DOLLAR AND YEN: Changes in the Dollar Standard System and Economic Regionalism

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DOLLAR AND YEN :
Changes in the Dollar Standard System and Economic Regionalism

Shojiro Tokunaga

Introduction :

International finance in the 1980s was featured by the liberalization and global integration of financial markets. Domestic financial markets of major industrialized countries were opened and not only dollar markets but also non-dollar offshore financial markets of major countries were put in good condition for further development. As a result, the international fund flows in the private sector play an increasingly important role as a means to supplement deficits of major countries, particularly the twin deficits (of current account and goverment budget) of the key-currency nation, the United States.

Although it had enjoyed its prosperity especially in the latter half of the 1980s, the international financial market began to experience an insecure and restless position in the 1990s. The breakdown of the money game (bursting of bubble economy) accompanied by a stock market crash centered around Japan at the outset of the 1990s made us realize that harsh aspect of the international financial markets. In the international financial markets and securitized offshore market of many advanced nations, non-bank financial institutions such as securities and insurance companies as well as commercial banks suffered a telling blow. Commercial banks have become creditors of huge amounts of bad debts and with decreasing rates of profits their capital positions were weakened. Non-bank financial private enterprises have also increased their rates of debts against asset values with stock prices plummeting and the economy declining. In addition, they are forced to face less efficient and stable opportunities for funds-raising in a situation where low-cost financing means such as stock issue no longer functions effectively.

The liberalization and globalization of finance became prominent in the 1980s to form a bubble economy and it became considerably prevalent in the international financial markets at the beginning of the 1990s. In this paper, I would like to focus on the decline in the stock price on a global scale at the outset of the 1990s to confirm the fact that the U. S. has been replaced by Japan as the leading actor in the financial crisis. That is, the bubble was mainly formed in

Japan in the latter half of the 1980s and the bubble burst in that country in the early 1990s. The recent problem of an excess liquidity originating in Japan is closely related to the constant imbalance of payments between Japan and the U. S., as well as large-scale foreign exchange fluctuations (and abrupt ups and downs) after the plaza Agreement in 1985. In this sense, we can safely assume that the problem of an excess international liquidity has entered a stage of history with new features and contents.

The second feature noticeable in the process of the liberalization of financial markets in major countries and the integration of international financial markets in the 1980s is a transfermation of the dollar standard system, an international currency system based on the dollar serving as the key currency.

The feature is reflected in the development of monetary integration in the European Community, and the relative departure of Asian currencies from dollar, which has become conspicuous in the process of upward revaluation of currencies in Japan and Asian NIEs against the dollar and a basket formation of ASEAN currencies. The weakening of the dollar standard system is clearly indicated by the fact that the dollar has relatively lost its "internationality" or "globality". While the U. S. economy troubled with twin deficits (chronic current account and budget deficits) finds itself in a recession, the dollar is increasingly playing a part in adjusting the domestic equilibrium as one of the main attributes rather than in adjusting the international equilibrium as an international currency. Of late, the dollar cannot independently maintain its international monetary function. Instead, it is simply fulfilling its international responsibility in international monetary cooperation with the other major currencies.

Dollar is suffering from a new dilemma as the international currency. It is matter an ironical today that the process of enforcing a cooperative system with the other currencies is that of those currencies constructing a non-dollar monetary settlement area separated from the dollar settlement area. Although the dollar maintains the international currency function through an international cooperation of monetary policies, Europe has previously declared its intention of shifting to the European Monetary Union (EMU), separated from the dollar, and Asian countries are departing from the dollar not only in foreign aid and external trade but also in financial transactions.

Thus, this paper aims at examining the historical significance of the integration of international financial markets which advanced in the 1980s from viewpoints of both international liquidity and the international monetary system, and also at groping for how the transformation of the international monetary and financial systems is interlinked with multipolarization of the world economy.

1. *Bursting of the Bubble Economy and the problem of Excess Liquidity : "Excess-capitalization" of the Japanese Economy*

1.1 Bursting of the Bubble Economy

The financial markets in the world have been confronted with two crises since the Plaza Accord in 1985. The first crisis was Black Monday in 1987 and the bursting of bubble economy in 1990 through 1991. Although, in the first crisis in 1987, world stock prices fell simultaneously to a large extent, Japan's stock market recovered to its previous state by the first half of the tollowing year and had continued to grow afterward.

As Figure 1 shows clearly, the falling of stock prices early in the 1990 was different from what happened on Black Monday in 1987. In the early 1990s the Japanese stock markets experienced an unprecedented decline of stock prices and the prices still remain at a comparatively low level. On the other hand, it was the stock markets of the U.S. and the U. K. that showed quick recoveries. Quite interestingly, stock prices remain unchanged at a low level after the falling in the early 1990s in Germany, an asset-rich country like Japan. In view of stock prices, the bursting of the bubble economy directly hit countries enriched with assets, Japan in particular,

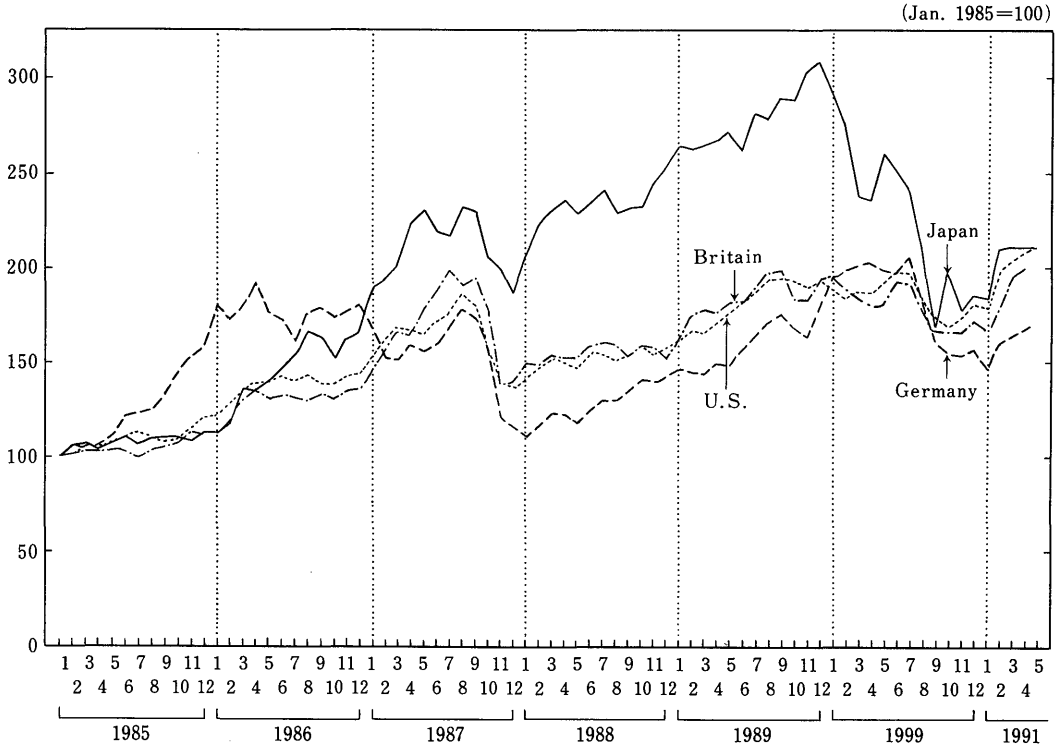

FIGURE 1 TRENDS IN THE STOCKPRICE INDEX

Source : Tokyo Stock Exchange

and caused much damage to its stock market.

Here arises a question. It is a mystery which was seen in the global bursting of the bubble economy in the early 1990s. In other words, the question is why the bursting of the bubble economy was centered around Japan at that time and caused a fatal blow to Japan's financial markets.

This is not a problem of only Japan, because the key to the solution of the problem is a clue to the explication of the international excess liquidity problem and the historical signiticance of the internationalization and liberalization of finance.

Prior to getting onto the main subject, I would like to stress that in this text, excess liquidity is simply defined as "funds which is not input for real investment activities but speculatively input for both financial assets such as stocks and real estates such as land and buildings and, therefore, floating capital (speculative *ZAITECH* * money) which moves in accordance with stock prices and foreign exchange fluctuations", although I understand that this definition still leaves a little to be desired [in detail, see Tokunaga, 1988A]

In the System of National Account of the United Nations (SNA), national income (disposable income) is regarded as only an added value (income gain) substantiated by producing activity. If, however, one thinks of the Japanese economy in the 1980s, it is not desirable to ignore capital gain, that is, an income corresponding to an increase in the values of domestic land and stock assets generated from increases of land and stock prices and an increase in the values of overeas assets generated from a fluctuation of foreign exchange rates.

As will be described soon, national wealth or net national assets (NNA) consists of real assets such as capital assets, housing and land and net financial assets (obtained by subtracting gross national financial debts from gross national financial assets). From 1955 through 1988 during which the post-World War II Japanese economy took off and attained full growth, an adjustment value accounting for about 37 percent of the gross national products (GNP) on an average was produced in the national wealth. In other words, as a result of capital gain generated from value fluctuations of land and stock prices and overseas assets, a value adjustment over one-third of net national assets was generated.

Before 1985, the adjustment of NNA (national wealth) had been mainly based upon an increase in land value. However, in the latter half of the 1980s, capital gain was considerably derived from not only land assets but also stock assets. In 1988, an increase of stock assets exceeded that of land assets for the first time in history, reflecting skyrocketed land prices. The

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* *ZAITECH* is the practice in Japan through which companies and institutions make investments of both their excess cashflow (that is, internal reserve) or funds raised in financial markets for the purpose of making profits on financial transaction.

adjustment value generated in the national wealth in that year amounted to 146 trillion yen. This amount was far from the previous year's value of 402 trillion yen (an enormous amount which exceeded the value of GNP of 346 trillion yen) and yet it symbolized a bubble-like income increase (capital gain) effect caused by an increase of stock and land assets [NIRA, 1991] .

These facts and figures show that a large-scale self expansion of financial and land assets was rapidly realized ahead of the bursting of the bubble economy early in the 1990s. Thus, let us turn to the subject of excess liquidity while checking the state of the "excess-capitalization" of Japanese economy, that is, excess-accumulation of in Japan's national assets and GNP.

1.2 The "Over-capitalization" of Japanese Economy : the Bubble Economy

National assets are classified into gross national assets (GNA) and net national assets (NNA). GNA are roughly divided into real assets (net fixed capital assets, housing, land, etc.) and financial assets (stocks, bonds and other financial assets). Since most of the financial assets are debts of domestic economic units (enterprises, individuals and government), net financial assets in the whole national economy are net external assets if an adjustment of financial assets due to stock prices increases is excluded.

With the adjusted financial assets in mind, net national assets are represented by adding net external assets to domestic real assets and such NNA are called "national wealth" (where external assets are taken as financial assets for domestic statistics whether real assets or financial assets).

An "excess-capitalization" aspect of the Japanese economy is elucidated in the outstanding amount of GNA in the 1980s caluculated according to the SNA. The ratio of national assets to GNP which was about 800% in 1970 increased to 1100% in 1980. The ratio further increased in the 1980s. At the end of 1988, the balance of GNA amounted to 5,338 trillion yen, about sixteen times the GNP. Such a rapid expansion of GNA indicates that Japan became an assets-rich country and "excess-capitalization" of the economy increased during that period of time.

The problem is the contents of "excess-capitalization" of the Japanese economy. As is clear from Figure 2, Japan's net capital assets with buildings included had been solely about twice the GNP through the 1980s. Despite that, the gross national assets to the GNP considerably increased from elevenfold in 1980 to sixteenfold toward the end of the 1980s. Such an expansion of gross national assets in the 1980s is another expression of the fact that the Japanese economy became a bubble economy. Let us confirm this by examining the contents of national assets.

One of the major factors which contributed to an expansion of national assets in the 1980s is land (real estate), an important element of real national income. After the land prices increased

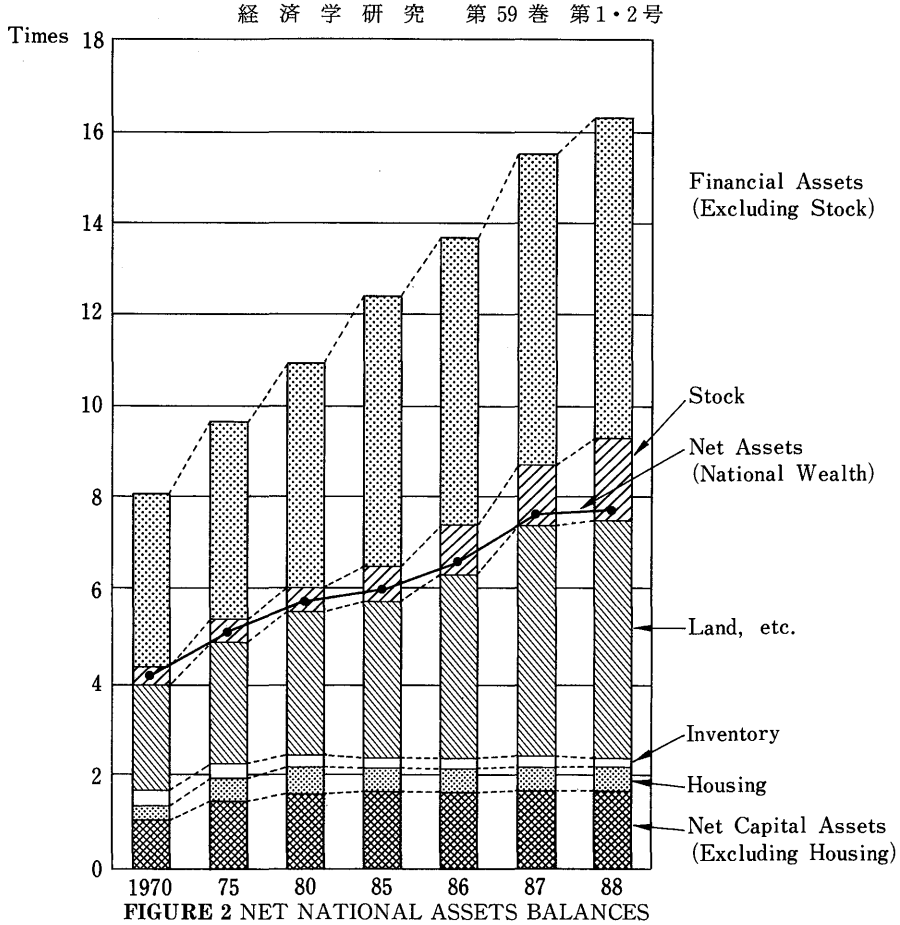

FIGURE 2 NET NATIONAL ASSETS BALANCES
(As Ratio of assets to GNP)

Source : *White Paper on the Japanese Economy 1990* (BII, Tokyo)

abruptly in the Tokyo metropolitan area in 1986 through 1987, they did so in the *Kansai* and *Chukyo* districts in the latter half of 1987. Besides showing an increase in the land prices, such a rapid increase in the asset value of land, a non-reproducible tangible asset, did serve as an important indicator of a bubble economy in the latter half of the 1980s. That is to say, a large part of national savings was absorbed during this period not in real capital assets which help the real economy grow but in the land incapable of reproduction on a progressive scale and expanded national assets in nominal terms.

The other reason for an expansion of national assets in the latter half of the 1980s is that stock assets among national financial assets increased through that period. Importantly, the increase of these stock assets was also nominal. As is clear from Figure 1, Japan's stock prices doubled, coping with an expansion of the value of stock assets, during a period of only five years from the beginning of 1985 when the world economy recovered from the recession in the first half of the 1980s to the end of 1989 when the bursting of the bubble economy became manifested. Such a growth of stock assets was also nominal as was the case with land assets, values.

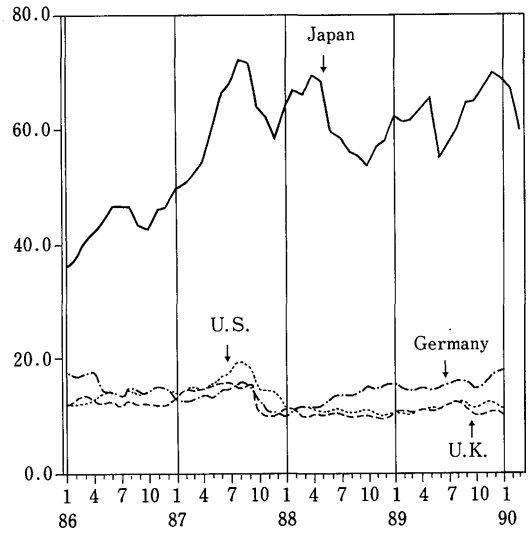

FIGURE 3 TRENDS IN PRICE/EARNING RATIO OF STOCK
Source : NIRA (1991)

Let us now turn back to the bursting of the bubble economy early in the 1990s. As I previously pointed out, the problem was that the bursting of stock markets happened as if Japan was the target. One of the main reasons that Japan's stock market enjoyed a faster growth than that in other countries in the latter half of the 1980s was an abnormally high capital gain. As is generally known, PER (Price-Earnings Ratio : after-tax profits/stock for this term) is an important criterion for stock investment. It rose sharply in the latter half of the 1980s. The value was about 30 in the first half of the 1980s and reached a level of over 70 toward the end of 1980 (see Figure 3). It should be noted that stock prices in the Japanese markets showed abrupt ups and downs after Black Monday in 1987, in addition to the fact that Japanese stock prices maintained an abnormally high level as compared to dividends and corporate profits [NIRA, 1991].

In summary, firstly, speculative activity was actively pursued in the latter half of the 1980s centering on stock and land assets. As I have previously described, an increase in the value of stock assets exceeded that in the value of land assets in 1988 for the first time in history under the influence of a sharp increase of stock prices. This plainly shows that capital gains were increased in the latter half the 1980s by increases in the values of both land and stock assets.

Secondly, we have to make sure of the interesting fact that land and stock speculation was mainly pursued in Japan. It was only in Japan and not in the U. S. and European nations that the PER rose sharply in the latter half of the 1980s and that stock prices showed sharp ups and downs (See Figures 1 and 3). During the same period of time, land speculation spread from the Tokyo metropolitan area to *Kansai*, *Chukyo* and other districts throughout the nation. Such a bubble storm which took place in the latter half of the 1980s in the form of land and stock speculation

was a strictly Japanese phenomenon.

1.3 International Assets Selection and Japan's Bubble Economy

Figure 2 also shows clearly, that an increase in the value of financial assets other than stocks acted as the third factor to increase gross national assets. In Figure 2, financial assets consist of not only domestic financial assets with stocks excluded but also overseas financial assets including direct overseas investment.

In 1989 when the bursting of the bubble economy has yet to become manifest, the outstanding sum of foreign direct investment (FDI) in the fields of agriculture, forests, mining and manufacturing was less than 30%. In contrast, FDI in overseas real estate including land and buildings and services mainly aiming at financial insurance took up more than 70%. Although FDI in real estate as well as financial insurance-related service made a remarkable progress after the Plaza Accord in 1985, direct investment in financial insurance-related service decreased sharply in 1990. (See Figure 4.)

As is generally known, direct investment in financial and insurance-related services which became conspicuous in and after 1985 had much to do with the large-scale fluctuations of foreign exchange that became manifest after the plaza Accord and the global liberalization of finance, which was promoted along with such foreign exchange fluctuations. Leaving out the financial institutions, non-bank private enterprise also set up local financial companies abroad as overseas financial affiliates. They engaged themselves vigorously in what we call "*Zaitech* activity" (international money game) besides regular fund raising and management.

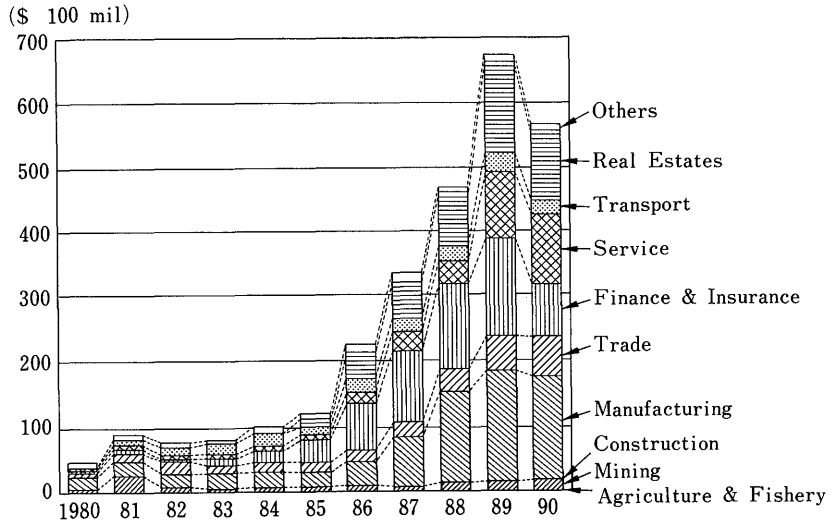

FIGURE 4 FOREIGN DIRECT INVESTMENT BY INDUSTRY
Source : Source : Ministry of Finance (Japan)

Zaitech in the fluctuating foreign exchange markets is featured by an international assets selection in the midst of foreign exchange fluctuations. Japanese money was directed at the selection of dollar assets centering U. S. government bonds, reflecting high dollar and interest rates in the first half of the 1980s. However, in the second half of the 1980s when the value of yen increased, Japanese money was directed toward acquisition of real overseas assets through direct investments. The typical case is an acquisition of overseas real estate.

On the other hand, a move for international assets selection was also interlinked with a fluctuation of value of domestic assets such as land, stocks and long-term bond prices (long-term interests). In the latter half of the 1980s when the value of yen appreciated, the prices of domestic land, stocks and bonds increased. The increase in the value of domestic assets resulted from either the fact that speculative funds not directed to investments in real economy were returned to the Japanese markets or the fact that similar foreign funds were absorbed, which under the condition of a relative decrease in the value of overseas financial assets accompanying the high yen rate. When the 1990s began, triple low rates of yen, stocks and land resulted. In actual fact, this meant the bursting of the bubble economy which expanded through the money game.

2 Globalization of Finance and Dollar as International Currency

2.1 U. S. as Net Debtor Nation and Global Integration of Financial Markets

Let us now focus on the U. S. as the key-currency nation. The year 1985 was a historic year for it was the time that the U. S. became a new debtor nation for the first time in the post-war period. The external assets of the U. S. registered s607 billion in 1980 and reached s934 billion in 1985. However, the external debts increased from s501 billion to s999 billion during the same period with the result that the net debts of the U. S. amounted to s64 billion. In sharp contrast to the U. S. whose external debts increased sharply, Japan, West Germany and the U. K. increased their external assets over their external debts in net terms (thus scoring net external assets). Japan's record was especially remarkable, its net external assets increased from 2 trillion yen in 1980 to 27 trillion yen five years later.

The year 1985 was also an interesting year to the international financial markets. A large-scale devaluation of dollar was determined by the Plaza Accord in September and the opening of financial markets in various countries and the formation of new international financial markets for non-dollar currencies were vigorously promoted throughout the year. The opening of financial markets in major countries and the integration of international financial markets are not

unrelated to the transformation of the U. S. into a net debtor nation, and thus, the transformation of Japan and West Germany into creditor nations. Back in 1985, the balances of external assets and debts of the U. S. were close to one-fourth of the GNP, or 23% and 25% of the GNP, respectively. In the case of Japan they were 28% and 25%, respectively, in the same year. The U. K. registered as high as 71% and 50%, respectively. If not higher than the U. K., West Germany, Italy and Canada scored higher percentage terms in both cases than Japan and the U. S. This means that the interdependent structure of financial markets in various countries had been established with their external assets and debts exceeding a quarter of GNP by the mid-1980s.

As is clear from the fact that the external assets and debts increased in major economies in the first half of the 1980s and that their share in the GNP increased to a great extent, the interdependence of global financial markets and the diversification of international financial markets (a development of the non-dollar market) had been promoted before the Plaza Accord. In the background of that development, there was an increasingly active international fund flow based on the fact that the economy of the key-currency nation, the U. S., has become a net debtor nation. In the latter half of the 1980s preceded by the Plaza Accord, the value of dollar fluctuated considerably and the fluctuation was accompanied by an accelerated opening of financial markets of various countries. Furthermore, the integration of major currency dominated financial markets in offshore markets was spurred.

After the submission of a report by the Yen-Dollar Committee (U. S. -Japan Ad Hoc Group on Yen/Dollar Exchange Rate and Financial and Capital Market Issues) in May, 1984, Japan lost no time in acting on the openintg of its financial market and the liberalization of yen through the submission of a report by the Foreign Exchange Council (in May, 1985) and the disclosure of an action program for liberalization (in Jnly, 1985) to prepare foundations for the fulfillment of the Plaza Accord. Toward the end of 1986, Japan opened a Japan offshore market. The opening of the markets in the EC nations including the U. K., West Germany and France was further promoted around that period of time. As a result, the interdependence of financial markets in many countries was deepened and expanded, and the integration of financial markets was promoted on a global scale. The integrated international financial markets provided opportunities for *Zaitech* money (floatinag capital) which are funds to be input speculatively in financial assets or real estate without being input in investment activity in real economy, rater than reinforcing the structure of interdependence in real economy involving trade and direct investments. That is, the international financial markets functioned as a forum for floating capital to obtain a profit margin making the best use of foreign exchange rate fluctuations, stock price fluctuations, inflationary gaps and interest rate differences.

It is not exaggeration to say that the worldwide integration of financial markets was a

process of money game in which the world markets rapidly expanded and deepened speculative operations integrated on a global scale while the international currency "dollar" was downgraded from the currency of a creditor nation to that of a debtor nation.

2.2 Globalization of Financial Markets and its Features

International financial markets had undergone remarkable changes, whether offshore markets or external financial markets (that is, international markets which, unlike offshore markets, have foundations in domestic financial markets and not under direct control of governments). The globalization of financial markets promoted in and after the latter half of the 1980s has the fllowing features.

First, the financial resources of the world have changed. Substantially different from the situation in the 1970s based on oil dollar, funds are concentrated in Japan and Germany for use to adjust an inequilibrium of the international balance of payments of the United States. Funds directed from Japan and EC member countries to the U.S. are used to reinforce international finance cooperation which is the main pillar of the dollar standard system. If private capital flows out of the U.S. because of a lower dollar rate, a mechanism comes into operation to supplement a resultant shortage of capital on the part of the U.S. with official debts. This substantiates the idea that an international monetary system equivalent to an "Settlements Union" proposed by J. M. Keynes and a "New Tripartite Monetary Agreement" proposed by Mckinnon can be established.

The U.S. still maintains the position of the key-currency nation while structurally retaining an international imbalance of payments. Such U.S. posture is virtually supported by international monetary cooperation among the U.S., Japan and Germany. The "reverse structure" of an international financial flows from Japan and EC nations to the key-currency nation, the U.S. has been in operation since the latter half of the 1980s. Although that flow is intended for private funds, leading countries are required not only to maintain dollar reserves, but also to adjust their financial policies to those of the U.S. for the purpose of safeguarding a breakwater (that is, a mechanism for official adjustment of financial flows) to prevent the international financial mechanism from being disturbed by speculative funds (hot money).

Second, the above-mentioned globalization is characterized by a move toward the integration and liberalization of European financial markets with the EMS (European Monetary System) playing a key role. In the same context, the role of the EC currency, the ECU (European Currency Unit) in particular, has become increasingly important in the international financial markets since the latter half of the 1980s. In other words, while international monetary cooperation to support

the international dollar standard system is being deepened among the U.S., Japan and the EC, a creation of monetary blocs departing from the international dollar system is being institutionally promoted. It is symbolized by EC's move toward the creation of an European Monetary Union (EMU).

While the EMS is now being now constructed as a system, a world Settlement system based on the international currency, dollar, is still in operation. However, it should be noted that in the international financial markets (both Euromarkets and external financial markets), the transformation has been promoted at high speeds from a monopolar system with the U.S. dollar acting as the core to a multi-polar international financial market structure based on major currencies.

The third feature of globalization is a structural change of the Euromarket. International financial markets have transformed in structure from those centered on syndicate loans which are indirect finance to Eurobond and external bond markets which are direct finance with the result that fund management and raising operations have become increasingly flexible. The securitization of international financial markets means the international liquidation of bonds at once and serves as a means to promote speculative, international assets selection.

As the change of the name from the Eurodollar markets to the Eurocurrency markets implies that the currency configuration has been considerably diversified. Offshore financial centers free from local financial regulations and customs in each country are growing in various parts of the world (a total of about 20 offshore financial centers are believed to be in operation thoughout the world).

Further, new types of offshore markets have also been founded. In contrast to "London types" (in London, Hong Kong, etc.) and "tax haven types" (in Kayman, Bahama Islands, etc.) which are not distinct from existing domestic markets, "New York types" of offshore markets (in New York, Tokyo, Singapore, etc.) have been created to permit only external-external transactions while regulating internal-external transactions. The New York and Japan offshore markets are new types of offshore centers where financial movements are strictly restricted between domestic markes and offshore markets.

Funds-raising means in the Euromarkets have undergone considerable changes. In place of previous syndicate loans, issuance of Eurobonds by companies in advanced nations and governmental organizations is now becoming a main funds-raising measure. Particularly since mid-1980s, the securitization of the Eromarkets has been accelerated through the use of fund-raising means such as NIF and Euro-commercial paper (CP) with high transferability (liquidity) and the introduction of interest rate swap and currency swap.

The fourth feature is the U.S. dollar has rapidly lost its importance in the Euromarkets. As of 1990, the share of U.S. dollar is merely one-third in the Eurobond market which serves as a

major international funds-raising market.

Fifth, the growth of the Euromarket was accompanied by the internationalization of financial markets in the leading countries, especially the fast opening of those in major countries, except the United States. As regarding "external bank loans", the U.S. took up only 11. 9% in 1989, a relatively low percentage when compared to 18.4% of the U.K. and 16.7% of Japan. In the "external bond market," the U.S. share is less than 20%. The external financial market of the U. S. is not that of a key-currency nation but simply a local, international financial market. The external financial market, an indicator of the internationalization of financial markets in each country, has grown in Japan and Europe rather than in the U.S. and its structure is more symmetrical than the Euromarkets.

2. 3 Multipolarization of International Financial Markets and Foreign Exchange Markets

Multipolar international financial markets are presently in operation under the unipolar international monetary system called "international dollar standard system (IDSS)." The classical international monetary (gold standard) system under which the financial market of the key-currency nation serves as the international financial markets no longer exists.

The configuration of the current international monetary and financial system with a unipolar international monetary system (IDSS) and a multipolar international financial market (localized dollar financial market) is a historical product of the fluctuating exchange rate system. In addition, the effect of the fluctuating exchange rate system can be seen in the fact that the role of international banking (indirect finance) in multipolarized international financial markets has become less important both relatively and absolutely and that the securitization of international financial markets has become Popular knowledge.

Let us examine the issue by dividing it into two parts. First, how has the fluctuating exchange rate system been associated with the formation of a multipolar international financial markets ? I would like to tackle the problem in relation to the internationalization of the yen.

Next, let us check the situation where the IDSS is being eroded under the floating foreign exchange system with relation to the foreign exchange market.

The Japan-U.S. Yen-Dollar Committee played an important role prior to the Plaza Accord in 1985 when an overall dollar devaluation was promised. The liberalization and internationalization of the yen became a practical issue toward the end of the 1970s but it was first brought to light at the Committee meetings held in 1983 through 1985. The Committee was set up in November, 1983, with a view to promoting the internatioalization and liberalization of the yen. The U.S. wanted to see the Japanese currency revaluated upward (thus, the dolar evaluated

downward) by making yen a more attractive investment currency. When the world economy was visited by a high dollar rate recession early in the 1980s, the underestimation of the value of yen and the increase in its competitive power were already a hot issue. A Solomon-Marchson report (submitted in September, 1983) referred to the necessity of constructing a structure with a high yen rate and a low dollar rate through the internationalization of yen and the suggestion became the basic principle of the Japan-U.S. Yen-Dollar Committee. The Committee set foundations for the internatioalization of financial markets through the creation of the Japan offshore (yen) markets, the liberalization of foreign currency transaction by non-bank residents and the creation of bank acceptance(BA) markets in 1984 and 1985. The Plaza Accord of the overall revaluation of dollar in September, 1985, was based on the internationalization of non-dollar financial markets and thus it could help to achieve a dramatically low rate of the U.S. currency.

In view of these facts and past trends, we can assume that for a fluctuating exchange rate system aiming at setting the dollar rate to a relative low level to function effectively, a multipolar currency dominated international financial market with two or more major countries participating must be established along with an international dollar financial market. The Eurodollar market was transfomed into a Eurocurrency market for the finance of currencies of major countries because a variety of investment currency markets were required. In addition, a liquidation of international financial assets is essential to the mechanism of a fluctuating exchange rate system (international asset selection) with incessant fluctuations of exchange rates accompanied by transfer to different types of currencies. This acted as a driving force for marking the securitization of international financial markets a common practice.

Let us look into the second problem briefly. The issue is the transformation of the fluctuating exchange rate system and the foreign exchange market.

Table 7 compares the transaction currency component ratio into the world foreign exchange market between the latter half of the 1970s and 1984. In the latter half of the 1970s, assuming that the gross transaction value of foreign exchange was 200%, 99% or about a half was taken up by U.S. dollar. In other words, currencies other than dollar were exchanged with dollar and further exchanged with third country currencies via dollar. The U.S. dollar had played the leading role in international transaction as an intermediary currency for foreign exchange.

However, a survey conducted by the Bank for International Settlements (BIS) in April, 1984, showed that the share of dollar to the gross transaction value (200%) was as low as 90% or less. This indicates that a direct settling system has been established involving some countries but without the use of dollar as an intermediary (thus, without the passage of the CHIPS, a U.S. clearing house). That is, the IDSS has been slightly unhooped. The more multipolarized the international financial market becomes, the more unhooped the market becomes.

In the degree of importance in the world foreign exchange market, the U.S. dollar is followed by yen, German mark and sterling pound (according to a survey conducted in 1984). In the Tokyo market, yen-mark transaction is currently believed to have changed from cross transaction via dollar to direct yen-mark transaction. This tendency appears to have been more promoted in the EC countries. The fact that an action of eroding the IDSS came into operation after the latter half of the 1980s when the fluctuating exchange rate mechanism virtually restarted is not unrelated to the fact that the financial mechanism centering on dollar has been obliged to undergo transformation with the establishment of a multipolar international financial market based on more than two currencies of leading nations. The action has been increasingly spurred by a diversification of external reserve currencies in the hands of monetary authorities. If the reserve currencies become more diversified, the unipolar structure of the international monetary system based on the IDSS may be fatally hit.

3 Floating Exchange Rate System and International Dollar Standard System

3.1 IDSS and Exchange Rate Systems

A shift form the international gold exchange system to the IDSS under the IMF-GATT regime with dollar used as the key currency was also a simultaneous shift from the fixed exchanged rate system to the floating exchange rate system. However, the international currency system in the former should not be regarded in the same light as the "international equilibrium adjustment system" in the latter.

The IDSS is a system in which the dollar-gold convertibility is sublated or suppressed through both international monetary cooperation and settlements among currencies of many nations are carried out through an interbank network with the U.S. dollar settlement mechanism (a clearing system based on the CHIPS and federal funds) serving as the core system.

On the other hand, a shift from the fixed exchange rate system to the floating exchange rate system means that the main constituency to adjust the international equilibrium among national economies has been transferred from one side (debtor country with the key-currency) to the other (surplus countries as peripheries). Thus, either the fixed or floating exchange rate system is derived from a concept relatively distinguished from the international monetary system in which international settlements are made by a multilayered system involving operations between enterprises, between banks and between monetary authorities across the international border. In other words, a selection of the fixed or floating exchange rate system means a transformation (a

change in quality) of the "international equilibrium adjustment system". Neither the fixed nor floating exchange rate system is equivalent to the international monetary system such as international dollar standard or gold standard system.

So long as the international balance of payments is adjusted, a fixed exchange rate system can be maintained even under the IDSS. If that is so, why on earth did the fixed exchange rate system collapse under the IDSS and change to the floating exchange rate system? The answer can be found in the change in the quality of the international monetary system from the gold exchange standard system to the IDSS. When the international gold standard system shifts to the IDSS, gold-dollar convertibity is lost. If an inequilibrium of international balance of payments of the key-currency nation becomes normal, an international monetary system with dollar used as the key currency can be maintained so long as peripheral countries possess dollar as a reserve currency and the inequilibrium of the key-currency nation is financially adjusted.

McKinnon proposed the concept of a "New Tripartite Monetary Agreement" for the establishment of an IDSS based upon such international monetary cooperation. He maintained that an international inquilibrium between a deficit country (key-currency nation: the U.S.) and surplus country (Japan or Germany) can be adjusted through a fixed exchange rate system under the IDSS because he set the issue of international convertibility (dollar reserve) in the framework of a simple savings-investment theory. The theory seems similar one to the international capital transfer in which a formation of dollar reserve on the part of a surplus nation is regarded as a sort of excess savings and the excess savings are circulated into the deficit nation and transformed into investment. (Theoretically, if the above-mentioned excess savings are "unfertilized", inflation may take place in the surplus nation and a system similar to the so-called "automatic adjustment mechanism of the gold standard system" may come into operation. Such a mechanism and the "principle of non-unfertilization" of international convertibility (dollar) suggested by Mckinnon seems impractical prepositions in view of a rapid growth of the Euromarkets.)

However, an international inequilibrium of the key-currency nation, the U.S., was derived from a decrease in the international competitive power in real economy and thus the employment of a parity adjustment mechanism was natural as a temporary political measure to get out of an everlasting inequilibrium of current balance of payment.

In that case, two choices are available. The first choice is to combine the dollar standard system with the fixed exchange rate system by resoulutely carrying out large-scale dollar devaluation as was the case with the Smithsonian Agreement in December, 1971, or the theory of return to the fixed exchange rate system proposed by Krugman (Case I).

The other choice is to employ a floating system in which the parity is adjusted using the mechanism of the international financial market as was typically seen after the Plaza Accord in

1985 (Case II).

These two choices are beyond the problem of simple policy selection. Differences of perception of the world market structure are concealed between Case I and Case II. In Case II , a mechanism capable of achieving a domestic equilibrium policy is formed without the U.S. being restricted by a domestic inequilibrium. That is, the existence of a Eurocurrency market outside national economies enables parity adjustment to be made through the asset selection mechanism. In addition, dollar discharged from the U.S. is made into assets in the market and can be used to achieve a domestic equilibrium policy in the form of U.S. govenrment expenditure ("national economic autonomy" can be secured).

In the case of McKinnon's concept and the return to the fixed exchange rate system in Case I, efforts to maintain international equilibrium of the key-currency nation become most important to retain the system. In a situation where the international competitiveness of the U.S. has structurally (even if relaitvely) decreased in real economy as compared to Japan, the EC and Asian NIEs, policy adjustments must be made ceaselessly (because parity adjustments are interlinked with "friction" in the real economic aspect).

3.2 International nature of fixed system and national nature of floating system

Viewed from the point of financial transactions, the fixed system has a nationalistic feature while the floating system is characterized by international and global nature. If reflected in the mirror of real economy, however, the fixed system functions as a free market mechanism, and the floating system is interlinked with protectionism focused on national economy and policies placing priority on internal (domestic) equilibrium.

Such a marked contrast in character between the fixed system and the floating system is quite obvious when viewed from the key-currency nation, the United States. The U.S. claims for the fixed system, and free trade under the IMF-GATT regime were a reflection of the national interest of the country which boasted of superiority in all industrial fields. The floating system embodies a policy of activating the U.S. economy while interlocked with the so-called international economic frictions. Besides, the floating system is generating an international evironment to promote the industrialization of Asian and other developing countries and the modernization of their economic structures.

Up to now, a mechanism (formaition of a multipolar international financial market) and a system (dollar standard system), both operated to help the floating system function in a large universe based on the only key-currency (the so-called Pax Americana), has been arranged on a global scale. However, two different "national characters" came to the surface in the same

process. One is the nationalism of the U. S. which as the key-currency nation attempts to put political and economic environments in good order for the recovery of national competitive power and the promotion of domestic equilibrium and the other is nationalism of Asian countries which are preparing conditions for the construction of the so-called national economy.

In contrast to these movements, a movement of "counter-nationalism" or regionalism inter-linked with the fixed exchange rate system is seen in Europe and North America such as EC and North American Free Trade Agreement (NAFTA). In other words, in a smaller universe (regional economic area) a fixed exchange rate system and a freer trade mechanism are being pursued. In Asia as well, regional economic linkage and interdependence are becoming increasingly deepened and expanded among Japan, Asian NIES, ASEAN countries and China. In reality, they are making attention to such "regionalism" as the East Asian Economic Caucus (EAEC) originally proposed by the Malaysian Prime Minister.

The IDSS with the floating exchange rate system is self-contradictory in dual aspects:

(1) The U.S. which has been lost and is losting her economic vitality is now promoting a diversification of the international financial markets within the framework of the IDSS with priority given to domestic equilibrium. The effort serves to negate the mechanism of the IDSS in the aspect of financial markets. Especially when the European Monetary System (EMS) is improved and developed in a form departing from dollar, the IDSS may become loose in the aspect of international financial cooperation.

(2) On the other hand, Europe has established a regional economic area centered around the EC, which is linked to the rest of the world with both the floating exchange rate and "fair" (not free) trade systems. In Asia, although their industrialization has been promoted through dollar depreciation (therefore, yen appreciation), the same floating exchange rate system (and U.S. "fare trade" (protective) policies linked with it) are now promoting the deepening and expansion of an intra-Asian economy from the previous economic structure dependent on the U.S. market. Also in North America, the construction of a local economic block is being attempted among the U. S., Canada and Mexico. Real economies in Europe, Asia and North America are gradually transfoming into not a unipolar world economic structure but multipolar local economies based on national economic development.

3.3 New Regionalism and "Optimum Economic Area":
Historic Role of and Limits to International Dollar Standard System (IDSS)

The histroric significance of the floating system based on the dollar standard system can be simultaneously examined in view of limits to the IDSS. In other words, conditions for the

formation of a multipolar economic area separated from the American (dollar) unipolar system are being set in multilayerd form.

Unlike in the 1930s, international financial markets (diversifed and multipolar international financial markets separated from dollar) have been established since the 1980s and the system for international economic and monetary cooperations have been arranged and developed with the result that realistic conditions for breaking away from the IDSS, a unipolar settlement mechanism. That is to say, conditions for the international settlement mechanism to shift from a system based on dollar as the key currency to a multipolar system are gradually being fulfilled. Such a grand experiment is currently being conducted in Europe.

The U.S. national interests (ie., the reconstruction of national economy) being pursued under the present fluctuating exchange rate system has been accelerating the maturing of economies of advanced counties, the Japanese economy in particular, while helping those economies becoming borderless. In tie-up with Japan's external aid (official development assistance: ODA and other official flow: OOF), this has been of use to promote the industrialization and modernization of Asian countries. In the process of economic development in the Asian area, the "national economic" growth of Asia's developing countries has be manifested and economic interdependence in Asia is rapidly being established.

The collapse of the international dollar system and the formation of tripolar economic areas in Europe, the American continent and Asia means the historic termination of the key-currency nation (suzerain power) -led world economic order and the birth of new "mosaic" regionalism based on economic and social interdependence among relatively independent countries. In this sense, an "optimum currency area" must be searched for in accordance with the degree of local economic development. Especially in Asia, the nurturing and development of a nationalistic financial and capital market in the area may become a prerequisite for the establishment of a new monetary system.

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