the position that the concept of a “tripartite” monetary system advanced by Robert Roosa starting with his testimony to the U.S. Congress on November 10, 1977, had become a practical matter as of the mid-1990s; both proposed a “yen zone” in this context. This sort of thinking now seems to be spreading among the public through influential media organs.

Overall, these two arguments are essentially the same in their thrust as the position taken in France by Jacques Rueff in France under De Gaulle during the 1960s, calling for currency independence. The recent discussions of currency matters in Japan may be labeled a form of “Gallicization.”

Toyoo Gyohten, chairman of the Bank of Tokyo, declares as follows (*Voice*, May 1995, p. 40): “Leaving aside the short-term movements of exchange rates, the phenomenon that is progressing most prominently around the world, especially in Asia, which is deeply tied to Japan, is the Americanization of finance and information. Whether in Hong Kong or Singapore, in Bangkok, or even in Shanghai, if one looks just at finance

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<sup>5</sup>*Asahi Shimbun*, April 28, 1995.

one finds that everything has now come to be controlled by American-style thinking, American standards, and American practices.”

It is necessary to develop the discussion of a yen zone with a full understanding of the fact that it is occurring in the general context of this sort of “financial Americanization.”

So to sum up, what is the aim of the yen zone being suggested by experts? Here, for convenience, I would like to offer the example of the Franc Zone as an extreme case.<sup>6</sup>

The Franc Zone is a currency alliance among France and 14 African countries (former French territory). Its main features are as follows: (1) The participating countries are linked by fixed exchange rates. (2) External settlements of accounts among the participating countries are conducted on a unified basis. (3) Foreign currency reserves are pooled.

In addition, the Franc Zone has these features: (4) Convertibility among the currencies of the participating countries is unlimited and is guaranteed by France. (5) France guarantees the value of franc-denominated deposits of foreign currency reserves with SDRs (IMF Special Drawing Rights).

I would guess that none of the Japanese experts who are proposing a yen zone have this sort of arrangement in mind. With respect to France’s responsibilities under items (4) and (5) in particular, even if neighboring Asian countries requested such features, is Japan willing to undertake them?

What most people who discuss a yen zone presumably have in mind is probably the following features: (1) a closer relationship with the yen in terms of exchange rates (if not a peg, then an increased weighting for the yen in the currency basket), (2) a raising of the proportion of yen in Asian countries’ foreign exchange reserves, and (3) expansion of yen-denominated trade and capital transactions. In other words, they are thinking of construction of a yen zone that might be convenient for Japan, but they are not giving any thought to having Japan pay costs for this purpose. Most people who discuss this subject seem to be using “yen zone” to refer vaguely to a situation in which the yen would be more widely used than at present in the Asian region. As is the case with discussions of other matters within Japan, the arguments are abstract, lacking indications of readiness to bear costs and also lacking concreteness.

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<sup>6</sup>Phillipe Jurgensen and Daniel Lebegue, *Le trésor et la politique financière*, Les Cours de Droit, 1986, pp. 696-99.

So let me here make a concrete proposal. Like the ideas that many others have offered, my proposal will not cost any money. It is not an overblown concept like that of the yen zone; it is for the creation of what may tentatively be called an "APEC common currency unit."

The concept is as follows:

(1) Create a "cocktail" of currencies of countries participating in the Asia-Pacific Economic Cooperation (APEC) forum, such as the U.S. dollar, Japanese yen, Chinese yuan, South Korean won, and Thai baht.

(2) The APEC finance ministers' conference would decide which specific currencies would be included, and at what ratios.

(3) The APEC secretariat would issue daily calculations of the exchange rate between the APEC common currency unit and other major currencies, such as the dollar and yen.

(4) Initially the currency unit would be used only as a unit of denomination. In other words, it would be purely a calculation unit and would not be given the shape of assets.

(5) It would be used as a currency of denomination for trade and direct investment within the APEC region. Monetary authorities would encourage use of the unit, but not mandate it. It would be up to private-sector parties' "freedom of contract" whether to use it to express the value of their trade and investment transactions.

As I explained in my 1979 book *"Kokusai tsuka" to shite no en* (The Yen as an International Currency; published by Kyoikusha), an international currency is defined as one that fulfills at least some of the following five functions: (1) standard of value, (2) means of payment for private-sector transactions, (3) store of private-sector assets, (4) reserve currency, and (5) currency of intervention. In making my current proposal, I have focused on the first of these functions.<sup>7</sup>

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<sup>7</sup>As Manuel F. Montes has noted (see his paper "Diagnoses of the Asian Crisis: Implications for Currency Arrangements," in "Strengthening Cooperation among Asian Economies in Crisis: Papers and Proceedings of the International Symposium on the Asian Economic Crisis and Its Impact on Trade and Investment held on November 6, 1998 in Tokyo," ed. Ippei Yamazawa [Institute of Developing Economies/JETRO, 1999], p. 31), my proposal is for a new numeraire currency. If however, the APEC currency unit went on to meet a need, then—as the history of the ECU shows—sooner or later private-sector markets would form.

Let me explain the background to this concept.

First of all, the Asia-Pacific region, just as Toyoo Gyohten describes, is in the midst of a process of financial Americanization. Also, conditions are not such as to allow quick progress toward cooperation among monetary authorities such as seen in Europe, for example, where countries have each contributed 20% of their foreign currency reserves, receiving equivalent amounts in ECUs and using the latter for their external settlements.

Second, the Asia-Pacific region must not lose its momentum as the world's growth center. If the present instability in the yen-dollar rate continues, with the G7 having effectively no means of dealing with it, there is a fear that this will hinder trade and investment within the region, thereby causing its economic growth to decelerate [this is precisely what happened during the Asian currency crisis that hit two years after I made my proposal]. This will not be good for the world. For this reason it is necessary to create a new instrument, a unit of denomination that will offer greater stability than either the dollar or the yen.

Third, the role of the authorities should be limited to the creation of an instrument. Whether the business community of this diverse and dynamic region finds it useful and decides to use it or not should be left up to the contracts between the parties involved; there is no need for the authorities to intervene.

Fourth, this proposal of mine is not especially radical. It does not aim for the creation of a yen zone or the exclusion of the dollar. APEC does not exist for America's sake, but it is an important axis of cooperation and coordination with the United States within a common bond, and I myself hope that it will be strengthened further.

Accordingly, APEC must construct a new framework different from that of the European Union (EU). Under this concept the dollar will continue to hold an important position, but even so, by comparison with de facto dollar links [which many Asian countries came to regret after the currency crisis] it would signify a moderate shift away from the dollar. From a long-term perspective it might serve to halt the process of "financial Americanization" and be a first step toward the evolution of an APEC monetary system.

Fifth, some may argue against emphasizing the Chinese yuan at this point, claiming that it is incapable of serving as an anchor currency. However, currencies are not merely matters of economics. One can hardly deny that currency issues also have an international political aspect. If they were merely matters of economics,

then it would be strange for the currency of the world's largest debtor nation (the U.S. dollar) to be the key currency. Considering China's latent strength and its presence in Asia, the yuan should be included in this sort of undertaking from the start.

Above I have offered one solution in the context of the "Gallicization" of the discussion of currency issues in Japan, the "Americanization" of Asian finance, and the "Asianization" of the yen.

The above represents the essence of my proposal for an Asia-Pacific common currency unit.<sup>8</sup>

When I came out with this in 1995, everybody seemed to be deliriously talking about a "yen zone." But once the extraordinary rise of the yen was reined in through the Rubin-Sakakibara intervention, this talk completely vanished. After the 1997 currency crisis it finally reappeared, this time not as the idea of a yen zone representing the internationalization of the yen but just in terms of the yen's internationalization.

In the following section I will confirm how the Asian currency crisis and the inauguration of the euro have heightened the need for what I originally proposed; I will offer stronger theoretical

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<sup>8</sup>The first citation of my proposal within Japan was probably by Yokohama National University Professor Takao Kamikawa (Takao Kamikawa and Eietsu Imamatsu, *En no seiji keizaigaku-Ajia to sekai shisutemu* [The Political Economy of the Yen-Asia and the Global System] [Dobunkan Shuppan, 1997], p. 28). More recently, Ritsumeikan University Professor Hiroshi Okuda has written as follows ("En no kokusaika to kokusai tsuka-ka ni tsuite" [The Yen's Internationalization and Transformation into an International Currency], *Ritsumeikan Kokusai Kenkyu*, vol. 11, no. 3 [March 1999], pp. 151-52): "Takehiko Kondo has recently again been urging the adoption of a proposal he made in 1995. . . . It seems likely that various countries will in the future adopt separate currency basket systems of their own and that the weight of the yen in them will rise. So the issue is whether we can come up with a prospect for a foreign exchange regime that goes beyond this. . . . Kondo declares that his proposal 'is not especially radical' and 'does not aim for the creation of a yen zone or the exclusion of the dollar.' His proposal is accordingly realistic. This is because a currency basket excluding the dollar could not be created quickly without encountering considerable discord and confrontation with the United States. . . . The prospect for the near future is the raising of the yen's weight within various countries' currency baskets, followed by the creation of a moderate 'common currency unit' setup as in Kondo's proposal."



arguments for it and also discuss steps and strategies for getting beyond the construction of the concept and turning it into reality, including where we should start.

## **II. The Need for an Asia-Pacific Common Currency Unit and Its Role as an International Currency**

### **Learning from the Asian currency crisis**

The Asia-Pacific region has learned, through its experiences since the mid-1980s of an excessively strong yen and weak dollar, of the reverse swing to an excessively weak yen and strong dollar, and of the Asian currency crisis, that currency stability is necessary in order to maintain rapid economic growth. Here I will consider the issue of how Asia's currency relations can be stabilized, starting with an analysis of the causes of the Asian currency crisis.

### **Causes of the Asian currency crisis**

The main cause of the Asian currency crisis was currency speculation and the rapid outflow of capital that it caused. A common recognition of this basic fact was initially lacking at places like the International Monetary Fund (IMF), but when in mid-1998 the crisis struck Russia, began to affect Latin American countries, and threatened to affect the United States, this became the consensus view of the international financial community. Subsequently the main topic at all forums for discussion of international monetary and financial issues became that of countermeasures against speculative short-term capital movements.

Here is how working-level market participants explain the crisis:

As monetary integration approached in Europe, meaning that it would no longer be possible to speculate among the European currencies, foreign exchange traders moved from London to Asia, Singapore in particular. These professional speculators then proceeded to carry out full-fledged currency speculation in Asia, which was relatively inexperienced in such transactions, as they had been doing in the West for many years.

Scholars of monetary affairs, by contrast, take the following view:

The various countries of East Asia have slightly different foreign exchange systems, but what can be said of them in common is that they took maintenance of a fixed rate against the dollar as the

linchpin, making the dollar their currency anchor, while encouraging direct investment from Japan and elsewhere.

Asian countries made good use of the strong yen and weak dollar in the decade following the 1985 Plaza accord in developing their own economies. Having succeeded in economic development, as the next step they turned to the gradual removal of their foreign exchange controls, making their own currencies convertible and liberalizing capital movements. Ironically, these countries, particularly the ones that moved ahead further in the direction of capital liberalization, then started to suffer from the same instability of exchange rates caused by massive unrestrained capital flows that had plagued the industrial countries of the West for decades since the 1960s.

The policies that these countries had adopted to set legal or de facto links between their currencies and the dollar were not a problem—these policies were, in fact, beneficial to them—as long as the dollar was falling. But when the dollar turned around and started to rise, the East Asian currencies that were linked to it became overvalued, and the exports of the countries in question lost their competitive strength. Particularly in the period following April 19, 1995, when the yen hit the extraordinarily high level of under ¥80 to the dollar, the Japanese currency rapidly depreciated. In 1996 the export growth rates of the East Asian countries declined across the board, and their trade and current account deficits widened. They made up for their current account deficits with inflows of capital.

If these inflows had consisted of direct investments or other stable, long-term funds, there would not have been a problem, but direct investment had peaked in 1993 or so, and, as typified by Thailand, the pattern adopted was one of raising short-term interest rates and thereby attracting short-term funds from overseas. And as a result of these inflows of foreign funds, domestic demand became excessively strong.

In the face of these bubble-like conditions, the Asian countries should have moved promptly to tighten their fiscal and monetary policies and to absorb and control the excesses of domestic demand, but they did not. In other words, they were unable to control the excess liquidity resulting from the inflows of foreign funds with their monetary policies. At the time, economic growth was

continuing smoothly, and the policy-making authorities took a rosy view of the prospects. Politically it was extremely difficult for them to decide to devalue their currency, a move that would damage their national prestige and mean an increase in the weight of foreign-currency-denominated liabilities for domestic borrowers. The speculators exploited this. The Asian currency crisis occurred when the trigger of speculation set off a sudden pullout of the massive funds that had flowed into the Asian countries against this backdrop.

Raymond Barre has assessed the Asian currency crisis as follows: “The Asian currency crisis does not mean an immediate crisis of democracy. It is one phenomenon that has occurred due to globalization and other causes; when the capital that has been invested is suddenly pulled out, a crisis visits. Mexico experienced a similar crisis in 1994, but Asia’s crisis was somewhat larger in scale.”<sup>9</sup>

This may seem at first glance to be a casual assessment, but in my eyes it is one of the most accurate readings to be found anywhere amidst the formidable numbers of news stories and commentaries that appeared after the crisis.

Asia’s currency crisis was not the first such international currency crisis, nor was it an Asian invention. Similar events have struck the countries of the industrialized West time and again since the 1960s. And after the Asian crisis, such events also struck Russia and Brazil. In the midst of the currency crises from the late 1960s on, the countries of Europe realized the need for a monetary union, and this served as the impetus for the start of the long process that eventually led to their integrated currency. History is a continuum. It is an exaggeration to declare, as some writers have done in the wake of the Asian currency crisis, that this represents the first crisis of global capitalism. It is true of course that the shape of crises changes in some ways to reflect the changing background of the times, but even before the American flip-flop at the time of the Russian crisis in 1998, there was the case of “Black Monday” in 1987, when the authorities of the countries concerned seriously feared the onset of a global panic, and the crisis was averted through close cooperation among the

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<sup>9</sup>As quoted in the report of a symposium conducted jointly by the Institut français des relations internationales (IFRI) and the (Japanese) Institute for International Policy Studies, February 1998.

United States, Europe, and Japan. So the 1997 Asian currency crisis was essentially not that unusual in itself as a currency crisis. As Barre said, it was merely a larger-scale version of the Mexican crisis.

The above may be described as the “monetary theory” of the Asian currency crisis. There are, however, other views of the causes. The most sensational of these is what we may call the “Asian-model theory.” According to this view, the currency crisis had its roots in the shortcomings and peculiarities of Asian values and of the Asian model. Some American scholars suggested that the crisis was due to Asia’s system of “crony capitalism.” But when the Long-Term Capital Management hedge fund was rescued in the wake of the Russian crisis, primarily by the Federal Reserve Bank of New York going around and drumming up “subscriptions” to the cause, even U.S. intellectuals pointed out that this approach itself was a form of crony capitalism; thereafter this particular criticism ceased to be voiced.<sup>10</sup>

A more cogent alternative view is that which may be labeled the “financial theory.” A considerable number of those writing about the Asian currency crisis, at least at the outset, called it a “twenty-first century” crisis, suggesting that it was set off and aggravated by the fragility of Asian countries’ financial systems; they urged that these countries should modernize their financial systems and bring them into line with global standards. In line with this thinking, IMF First Deputy Managing Director Stanley Fischer declared that the core of the IMF’s program to deal with the crisis was not macroeconomic adjustment but financial and other structural reform.<sup>11</sup>

There will be little disagreement with the observation that Asia’s financial systems, including its banking systems and capital markets, are still fragile and deficient as vehicles for financing rapid

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<sup>10</sup>In an April 22, 1999, meeting with the author, Philippe Lefournier, head of the economic forecasting unit of *L’Expansion*, noted: “It is natural for the “Asian model” to come under criticism when a crisis occurs in Asia. (The cause of the Asian currency crisis was speculation.) For example, if the U.S. dollar plunged, people would probably start saying that there had been defects in the ‘American model.’ ”

<sup>11</sup>*Asahi Shimbun*, April 2, 1998.

economic development. But the “financial theory” places excessive weight on the financial system’s role as a cause of the crisis.

One reason for this claim is that crises have not occurred in other places where the financial system is still fragile. For example, Taiwan was relatively little affected by the Asian currency crisis. But its banking system has yet to be liberalized to any considerable degree. The small and mid-size companies that are the mainstay of the Taiwanese economy depend for the most part not on bank lending but on informal financing. And China too has been reluctant to liberalize its banking system. The Asian currency crisis had only a slight impact on China, Taiwan, and India, none of which can be said at this point to have adequately sturdy or open financial systems.

Meanwhile, in Europe, whose financial systems are sturdier overall than Asia’s, currency crises struck a number of times from the 1960s through the early 1990s.

In Asia’s case, certainly the fragility of financial systems contributed in some ways to making the currency crisis more serious. But it is going too far to suggest that the cause of the crisis was the immaturity of the region’s financial systems or that if they had been more mature the crisis would not have happened. No matter how well developed and established a financial system may be, that does not eliminate the risks of foreign exchange, or in other words, the possibility of currency speculation. The occurrence of currency crises is related to the problems of volatility and “overshooting” that are characteristic of floating exchange rate regimes.

The Asian currency crisis was essentially a problem of the exchange rates between Asian currencies and the U.S. dollar. Changes in these exchange rates were the cause of the rapid movements of capital. The rapid capital movements went beyond anything that could be accounted for by conditions in the real economies of the affected countries; they were “self-fulfilling” speculative lurches. According to a 1998 report from the IMF (*International Capital Markets: Developments, Prospects, and Key Policy Issues*, World Economic and Financial Surveys), in 1996 there was a net inflow of \$40 billion to the five countries of South Korea, Indonesia, Malaysia, Thailand, and the Philippines, but in 1997 this turned into a net outflow of \$30 billion. Thus was the Asian region buffeted by capital movements before and after the onset of the currency crisis.

### **III. Features and Functions of an Asia-Pacific Common Currency Unit**

In the first part of this essay I have outlined my proposal for an Asia-Pacific common currency unit. Here I would like to emphasize the features that led me to design it this way.

#### **Feature 1**

My concept is formulated at the APEC level. The task of constructing a common currency for Asia (the Asia-Pacific region) is a grand undertaking for the twenty-first century, and as such I decided it should be entrusted to APEC, which has both historical inevitability as a union of the victors and vanquished of World War II and the institutional infrastructure of summit meetings and finance ministers' meetings.

#### **Feature 2**

The new common currency is to be based on a currency basket. By being set up as something separate from both the dollar and the yen, it can protect trade and investment transactions in the Asia-Pacific region from unsteadiness in the yen-dollar exchange rate, for example; the policy objective is to contribute to the sustained development of the Asia-Pacific region in the twenty-first century and thereby to contribute to the global economy.

#### **Feature 3**

I envisage a basket of five currencies: the U.S. dollar, Japanese yen, Chinese yuan, South Korean won, and Thai baht.

The inclusion of the dollar and yuan is based on a conviction that if we hope to see the forward-looking development of a common currency for the Asia-Pacific region, we will need to have the assent of the United States and China. My concept, as I have explained above, was published in 1995, well before the Asian currency crisis. If the concept of an "Asian Monetary Fund" that the Japanese government came up with in 1997 was, as has been reported by some, an

undertaking that Japan was attempting to achieve without including the United States, then this approach differs from that of my concept. Though the United States and China are certainly not the entirety of the Asia-Pacific region, it is not possible to accomplish major deeds in this region while excluding these two great powers. One of the major features of my concept of an APEC common currency unit is that it includes the dollar. The dollar is in fact the central constituent currency. On this point, Manuel Montes has noted that my proposal, by adding the dollar to the basket, shows that the aim is not to create a yen zone, and is characterized by the care it takes to avoid U.S. resistance.<sup>12</sup>

Though it may seem like something of a digression, I would like to report that, after I published my concept in Japan, I asked the opinions of a number of Western experts prior to publishing it at the Europe/East Asia Economic Summit held in Singapore in the autumn of 1995.<sup>13</sup> I paid particular attention to see whether normal American intellectuals would react to my concept as being “anti-American.”

One American expert I asked offered the following view: “It doesn’t seem particularly anti-American. After all, this sort of instability in the yen-dollar rate [1995 was the year in which the dollar fell below ¥80 at one point] benefits nobody.” And the reaction I got from European experts in 1995 may be summed up as follows: “As the European experience shows, achieving monetary union is a long, hard process. It seems unlikely that Asia will move ahead in this direction right away. It’s still too early to achieve this. But the time may come within the next ten years when people will look back on your proposal and recognize its worth.”

With respect to the South Korean won, we need to recognize South Korea’s dynamic contribution to the Asian economy. In addition, the idea of a free-trade agreement between Japan

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<sup>12</sup>Montes, *op. cit.*, p. 30.

<sup>13</sup>For the text of the paper I delivered in Singapore and the reaction to it, see my book *Kokusai tsuka to APEC-Nihon taigai kodo ron* (An International Currency and APEC: Considerations on Japan’s External Behavior), Ministry of Finance Printing Bureau, 1996, pp. 207–20.



and South Korea has been advanced; the economic effects of this sort of concept may be limited if consideration is not given to the currency side of the picture.

In including the Thai baht in the basket, I have noted the possibility that Thailand may play an important role at the subregional level in connection with the “baht zone” concept.

I would note that I do not oppose the inclusion of currencies other than these five in the basket. If the APEC finance ministers’ meeting so decides, my concept does not block the inclusion of the currencies of additional APEC participant countries or regions.

However, the concept of a basket for an APEC common currency unit does not go so far as to envisage inclusion of Europe’s integrated currency, the euro. The countries of the region can conduct dialogue and cooperation with Europe through the finance ministers’ session of the Asia-Europe Meetings (ASEM), but the euro will not be added to the currency basket of the APEC common currency unit. This is because it is based on a regional concept. Some people may be surprised at this aspect of a concept coming from me, known as a member of the “French school,” but the concept is one of closeness to the U.S. dollar and distance from the euro.

In view of the fact that the currency unit is to start out as a numeraire (standard of value), and also that Asia’s trade ties with Europe are strong, some may well advance the view that including the euro would result in greater stability. In my thinking, however, the status of the currency as a numeraire should be seen only as the first stage, with the eventual aim being to create an Asian (Asia-Pacific) common currency. The APEC common currency unit is only a transitional stage, the first step on the way to creation of an Asian (Asia-Pacific) common currency. Though it is only the first step, we must keep the eventual goal of creating a common currency in mind from the start. I thus think we should distinguish between the role of the dollar and that of the euro in view of the future prospects of this concept.

#### **Feature 4**

The technical aspects, such as the weights of the various currencies included in the basket, can be considered by a panel of specialists from the countries involved set up under the APEC finance ministers' meeting.

### **Feature 5**

The fact that the common currency unit is to be set up first as a numeraire is a major feature of this concept. I will return to this point, including the definition of an international currency, in detail below.

### **Feature 6**

The APEC common currency unit will not interfere with the sovereignty of the participating countries in the area of monetary policy. The circumstances of the countries within the Asia-Pacific region are diverse. The region is dynamic, but there is unevenness in the level of economic development. Aiming right away for a single currency like Europe's is not suited to this actual state of affairs in the region. The main role of the APEC common currency unit will be to lessen foreign exchange risks; the concept preserves countries' monetary policy autonomy. It will be sufficient to achieve convergence of monetary policy in time for the stage of launching the common Asian (Asia-Pacific) currency. For this purpose we can start with a loose form of surveillance of monetary policies within the region.

### **Feature 7**

The concept aims to keep the role of governments to a minimum and places its expectations in private-sector economic circles. In order to form a common currency, we will need to have political will, as described below. But political decisions alone are not sufficient for the creation of an international currency. Currencies also have a technical side. As is often said, "The market selects currencies." Unless the businesses and banks of the Asia-Pacific region support it, its use will not

expand. For this reason the common currency unit must of course be highly stable, but in addition constant efforts must be made to lighten the costs involved in using it.

The aim of having an Asian (Asia-Pacific) common currency (unit) is for its use to stabilize trade and investment transactions within the Asia-Pacific region. In today's global economy, where capital movements are dominant, use of an APEC common currency unit may start not with trade transactions but with capital transactions, leading to the formation of a capital market, as the earlier example of private-sector use of the ECU suggests. For example, a reasonable starting point would be the use of the new currency unit as the unit of denomination of bonds issued by the ADB in the capital markets of the Asia-Pacific region, including Japan.

### **Feature 8**

As I will explain in the following section, the fact that this is an extremely simple scheme eases the task of forming political will to implement it.

The above eight points are the core features of the proposed APEC common currency unit.

Now I would like to discuss five of these features further. An international currency, defined as "a currency in wide international use," must have at least some of the following attributes:

- (1) Numeraire
- (2) Means of payment for private-sector transactions
- (3) Store of private-sector assets
- (4) Reserve currency
- (5) Currency of intervention

The first attribute, "numeraire," refers to a currency's role as a standard of value. For example, "SDR-denominated" means that the SDR is the standard of value. The word *numéraire* is French; it was first used by Léon Walras in 1870 (*Eléments d'économie politique pure*) to refer to the representation of the value of other goods. It has been appearing in international monetary negotiations since 1971.

Under the Bretton Woods agreement, the numeraire for the international monetary system was gold. But the agreement gave an almost equivalent position to the U.S. dollar. The two were linked by convertibility. The Bretton Woods system was not based on a gold standard but centered on a U.S. dollar that was freely convertible into gold; it is called a “gold exchange standard.” In the old Articles of Agreement of the International Monetary Fund, Article 4, Section 1, it was provided that the par values of currencies would be expressed “in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.” Eventually the convertibility between the dollar and gold came under doubt; the solution chosen was not to strengthen the link between the two but rather to separate them and banish gold from its role as numeraire.

Following World War II the U.S. dollar enjoyed overwhelming strength, but in 1959 the United States’ international payments balance fell into the red (though it still had a trade surplus). The first crisis in the convertibility of the dollar into gold occurred in October 1960. In response to this President John F. Kennedy sent U.S. gold holdings to London and set up a “gold pool” including the United States and seven European countries. On March 15, 1968, following the sale of about 1,000 tons of gold through this pool over the preceding few days, the United States hurriedly summoned representatives of involved countries to a meeting and declared that henceforth central bank holdings of gold would be used only for transactions among public authorities.

This marked the effective shift from a gold exchange standard based on free convertibility between the dollar and gold to a dollar-centered system. The official end of convertibility between the two was announced by President Richard Nixon on August 15, 1971. Reflecting this change, the IMF adopted revised Articles of Agreement in 1978, eliminating any official price for gold and selecting the special drawing right (SDR) as the numeraire.

The second attribute of a international currency is its wide use as a means of payment for private-sector international transactions in goods and capital.

The third attribute is that it be held as a store of assets in the private sector.

The fourth attribute is that it be a public reserve asset, or in other words, that it be held in foreign-currency reserves. The difference is that, while the preceding three points involved private-sector holdings, the fourth point involves public holdings.

The fifth and final attribute is that it be a currency of intervention, meaning that it be used by monetary authorities when intervening in foreign exchange markets. All currencies used for intervention are reserve currencies, but not every reserve currency is necessarily used as currency of intervention.

If we examine international currencies against this list of attributes, we find that the ones that they all share are the roles of numeraire and reserve currency. Working in the other direction from this finding, I judged that a currency with the attribute of being a numeraire is capable of becoming an international currency, and what I put together on this basis was the APEC common currency unit.

The APEC common currency unit that I discuss in this essay is formed as a numeraire. The thinking that constitutes the core of my concept is the conclusion that, based on an analysis of the European experience, it was the birth of the ECU as a numeraire currency under the European Monetary System (EMS) broke through the deadlock that had been reached with the EC's existing currency "snake," serving as the technical essence for the developments leading to the launching of Europe's integrated currency—and that applying this experience in the Asia-Pacific region is the shortest route to achievement of the goal of a common Asian currency.

#### **IV. Conditions for Establishment of the New Currency (Unit)**

There are two conditions for the establishment of a common currency in a certain region: (1) objectively, that there be a need for it and (2) subjectively, that there forms the political will for it.

##### **1. Formation of political will**

As for the first condition, as I noted above, since the mid-1980s the Asia-Pacific region has experienced both an excessively strong yen and an excessively weak yen, and also the Asian currency crisis; in order to sustain a high growth rate, above all it is necessary to maintain currency stability.

With respect to the second condition, the formation of the political will to implement this concept, Tomomitsu Oba has offered the following observation: “The birth of the euro, I would suggest, was achieved because of the existence of the goal of political integration. As I see it, after experiencing two world wars, the political will that ‘we’ve had it with war’ gained strength, and this strength led to integration. In that sense, in Asia unfortunately one doesn’t see the strong political will to aim for integration.”<sup>14</sup>

Let me start out this section with three comments on Oba’s view.

First, when speaking of “political will,” should we not distinguish two meanings? The first meaning is “political will” in the sense of something distinct from economic interests. For example, this is the sort of will that would lead people to declare, “We will proceed with monetary union even if there are economic losses inasmuch as greater political interests are involved.”

In 1950, at a meeting to prepare for the establishment of the European Coal and Steel Community (ECSC), West German representative Walter Hallstein declared: “The German government reaffirms that the Schuman Plan is above all of a political nature. From this perspective, economic considerations, however weighty they may be, occupy only a secondary position. There is

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<sup>14</sup>*Yomiuri Shimbun*, April 8, 1999.

always some way of solving economic problems.”<sup>15</sup> The “political nature” that Hallstein emphasized corresponds to “political will” in this first sense.

The second sense of “political will” is the unwavering resolve to do something by all means. This is the sort of political will behind the declaration, “We will move forward with monetary union as a matter of supreme national will.”

In the case of Europe’s monetary integration, “political will” encompasses both of these meanings together. It is “the will of the participating states to move forward [with monetary integration] apart from economic interests.” However, in the Asia-Pacific region the political side that is distinct from economic interests under the first sense of the term is weak, and it is the economic side that comes to the surface. So in the case of the Asian (Asia-Pacific) common currency concept, “political will” means “the will to move forward based on a calculation of the economic interests”; it is of a different nature from that of Europe. At least for the near future, the debate can be expected to progress on the basis of pure economic calculations of whether implementing the concept will be advantageous or not. In order for an Asian (Asia-Pacific) common currency (unit) to be established, it will be necessary for the economic debate to be deepened and for it to be proved, in qualitative and quantitative terms, that a common currency is economically advantageous. The role of political will (in the second sense) in this case is that of moving forward with the undertaking once this point has been proved. In Europe, countries faced the issue of having to yield some parts of their sovereignty from the initial stages of the ECSC and the move to common tariffs, but the Asia-Pacific region has not had this sort of experience.

The second comment I would make is that the political will to undertake this project cannot be said to be totally absent.

First of all, note this comment from Luo Yuanzheng, an assistant to Zhou Enlai who also provided advice to Li Peng: “In order for China and Japan to get along successfully in the twenty-first century, they should move ahead with economic cooperation. After World War II Germany and France built a system to avoid war through the EU. We need to learn from this example. The

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<sup>15</sup>Jean Monnet, *Mémoires* (Fayard, 1976), p. 384.

Chinese and Japanese share the same black hair and dark eyes. I hope Japan will not forget its invasion of China and that the two countries will build a mutual relationship in the economic sphere.”<sup>16</sup>

Secondly, at a meeting of ASEAN finance ministers held in Bangkok in the year the Asian currency crisis struck, hitting the baht first, Thai Finance Minister Thanong Bidaya reportedly put forward the concept of a single currency for ASEAN.<sup>17</sup>

Thirdly, as of two years later, in 1999, the political leaders of the Asia-Pacific region have reached a shared view that excessive dependence on the U.S. dollar had invited the 1997 Asian crisis; in fact President Joseph Estrada of the Philippines has been urging consideration of an Asian common currency.<sup>18</sup>

In this respect the situation has changed greatly from 1995, when I initially proposed an APEC common currency unit. We should be sensitive to this change.

At the same time, however, as Oba has pointed out, the political will to move forward with debate on a common currency has not yet matured in Asia or the Asia-Pacific region. Most of the proposals from advocates of a common currency either lack concrete substance or are copies of the European model. Also, the leaders of the three key countries of the region, the United States, Japan, and China, do not feel the need for a common currency that strongly. Behind this is the fact that these three countries, which would form the core of an Asian (Asia-Pacific) common currencies, are not thought to have been directly hurt by the Asian currency crisis. Some people are of the view that it will take the experience of another serious crisis to make people loudly call out the need for a common currency. Consider this comment from Jean Monnet, the father of the European Community: “Wisdom and reform only emerge at times of great difficulty. ‘Couldn’t the major crisis have been avoided if measures as simple as this were taken in advance?’ Any who may ask this do

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<sup>16</sup>Takehiko Kondo, *Taikenteki datsu-O nyu-A no ki-Puraza no kiseki* (A Personal Record of Moving “out of Europe into Asia”: The Plaza Experience) (JETRO, 1994), p. 188.

<sup>17</sup>*Nihon Keizai Shimbun*, September 21, 1997.

<sup>18</sup>*Nihon Keizai Shimbun*, June 4, 1999.



not understand that people do not accept change except in the midst of necessity, and that they do not feel necessity except in the midst of crisis.”<sup>19</sup>

My third comment is that “political will” is not something that springs up suddenly overnight. If it does not exist now, rather than give up on the idea itself, we should consider how it can be formed, draw up a blueprint of the process leading to its formation, and induce political leaders and markets to move their thinking in this direction; otherwise this political will can never be expected to emerge. I think that the present lack of political will must not be used as an excuse for inaction.

So how can this political will be formed? Three elements are required: (1) motivation, or a strong sense of purpose, (2) propulsion and strategy to serve as a lever, and (3) a continuous step-by-step plan to serve as a guideline. I will next consider these in turn.

### **(1) Motivation**

In looking at the presence or absence of the motivation that is a precondition to the formation of political will, here I will look separately at Southeast Asia, China, the United States, and Japan.

*(a) Southeast Asia* Based on what I have written above, the need for an Asian (Asia-Pacific) common currency (unit) is probably great first of all in those places that were directly hit by the Asian currency crisis. This is because the existence of such a currency (unit) will contribute to strengthening their resistance as a group to a recurrence of the problem of sudden capital outflows and inflows and to achieving the long-term correction they seek for their lopsided dependence on the dollar.

What is important for Southeast Asia over the medium to long term is technology transfer, meaning direct investment. In his 1994 essay “The Myth of Asia’s Miracle,” Paul Krugman asserted that the economic development of Asia was being powered by increased inputs of capital and labor, which had resulted in increased production, and that the region had not progressed technologically;

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<sup>19</sup>Monnet, *op. cit.*, p. 129.

this growth, he said, would decelerate, and the idea that it would not was a “myth.” The negative growth that Asian economies experienced following the 1997 crisis was due to currency speculation, not to a lack of technology, but the extent to which Southeast Asia can develop in the world during the period to come will depend to a large degree on technology transfers from Japan and other countries, as well as on the formation of a technology network within the region.

One point that bears noting in this connection is the lack of signs of withdrawal from the region by Japanese companies that moved in to set up operations in the wake of the 1985 Plaza accord, which sent the yen surging to great heights and thereby promoted a move to offshore production among Japanese manufacturers (the “Plaza effect”). It is fortunate that the Asian crisis is coming to an end without such withdrawals. Once the crisis is overcome, for example, the network of supporting industries that had been forming in Thailand before the crisis in the automobile industry should come to be a powerful force contributing to the country’s economic recovery.

What Southeast Asia requires for sustained economic development in the period ahead is a combination of the technological progress to which Krugman drew attention and the currency stability that the crisis highlighted the need for.

*(b) China* In order for China to achieve its economic planning goals and achieve further development of its economy in the twenty-first century, it is expected to need massive amounts of foreign investment. The problem is what currency of denomination to use in raising these funds.

One idea would be to raise the funds in yuan. This would be the most desirable option for the Chinese, because it would entail no foreign exchange risk for them.

Ever since 1994 China has been running a trade surplus. And ever since 1993, long-term foreign capital has been flowing into the country on a major scale, as direct investment and in other forms. Up to the time of the Asian currency crisis in 1997, China was enjoying a virtuous circle of trade surpluses, inflows of direct investment, increasing foreign currency reserves, and a stable yuan, all leading to further growth in trade and in capital inflows. It was predicted that if this strengthening of China’s external position continued, the yuan would soon become an international currency. For

the near future, however, it will probably be impossible to attract many international investors with yuan-denominated instruments.

Another idea is to raise the necessary foreign capital in U.S. dollars. This may attract international investors, but it means that the Chinese will have to accept a major foreign exchange risk. Foreign exchange risks are frightening when raising huge amounts of funds. It has even been argued that the dollar exchange-rate risk that Japan bore after the Plaza accord caused it to lose the “economic war.”<sup>20</sup>

A compromise solution would be to spread the risk between the Chinese and the international investors by using a common currency unit somewhat removed from both the dollar and the yuan. If China wants to bring in huge amounts of foreign capital, this is probably the only approach that can logically be adopted.

China is a great power, and it is possible that the scale of its economy will greatly outstrip that of other Asian countries in the twenty-first century. The Chinese may thus attempt to achieve a diversification of this foreign exchange risk on their own. In other words, rather than rely on a “common” currency unit, they could choose to link their own currency to a basket of other currencies, thereby seeking to avoid foreign exchange risk for themselves and to stabilize the yuan. The active moves by the Chinese monetary authorities to add the euro to their foreign currency reserves may be taken to suggest that they are already inclining in this direction.

In my own view, Japan’s position will be decisive in this connection. Japan and China are neighbors both with major economies, and given their geographical positions and their respective situations with respect to resources, it is highly likely that their ties of economic interdependence will grow even deeper in the century ahead. If in this context Japan rigidly insists that its transactions with China be denominated in yen, the scope of use of the yuan will be limited, and it will become that much less able to cope with shocks and that much more likely to become the target of speculation.

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<sup>20</sup>Mototada Kikkawa, *Mane haisen* (Defeat in the Money War), Bunshun Shinsho (Bungei Shunju, 1998).

The Chinese economy may grow tremendously in the twenty-first century, but even so, I would suggest that it will probably continue to be impossible for China to protect its domestic sector from the effects of currency speculation through its own efforts alone. If that is the case, then I think a practical policy choice for the Chinese is the approach of a common currency unit that involves the yen, other East Asian currencies, and the dollar as well.

(c) *United States* When considering international monetary affairs, the position that the United States takes is of decisive importance. America's leadership in the international monetary field is, along with its military might, central to its superpower status. Back in 1975, when Jacques Rueff was still alive, I heard directly from him that when he presented his own position on gold convertibility to President Valéry Giscard d'Estaing, the latter immediately responded, "But our partners won't agree to that"; the "partners" to whom he referred were the Americans. The "Asian Monetary Fund" concept of 1997 also went aground because of U.S. opposition. Since World War II, no proposal concerning currency arrangements has seen the light of day unless the United States agrees to it. In other words, this is an area where the Americans exercise veto power.

Does an Asian (Asia-Pacific) common currency (unit) have merit for the United States? The fact that the dollar is the world's sole key currency is something of a burden, but it is also an advantage in terms of financing the country's savings deficit.

In macroeconomic terms, if we hypothesize that the United States' savings deficit (and trade and current account deficits) will persist even in the twenty-first century, then this sort of common currency can serve to create currency neutrality—a level playing field, so to speak—among the United States, China, and Southeast Asia in competitively making effective use of Asian, particularly Japanese, savings to cover such shortfalls. Even a country as mighty as the United States cannot compel others to lend to it in dollars. If Japanese and other investors decide they want to avoid the risk of investing in dollars and choose to invest their savings in other currencies, then the United States will be compelled to accept the risk of taking in funds denominated in these other currencies.

Japanese investors might prefer for their funds to be denominated in yen so as to avoid any foreign exchange risk for themselves, but denomination in an APEC common currency unit would lessen the foreign exchange risk for the United States. In order to get the United States to accept use of a common currency unit for its borrowing, Japan will first of all need to make it clear that it intends as a matter of policy direction to move toward greater use of the yen and toward its internationalization, and that it will not finance the U.S. deficit further unless the funds are denominated in yen. Every country wants to avoid foreign exchange risks; the desire of Japanese investors for yen-denominated instruments is a matter of financial common sense, not a reflection of anti-American emotionalism.

Be that as it may, the concept of an Asian (Asia-Pacific) common currency unit is one with a much milder impact on the international monetary system than that of Rueff's concept of convertibility with gold. It does not directly challenge the United States' specially privileged position in currency matters but merely seeks to avert needless confusion in the international economy by somewhat lightening foreign exchange risks.

This concept is not one that considers Japan's interests alone; it aims for stabilization of trade and investment transactions for the entire Asia-Pacific region, and it arises from a practical recognition of the problems, seeking to meet the actual needs in the area of international transactions. Adding an APEC common currency unit as a numeraire currency is a move to fill out the line of available products in the currency market.

So even if an APEC common currency unit is created, this does not mean that the United States will have to abandon its dollar, nor, inasmuch as it is a numeraire currency, will the United States be expected to supply liquidity. To take the argument a step further, if something like the APEC common currency unit were to emerge from the private sector in the form of a new financial product including the dollar, the United States could not object.

If the members of APEC were to launch this sort of common currency unit, it would not be possible for the United States to oppose inclusion of the dollar in the currency basket, any more than Britain could oppose the inclusion of the pound as one of the constituents of the ECU currency

basket, even though it was not participating in the EMS. And once the currency unit was established, if the market grew, the main factor would be market factors, which not even the United States can resist.

Would the United States be able to object if the undertaking were carried to the further stage of creating an actual Asian (Asia-Pacific) common currency? Even in this case, the Americans could not oppose a move by other countries to adopt such a common currency based on the APEC common currency unit, a basket numeraire currency that had grown up in the market. This is analogous to the situation in Europe, where Britain was able to decide not to become part of the monetary union but was not in a position to block the transformation of the ECU, which had included the pound, into the euro.

So in the final analysis, as long as the market mechanism is the operative force, the United States cannot block the emergence of an Asia-Pacific common currency unit or common currency, and even if the United States does not participate, it merely means that this will be an issue for the monetary authorities of other countries and markets in the region, not for the monetary authorities of the United States. As a senior American administration figure once said, “The dollar is *our* currency, but it’s *your* problem.”

My concept is thus inherently structured as one based on the market mechanism so that the United States will ultimately have to accept it. In this sense the approach is different from that taken in Europe, where “political will” was emphasized and the integrated currency was created through sheer political force. The concept of an Asian (Asia-Pacific) common currency is an attempt to use the more supple force of market persuasion to push the United States and China, as noted above, toward the desired goal. So as I stated at the beginning of this section, the “political will” that is required for the implementation of this concept is different in nature from that which was required in Europe.

(d) *Japan* For Japan, the common currency concept offers both political and economic advantages.

On the economic side, over the medium to long term if the Chinese economy develops further, the yuan will probably gain strength. If this happens in the absence of a common Asian (Asia-Pacific) currency, the region is liable to become effectively split between a dollar zone and a yuan zone. And if the dollar-yuan exchange rate is unstable, the yen will find itself caught between these two currency zones, becoming even more volatile than at present, and the Japanese economy will suffer; the economic growth of the region as a whole will probably also lose speed as a result.

On the political side, an extended period of work leading up to the birth of an Asian (Asia-Pacific) common currency and the progress of the process toward this goal will serve as evidence of the development of ties of mutual interdependence within the region, causing members' behavior to be motivated by the desire not to destroy these ties.

Though it may seem like overstatement, I would suggest that this will also contribute greatly to security within the Asia-Pacific region. As Barry Eichengreen notes, "monetary unification may be a credible way for governments to renounce extraterritorial ambitions. Abandoning national control over seigniorage by joining a monetary union diminishes the capacity to wage war" (in other words, countries that join a monetary union cannot simply print money to cover their military spending).<sup>21</sup> For Japan, which has taken international peace as its guiding principle and has adopted a firm national policy of minimizing military power, this concept may be seen as one of "currency-based security."

To sum up, in my view Southeast Asia, China, the United States, and Japan all have the motivation required as a precondition for the formation of the political will to create a common currency, though their reasons are different from each other's.

## **(2) Propulsion**

I believe that Japan is the country that can and should take the initiative in propelling the concept of an Asian (Asia-Pacific) common currency. While it has both the funds and the

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<sup>21</sup>Barry Eichengreen, *International Monetary Arrangements for the 21st Century* (Brookings Institution, 1994), p. 89.

technology that the Asia-Pacific region seeks—a precondition for the formation of the political will for a common currency—unlike the United States or China, it is not in a position to force this concept on others through its own “hegemony.” For this very reason other countries would be happier with a Japanese initiative, and this would be beneficial to Japan itself. The hurdle will be getting U.S. and Chinese agreement. Within the process of establishing an Asian (Asia-Pacific) common currency (unit), finding a way to do this may be just as difficult as deciding on the contents, if not even more so.

If Japan takes the initiative, what I think will serve as its “lever” will be the presence of the yen. For this reason Japan must actively pursue a “yen strategy.” I will return to this point below. To put it baldly, insisting on use of the yen is the biggest single form of propulsion for this concept, and Japan should concentrate single-mindedly on this point.

### **(3) A step-by-step approach**

Next I will offer a model for the process leading up to the creation of an Asian (Asia-Pacific) common currency. I will first typologize the European example and then offer an Asian model as a modified version of the European model with respect to political will.

The process of achieving political will and reaching decisions for monetary integration in Europe had five stages. The first was that of reaching political agreement on the importance of regional unity. This agreement was formed in the 1950s under the leadership of France’s Robert Schuman and West Germany’s Konrad Adenauer. In his memoirs, Jean Monnet quotes the following statement that Adenauer made to him in connection with the concept of a European Steel and Coal Community: “I am not a bureaucrat, nor am I totally a politician. I like you, am considering this plan from the highest plane—one that approaches the moral realm. Realizing this grand aspiration is a matter of our moral, not administrative, responsibility to our nations. The welcome for this concept in Germany is enthusiastic. So we will not fuss over the details. I have been hoping for this initiative for twenty-five years. My government and my country are not seeking to grasp hegemony through our joining. History has taught us since 1933 how valueless such considerations



are. We know that Germany's fate is bound to that of Western Europe."<sup>22</sup> This was the first stage of the political will for European integration that continued unbroken through the 1999 birth of the single European currency.

Given Asia's practical-mindedness, I think the achievement of agreement at this stage will follow a process different from Europe's, namely, the formation, confirmation, and strengthening of the political will in question on a repeated basis at the second and subsequent stages described below.

The second stage was the agreement on the need to form a monetary union. The political will to do this came from an initiative by French President Georges Pompidou in the late 1960s and early 1970s. The political will I was aiming for with my proposal for an "APEC common currency unit" corresponds roughly to this stage of the process in Europe.

The third stage was that of agreeing on the technical outline of the monetary union. This was seen in the launching of the EMS in the late 1970s based on leadership from France's President Valéry Giscard d'Estaing and West Germany's Chancellor Helmut Schmidt.

Fourth came the agreement to create a single European currency, the political will for which was based on the initiative of West Germany's Helmut Kohl and France's François Mitterrand in the late 1980s.

The fifth and final stage involved the political will required to persuade skeptical markets through the implementation of forceful domestic economic policies. France's Jacques Chirac played a key leadership role in this connection.

The process leading up to the inauguration of Europe's single currency was thus a multitiered one, and it was accompanied by a consistent unity of direction. It was not something that could be accomplished on the basis of the philosophy of a single leader; the political will had to be formed step by step over an extended period of time, and it took the participation of multiple leaders spanning generations.

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<sup>22</sup>Monnet, *op. cit.*, pp. 366-67 (translated into Japanese by the author and thence into English).

## **2. From the European model to an Asian model**

Now I will modify the process seen in the five stages of the European model above so as to derive an Asian model.

The first modification is the absence of a first stage as seen in Europe. Given the Asians' attitude of taking care of matters on a practical basis, it seems to me that the political will seen at this stage in Europe can in Asia's case come at the final stage of launching the common currency.

The second modification involves breaking down the process into a number of essential elements and reordering them. One such element in the European case was the introduction of the currency "snake," which was based on an initial focus on the desire to reduce the degree of fluctuation in the exchange rates among the countries involved; it was believed that if this could be accomplished, monetary integration could also be achieved. But in the end this undertaking was a failure. So for the Asian model I would propose instead that first a common currency basket be created and that this be given a chance to become firmly established as a numeraire, with the attendant development of markets; the linking of currencies to the currency basket (common currency unit) can be considered after the common currency unit has achieved an established position.

Another essential element found in the European model is the achievement of convergence in monetary and other macroeconomic policies. In the Asian case this process should not be rushed. Surveillance of macroeconomic policies should be conducted at the regional level from the start, but this should be an area just for discussion, not for policy coordination. The underlying thinking is that if progress is made toward a common currency, the need for policy coordination will become self-evident; in other words, this sort of coordination can be pulled along by the momentum toward monetary integration.

In Europe there was a debate from the start over which should come first, monetary integration or policy coordination, but the model I would propose for Asia would put policy coordination later. In other words, a feature of my concept is that it takes a market-oriented

approach to the monetary integration process, first creating a numeraire called the “APEC common currency unit” and then, with this as a base, observing and encouraging the development of markets using the new currency unit.

Before monetary integration was undertaken in Europe, various other forms of integration were achieved—the ECSC, tariff unification under the EC, and the Common Agricultural Policy—all founded on agreements between France and Germany. But in Asia monetary integration will come first. In Europe’s case, initially the idea was to go with the system of currencies fixed to the gold exchange standard. It was the collapse of this system of fixed parities that led to thinking about monetary integration. The Asian model should be the reverse of this. Moves toward capital liberalization and the resulting huge flows of capital across national borders have the potential to destroy small-scale economies, as Asia saw during its currency crisis. Without currency stability, the countries of the region cannot develop stable trade and investment dealings with each other. The conditions that Europe faced earlier and those that the Asia-Pacific region faces now are very different in this respect.

The common point among the modifications made to the European model to create an Asian model is that the latter is a “softer” version of the former. At the same time, however, it must contain a firm core capable of serving duty for over a century. The core of the Asian model is first to create an “APEC common currency unit” as a numeraire, to have this establish a place for itself, and then, once this process has achieved a certain momentum, to deal with the specialized technical problems relating to the creation of an Asian (Asia-Pacific) common currency, such as the setting of intervention points (against the currency basket) and the achieving of convergence in monetary and other macroeconomic policies. The course to an Asian (Asia-Pacific) currency should start with the winning of popular understanding through the construction of a common currency unit, to be followed later by the discussion of intervention points and policy convergence.

I attach an outline of the stages of a proposed Asian model.

Stage 1. Launching of an APEC common currency unit

- Stage 2. Establishment and development of APEC common currency unit markets
- Stage 3. Linking of Asian national currencies to the APEC common currency unit within certain bands
- Stage 4. Strengthening of monetary policy surveillance within the APEC region and convergence of policies and economic conditions toward a set direction
- Stage 5. Formulation of APEC common monetary policy
- Stage 6. Launching of APEC monetary union

Political will should be formed with the aim of achieving this objective.

### **3. Forums for the formation of political will**

What would be the concrete forums for the formation of the political will that I have discussed above?

My proposal is designed with the APEC level in mind. APEC already has summit meetings among leaders of the region. Technical monetary matters could be handled at the level of the finance ministers' meetings. But a major undertaking like the creation of a common currency, which involves countries' sovereignty, is beyond the mandate of the finance ministers and would require the decision of the government heads. So in my opinion, the formation of the political will to create a common Asian (Asia-Pacific) currency is to a considerable extent synonymous with the strengthening of APEC.

If APEC is strengthened, ideas like the creation of an APEC monetary union will arise. And if the idea of creating an APEC monetary union gained strength among the region's political leaders, this would in itself strengthen APEC and give it a political vision. To simplify, the strengthening and development of APEC is a precondition for the formation of the political will for an APEC common currency.

At some point along the way toward formation of a common currency, the APEC leaders would need to set up a group of "currency sages" and have a blueprint drawn up for APEC

monetary union. In terms of the European experience, what would be needed would be something perhaps not as ambitious as the Delors Commission but like the Werner Commission. But we can observe the European record of having created something out of nothing; using this ‘latecomer’s advantage,” we should be able, despite the hurdles arising from the diversity of the region, to greatly shorten the length of the path to a common currency.

## **V. The Role of the Yen in the Asia-Pacific Common Currency Unit**

In this section I will discuss concrete policies.

The hypotheses serving as the starting point for this discussion are as follows:

The further internationalization of the yen is both necessary and desirable. Unless the yen has a regional presence, it will not be possible to develop an Asian (Asia-Pacific) common currency. This is because, in the yen's absence, the U.S. dollar and Chinese yuan, the currencies of the region's two biggest political and military powers, will maintain and extend their influence; both the United States and China will be striving to achieve greater clout for their own currencies. Also, without the yen's presence, neither Washington nor Beijing is likely to pay much heed to the words of the monetary authorities in Tokyo. An increased presence of the yen, however, will not eliminate the need for a common currency. This is because Japan lacks political and military influence, meaning that even if it wanted to impose its own hegemony over the region, it is incapable of doing so. As long as the dollar and yuan are on the scene, the need for a common currency will continue to exist in this region.

Even if the internationalization of the yen progresses, it will be to Japan's advantage eventually to give up its own currency in favor of a regional common currency. The fact that the internationalization of the yen will actually lead to its abandonment is what we may call "the paradox of the yen." Japan must accordingly consider the strategic internationalization of the yen from this sort of perspective. To repeat, without the yen's assuming an expanded role, a common currency will not be born in this region. The yen must serve as the initiator. It is inverted logic to think that there is no need to internationalize the yen now because we will eventually have a regional currency. In Europe as well, it was the presence of the deutsche mark as an international currency ranking second to the dollar, along with the fact that the French franc was strengthened through the application of anti-inflationary domestic policies, that made it possible to create a single currency. The Asian (Asia-Pacific) common currency will make use of the dollar, and it will incorporate the

yuan. If this comes to pass, even the advocates of creation of a “yen zone” will be able to see their ideas accomplished in a practical shape.

### **The strategic internationalization of the yen**

Now that we have been through the Asian currency crisis, the discussion of internationalization of the yen is taking place against a background considerably different than before. In April 1999 the Council on Foreign Exchange and Other Transactions, an expert panel affiliated with the Ministry of Finance, issued a report concerning the yen’s internationalization.<sup>23</sup> In the wake of the Asian currency crisis and the launching of the euro, the topic of internationalizing the yen has become the focus of renewed interest, but it seems to me that in some respects this is a nationalistic reaction to the rejection of our country’s 1997 proposal for establishment of an Asian Monetary Fund. Japan’s response should be as follows:

First, we should seek to achieve strength and stability for the yen over the medium term and keep our currency from becoming undervalued. Raymond Barre once remarked, “Based on my experience of international relations so far, countries with weight are countries with strong, stable currencies.”<sup>24</sup> Also, Karl Otto Pöhl, former president of Germany’s central bank, has declared, “It is my conviction that a central bank or government must never seek to lower the value of its own currency.”<sup>25</sup>

On the external front, a stable yen will contribute to Asian stability, building a solid framework for the regional economy. Also, if the value of the yen declines, so will that of domestic financial assets in global terms. As a country with a rapidly aging population, Japan must not allow this sort of asset value erosion. Macroeconomically speaking, there is even a possibility that Japan may shift from a savings-surplus economy to a savings-deficit economy. Mistaken economic policy could cause the value of the yen to plummet. In order to avoid the yen from falling too low, we must

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<sup>23</sup>“Internationalization of the Yen for the 21st Century”  
<<http://www.mof.go.jp/english/if/e1b064.htm>>.

<sup>24</sup>*L’Expansion*, September 1976.

<sup>25</sup>*Nihon Keizai Shimbun*, September 13, 1995.

maintain the trust of the market in our currency. The first precondition is a sound set of monetary and fiscal policies. It is strongly to be desired that Japan adopt moderate economic policies, both fiscal and monetary, such as those implemented by European countries as they aimed for achievement of their single currency, so as to stabilize the yen.

Second, Japan should aim for a currency strategy that stresses Asia. The construction of a new Asian funding strategy that puts together the New Miyazawa Initiative, internationalization of the yen, and the new plan for official development assistance is a task that Japan faces now, two years after the Asian currency crisis. The issue is one of how to put Japan's surplus savings to work effectively elsewhere in Asia while avoiding foreign exchange risks.

If we base our thinking on the assumption that Japan cannot recover and survive economically, finding enough workers as its population rapidly ages, unless it develops its ties of mutual interdependence with the countries of the Asia-Pacific region based on the price mechanism, then it follows that, even if Japan has a macroeconomic savings surplus, it is sufficient that balance between savings and investment be achieved in Asia as a whole; there is no need for Japan to make unreasonable efforts to transform its savings into domestic demand. Provided steady, high returns can be achieved, it is better for our savings to be used elsewhere in Asia to fund productive and profitable investments there rather than to be devoted to low-profit investments within Japan. But we should in this case try by all means to avoid bearing foreign exchange risks. If the new funds Japan invests in Asia are denominated in yen, this investment will itself promote the yen's internationalization.

Third, we should get Japanese businesses to rethink their own positions regarding the yen. The most effective way to internationalize the yen is to have Japanese corporations decide that in principle they will not accept currency risks. The attitude of our own business community has been a hurdle to wider use of the yen. When counterparts in other countries, such as Malaysia, have sought to pay in yen, Japanese corporations have said no. They have reportedly insisted that dealings be conducted in dollars. It seems to me that this is a result not so much of "currency inertia," as people often say, but rather of active decisions on the part of businesses. They have thought of the dollar as



a convenient, stable, and profitable currency to use, and they have undeniably failed to be sufficiently wary of the foreign exchange risk involved. The determination to use the dollar has been all the stronger at the largest of Japan's business corporations, banks, and trading companies. The result has been exchange rate losses for them when the yen-dollar rate has turned the wrong way, plus a situation where Japanese banks have sometimes been forced to pay a "Japan premium" in order to borrow money in international markets.<sup>26</sup>

Fourth, we should work to make the yen more convenient to use internationally, that is to say, internationalize it further.

According to the materials attached to the April 1999 report of the Council on Foreign Exchange, as of 1992 the share of the yen in world trade was 5%, against 48% for the U.S. dollar and 31% for the 15 national currencies of the EU. And the yen's share of global foreign exchange reserves at the end of 1997 was only 4.9%, compared to 57.1% for the dollar and 22.8% for the EU currencies. Considering that the respective shares of the world's 1997 gross domestic product were 26.1% for the United States, 27.0% for the 15 countries of the EU, and 14.0% for Japan, it is clear that international use of the yen is disproportionately small.

Rather than rely just on these traditional indicators of international use, I consider it appropriate to consider the share of Japan's external assets denominated in yen, inasmuch as capital movements play such a major role in the world of finance today. Roughly speaking, Japan has ¥1.3 quadrillion worth of financial assets; as of the end of 1998 its net external assets came to ¥133 trillion. The net external assets of Japan's banks and similar institutions at the end of the same year amounted to ¥29 trillion, of which ¥16 trillion was denominated in yen, a fairly high share. One factor is that, with the monetary authorities in Tokyo holding yen interest rates extremely low, hedge

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<sup>26</sup>Toshikatsu Fukuma, executive vice president of Mitsui & Co., has declared: "The conditions for internationalization of the yen are in place, so now the private sector needs to work harder at this. We need to change our attitudes so as to make yen-denominated trade possible. We mustn't keep using the dollar out of a kind of inertia just because that's what we first used. It's ridiculous for the world's largest creditor to be borrowing dollars from the world's biggest debtor so as to lend them to others, and this is making the Japan premium bigger" (in a round-table discussion carried in *Gekkan Keidanren*, June 1999).

funds and others are borrowing yen to finance their speculative dealings. It is not clear whether this use of the yen will persist, but once our interest rates are back to a more normal level, I think we should pay more attention to this indicator as a measure of the degree of internationalization of the yen.

Experts have judged the yen's low shares in global trade and foreign reserves to indicate that the Japanese currency is inconvenient for international users, causing its presence to be small by comparison with Japan's economic strength. In response, measures like those listed below have been proposed as ways of making the yen more convenient and thus boosting its internationalization; since the 1980s these have been the object of various arguments in opposition and calls to go slow.

(1) The withholding tax should be eliminated for interest payments on government bonds held by nonresidents: The United States exempts holders of its treasury securities from withholding tax on interest payments provided they meet certain requirements, such as an identity check. There is a need to make Japan's practices conform to those of other international markets.

(2) The government should meet its short-term financing requirements not through 60-day financing bills (FBs) issued with interest rates set below the official discount rate but rather entirely through open public auction, such as is done for short-term (three- and six-month) government bonds, setting the interest rate to reflect market conditions.

(3) A yen banker's acceptance (BA) market was established in June 1985, but it is dormant, reasons including the limits on the eligible instruments. Meanwhile, since the currency crisis Asian countries have been having a hard time expanding their exports because they cannot get credit from banks in the industrial countries. In order to facilitate the financing of these countries' trade, the yen BA market should be activated and it should be made possible for their BAs to be traded in the Japanese market; this should include rediscounting by the Bank of Japan.

(4) Japan's international commodity markets should be diversified to handle additional types of commodities as a way to expand yen-denominated transactions. When an international

commodity is traded in Japan, its price is quoted in yen. The international use of the yen would be greatly promoted in particular by the availability of yen-denominated crude oil transactions.

Progress has been made on items (1) and (2): Since April 1999, nonresidents have been exempted from tax withholding on government bond interest payments subject to certain conditions, and the government has been issuing its short-term financing bills through competitive price auctions.

Back in the 1980s, in what was a fresh development, internationalization of the yen progressed in the form of use of the Euro (international) bond market, a move to sidestep domestic Japanese regulations. This tactic appeared for a while to have worked; as of 1994 yen bonds accounted for 18% of the total in the international market. But as of January–June 1998 the yen's share had plummeted to 2%. What this reminds us is that even if the conditions for internationalization of the yen are in place, Japan's currency will not actually be used unless people consider it reliable. Markets are not interested in weak currencies. I would once again emphasize the primacy of the requirement to achieve a strong, stable yen through disciplined monetary and fiscal policies. In a sense the internationalization of the yen should be seen as a result, not a policy objective.

What we should simultaneously keep in mind is the example of the deutsche mark, which had achieved a higher degree of internationalization than the yen but whose status is being abandoned for the sake of the euro, Europe's new single currency. Japan should not remain stuck in a 1980s mind-set but should come out with fresh new ideas with a focus on the experience of the Asian currency crisis and the region's ties of mutual interdependence. We should not be satisfied with 'scraping the barrel'—dealing with the leftover items from the 1980s agenda—as our approach to internationalizing the yen.