

## Foreword

This report was compiled by the Institute for International Monetary Affairs (IIMA) concerning the “Study on the Measures to Promote the Internationalization of the Japanese Yen from the Perspective of Japanese Financial Institutions and Multinational Businesses,” commissioned by the Ministry of Finance of Japan in 2005.

Internationalization of the Japanese yen, by which is meant the promotion of the use of the Japanese yen in cross-border transactions, could have the effect of reducing foreign exchange risks and foreign currency settlement risks for Japanese businesses and financial institutions. This would be expected to make the Japanese economy as a whole less susceptible to foreign exchange fluctuations. It would also contribute to invigorating the Tokyo financial market as an international financial center and help the Asian economies diversify the risks they face. In view of such positive effects that the internationalization of the yen could have, Japan has been taking measures to increase the share of the use of the Japanese yen in trade, capital, and foreign exchange transactions. Thus far it has seen some progress, although limited.

When we look at Asia, economic interdependency within the region is becoming continuously stronger as can be seen by the increase in the share of intra-regional trade. Striking evidence for this is the fact that China surpassed the United States as the largest trading partner for Japan in 2004. Regional financial cooperation is also gathering momentum in Asia. In light of these facts as well as learning from the Asian currency crisis, the promotion of Asian currencies including the Japanese yen will be beneficial in many ways. In this region where interdependency is becoming increasingly important, it will contribute to the growth and stability of the economies, as well as regional financial activities. If Japan continues to take steady steps to encourage the internationalization of the Japanese yen, and if other Asian countries develop and improve their domestic markets to make them more user-friendly, there would be a better environment for the use of Asian currencies including the Japanese yen in the region. Such efforts and developments would also greatly contribute to the growth and stability of economies and financial markets in the region.

Recognizing these facts in the current situation, it would first of all be essential to support the business activities of the Japanese financial institutions and multinational businesses in various Asian countries. As they are familiar with the use of the Japanese yen and have a need to use the local currencies in the region as well, this support will facilitate the internationalization of the Japanese yen.

If we take a look at their activities in Asia, Japanese financial institutions made progress in penetrating the Asian market before the Asian currency crisis of 1997-98. After the crisis, most of them made a drastic retreat from those markets. Now that the problem of domestic non-performing loans in Japan has come a long way to be solved, there are demands from Japanese corporations as well as local companies for Japanese financial institutions to resume and expand their business activities in Asia. Even though it has been eight years since the eruption of the crisis, they have not resumed their operations seriously except in China. On the other hand, Japanese multinational corporations are aggressively expanding their business in China and in other countries in the region, in order to decrease production costs and to penetrate the consumer markets that are expected to expand rapidly. They are increasing their business dealings not only with Japanese banks but also with major local banks as well as European and US financial institutions.

However, there is a wide range of financial regulations restricting the business activities of foreign financial institutions in Asia. Some examples are regulations on paid-in capital from parent companies, legal lending limits on large borrowers, adequate levels of liquidity to be maintained, and the number of expatriate employees that can be accepted from the home country (visa restrictions). Also, foreign exchange controls (including non-internationalization of the currency) and withholding tax on interest payments on borrowing from abroad are other examples. These regulations sometimes restrict the activities of Japanese financial institutions, although the degree of restriction differs across the countries. Japanese multinational corporations, among which especially the major trading companies, electric-appliance manufacturers, and automobile manufacturers, are well experienced and run sophisticated businesses in the region. They have operating networks in East Asia, establish regional subsidiaries and employ various financial methods, such as netting the settlement of transactions of their branch offices and local affiliate companies. However, the regulations of local authorities sometimes become an impediment to using such financial services. Also, the multinationals are often disappointed with the financial and capital markets of their host countries. Since they are not necessarily fully developed, these markets restrict the multinationals' activity of fund raising and management in the local currencies.

In view of the above, we focused on the financial regulations of six countries --- China, South Korea, Thailand, Malaysia, the Philippines, and Indonesia --- in order to clarify how they are affecting Japanese financial institutions and multilateral corporations in their business activities, as well as to suggest proposals that should be made to local authorities to change those rules and regulations. In chapter 1, titled "Financial Regulations and Business Activities of Japanese Corporations in China, South Korea, and ASEAN Countries," the results of the study are described.

Secondly, we focused on the Tokyo financial market. This is because making the Tokyo financial market more user-friendly, particularly for nonresidents, will naturally contribute to making the Japanese yen more attractive and convenient to use as an international currency. This can eventually lead to promoting the internationalization of the Japanese yen. A number of problems have been pointed out about the Tokyo financial market and a wide range of policy proposals for improvement has been made up until now by various kinds of committees or organizations studying "the internationalization of the Japanese yen." Chapter 2, titled "Creating a More Active Tokyo Financial Market," first takes into account what has been done to improve the infrastructure of the Tokyo financial market. It then studies the remaining problems in funding and management from a practical viewpoint, namely "The user-friendliness of the Tokyo Capital Market, mainly for nonresidents."

Thirdly, one of the measures of promoting the internationalization of the Japanese yen is for Japan to directly encourage the Asian economies to use the yen more actively while fully taking their individual situations into account. Chapter 3 titled "Practical Steps toward Promoting the Use of the Japanese Yen for Trade Finance in Vietnam" describes such a promoting project in Vietnam. As part of the project a working group was formed between IIMA and the State Bank of Vietnam (SBV), the central bank. IIMA provided the parties that participated in the project with the necessary support in order to materialize some pilot cases. These cases concern the actual transactions of a financial scheme, in which Japanese banks in Vietnam provide yen funds to Vietnamese commercial banks, which in turn extend yen trade finance to Vietnamese enterprises. At the time this report is made, pilot transactions between the participating Vietnamese banks and their clients of exporters/importers have not yet materialized. However, in the process of coming close to materializing the pilot cases,

we believe that the activities in the project contributed to creating positive conditions and improving the financial environment. This would provide the opportunity for materializing the actual transactions in the future. For instance, the cooperation in connection with the necessary yen funding would by itself be an achievement under the project. Also, for the participating Vietnamese banks to improve their institutional capacity for developing and diversifying the financial products they offer clients, would be an accomplishment. This chapter reviews the activities concerning the project in Vietnam and examines the outcomes.

In conducting the above study, we have received extensive cooperation from the authorities, financial institutions, and corporations of the relevant countries. Although we do not have the space to mention their names individually, we would like to take this opportunity to express our deepest appreciation to them. We hope that the fruit of this study will contribute to the internationalization of the Japanese yen and to the increasing use of the Japanese yen and other Asian currencies.

Listed below are the authors of the report.

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