

# Yen Bloc: Towards Economic Integration in Asia

Review >  
Japan

Yes, a Yen bloc is desirable for Asia including Japan. And yes it can become reality. Here are the conclusions drawn by Chin Hung Kwan in his latest book *Yen Bloc: Towards Economic Integration in Asia*.

By Marie-Aimée Tourres

The admission that 'Asia's developing countries with most of their international transactions denominated in US dollar and with their currencies pegged loosely to the dollar belong to a de facto dollar bloc' is the kick-off start of the book. Two questions follow: 'Is the formation of a yen bloc desirable, and if so, is it possible?' A senior economist at the Nomura Research Institute, specialized in the Asian economy, C.H. Kwan has become notorious on this issue, which he has been covering for almost a decade, ever since his book *Economic interdependence in the Asia Pacific Region, towards a Yen bloc* (1994).<sup>1</sup> Combining academic analysis with his experience as a member of various committees advising the Japanese prime minister and the minister of finance, he answers them in two-part presentation comprising a total of nine chapters. In the first part presenting 'The economic fundamentals supporting a Yen bloc', he explains the rise of regionalism in Asia, the yen-dollar rate, the de-dollarization versus re-dollarization or the aftermath of the bubble economy. Having armed us with the basic but essential concepts to understand the Yen bloc subject, the author uses each chapter composing the second part 'Forming a Yen bloc in Asia', to present the different perspectives on the Yen bloc issue from Japanese to global.

Until the early 1980s, the Japanese government was reluctant to promote the yen as an international currency, fearing that a large demand for its currency would destabilize the Japanese economy while making it difficult to conduct a monetary policy. But now, as Asia is replacing the US as Japan's largest trading partner, stabilizing the Yen's effective exchange rate through the formation of a Yen bloc should help reduce the vulnerability of the Japanese economy to fluctuations in the yen-dollar rate while bearing less exchange risk in both current account and capital account transactions. From the 'Asian perspective' (the only empirical chapter), the latest crisis has vividly illustrated that the traditional exchange rate policy of pegging to the US dollar is no longer compatible with macroeconomic stability in Asian countries.

The theory of optimum currency area is then used to provide a regional perspective. The author focuses on three main criteria as major determinants: the extent of economic integration, the similarity in economic structures, and the similarity in policy objectives. He concludes stating 'it is unrealistic that Japan, the Asian Newly Industrialized Economies (NIEs), members of ASEAN, and China together and at once form an optimum currency area [...] It is more likely that Japan and the Asian NIEs form an optimum currency area, with potential membership extended to include Malaysia and Thailand as they reach a higher level of economic development. Countries still at an early stage of economic development such as China, Indonesia, and the Philippines fail to meet the conditions for forming an optimum currency with Japan.'

But some of Kwan's most interesting observations occur in the final reflective section, relative to the 'global perspective', where he replaces the United States in its due position as regarding international finance. He points out that: 'thanks to the need to finance its chronic current account deficit by borrowing overseas, the US has turned into the world's largest debtor country. The mirror image is the emergence of Japan as the world's largest creditor country and by far the largest foreign holder of US treasury bonds. Never before has the world's leading creditor country had most of its overseas assets denominated in the currency of the world's largest debtor country. This unprecedented situation has become a major source of instability in the international financial system, as symbolized by the gyration of the yen-dollar rate. The emergence of international currencies that compete with the dollar may help impose discipline on the economic policy of the US by rendering the international environment less forgiving of its mistakes'. Together with the euro, the emergence of the yen as an international currency, by imposing discipline on US economic policy, should therefore enhance the stability of the system.

Worth noting, in contrast to Europe and America, economic integration in Asia has been achieved mainly through the initiative of the private sector, without formal treaties. Likewise, according to Kwan, a Yen bloc is unlikely to be established under Japanese government initiative; rather it will be the result of the increasing preference for the yen over the dollar by the Asian economic agents. Yet, perhaps Japan is capable of facilitating this process. Kwan believes it 'no exaggeration to say that Japan is facing the choice between now or never in its attempt to promote the yen as an international currency'. However, the author stresses that due to its current economic situation Japan



will first need to revitalize its economy, before it can even contemplate facilitating the yen is to play the role of Asia's key currency.

The political aspect cannot be ignored either. The Japanese occupation during World War II is still fresh while the real political opposition may come from the US, if the formation of a Yen bloc is interpreted as posing a challenge to the status of the dollar as the key currency. But the idea will mature when the potential economic benefits will surpass the political costs. In this context, the formation of an East Asian Economic Caucus (EAEC) advocated by Mahathir, Prime Minister of Malaysia, contains a clear and symbolic say, that is, an element of 'thinking East-Asian' by strengthening the voice of East Asia and East Asian economic cooperation. One thing however: the book was written under the premiership of Obuchi keener on such visions than Koizumi. At present, Kwan's views more clearly follow what Eisuke Sakakibara, former Vice Minister of Finance for International Affairs and now professor at Keio University, Tokyo, has been strongly advocating for years. If Sakakibara was nicknamed 'Mr Yen' for his influence over currency markets, it is not for no reason. Beyond the so-called Chiang Mai initiative, which aims to create a network of Central Bank currency swaps among ASEAN+3, Sakakibara states that Asia should aim for creating an Asian Currency Union in ten to twenty years. <

- Kwan, C.H., *Yen Bloc, Towards Economic Integration in Asia*, Washington DC: Brookings Institution Press, (2001) pp.204, ISBN 0 8157 0083 0, index



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## Editor's note >

Parts of the book have been published earlier in 'Towards a Yen bloc', *NRI Quarterly*, Vol.8 number 2, Summer 1999, pp. 2-13.

## Note >

<sup>1</sup> Also see: Kwan, C.H., 'The theory of optimum currency areas and the possibility of forming a Yen bloc in Asia', *Journal of Asian Economics*, 1998.