Initiative for Internationalization of the Yen Begins

By Sakamoto Sakae

Although Japan's economy has not yet made a clear transition toward recovery, the Japanese government has already begun an initiative to internationalize the yen on the assumption that the Japanese economy will soon make a complete recovery within the world economy. Until now, Japan has been overly dependent on the U.S. dollar in terms of both trade and capital transactions. The Japanese government reviews this situation which caused Japan's *Mane Haisen* (Lost Money War, a best-selling book in Japan) against the U.S.

Is it possible for the yen to become an international currency?

In addition, the experience of the Asian currency crisis which occurred in 1997 has caused many Asian nations, particularly the nations of Southeast Asia, to strongly feel the danger of pegging their currencies to the dollar. Furthermore, the adoption of a unified Western European currency, the euro, in January of this year, has created conditions whereby the role of the U.S. dollar is relatively diminished. These changes in the prevailing conditions have also led Japan's monetary authorities to believe that now is the chance for Japan to initiate the internationalization of the yen (the expansion of the yen's role in the world economy).

Minister of Finance Recommends Currency Basket

In a series of international monetary conferences held in Washington DC during the latter part of April, the focus of the media was on Japan's economic difficulties and its economic stimulus measures. Finance Minister Miyazawa Kiichi, however, brought the message of the internationalization of the yen to the monetary authorities of each participating nation. The main gist of his message was a recommendation to break away from the dollar peg which had caused the Asian financial and currency crises, moving instead to a currency basket (in which the Japanese yen would naturally figure).

At the Interim Committee of the International Monetary Fund (IMF), Finance Minister Miyazawa highlighted the need for stable currency markets, stating "as the international movement of capital became increasingly active, fluctuations in exchange rates became even greater, seriously affecting the real sectors, even those of the major economies. In light of these considerations, I believe that efforts must be maintained to increase stability among the currencies of the major industrial countries. Major industrial countries must work hard, and work together, to create an exchange rate regime that will bring about both greater stability on the one hand and needed flexibility on the other among the yen, the dollar, and the euro. The Government of Japan is working hard to make our financial and capital markets more user friendly for investors and borrowers, in order to promote the further international use of the yen."

Miyazawa reiterated the danger of a peg to the dollar. "From our recent experiences in Asia, we have learned about the risks involved in pegging a country's currency to a single foreign currency." He then introduced concrete measures backed by the U.S. monetary authorities, stating "In this context, the so-called two-corner solution has started to gain popularity in discussions on the choice of a foreign exchange regime for emerging economies. The two-corner solution is that, in countries that chose a fixed rate regime, monetary policy would be allocated entirely to exchange rate policies, as with a currency board arrangement, while countries unwilling to abandon monetary policy would have to settle for a completely free-floating exchange-rate regime."

Miyazawa went on to enumerate the differences between his views and those of the U.S. monetary authorities, however, advocating the adoption of a currency basket: "As is evident with the experiences of the ERM in Europe, or in east European countries whose currencies are pegged to those of Western Europe, there are regimes that are positioned in between a currency board and a complete free-floating exchange-rate regime. When properly managed under appropriate conditions, such regimes can contribute to both economic stability and growth. In this respect, it might be an idea for emerging or developing countries to peg their exchange rates to a basket of currencies of the industrial economies with which they have the closest interdependence in terms of trade and investment, adjusting the peg periodically."

With a 14% Share of World GDP, the Yen's Share is 5%

These statements were based on a report published by the Council on Foreign Exchange and Other Transactions (an advisory group of the Minister of Finance) on April 20 titled "Internationalization of the Yen for the 21st Century." According to this report, as of 1997 the Japanese nominal GDP accounted for 14% of the global economy (that of the United States accounted for 26%), yet the yen was used in only 5% of international trade transactions (48% for the dollar), and the yen's position as an international reserve currency was also a mere 5% (57% for the dollar). Given the share of the global economy accounted for by the Japanese economy and the fact that Japan is the world's largest net creditor, the current state of progress toward the internationalization of the yen is insufficient.

The report highlights the following four merits favoring the internationalization of the yen: (1) By complementing the dollar, the euro representing Europe and the yen as the principal Asian currency are in a position to contribute to the establishment of a stable international monetary system. (2) The strengthening of the international role of the yen will contribute to the stability of foreign exchange markets in Asia, and to the stability of Asian economies. (3) The diversification of currencies used in international transactions creates the possibility for developing new financial service business (increasing business opportunities for Japanese financial institutions). (4) The expansion of yen-invoiced international transactions can serve to reduce the foreign exchange risk of Japanese companies.

The report quietly offered the currency basket idea: "One of the options for Asian countries would be to establish a system which stabilizes Asian currency exchange rates against a currency basket containing the dollar, yen, euro and other currencies, each being assigned a weight in light of trade and other economic factors. In this system, it would be desirable that the correlation between the Asian currencies and the yen be strengthened." It continued, saying "Japan must become actively involved in discussions concerning future monetary systems in the Asian region."

Even if the yen is used it is unrealistic to think that total dependency on the yen (a peg to the yen) would result; the intent of the first part of this proposal is probably first to break the peg to the dollar, the risks of which were demonstrated in the Asian crises, and in its place adopt a currency basket in which the yen would figure, and then to gradually increase the yen's circulation. Although the latter part of the proposal is extremely ambiguous, it likely means that if there is an invitation to create an Asian version of a unified currency bloc (or an Asian yen currency bloc), Japan would go along with it (if this type of proposal is pushed too actively, the other Asian countries would become alarmed).

The Prime Minister's Proposal for a Free-trade Bloc

Although it is not sure if there were behind-the-scenes moves by the Japanese monetary authorities, Japan's low-key push for the internationalization of the yen is starting to be met with approval from other Asian countries. At a finance minister's meeting of the Association of Southeast Asian Nations (ASEAN) held in Hanoi in mid-March, the finance ministers, in a joint statement, appreciated Japan's assistance to ASEAN countries affected by the currency crisis, especially the New Miyazawa Initiative (a 30 billion-dollar assistance scheme). It went on to say that ASEAN endorsed Japan's efforts to internationalize the yen.

In addition, on March 20 Prime Minister Obuchi Keizo, in an address to Korea University during his visit to Korea, stated a proposed free-trade zone between Japan and the Republic of Korea. He first highlighted the fact that Japan and Korea had developed unbreakable bonds as competitors and mutually beneficial partners. From the mere 800 million dollars' worth of trade between the two countries immediately following the normalization of diplomatic relations in 1966, that sum has today expanded to 50 billion dollars. This sum is comparable to the level of trade between Britain and France, continued the prime minister.

Prime Minister Obuchi went on to say that Western Europe had successfully adopted a unified currency, and was steadily progressing toward economic integration, but that 50 years ago this was a mere fantasy. In Asia there has as yet been no serious movement toward this kind of unification, but in addition to the regional cooperation of organizations like APEC, there has also been talk of a Northeast Asian free-trade zone concept. Discussions on this topic are already progressing at the private level. The prime minister concluded by expressing his hope that young people of both countries with creative and flexible minds will study the "dream" of creating a free-trade zone in Asia comparable to the EU, with Japan and Korea as its core, in the 21st century.

A free-trade zone for goods and services is a different concept from that of a single currency sphere, and would be controlled by different government agencies, but they can be regarded as two economic strategies based on the same concept. JJTI

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