East Asia's Currency and Economic Crisis and a New Financial and Cooperation Order

---A View from Japan---[250]

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Introduction

East Asia's economies were thrown into a harsh crisis beginning with the Thai baht's depreciation in July 1997. The Enthusiasm that had been felt for East Asia's economic growth before the currency and economic crisis almost seemed to disappear[252]. However, in 1999, optimistic views that the currency and economic crisis in East Asia is over, or out of the worst stage, have begun to appear[253]. Actually, the recent recovery from the crisis seems to be

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252 The president of the Institute for International Economics, C. Fred Bergsten, wrote in a recent article: "Not too long ago, there was much debate over whether the next hundred years would be the 'Japanese' or 'Asian' century. Now, that looks less likely. The 'European century' seems a more likely prospect, or even a 'second American century'"[Bergsten1999:33].

253 Michel Camdessus, the managing director of the IMF, said, on April 25, 1999 that the financial crisis that had hit most of world's emerging market economies 'seems to be over'. And the Financial Times, which published the article, explained, saying that 'his remarks before this week's IMF spring meetings reflected a growing optimism among international economic policymakers that the worst of the turmoil is now behind them' [Financial Times, April 26, 1999].

taking place much faster than expected, though there is still a huge amount of unemployment and degradation of employment conditions in the crisis-hit countries, such as Indonesia and South Korea, where political and social instability continues[254]. The Outbreak of the currency and financial crisis in East Asia and its course since then seems to be far from the expectations of almost all economists, policy makers and ordinary people.

What made the Asian countries fall into the currency and economic crisis? How will the countries affected by the crisis recover from it? Though there are still crucial difference in understanding the currency and economic crisis among economists and policymakers, the policies for overcoming it seem to be converging. The programs imposed on the affected countries by the IMF, which have been strongly supported by the United States, seem to have been loosened to some extent, on the one hand, while there have been discussions, on the other hand, regarding regulation and monitoring of short-term capital movement, which has been free internationally. And among East Asian countries and people, the necessity of a regional financial system and cooperation has begun to be considered.

In this paper we will begin by briefly describing the transition of main or popular understandings of the Asian currency and economic crisis, and consider what the essence of the crisis is and what lessons can be drawn from it. Then, we will go on to consider an international currency system to prevent another crisis from taking place, from the viewpoint of East Asia.

[I] Understanding East Asia's Currency and Economic Crisis and its Transition

(1) Popular Understanding of the Crisis and Controversies

254 The International Labour Organization (ILO) issued a Press Release on 4 March 1999, describing the social consequences of East Asia's financial crisis. According to the ILO, its social consequence "has exceeded all forecasts and shows few sighs of reversing, in spite of the stabilization of financial indicators, such as currencies and equity prices 'The social implications of the crisis have become enormous, with unemployment, underemployment and poverty rising steeply"'[ILO's Millennium Priorities to be aired at Budget Hearings, ILO/99/4]

What made the Asian crisis take place? There have been many interpretations. Among them are a loss of competitiveness and overproduction. For example, the Chinese renminbi's depreciation in January 1994, and the yen's depreciation beginning in the second half of 1995 made the currencies of Thailand, South Korea and other countries, increase compared to China's and/or Japan's, which meant a loss of competitiveness of the ASEAN and NIEs.

The idea of overproduction is that the East Asian countries increased investment too rapidly into productive capacity after the second half of the 1980s, especially in the first half of the 1990s, and 'the drive to expand capacity and market shares may be seen in the increase in the ratio of investment to output from already high levels, which was facilitated by the availability of relatively low-cost foreign funding' [UNCTAD 1998[255)]]. But these views fail to explain why the crisis spread throughout East Asia, and thereafter to Russia and Latin American countries, as a currency and financial crisis. Actually, it does not seem not to be true that China's currency depreciation stopped Thailand's exports from increasing. As for the idea of over-investment, too, though its manufactured exports were largely microelectronics, Singapore was not affected by the currency crisis, as South Korea was. These understandings can explain partly the cause of the crisis in particular countries.

Incidentally, popular understanding of and interest in the East Asian crisis have changed during the two years following the crisis. By briefly describing the transition of the main understanding, we can inquire into the main causes of the crisis and policy changes.

First, as the currency and economic crisis, which broke out in Thailand on July 2, 1997, spread to Malaysia, the Philippines, Indonesia and so on, MIT professor Paul Krugman's paper 'the Myth of Asia's Miracle' which had been published at the end of 1994, immediately draw public attention because it appeared to have foreseen the crisis in Asia.

In the previous year, 1993, the World Bank's famous report "The East Asian Miracle" had been published, the growth rates of East Asian economies

255 UNCTAD, Trade and Development Report 1998,Offprint from Part One, Chapter III.

were very high, and confidence in East Asia's growth was at its peak. Krugman, conscious of the work of the World Bank, used the term 'myth' in his paper's title instead of 'miracle' used by the financial institution. He pointed out that 'East Asian growth seems to be driven by extraordinary growth in inputs like labor and capital rather than by gains in efficiency,' and that it was 'like that of the Soviet Union in its high-growth era'[Krugman 1994:70]. In actuality, the Soviet Union had collapsed in the last month of 1991; this fact continued to shock the world, and Krugman's paper was treated sensationally by economists and policy makers who believed in the growth potential of East Asia. Therefore, the crisis brought back memories of his assertion when it took place.

But Krugman denied that his paper explained the current crisis, and remarked that the scenario he had thought up was different from that of the East Asian crisis[256] [Krugman 1998a; Nihon Keizai Shinbun, October 20,1997].

The following widely-accepted understanding of the East Asian crisis was that the East Asian capitalist model was the cause of the crisis. International financial institutions, United States officials, the IMF staff, and neo-classical economists, those who belonged to the orthodoxy in economics, seemed to support this kind of understanding. It appeared immediately after the currency and economic crisis broke out in Thailand, and became widely accepted as the crisis spread to Indonesia, Malaysia and even to South Korea through the summer and fall. As a result, quite a few Asian area researchers and journalists in East Asia seemed to support this view.

According to this view, the Asian crisis stemmed from a state-led or bureaucracy-led model of development, crony capitalism or nepotism, which could not cope with the changing current markets. The way of economic management led by Asia's governments, supplied great sum of money to a

256 Krugman said: 'It seems safe to say that nobody anticipated anything like the current crisis in Asia. True, there were some Asia skeptics --- including myself --- who regarded the claims of an Asian economic miracle as overstated, and argued that Asia was bound to run into diminishing returns eventually. ..But even pessimists expected something along the lines of a conventional currency crisis followed by at most a modest downturn, and we expected the long-term slowdown in growth to emerge only gradually. What we have actually seen is something both more complex and more drastic'[Krugman 1998a: first paragraph].

small number of political or military leader's families' businesses and big businesses (like the chaebols in South Korea), which, in turn, could make investments or over-investments without regard for efficiency. Naturally the corruption among political leaders and businesses bred widely, and made the economies inefficient.

For example, early in December 1997, the vice chairman of Goldman Sachs International, Robert Hormats, in an interview about 'Japan and South Korea in the midst of the financial crisis', commented that 'Asian neo-mercantilism---the strategy of closed financial sectors, high tariffs and aggressive export promotion---had hit a wall' [Newsweek, December 1, 1997].

Treasury Secretary Robert Rubin defended IMF policy against criticism, stating that:

> 'the Asian crisis is essentially one of confidence. The best way to restore investor confidence, is to reform financial institutions, restructure corporations overburdened by debt, and prohibit governments' telling banks to lend to favored companies. Healthier banks could begin lending again to power an economic revival' [Wall Street Journal, June 30,1998].

The U.S. Treasury Under Secretary, Larry Summers stated that

> '(this crisis) is profoundly different because it has its roots not in improvidence but in economic structures. The problems that must be fixed are much more microeconomic than macroeconomic, and improve the private sector more and the public sector less'[Financial Times, February 20, 1998, cited from Singh 1998:1].

And the Managing Director of the IMF, Michel Camdessus and the chairman of the US Federal Reserve, Greenspan have expressed similar views [Singh 1998:1; Nihon Keizai Shinbun (E evening ed.), May 28,1998].

Of course, the IMF initially pursued the structural reform of the Asian capitalist model with such an understanding. It required the countries not only to accept the traditional prescriptions of tightening financial expenditures, maintaining high interest rate policies and so forth, but also to accept new prescriptions including greater market opening to foreign capital, removals of subsidies, and amendments of employment related laws.

Incidentally, another criticism of the East Asian state-led model of development seems to have come out mainly from Japan. East Asian states as late comers, were able to develop their economies under high growth rates, making effective use of limited resources through industrial and others policies. However, in spite of having reached the stage where the removal of regulations was inevitable, they continued intervening in the market. This error brought about the crisis.

However, it can be said that this understanding is one that applies to Japan's case of state-led development as much as it does to other East Asian developing countries. It clearly differs from the criticism of the East Asian development model made by neo-classical economists who consider the market to be synonymous with the discipline of economics. In the view of the neo-classicalists, there is no room for a staged approach.

At any rate, the criticism of East Asian development model was strongly critiqued by many prominent economists, among them Harvard University Professor Jeffery Sachs, Martin Feldstein, a professor at the same university and President of the National Bureau of Economic Research, the United States, Colombia University Professor Jagdish Bhagwati, and Cambridge University Professor Ajit Singh.

Sachs wrote, in a paper in collaboration with Steven Radelet, that 'the Southeast Asian currency crises of 1997 are not a sign of the end of Asian growth but rather a recurring---if difficult to predict---pattern of financial instability that often accompanies rapid economic growth [Radelet & Sachs 1997:45].

Feldstein criticized the IMF:

> 'The IMF is now acting in Southeast Asia and Korea in much the same way that it did in East Europe and the former Soviet Union: insisting on fundamental changes in economic and institutional structures as a condition for receiving IMF funds. It is doing so even though the situations of the Asian countries are very different form that of the former Soviet Union and

Eastern Europe.' 'Since Korea's total foreign debt was only about 30 percent of GDP (among the lowest of all developing nations), this was clearly a case of temporary illiquidity rather than fundamental insolvency. Moreover, since the current account deficit was very small and rapidly shrinking, there was no need for the traditional IMF policy of reduced government spending, higher taxes, and tight credit' [Feldstein 1998: 22,24].

'the IMF's serious error was to use the current crisis as a chance to impose structural reforms on those counties' [Nihon Keizai Shinbun, May 7,1998].

Actually, there are other difficult points to settle in understanding the East Asian development model as the cause of the crisis. The first question is: if the East Asian development model brought about the crisis, why did it have contagion effect on Russia, Latin America, and so forth? The second question is: why has East Asia remained as a world growth center for the last several decades? As Stiglitz pointed out, 'this is a single crisis against a record of thirty years of remarkable growth'[257].

Perhaps, as the development model of East Asia is considered to be different from the Anglo- American model of capitalism among IMF economists and American government staff, they were confused into thinking that the East Asian model was the cause of the crisis. Why do many area researchers and journalists, even in East Asia, support this view? Their tendency to focus mainly on internal factors seems to lead to a conclusion which disregards international factors. But as the crisis broke out, the East Asian model became an issue, though the model itself had not brought about the crisis. This understanding leads to a reversal of the causal sequence. Actually, this understanding seemed to lose its influence gradually after the Russian crisis in the summer of 1998 and Brazil's policy change into a

257 Joseph Stiglitz wrote, ' We seem to be ignoring the fact that this is a single crisis against a record of thirty years of remarkable growth. Although a significant setback, the current turmoil does not seem likely to permanently reverse the gains of the past quarter century. We are unjustifiably treating the occurrence of a crisis as compelling evidence of a fundamentally malfunctioning economy. No economy since the beginning of capitalism has escaped fluctuations. The historical record, in fact, shows that East Asia has had less such fluctuations than other parts of the world -- hardly evidence of a striking vulnerability in the economies [Stiglitz 1998a].

floating exchange rate system in January 1999.

A third understanding drawing attention recently is one that stresses policy errors and/or sequence errors in the liberalization of the Asian countries affected by the crisis. World Bank staff, policymakers, IMF staff and so forth seems to support this kind of understanding, which can be outlined as below. Asian countries continued to increase short-term debt in a irrational way under dollar peg exchange rate systems, creating a bubble economy there. Explicit guarantees by East Asian governments created a 'moral hazard' for both foreign and Asian domestic banks, and allowed them to lend and borrow great sums of money without regard for risk. But when the increase of exports nearly dried up in those countries in 1996, and foreign banks and investors saw the increase in those countries' current balance deficit, lost confidence in the growth in East Asian countries, and consequently withdraw large sums of money abruptly. This precipitated the currency and financial crisis.

The World Bank had already assumed a rather critical attitude, from the 1980s toward IMF support programs which mainly consisted of tax increases and higher interest rates, claiming that such prescriptions would make it difficult for the private sectors to invest in the long term, and would prevent developing countries from achieving economic growth[258]. On September 11, 1997, the institution approved a loan of US$15 million to Thailand, which had been affected by a currency and financial crisis, for improving the structure, resiliency, soundness of the financial sector and so forth [World Bank 1997a].

In a speech to the annual meeting of the World Bank and the IMF held in Hong Kong on September 23, President James D. Wolfensohn said that the Bank was scaling up its work to restructure banking and financial systems in developing countries. He also outlined a plan to meet what he called 'the challenge to inclusion,' focusing on strengthening the social safety net to narrow the gap between rich and poor [World Bank 1997b]. The Annual Report of the World Bank 1998 explained the East Asian crisis as follows:

258 According to Shirai, World Bank criticized the IMF's prescriptions in World Development Report 1984[Shirai 1999:166].

While the chief factors contributing to the crisis differed from country to country, there were common characteristics: failure to contain demand and a boom in lending resulted in large current account deficits and property and stock market bubbles; the rigid nature of currency regimens encouraged foreign borrowing leading to imprudent exposure to foreign exchange risk by banks and corporations; and lax prudential rules and supervision of financial sectors led to sharp deterioration in the quality of bank's loan portfolios. These factors were compounded by shortcomings in the way countries allocated their resources, including state-directed lending, nepotism, skewed industrial structures, and limits on foreign participation and competition [World Bank Annual Report 1998].

The World Bank considered that the cause of the crisis was the adoption of liberalization on capital before building healthy domestic financial systems.
The World Bank's chief economist on the East Asia region, Masahiro Kawai, expressed a similar view:

'It is 'order' that is important. 'Former and traditional orders have overlooked the point that the building of strong and healthy domestic financial systems was made prior to the liberalization of capital movements.(Then) If abrupt and large inflows and outflows occurred, the financial system could avoid hypertrophy of financing, sudden credit contraction and partial paralysis of financing' [Kawai 1998].

The Asian Development Bank has taken the same view [ADB 1999c]. It expressed the same interpretation in its annual report, "Development Outlook 1999,"

'The Asian crisis showed that when countries open up their capital accounts without effective supervision and regulation of financial intermediaries, they become more vulnerable to crisis, because the access to foreign capital magnifies the weakness and distortions of the domestic financial system. This suggests that financial liberalization must be carefully sequenced' [ADB 1999a:39; ADB 1999c].

Since 1998, the IMF has changed its understanding from defects in the East Asian development model to sequencing misses in liberalization, and relaxed its conditionalities[259]. As for the origin of the East Asian crisis, IMF First Deputy Managing Director Stanley Fischer stated the following:

> 'The key domestic factors that led to the present difficulties appear to have been: first, the failure to dampen overheating pressures that had become increasingly evident in Thailand and many other countries in the region and were manifested in large external deficits and property and stock market bubbles; second, the maintenance of pegged exchange rate regimes for too long, which encouraged external borrowing and led to excessive exposure to foreign exchange risk in both the financial and corporate sectors; and third, lax prudential rules and financial oversight, which led to a sharp deterioration in the quality of banks' loan portfolios. As the crises unfolded, political uncertainties and doubts about the authorities' commitment and ability to implement the necessary adjustment and reforms exacerbated pressures on currencies and stock markets' [IMF1998a].

Though Fischer pointed to global factors as reasons behind the crisis in East Asia, he claimed they were only secondary. He said that 'although the problems in these counties were mostly homegrown, developments in the advanced economies and global financial markets contributed significantly to the buildup of the imbalances that eventually led to the crises.' This meant

259 In October 1997, the IMF imposed on Indonesia government an economic restructuring program as a conditionality, which the goal of government financial balance to 1% of GDP, and on the 1st of the next November, it forced the closure of 16 financial institutions. However, it amended the goal of government financial balance to minus 1% of GDP in January 1998, because of the worsening economy. In Thailand, the IMF eased the government financial expenditure from plus 1% of GDP in 1997 to minus 2% in February 1998 in order to strengthen its social safety net, as Thailand's economy continued to worsen in spite of the implementation of conditionalities. In South Korea, though the initial condition on government financial balance was plus 0.2% of GDP, it was relaxed to minus 1.7% in May 1998 [Shirai 1999:150-60]. According to the South China Morning Post on 5 May, 1998, IMF Managing Director M. Camdessus in Singapore backed Singapore Finance Minister Richard Ho who 'had blamed the East Asian crisis on countries that rushed to liberalize their financial systems and capital accounts without first putting adequate safeguards in place.' Therefore, the post used as its headline, 'IMF joins critic of rapid reform.'

that huge sums of private capital accumulated in advanced countries had flowed to emerging markets in search of high interest [IMF 1998a].

Therefore, the following measures are needed to overcome the crisis. It really is a myth that developing countries should pull back and slow down their liberalization to reduce their vulnerability. However, 'liberalization of the capital account must be carried out in an orderly, properly sequenced manner, carefully married to a strengthening of the domestic financial system' [IMF 1998c].

Barry Eichengreen, a professor at University of California, Berkeley and also Senior Policy Advisor in the IMF's Research Development, and Michael Mussa, Director of the IMF's Research Development, also point out in a collaboration in a joint magazine published by the IMF and the World Bank that:

> The most important point to recognize in the sequencing of capital market liberalization is the danger of precipitously removing restrictions on capital account transactions before major problems in the domestic financial system have been addressed' [Eichengreen & Mussa 1998:19].

As problems in the domestic financial system, they point to: (a) inadequate accounting, auditing, and disclosure practices in the financial and corporate sectors that weaken market discipline, (b) implicit government guarantees that encourage excessive, unsustainable capital inflows, and (c) inadequate prudential supervision and regulation of domestic financial institutions and markets, which open the way for corruption, connected lending, and gambling for redemption [ibid.:19].

The last interpretation is one that criticizes the free movement of capital. It has recently been widely accepted, and was advocated by Malaysian Prime Minister Mahathir Mohamad who criticized the billionaire financial investor, Gorge Soros first on July 26, 1997 [Nihon Keizai Shinbun, July 27,1997]. Mahathir 'blamed Soros and other foreign fund managers for causing this summer's currency crisis and especially called Soros a 'moron' as he criticized him. The dispute between Mahathir and Soros reached its peak at the World Bank and International Monetary Fund meeting in Hong Kong in September 1997. According to Wall Street Journal, 'with finance officials around the world looking on anxiously, Mahathir blamed Soros for Malaysia's current economic crisis.' While Mahathir said 'I am saying that currency trading is unnecessary, unproductive and immoral. It should be stopped. It should be made illegal,' Soros disclaimed responsibility for Malaysia's foreign-exchange woes, and called Mahathir's suggestion 'so inappropriate that it doesn't deserve serious consideration.' [Wall Street Journal, September 22, 1997]. On the day of the dispute between the two, according to Financial Times, the dispute of the two undermined confidence in South-east Asian markets, especially Malaysia, and Malaysia's currency recorded 'another historic low [Financial Times, September 23, 1997].

The problem about speculation using short-term capital was submitted as an economic argument by Colombia University Professor Jagdish Bhagwati, when he published his article, 'The Capital Myth' in Foreign Affairs in the May/June issue of 1998. Bhagwati pointed out the essential difference between free trade and free capital movement.

> 'Many assumed that free capital mobility among all nations was exactly like free trade in their goods and services, a mutual-gain phenomenon.' 'Freeing up trade is good, why not also let capital move freely across borders? But the claims of enormous benefits from free capital mobility are not persuasive,' 'Capital flows are characterized, as the economic historian Charles Kindleberger of the Massachusetts Institute of Technology has famously noted, by panics and manias' [Bhagwati 1998:7,8; ditto 1999:33]

World Bank Senior Vice President Joseph Stiglitz declared the followings:

> More generally, there is little evidence that full capital-account liberalization contributed to investment or growth. What is clear is that short-term capital flows increase volatility, which is bad for growth. Our research shows that countries which have gone further in financial liberalization, including capital-account liberalization, are more likely to experience a financial crisis [Stiglitz 1998: from World Bank Home Page].

Paul Krugman, MIT Professor describes that:

> it is possible in principle that a loss of confidence in a country can produce an economic crisis that justified that loss of confidence---that countries may be vulnerable to what economics call 'self-fulfilling speculative attacks.' And, while many economists, myself included, used to be skeptical about the importance of such self-fulfilling crises, the experience of the '90s in Latin America and Asian has settled those doubts, at least as a practical matter [Krugman 1998d].

Finally, in September, he came to recognize the significance of regulations on the free movement of capital.

> 'If Asian nations did adopt currency controls, they'd have to brace themselves for an even rougher ride. Any chance of attracting new foreign investment would disappear. The financial markets would probably go into another swoon. But damage, though painful, would be only temporary' [Krugman 1998c:38].

Incidentally, in August 1998, prior to Krugman's acceptance of currency controls, the United Nations Conference on Trade and Development (UNCTAD) criticized the IMF, saying that 'tightening monetary policy may simply intensify the stampede, further undermining creditworthiness and increasing the risk of default,' and proposed debt moratoria, and capital controls as essential tools to provide 'the breathing space needed to design a debt reorganization plan'. UNCTAD also insisted that flexibility on the introduction of capital controls should be permitted as 'an indispensable part of developing countries' armoury of measures for the purpose of protection against international financial instability' [UNCTAD 1998d; ditto, 1998b].

In this context, on September 1, 1998, Malaysia decided to implement capital controls in spite of expecting to criticism from the IMF, neo-classicalists, US officials, many newspapers and so forth. Krugman essentially accepted Malaysia's decision in an 'open letter to Prime Minister Mahathir' on the same day [http://web.mit.edu/krugman/]

Bhagwati put forward Krugman's argument further, and analyzing the structure driving the liberalization of capital movements worldwide. His conclusion was that 'Wall Street has exceptional clout with Washington for the simple reason that there is a definite networking of like-minded luminaries among the powerful institutions---Wall Street, the Treasury Department, the State Department, the IMF, and the World Bank most prominent among them.' He called it the Wall Street-Treasury complex [Bhagwati 1998:11].

Of course, the IMF attempted to refute Bhagwati's argument, but its counterarguments appeared to remain on the level of a general explanation that the liberalization of capital movements can supply money to a country where capital is in short supply [IMF 1998d:142-3]. US Federal Reserve Chairman Alan Greenspan offered, in a speech in Washington, his view of the East Asian crisis, that it was like a milestone which was unavoidable in the market economy [Nihon Keizai Shinbun (Evening ed.), May 28, 1998].

In summary, there are several main interpretations of the Asian financial and economic crisis, and influential views have changed sharply, though at present the last two perspectives are involved in a hot dispute. In the initial stage, domestic factors in the affected countries in East Asia were strongly pointed out as main causes of the crisis. And later, international factors have been given more attention.

In actuality, capital liberalization in East Asia has been carried out mainly forcibly under the IMF's and United States' leadership [Kawai and others 1986:2-3,9]. Capital liberalization in the region has been a natural part of globalization, which contains policies that transition economies have adopted. The currency and economic crisis in East Asia was not limited to the region, but spread out to Russia and Latin American countries, etc. As UNCTAD insisted, the East Asian crisis is part of an increased frequency of financial crises in both the developed and developing countries, which have taken various forms [UNCTAD 1998b: chap. III]. Therefore, the cause of the Asian crisis should not be sought inside East Asia. Instead, it is natural to think that its cause is the financial globalization that has been led by the United States and the IMF. Market volatility and vulnerability have stemmed from the capital account liberalization itself. From a moral standpoint, the IMF and the United States, who forced globalization, should take much more responsibility for the crisis than the affected countries in East Asia.

Incidentally, financial globalization has been pushed forward since around the second half of the 1980s, following the internationalization of production led by transnational firms in the 1960s, the great advances in information technologies since the 1970s which have made it easy to integrate operations all over the world, and the accumulation of a huge amount of capital in the advanced industrial economies, especially the United States, in the 1980s. Needless to say, the globalization of the real economy has already come into existence. It would be impossible to return to the age of the national economy. We can no longer think about economic development based on a national economy isolated from the world economy. Accordingly, the question is not whether globalization is good or not, but how we think globalization should be.

If we consider the issue in this way, it is easy to understand that some countries in East Asia seem to have begun the process of recovery faster than expected. Part of the huge amounts of capital which is created in stock and financial markets in the United States has moved back to some East Asian countries again. We should realize that crisis and boom no longer depend on a single country's economic indicators.

(2) Recent Arguments Regarding Liberalization and Regulations on Short-term Capital Movements

Asia's currency and economic crisis was followed, through a contagion effect by the Russian financial crisis and the Latin American crisis, showing that the current liberalization of capital flows is very volatile. Then, after the near-collapse of a famous American hedge fund, Long Term Capital Management, in September 1998, the regulation of short-term capital movements was taken up for discussion [Motoyama 1999]. Strengthening monitoring of financial institutions, especially hedge funds, information disclosure on the activities of highly-leveraged financial institutions, monitoring of international capital movements, some form of regulation of capital movements, and so forth, are now under examination among the IMF, World Bank, and other international financial institutions, as well as various government and people.

In October, 1998, British Prime Minister Tony Blair in a speech in Hong Kong, said that funds which secretly manipulate unprecedented volumes of capital cannot be seen by national governments or international financial organizations, and therefore that we need new rules. Even the famous American speculator George Soros, in a speech in Washington, took a position in the controversy against free capital movements, saying that it wound not be wise to approve the complete liberalization of capital movements [Nihon Keizai Shinbun (Evening ed.), October 6, 1998; ditto, October25, 1998]. In the United States Congress as well, arguments against short-term capital movements appeared. In Europe, it is said that the Chief of the European Central Bank's supervisory committee proposed a limit on the amount borrowed on hedge funds, a fundamental prohibition of European banks from holding a stake in hedge funds, and so forth [Nihon Keizai Shinbun, October 13, 1998].

The Japanese government has insisted that excess liquidity and over-dependence on the US dollar were the main causes of the East Asian currency crisis, and therefore that some regulations of large-scale and speculative short-term capital outflows and disclosure of hedge funds were needed. The Japanese government developed an idea of building a international financial supervisory organization and floated this proposal at a meeting of proxies of the G7 finance ministers and central bank governors. The organization was expected to be an independent one, integrating supervisory divisions separated from the IMF, the World Bank and the Bank of International Settlements (BIS), and its role would be (a) to monitor financial surveillance systems in each country, (b) to offer technical advice to the financial divisions of each country and exchange financial information between them, (c) to supervise international investors including hedge funds, (d) to gather information and conduct surveys on international capital movements, and so forth [Nihon Keizai Shinbun, November 1, 1998]. At a summit meeting of APEC (Asia Pacific Economic Cooperation Conference) held in Kuala Lumpur, Malaysia in November 1998, there was a controversy on whether speculation by investors should be regulated or not, mainly between the United States and East Asian countries. Though no concrete results came from discussions, Malaysia, China, Japan, etc. insisted on regulations against free capital movements, while the United States opposed them [Nihon Keizai Shinbun, November 11, 1999].

The Asian Development Bank also changed its view of what kind of financial liberalization should be adopted by the affected countries, from a reckless to a prudential one. The Asian Development Bank describes in its latest annual report.

> The Asian crisis showed that when countries open up their capital accounts without effective supervision and regulation of financial intermediaries, they become more vulnerable to crisis, because the access to foreign capital magnifies the weakness and distortions of the domestic financial system. This suggests that financial liberalization must be carefully sequenced [ADB 1999:39].

Moreover, even the government of the United States, which has long opposed any restrictions on capital movements is changing its attitude toward accepting some restrictions on short-term capital movements, according to a correspondent of Nihon Keizai Shinbunsha in Washington who sent to Japan an account of US Treasury Secretary Robert Rubin's address on April 21, 1999. It was written that in order to regulate excess capital movements and speculative trading, Rubin had expressed the idea of asking the financial institutions to disclose information on their investments in hedge funds and other financial institutions. He also said that in some circumstances regulations on private banks' dealings in foreign exchange and making short-term foreign currency borrowings, as well as government control of foreign debts in emerging markets, would be needed [Nihon Keizai Shinbun, April 22, 1999]. Thereafter, on April 29, the President's Working Group on Financial Markets, chaired by Rubin submitted a report, which 'urged that Congress give two financial regulators, the Securities and Exchange Commission (SEC) and the Commodity Future Trading Commission (TFTC), more authority to collect and verify the accuracy of information about unregulated affiliates of securities and futures firms, including those that enter into financial contracts with hedge funds.' The report also recommended that the SEC issue new rules requiring public companies to disclose any material exposure to hedge funds and other financial institutions that relied heavily on borrowed money [Washington Post, April 29, 1999]. In the United States, the government is trying to strengthen the government's monitoring of financial institutions in order to ensure sound markets.

As for the IMF, UC Berkeley Professor Barry Eichengreen, who is Senior Policy Adviser in the IMF's Research Department, expressed his views in his latest work:

> 'I am explicit about the need for Chilean-style capital-inflow taxes as the only effective solution to this problem for the vast majority of developing countries' [Eichengreen 1999:6].

But according to him, 'there is a crucial distinction between controls that seek to prevent international financial transactions from taking place at any price and taxes that merely seek to correct the price for discrepancies between private and social cost. Taxes are not prohibitions' [Eichengreen 1999:51].

In addition, at meetings of G7 Finance Ministers for the Kln Economic Summit, held in Frankfurt in June, 1999, controls of capital outflows were agreed, if any, negative. The Report said,

> (emerging countries) need to pursue sound macroeconomic policies, including sustainable exchange rate regimes and prudent fiscal policies. .A high priority should also be given to strengthening emerging economies' financial sectors and supervisory regimes'. (And also), 'Capital account liberalization should be carried out in a careful and well-sequenced manner, accompanied by a sound and well-regulated financial sector and by a consistent macroeconomic policy framework.
>
> The use of controls on capital inflows may be justified for a transitional period as countries strengthen the institutional and regulatory environment in their domestic financial systems .(As for) controls on capital outflows they may be

necessary in certain exceptional circumstances [Report of G7 Finance Ministers to the Kln Economic Summit; Nihon Keizai Shinbun, 13 June, 1999].

Even though Eichengreen asserts that Chilean-style capital-flow taxes do not contradict the discipline of neo-classical economics, and the Kln Economic Summit approved controls on capital flows (though only in certain exceptional circumstances), it is clear that such views have retreated compared to the view of the Washington consensus and neo-classical economics, which assert almost complete freedom of market.

[II] The East Asian Currency and Economic Crisis and Japan

(1) The Emergency Thailand Financial Support Meeting in Tokyo in August, 1997 and the Asian Monetary Fund

In the 1990s, Japan has needed to carry out Asian policies from a new point of view. The boom of investment by Japanese companies in the East Asian region since the second half of the 1980s has played a part in integrating the economies of the Asian newly industrializing countries, the ASEAN countries, China and so forth through the growth of intra-Asian trade. Though Japan's rate of manufactured imports as a percentage of total imports was 31 percent in 1985, this rate increased to more than 50 percent in 1989, then attained around 60 percent in 1995. Moreover, Japanese banks, who had close linkages with Japanese companies in East Asia, advanced into the region, in order to expand their own financial businesses and supplied huge sums of money. However, the currency and economic crisis then broke out. Japan was simultaneously facing the bursting of the bubble economy in the 1990s, and almost all Japanese banks had huge amounts of bad loans, and in addition, following Japan's financial 'big bang,' it found itself mired in a depression in the wake of bubble economy. Japanese banks faced difficulties not only in their domestic businesses but also in East Asia business. It seems that the Japanese government had no choice but to deal seriously with the currency crisis in East Asia, mainly in order to support its own banks, and this led the Japanese government to adopt rather prompt countermeasure.

After the baht began to depreciate on July 2, 1997, an emergency meeting of countries planning to give financial support to Thailand was held in Tokyo on August 11. At this meeting, which the United States declined to attend [Ito 1998:53], the participating nations, at the request of the Thai government, agreed to a US$16 billion package of financial support for Thailand. Out of this US$16 billion, the IMF and Japan agreed to contribute US$4 billion each, the World Bank US$1.2 billion, Australia, Hong Kong, Singapore, and Malaysia US$1 billion each, and Indonesia, South Korea and China US$1.3 in total [Ekonomisuto 1997:43].

Inside Japan, there had been some opinion that Japan should provide financial support to Thailand, even if it had to do so alone. Therefore, the international agreement was much appreciated in Japan. Japan had several reasons to support Thailand. First, Japan is proud of its position as an advanced country in Asia, and recognized this as a good chance for it to assume leadership in Asian politics. Secondly, the Bank for International Settlement (BIS) had granted private loans in Thailand amounting to US$70.3 billion by the end of 1997, and Japanese private banks had loaned more than half this, or US$37.5 billion. Because of this, the Japanese government needed to help the Japanese banks to finance this huge amounts of money. Thirdly, this support was considered useful for the internationalization of the yen[260].

However, for other Asian countries/regions, this agreement to support Thailand had another significance. Many East Asian countries participated in making the financial support package together, in the form of international or Asian regional cooperation. This means that each country was becoming convinced of the existence of common interests and that they were in a dangerous situation.

In this meeting, there was another important proposal. A proposal to establish a Asian Monetary Fund (AMF) was made mainly under Japan's leadership, in response to the Thai government's request. The first idea was that the AMF would be an international institution giving emergency financial

260 The chief managing director of Nihon Sogo Kenkyusho, Mikio Wakatsuki, said, regarding the meeting of countries planning to make financial support to Thailand, that it was necessary for Japan to make it easy to use the yen internationally in response to Asian countries' needs [Wakatsuki, 1997:18].

support to the countries affected by the currency crisis, and would be independent from the IMF. On September 21, Japanese Finance Minister Hiroshi Mitsuzuka explained the Japanese idea about the fund at an informal meeting of Japan-ASEAN finance ministers held in Hong Kong.

By this time, Japan had changed the plan, increasing the member of participating counties, and adding China and South Korea to ASEAN as member countries. The fund would be run cooperatively in cooperation with the IMF [Nihon Keizai Shinbun, September 22, 1997]. This idea was further adjusted according to differences of opinion expressed by concerned countries during a series of international meetings on financial issues held in Hong Kong in September, consisting of the IMF-World Bank Annual Meeting, G-7 Meeting, and so forth [Nihon Keizai Shinbun, September 24, 1999]. In the beginning, the plan has to establish the AMF with US$50~60 billion in funding, and to establish it within 1997, so it could act as a regional complement to the IMF. The funding was later increased to $100 billion, 'half of which was to come from Japan and the remainder from PRC; Hong Kong, China; Singapore; and Taipei, China' [ADB 1999:44].

However, the AMF was mainly proposed by the Japanese government and supported by the ASEAN countries, but faced strongly opposition from the United States and the IMF. The opponents' argument was that AMF financing of the countries affected by the crisis could encourage moral hazards, on one hand, and the leadership or political power Japan would get through the AMF would threaten the United States' political supremacy, on the other hand. The Wall Street Journal said as follows:

> 'Mr. Rubin (U.S.) Treasury Secretary and Mr. Summers (Deputy Treasury Secretary) feared the fund would offer big loans with less-stringent conditions than the IMF's and would threaten U.S. economic supremacy. Treasury officials worked the corridors of Hong Kong's convention center and the city's private dining rooms to slow the Japanese plan's momentum. China, South Korea and other nations suspicious of Tokyo's ambitions leaned toward the U.S' [Wall Street Journal, September 24, 1998].

In the end, in a Manila meeting of proxies of finance ministers and central bank governors from fourteen countries held on November 18-19, 1997, Japan abandoned its proposal. The Asian Development Bank explained as follows:

> 'Despite strong support from Malaysia, the proposal did not get far. Only two months after it had first been suggested, it was turned down. One objection was the fear that financial support without any conditions attached would raise the risk of moral hazard. Another risk was lack of coordination and of potential conflict with the IMF' [ADB 1999:44].

Though the Asian Development Bank's report did not specifically name the United States, Japan mainly met with the opposition of the United States, and was obliged to give up the plan, notwithstanding the fact that some ASEAN member countries supported it.

(2) The New Miyazawa Initiative in 1998

On October 3, 1998, Japan's government announced 'a New Initiative to Overcome the Asian Currency Crisis,' which carried the name of Finance Minister Miyazawa. The initiative was 'a package of support measures totaling US$30 billion, of which US$15 billion will be made available for the medium- to long-term financial needs for economic recovery in Asian countries, and another US$15 billion will be set aside for their possible short-term capital needs during the process of implementing economic reform.'

The Japanese government itemized four targets that crisis-hit Asian countries would implement using the medium- to long-term financial support.

(a) Supporting corporate debt restructuring in the private sector and efforts to make financial systems sound and stable.
(b) Strengthening the social safety net.
(c) Stimulating the economy (implementation of public undertakings to increase employment)
(d) Addressing the credit crunch (facilitation of trade finance and assistance to small- and medium-sized enterprises)

[http://www.mof.go.jp/].

When the Miyazawa Initiative was announced, governments such as Thailand, Indonesia in East Asia quickly expressed their approval. Furthermore, prominent persons such as World Bank Vice President J. Stigliz, Harvard University Professor J. Sachs, and so on supported Japan's Miyazawa initiative. And, naturally, the Japanese government publicized the initiative aggressively but carefully. Three days after the first statement, on October 6, State Secretary of Finance Sadakazu Tanigaki delivered a statement by Finance Minister Kiichi Miyazawa at the fifty-third Joint Annual Meeting of the IMF and the World Bank. In his statement, while criticizing the IMF's prescriptions[261)], Miyazawa proposed the New Miyazawa Initiative as 'a new scheme of financial assistance totaling some 30 billion US dollars to be provided as Japan's bilateral support.' His statement was an expression that the Japanese government was determined to provide bilateral support in opposition to the United States and the IMF.

On December 15, 1998, in his speech, 'Towards a New International Financial Architecture' at the Foreign Correspondents Club of Japan, Tokyo, Miyazawa proposed:

> ..... some concrete ideas about mechanisms for providing quicker and greater liquidity,' out of which there were reinforcing functions of the IMF, and establishing regional currency support mechanisms. That is to say, (a) the IMF could create a new facility that would be precautionary as well as quick in disbursement when needed, (b) the IMF could borrow in the market as the institution is granted the capacity to do so by its Articles. (c) it is appropriate to consider establishing regional currency support mechanisms, and so forth.

In the last idea, (c), he referred to the New Miyazawa Initiative, totaling

261 Miyazawa criticized the IMF, saying that 'on a macroeconomic policy level, there are cases where the Fund's traditional prescription that combines fiscal balance improvements with tightening of monetary policy is not appropriate. I say this because in many cases nowadays a currency crisis or international payments difficulties do not stem from current account deficits.'

US$30 billion, for the Asian countries affected by the crisis, then, he said, 'I am hoping that this initiative could lead to further discussions toward a regional currency support mechanism of the type that I just mentioned [http://www. mof.go.jp/].

Needless to say, the United States' and the IMF's attitude toward the New Miyazawa Initiative would be decisive in whether it succeeded or not. For that reason, the Japanese government changed the AMF to the Miyazawa Initiative, and seemed to have found the right timing to start it in order to have it accepted by the two.

In contrast with the AMF, which was planned as an international institution, the Miyazawa Initiative would be bilateral support[262], even though Finance Minister Miyazawa admitted that the Miyazawa Initiative could in time develop into some kind of regional currency fund and to a wider internationalization of the yen [Business Times (Singapore), October 5, 1998]. This means that while bilateral assistance lessen the room the United States and the IMF to express opposition, and gives Japan' government freer activities, it is only Japanese assistance, rather than a regional agreement or institution of collaboration.

There were actually quite a few cases of the Japanese government giving financial support in the form of assistance, co-financing, parallel loans and so forth with the World Bank, the IMF and the Asian Development Bank. For example, it is co-financing with the World Bank a yen loan for banking system reform project equivalent to approximately US $300 million, which the Japanese government announced to the Philippine government in January 1999, as well as yen loan of the same amount for a Metro Manila air quality improvement sector development program, also co-financed with the Asian Development Bank. A yen loan equivalent to approximately US$ 1500 million was extended to Indonesia in February 1999, as a parallel loan with the

262 In Q&A about the New Initiative to Overcome the Asian Currency Crisis (New Miyazawa Initiative), Japan's Ministry of Finance explains that 'the AMF, discussed last year (1997), was a multinational scheme focused on the stabilization of currency. The New Miyazawa Initiative, announced this October, mainly consists of bilateral support focused on assisting Asian countries affected by the currency crisis on overcoming their economic difficulties and contributing to the stability of international financial markets' [http://www.mof.go.jp/]

IMF/Extended Fund Facility and co-financed with the Asian Development Bank and the World Bank.

In fact, on the day, December 16, 1998, that the Miyazawa Initiative started, involving financial support initially to Thailand and Malaysia, Japan's Prime Minister Keizou Obuchi, in Hanoi, called for greater cooperation without involving Western powers. However, because of its involvement in Iraq and the impeachment proceedings, the Clinton administration could not offer any comments [Far Eastern Economic Review, December 31, 1998].

In this connection, by early May, 1999, a total of US$17 billion in financial support to East Asian countries had been announced under the Miyazawa Initiative. The support was made first to Malaysia and Thailand, in December 1998, thereafter to Indonesia in January, 1999, to Indonesia and the Philippines in February, and to Malaysia and South Korea in March. More recently, the Japanese government is planning to add Vietnam to the qualifying countries for the Miyazawa loans [Nihon Keizai Shinbun, May 1, 1999]. In addition to this, on March 25, 1999, the Asian Development Bank approved the establishment of an 'Asian Currency Crisis Support Facility,' established by Japanese contributions of 7.5 billion yen (US$625 million equivalent at an exchange rate of US$1 to 120 yen) in cash for interest payments and technical assistance grants, and 360 billion yen (US$3 billion equivalent) in government notes for guarantees in fiscal year 1998, under the Miyazawa Initiative [MOF Press Release March 23, 1999; ADB 1999b]. This facility's purpose was to assist the crisis-hit countries to overcome their immediate economic difficulties.

Incidentally, in the proceeding part of this chapter, we confirmed the relation between the AMF and the Miyazawa Initiative. The Miyazawa Initiative appeared as a substitute for the AMF, which Japan was forced to abandon due to opposition from the IMF and the United States. The Japanese government does not seem to realize the difference between the two so much, especially because the latter was accepted rather successfully. But we have reservations about its form, as we will see in the following section.

(3) Significance and Problems of the Miyazawa Initiative

It is now clear that financial liberalization, as led mainly by the IMF and the United States, has caused market volatility and weakened stability. Bhagwati's assertion that there is a difference in quality between the liberalization of goods and services and that of capital mobility, and UNCTAD's approval of debt moratoriums and capital controls as essential tools for countries affected by crisis, were prompt reflections of reality. Therefore, the management of free short-term capital movement must be pursued at the international level. While information disclosure by financial institutions, and especially hedge funds, is needed, capital controls by host developing countries should naturally be approved. Malaysian-type capital controls should be approved as an experiment, just as the Chilian type are. They should not be condemned.

Incidentally, the East Asian crisis is new type of financial crises, as Camdessus said 'the crisis of the 21 century.' East Asian countries have high saving rates, stable financial conditions and low inflation rates, etc. But in spite of this, a financial crisis broke out.

In general, medium- to long-term capital is crucial in the process of economic growth of developing countries. Criticism of the East Asian development model notwithstanding, these countries did manage to induce multinational corporations' foreign direct investment and offered manufacturing bases to their affiliates, and in addition, built frameworks for supplying domestic savings to manufacturing industries. These systems allowed East Asian countries to grow for more than three decades.

Globalization as driven by the IMF and the United States, or the Washington Consensus, takes the role of medium- and long-term capital in latecomers lightly. The IMF neglects responsibility or moral hazard on the lending side, and international financial institutions, on the one hand, and stresses the responsibility or moral hazard of the borrowing side, developing countries, on the other. Besides, the IMF seems to have been possessed by the illusion that structural reform of the crisis-hit countries could be easily attained by imposing its programs[263].

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263 Vice Minister of Finance for International Affairs Eisuke Sakakibara, at the Manila Framework Meeting in Melbourne, Australia in March 1999, spoke as follows. His

The Miyazawa Initiative seems to have been accepted by the crisis-hit countries. This is because the IMF's unreasonable programs worsened the economies of East Asian countries, and the Miyazawa Initiative was considered to be a set of support measures for governments and private sectors in difficulties caused by the IMF's programs. In a situation of credit crunch prompted by the IMF's belt-tightening policy of high interest rates and fiscal balance improvements, even many healthy companies became doomed to bankruptcy. Goals such as supporting corporate debt restructuring in the private sector, implementing public works to increase employment, strengthening the social safety net and addressing the credit crunch were undoubtedly accepted easily.

Certainly, there is a dilemma. Such loans may partly help crony capitalism, and allow ineffective economic systems to survive. However, this does not mean that everything should depend on the market. As much as possible, the Japanese government must listen seriously to the voice of people and governments in East Asia [Hirakawa 1999a].

There is another reservation. The Miyazawa Initiative is 'a more modest revised proposal' compared to the AMF proposal in 1997 [ADB 1999a:44]. The transformation of the AMF, which would have been multinational cooperation among East Asian countries, into the Miyazawa Initiative, which was bilateral cooperation between Japan and other East Asian countries, means that Japan gained increased discretion. As Miyazawa himself pointed out, in his statement of December 15, 1998, when he said that it was a step to future development, the Miyazawa Initiative needs to be developed into a regional public organization with an East Asian perspectives. Though the issue of the AMF is hardly discussed in Japan anymore, this theme should be pursued further

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comment was much to the point:

'For example, there were more than fifty items of structural reform required in the program for Indonesia, including reforms of the food distribution system. I doubt whether all these reforms were absolutely necessary to resolve the crisis. The reform measures were also too ambitious, as evidenced by the closure of 16 banks in Indonesia in a matter of a few days without adequate protection for depositors. Structural reform is not something that can be implemented by a single decision by the decision-maker, like a change in interest rates' [Reform of the International Financial System, http://www.mof.go.jp] toward realizing it.

[III] Groping for a New Regional Financial and Cooperation Order in East Asia----from the Viewpoint of Japan

(1) Necessity of a Regional Financial System

We must understand that essentially East Asia's financial and economic crisis does not stem from internal factors, but rather from financial globalization. As the currency and economic crisis spread beyond East Asia to Russia, Latin America and so forth, the essence of the crisis has become even clearer.

Incidentally, it would seem unreal for East Asian countries to adopt traditional and domestic-centered development strategies. Industrialization and economic growth in East Asia since the 1960s has been realized only by the region's open development policy to the world economy. While transnational enterprises, which have become major main actors in the world economy, spread their production sites worldwide thanks to progress in transportation and telecommunication as well as production technologies, East Asian countries lured them to invest, and in doing so became integrated in their worldwide production networks. By doing so, East Asia gained the chance to industrialize and to develop their economies through exports.

However, after the second half of the 1980s, financial liberalization was carried out, driven mainly by the United States, and the age of globalization of finance came into existence. Institutional investors and hedge funds that manipulated huge amounts of capital accumulated in the advanced industrial countries and/or augmented the capital through leverage increases actively enlarged their financial business. Astonishing progress in information technology helped this financial globalization. In the same period, East Asian countries adopted financial liberalization policies mainly under IMF guidance. The free movement of capital or globalization of finance, underpinned by the Washington consensus, or the Wall Street-Treasury complex (in the words of

Bhagwati), or the Wall Street-Treasury-IMF complex (R. Wade and F. Veneroso). This group's belief that market is best[264] seemed to be strengthened by the collapse of the socialist countries, and the industrialization and economic success of the export-led newly industrializing economies in East Asia. However, as a result of the financial liberalization, the crisis then broke out in East Asia.

Therefore, the development of the real economy in East Asia should be considered to be a fruit of the globalization of production since the 1960s. In this sense, single nation-based economic development is impossible[Hirakawa 1999b]. The matter is not whether globalization is be right or wrong, but how to manage financial globalization.

At any rate, the currency and financial crisis should be managed by international cooperation systems beyond national boundaries, in accordance with the nature of the crisis. However, the current currency and financial crisis has characteristics which strongly impact on the real economy. Therefore, the social safety net has begun to affect more attention, and economic reforms have had to be implemented prudentially, in balance with the social burden on people. In spite of this, the IMF has clearly neglected regional realities and imposed its own programs which worsened the economies. Of course, East Asian societies have their own histories and conditions, as every society has. Prescriptions for economic reforms can not be implemented successfully if they neglect the characteristics of the societies. In the East Asian region, it is ideal that an organization which is familiar with the societies implement reforms prudentially.

At the Kln Economic Summit, although the strengthening of financial regulation in industrial countries was discussed and attention was focused on supervisors and regulators of highly leveraged institutions, there are still no concrete regulations. There are no mechanisms to cope with crises occurring because of free capital movements. Regional financial cooperation or organizations are needed in order to prevent a region from falling into crisis

264 Bhagwati wrote, regarding the belief in free capital movements, 'Free capital mobility among all nations was exactly like free trade in their goods and services, a mutualgain phenomenon' [Bhagwati 1998:7-8].

because they understand the real society. Needless to say, their works can be don in cooperation with the IMF, World Bank and other international institutions.

(2) **The Stability of East Asian Currencies and the Internationalization of the Yen**

The stability of East Asian currencies is crucial for their development, because the region's economic development has been attained within the world economy. However, it is quite difficult to stabilize currencies. For example, the fluctuations in 1998 of the yen against the dollar ranged 36 yen between the lowest 147.64 yen, recorded on August 11, and the highest, 111.45 yen, on October 8. Particularly great fluctuation occurred from August to October, indicating that international factors were moving the yen's rate. Even in Japan, which produces 14 percent of the world's gross domestic product (GDP) in 1997, there were huge fluctuations. It should therefore be considered impossible for developing countries to absorb such large fluctuations of exchange rates, because they have adopted export-led policies that their resistance against fluctuations is low.

Many kinds of systems for keeping currencies stable have been proposed. There seem to be a few alternatives left. Eichengreen, who examined the history of currency systems, concluded that only two exchange systems would be able to survive in the 21st century: flexible exchange rate systems or a currency union. Pegged rate systems, adjustable hedging systems `target zone systems, and managed floating rate systems as well as, of course, fixed rate systems would continue to face difficulties as capital movement increased and globalization developed [Eichengreen 1994:68 (Japanese edition)].

In actuality, Europe launched the 'euro' in January 1999, opening a new step for the currency unions, on one hand, while on the other, many developing countries have moved from dollar pegged systems to floating rate systems. In particular, Latin American countries depend enormously on the dollar. "Dollarization" is taking place there both in policy and in de facto.

Since Brazil changed to a floating rate system in January 1999, its currency has depreciated and depreciation pressure on the Argentine peso have increased. Under this situations, Argentina's central bank governor announced a plan to adopt the dollar as its currency. One newspaper in Japan said:

> Argentine will make progress on dollarization, replacing the local currency with the US dollar in the future. Argentine will ratify a treaty on dollarization with the United States several years hence, and a currency union of the dollar will be built throughout the Americas. Argentine will be the core of dollarization [Nihon Kezizai Shinbun, January 23, 1999].

The Washington Post said that some Latin American countries were engaged 'in quiet conversations about adopting the dollar as their currency, as a way of achieving financial stability and faster growth'. Argentine, El Salvador, Panama and Mexico too are actively considering dollarization and

> 'the finance ministers of eight Central American countries are scheduled to meet in July 1999 to discuss the pros and cons of dollarization'. 'Officials in Washington and Latin America must reckon with the de facto dollarization of Latin America..Latin Americans already hold a majority of their savings in dollars, and in countries such as Argentina, Bolivia, Peru and Uruguay, at least 70 percent of all banking assets and liabilities are now dollar-dominated [Washington Post, April 28, 1999].

It is said that an interim committee of the IMF stressed the merits of dollar-centered currency exchange systems in its conclusion [Nihon Keizai Shinbun, May 1, 1999]. According to the Financial times, US. Treasury Secretary Rubin, in a policy speech before recent meeting of leading finance officials of the G7, stated that he opposed pegged exchange rate systems. The Times wrote:

> Big international financial packages led by the international Monetary Fund should, as a general rule, no longer be used to support pegged exchange rates.Crises in Asia, Russia and Brazil have all stemmed from pegged exchange rates that proved unsustainable. Mr. Rubin said emerging economies should adopt either a flexible exchange rate or a strong institutional mechanism such as a currency board that would fix a credible rate [Financial Times, April 22, 1999].

In contrast with Europe and Latin America, the future of international exchange rate systems in East Asia remains unclear. The latest annual report of the Asia Development Bank refers to the Asian exchange rate systems, the future of which is still uncertain[265).

The countries of East Asia certainly had interest in the single European currency. In September, 1997, during the crisis, the issue of a single currency came up for discussion at the meeting of finance ministers of East Asian countries [Nihon Keizai Shinbun, May 2, 1999], and the birth of a single European currency increased interest in such a currency in East Asia.

In an interview by Mainichi Shinbun Editor in Chief Minato Kido of Malaysian Prime Minister Mahathir Mohanmd on January 11, 1999, Mahathir claimed that an international currency was now needed in Asia as the euro was born, he said the yen should shoulder the role [Mainichi Shinbun, January 12, 1999]. And, on January 11, some bankers from Asian nations that had been severely affected by the region's financial crisis suggested that Asia might someday end up with a single currency similar to the euro, though they acknowledged this would not happen anytime soon, if at all. Some of the central bankers also expressed the opinion that "a single currency for Asia might someday be in the cards," though, according to the Japan Times, they were "far from ready to seriously consider such a step" [Japan Times, January 12, 1999].

Thereafter, at an international conference entitled the Future of Asia held in June, 1999, and organized by Nihon Keizai Shinbunsha, Philippine President Joseph E. Estrada insisted that 'an East Asian common currency' be seriously considered in order to reduce over-dependence on the US dollar [Nihon Keizai

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265 The Asian Development Bank observed as below. 'In Europe, for instance, it is likely that more countries will ultimately adopt the euro. In Latin America, Argentine policymakers are talking seriously of dollarization. In Asia, the future is much more uncertain, and political and practical hurdles to any regional currency union are high. Yet the costs of excessive volatility and competitive devaluation are an important concern in Asia's highly open economies. .. Although the post-crisis period has seen a general movement toward greater exchange rate flexibility, the diversity in exchange rate regimes continues. This suggests that Asian economies are unlikely to see complete uniformity in exchange rate management soon' [Asian Development Bank 1999a:42].

Shinbun, June 25, 1999].

However, interest in a single currency for East Asia seems to have cooled. A certain high-ranked official of the Monetary Authority of Singapore remarked that concrete discussion of a single currency for East Asia had not progressed thereafter. 'As economic differentials between East Asian countries cannot be compared with those between European countries, there is no reality of any single currency for East Asia' [Nihon Keizai Shinbun, May 2, 1999].

Incidentally, as Mahathir pointed out, the yen's role is expected to increase gradually. The Japanese government has also seriously, and with sense of crisis, begun to embark on the internationalization of the yen since the birth of the euro. Japanese Finance Minister Matsunaga, at a meeting of Finance Ministers of APEC member countries held in Canada, in May, 1998, announced the internationalization of the yen, and in July, two months later, at the Council on Foreign Exchange and Other Transactions of the Ministry of Finance launched a Sub-council on the Internationalization of the Yen, which submitted an interim report in November. On December 22, the Ministry of Finance stated it would step up the internationalization of the yen mainly through two measures: (i) inducement of competitive price auctions for financing bills (FBs), and (ii) the enforcement of tax reforms related to the internationalization of the yen.

Thereafter, Minister of Finance Miyazawa made a statement celebrating the birth of the euro on the first day of its launch, January 1, 1999, in which he pointed to the importance of the internationalization of the yen to pull the East Asian countries out of the crisis[266].

Furthermore, on April 21, 1999, the Council on Foreign Exchange and Other Transactions submitted a report, stating that a currency basket exchange rate system for East Asian countries, containing the dollar, yen, euro, and other

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266 Miyazawa's statement of January 1st, 1999 was a follows: 'Today marks the birth of a new currency, the euro, which I very much welcome. This is a great step forward a closer Economic and Monetary Union which has been made possible by the European countries' efforts in the past 30 or so years궵.We acknowledge the importance of the internationalisation of the yen in light of global economic and financial developments such as the Asian financial crisis [http:www.mof.go.jp].

currencies, was desirable both for the internationalization of the yen, and for East Asian countries to stabilize their currency exchange rates. 'The Asian currency crises beginning in 1997 exposed at a stroke the critical risk of linking a currency to the dollar without considering the level of that economy's trade and investment ties with other economies'. Therefore, East Asian countries should adopt a currency basket system to lessen the exchange risks, the report said [Council on Foreign Exchange and Other Transactions, Japan 1999].

Although the United States opposes currency basket systems[267], it seems that East Asian countries are generally showing a tendency to adopt such systems. On May 1, 1999, at a meeting of finance ministers of Japan, China, South Korea and ASEAN countries held in Manila, there was agreement that they would augment the usage of the yen, for market stability and for strengthening the economic relation between Japan and the other countries. They also expressed approval, one after the other, for currency basket systems using the yen, euro, and others. In regard to this, Nihon Keizai Shinbun commented that this drew a clear line of demarcation against the conclusion of the IMF's interim committee which stressed the merits of dollar-centered currency exchange systems [Nihon Keizai Shinbun, May 1, 1999]. Of course, basket currency systems may be less stable than currency unions and face Eichengreen's grim forecast, but still they must be considered a step forward. Japan should consider its role in East Asia and try to increase this role, not only for Japan, but also for East Asia in general.

(3) Groping toward Regional Cooperation in East Asian

Will it be possible to achieve the internationalization of the yen? It is true that Japan produced 14 percent of the world's gross domestic product, and is

267 At an international monetary meeting held in Washington on April 28, 1999, Finance Minister Miyazawa proposed currency basket system using the euro, yen and others as an exchange rate system for emerging countries. However, the US Treasury Secretary Rubin rejected it. Instead, he asked 'do you want discretional renunciation of monetary policy or a complete floating system? You must choose between two' [Nihon Keizai Shinbun, April 28, 1999].

the biggest economy in Asia. But Japan's share in the total trade of 9 East Asian countries, consisting of major 4 ASEAN member countries (Thailand, Indonesia, Malaysia and the Philippines), 4 Asian Newly Industrializing Economies (NIEs: South Korea, Hong Kong, Taiwan, Singapore), and China, was only 16 percent in 1997. The figures for the United States and the 15 European Union member countries were 17 percent, and 14 percent, respectively. Japan's share in total exports and imports of the 9 ASEAN member countries (the ASEAN 4 plus Singapore, Brunei, Vietnam, Laos and Burma) were 13.4 percent and 19.0 percent [Council on Foreign Exchange and Other Transactions 1999, appendix]. Japan's share is rather small, considering the geographical proximity between Japan and other East Asian countries.

However, quite a few Japanese firms' affiliates and multinational firms' affiliates from other advanced industrial economies and NIEs have developed businesses in East Asian countries, and they have been rapidly increasing intra-East Asia regional trade. If Japan could stabilize the yen's rate against the US dollar, it could open its domestic market to East Asian countries much more than now, and the internationalization of the yen would progress. For this, Japan would have to become convinced of the significance of East Asian economies, and try to build close organic economic relations with them. These will be crucial conditions for Japan to attain the internationalization of the yen.

Incidentally, should Japan decide to pursue the internationalization of the yen, it will have to give preference to common interests in East Asia. Still today it maintains the negative legacy of the Great East Asia Co-Prosperity Sphere form the period of the World War II. In due consideration of this history, Japan needs to win the trust of East Asian countries. For the internationalization of the yen, one possible option might be a new East Asian currency or some currency unit. Just as Europe created the euro, Japan along with other East Asian countries may be able to create a new currency or currency unit. With the birth of the euro, Germany decided to abolish the Deutsch mark. If Japan tries to pursue the internationalization of the yen merely because of fears that the yen will lose influence compared to the US dollar and the euro, it will be difficult to achieve real internationalization.

From now on, the development of the Japanese economy will much more than before mean the development of East Asian economies. Japan needs to consider the possibility of a common currency for East Asia.

Therefore, it is significant that Japan, along with other East Asian countries, is working to build an Asian Monetary Fund. A policy change from the Miyazawa Initiative to an AMF may be needed for the Japanese government.

Since last year (1998), the idea of a Japan-South Korea Free Trade Zone has emerging, and has drawn much attention. It could be a big step for the future of the East Asia. We are aware that we do not have any concrete economic cooperation systems in Northeast region, like the ASEAN Free Trade Area in Southeast Asia. The Japan-South Korea Free Trade Zone was first proposed at a Japan-Korea ministerial conference in November 1998, and joint research between research institutes in both countries regarding the feasibility of a Free Trade Zone has been going on since then. The Korea-Japan and Japan-Korea Business Conference held in Soul in April, this year, took up this proposal for serious discussion.

Korean government and business interests have expressed strong expectations for the Free Trade Zone [Higashi Ajia Review, May issue, 1999; Nihon Keizai Shinbun, May 7, 1999]. However, one Japanese Newspaper said that Japanese business interests are taking a cautious attitude toward the idea of a Free Trade Zone, because Japanese businesses have faced a long domestic recession, and suffer from excessive capacity and debt [Nihon Keizai Shinbun, May 7,1999]. The Japanese government and business interests should work to establish the Free Trade Zone along with Korea's government, people and business interests.

Incidentally, any strengthening of East Asia's regional cooperation will naturally raise tensions with the United States. However, while working to relax the tense relations between East Asia and the United States, the East Asian countries and people need to attain their goal. In actuality, the United States' attitude toward the birth of the euro was irrational. Institute for International Economics Director C. Fred Bergsten pointed out that even if Europe's proposal was constructive, United States officials opposed it simply because it has not been made by the United States, and he called this behavior of his own country "schizophrenia"[268]. In our experience, attitude would be stronger toward East Asia than toward Europe.

The United States refused to attend the meeting of countries planning to give financial support to Thailand, and opposed the AMF. Though it did not reject Miyazawa Initiative, it is very sensitive to thing through which Japan or other East Asian countries try to take the initiative. At its annual meeting in May 1999, the ADB approved the establishment of a facility, called the Asian Currency Crisis Support Facility (ACCSF), for which funding would be raised through contributions to the ADB by the Japanese government under the Miyazawa Initiative. The ADB was supplying emergency relief to South Korea and other countries in the midst of the crisis by reassigning financial funds for long-term loans, this was an attempt to institutionalize it.

However, as Japanese newspapers commented and showed obvious anxiety, the field of emergency relief had become 'one where the IMF has taken leadership'. In fact, the United States and European countries resisted this institutionalization. The reason of their opposition was the argument that the ADB should be an institution supplying long-term loans [Asahi Shinbun, May 4, 1999]. Behind the United States' opposition was its feared that Japan would augment its political influence in the region through the ADB [Nihon Keizai Shinbun, May 3, 1999].

Both Japan and other East Asian countries have grown within the Asia-Pacific economy after the World War II. This structure has not changed fundamentally. Even though Japan is now opening its market much more to East Asian countries, still the United States is trying to retain its position as a major political power and major market supplier. Cooperation and conciliation

268 He writes: 'One the one hand, the United states claims that Europe (and, during better times, Japan) should assert greater international responsibility and "share the burdens of leadership." On the other hand, its revealed preference is to try to maintain American dominanceeven while asking others to pay the billand to exploit national differences within Europe whenever possible. One senses that some American officials resist European or other international ideas simply because they originated elsewhere. Whatever the cause, the administration has responded with studied indifference or outright hostility to constructive European trade and monetary proposals' [Bergsten 1999:30-1].

between East Asia and the United States are needed. Globalization itself is not the problem; rather the problem is the way of globalization. It is safe to say that the IMF's imposition of structural reforms on crisis-hit East Asian countries was a rough-and-ready method. Clearly, the way globalization is done must be considered. In developing areas, social costs should be minimized. And regional organizations such as an AMF, the ADB and so forth should increase their initiatives in cooperation with the World Bank and other international organizations, including non-governmental organizations (NGO). Of course, it is important to create mechanisms that can hear the voice of the many people and workers who suffer from the crisis.

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