# Reforming the International Monetary System
## — Japan's Perspective —

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## 1. Introduction

Recently, debates on the reform of the international monetary system have been thrust into the spotlight. What is Japan's perspective on this issue?

The International Bureau of the Ministry of Finance deals with the International Monetary Fund, the World Bank, international conferences such as the G7 and the G20, management of foreign currency reserves, monetary cooperation with authorities in Asia, and bilateral relations with economies such as the U.S., China, and the eurozone. Considering the reform of the international monetary system is, of course, one of the most important tasks for us.

While there is no "one right answer" from either an academic or a policy perspective, I would like to present my views based on recent exchanges of views with a number of experts including overseas authorities.

In the next section, I will touch on the factors underlying the recent surge of debates regarding the international monetary system, and then, I will focus on four topics that are important to Japan.

The first topic is the future of the U.S. dollar as the key currency.

Second, I will try to redefine "the internationalization of the yen" that Japan has pursed since the early 1980s as a policy objective.

Third, I will discuss Japan's perspective on the IMF's role after the crisis.

Fourth, I will discuss developments of financial and currency cooperation among Asian authorities that will serve as a foundation for continued growth in the region where countries have shown robust growth beyond initial expectations after the crisis.

## 2. Background to the recent arguments

The following points seem to underlie the recent surge of active debates on the international monetary system.

The first point relates to the recent global financial crisis. Although we have seen a number of financial and currency crises in history, the fact that the current crisis emerged from the reserve issuing country, the U.S., has taken on a special meaning to the international monetary system. It undermined confidence of the U.S. as the core of global finance and the economy. The massive fiscal stimulus for responding to the crisis that sharply increased the U.S. budget deficit led some to believe that the system of using the dollar as the global key currency has been shaken.

Second, the crisis has expanded the role of the IMF. Before the crisis, some were even arguing that the IMF is no longer needed. As the financial crisis spread instantly around the world, however, the IMF returned to the center of the international financial system. How to reform the IMF's mission and functions in light of lessons from the crisis is now being examined..

The third point relates to the emergence of China as a key international player. An article[1] published last March by People's Bank of China Governor Zhou Xiaochuan has caught wide attention. The article presented the view that it is undesirable for foreign currency reserves to be concentrated in the currency of a specific country (the U.S.). Instead, the role of the SDR should be enhanced. As China holds the world's largest foreign currency reserves,[2]the article further galvanized debates on the international monetary system. In addition, along with China's recent remarkable economic growth, nascent attempts to promote the international use of the renminbi, in other words, the "internationalization of the renminbi" has also been attracting attention.

The fourth point is recent developments in the euro area. During the crisis, the eurozone had seemed to show resilience as each country was no longer a target of currency attacks because of the introduction of a single currency of the euro. Recent problems, notably in Greece, however, have drawn new attention to intrinsic questions of the euro such as whether or not the currency integration with limited political integration and fiscal transfer could be sustainable, and more fundamentally, whether or not the euro zone is an optimal currency area.

## 3. International monetary system and the dollar

### (1) Views on a key currency and the role of the dollar

I will now consider the first of the four topics, "the future of the dollar as the key currency." When discussing this issue, it would be helpful to clarify a key currency's role.

A key currency should fulfill a global role as a means of storing value (reserve currency for the public sector / asset currency for the private sector), a means of payment (intervention currency/settlement currency), and a unit of account (currency used in defining parity/currency used in invoicing merchandise trade). That being the case, to what degree does the dollar fulfill those roles today?

The dollar accounts for about 60 percent of global foreign currency reserves (not including reserves of the unknown portion).[3] Oil and many other globally traded commodities are denominated in the dollar. Looking at the issuance of Eurobonds and other international bonds, in 2009, euro-denominated bonds accounted for as much as 47 percentage shares, but dollar-denominated bonds remained high at about 36 percent. In terms of the amount of outstanding national government bonds issued by major countries that are to be used in international asset management, dollar-denominated U.S. Treasury instruments account for an extremely large share.

During the recent crisis, financial markets in various countries run short of dollar liquidity, again indicating high demand for the dollar as a means of storing value and a means of payment.

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[1] Zhou Xiaochuan, "Reform the International Monetary System," published March 23, 2009, on the PBC website.

[2] As of the end of 2009, China's foreign currency reserves totaled 2.3992 trillion dollars. Japan was second at 1.494 trillion dollars.

[3] According to the IMF's Currency Composition of Official Foreign Exchange Reserves (COFER), during the third quarter of 2009, of the world's foreign currency reserves (not including the unknown portion), the dollar accounted for 61.6 percent, the euro for 27.7 percent, and the yen for 3.2 percent.

Furthermore, as major corporations become more multinational and supply chains become networked across national borders, these corporations engaged in international businesses, including those of Japanese, continue to hedge their exchange risk mainly via dollars.

All in all, the dollar is showing an overwhelming presence as a global means of storing value, means of payment, and unit of account. Unquestionably, the dollar is the key currency in the current international monetary system. Elements that support the dollar as the key currency include trust backed up by the U.S. economic, political, cultural, and military might, as well as the liquidity and depth of financial and capital markets along with the settlement infrastructure maintained by the U.S. currency authority. High user benefit from so-called “network externalities” also works favorably.

Some argue that with the decline of the U.S. political and economic power, the dollar's position as the key currency is being challenged. However, the U.S. economy seems to have the flexibility and diversity to constantly undergo needed dynamic transformation of the age. It may not be appropriate to assert that the U.S. power must decline based only on the recent observations. Furthermore, many argue that the dollar will remain the key currency due to the "network externalities", in that players in the international monetary system will have a tendency to keep the current system out of inertia.

### (2) Multiple key currency system

The view in favor of changing to a system of multiple key currencies has been raised repeatedly on the ground that the current system has an inherent instability, as it depends on the U.S. economic situation and the state of its balance of payments. Those who support the idea of the multiple key currency system argue that such a system should be more stable than the existing one because a mechanism for enforcing discipline in macroeconomic policy in reserve issuing countries would be incorporated into the system through the competition between multiple reserve currencies. On the other hand, those who are skeptical of multiple key currencies argue that the system should be less stable than the current one as differences in economic performances and interest rates among reserve issuing countries would increase the degree and impact of volatility in capital flows and exchange rates.

Supporters of the idea of multiple key currency system often cite a historical experience in the 1920s, when the pound, dollar, and franc coexisted safely as key currencies. That system, however, was based on the gold standard. Although the multiple currencies seemed to serve as units of account and means of payment at that time, it should be noted that the value of each currency ultimately depended on the value of gold. It is therefore doubtful whether that framework truly qualifies as a genuine system of multiple key currencies.

During the 1980s and into the 1990s, there was a vision of a tripolar currency system based on the dollar, yen, and mark, but such an idea has now receded.

### (3) The euro’s potential

When one considers the possibility of another currency paralleling or replacing the dollar as a key currency, the euro is usually seen as the most promising candidate.

However, a key currency requires deep and liquid financial markets denominated in that currency. In the case of the euro, one problem is that each eurozone country has a separate market for its government bonds, the most stable assets serving as benchmarks. Market depth and liquidity are thus lacking compared to the dollar. University of California Professor Barry

Eichengreen emphasized this point in a much-discussed article published last year.[4] In addition, as I have already mentioned, the intrinsic difficult issues about the euro system again brought to the fore by the crisis.

The establishment of the euro as a common currency has contributed to deepen European economic integration thereby bearing much fruit such as revitalizing the economy. I expect that countries in the euro zone bring their collective wisdom to overcome the challenges they are facing. At the same time, it is true that the euro has a number of constraints. Even if surrounding countries and regions with strong historical ties to Europe expand their use of the euro, it seems unlikely that the euro will match the dollar as an international key currency anytime soon.

(4) Chance for the renminbi

Next, I would like to discuss the status of the renminbi in the international monetary system. Some people have begun to suggest that with China's remarkable economic growth, the renminbi will become a key currency alongside the dollar at some time in the future. Indeed, China has recently seemed to expand international use of the renminbi; it lifted its ban on renminbi-denominated trade settlement on a pilot basis with neighboring countries (July 2009);[5] it issued renminbi-denominated government bonds (October 2009) and financial institutions and corporations in Hong Kong (in 2008 and 2009, respectively); and, the People's Bank of China carried out currency swaps with emerging countries (December 2008–April 2009).[6] In light of these actions, there have been much reports on the "internationalization of the renminbi."

However, Chinese officials themselves explained their stance that using the renminbi for trade settlement is aimed to respond to insufficient dollar liquidity during the crisis and to facilitate the convenience of traders, and that the intention is only for maintaining smooth trading, not for seeking a full-fledged "internationalization of the renminbi” in the near future. In fact, even if the renminbi is to be only used for trade settlements, importers and exporters would have to finance renminbi and to manage surplus, which cannot be kept completely separate from the liberalization of capital accounts. The liberalization of capital accounts in China, which would be preceded by deregulation of its domestic financial markets including the liberalization of interest rates, still requires a great deal of time.

The use of the Japanese yen for trade settlement dates back to the establishment of free-yen accounts in 1960. Comparing China's economic development model with Japan's high economic growth in the past, China’s model is more open to mobilizing international capital reflecting different international economic environment, and there is a network of overseas Chinese throughout Asia. In light of this, China might be able to "internationalize" its currency more quickly than Japan did, but this is not simple matter at all.

Last September, Chinese Premier Wen Jiabao said that whether a country’s currency is recognized internationally as a major circulating currency depends on that country’s economic

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[4] Barry Eichengreen "The Dollar Dilemma - The World’s Top Currency Faces Competition -" *Foreign Affairs* September/October 2009

[5] Trail of lifting of the ban on renminbi-denominated trade settlement in a pilot basis: between the Guangdong/Yangtze Delta region and Hong Kong/Macao and between Guangxi/Yunnan and ASEAN. However, the amount as of the end of 2009 was above about 3.5 billion yuan (roughly 45.5 billion yen).

[6] Currency swaps by the People's Bank of China with emerging countries: six bilateral currency swap agreements were agreed with currency authorities in South Korea (December 12, 2008), Hong Kong (January 20, 2009), Malaysia (February 8, 2009), Indonesia (March 23, 2009), Belarus (March 11, 2009), and Argentina (April 2, 2009). The swaps totaled 650 billion yuan (approximately 94.7 billion dollars at the rates on the days of the swaps).

prowess, which should be decided by the market, and that it will require a considerable time for the renminbi to become a truly international currency.[7] I think this is an accurate observation.

In any event, for the time being, China is likely to concentrate its efforts on promoting renminbi-denominated settlements in cross-border trading with neighboring countries. This policy direction is beneficial for Japanese corporations trading with China, and we should welcome such policies of China. At the same time, it is expected that China will pursue the appropriate policies commensurate with expanded international use of the renminbi, such as responsible macroeconomic management, appropriate exchange policy, gradual liberalization of capital transactions, and deregulation of the domestic financial sector based on the principle of equal footing between Chinese and foreign companies.

(5) Special Drawing Rights

What is the potential of the synthetic currency SDR? The London Summit in April 2009 agreed on a new 250 billion dollar SDR allocation to all member countries. This has increased the total SDR allocation to date by about tenfold. With this SDR allocation, emerging market countries and developing countries are able to attain foreign currency reserves as a buffer against sudden reverses of capital flow at a lower cost than the market.

On the other hand, even after the new 250 billion dollar SDR allocation, SDRs account for only 3 percent of the world's foreign currency reserves, totaling 7 trillion dollars. Moreover, an SDR is a mere synthetic currency composed of the dollar, euro, yen, and pound. There are no SDR banknotes or coins that can be used for transactions in the private sector. One could even say that an SDR is a mere "right to claim borrowing in freely usable currency" for the countries that use them and a "duty to lend freely usable currency" for provider countries, and that an SDR is not more than a kind of lines of credit without conditionality through which countries finance foreign reserve each other. In fact, if currency authorities were to use SDR for intervention, they have to exchange SDRs for hard currencies such as dollar and yen provided from other countries.

In light of these limitations on the functions and scope of use of SDRs, it would be difficult for them to play a much larger global role.

Meanwhile, it is possible and necessary to devise wider use of SDRs. For example, recently Japan and some other major countries have been using their allocated SDRs as a source of loan to the trust fund of the IMF for concessional financing to low-income countries.

(6) The future of the international monetary system

In total, it would be difficult to conceive of currencies such as the euro, the yen (which I'll discuss next) and the renminbi, becoming global reserve currencies and means of payment -- key currencies, in other words -- on par with the dollar in the foreseeable future, even though their usage might expand in neighboring countries and regions. Similarly, it is difficult to imagine SDRs playing the role of a global key currency.

Realistically, then, policy issues should focus on how to enhance efforts by countries and regions in the international community in order to strengthen the current system's stability, based on the premise that the dollar will remain the key currency. First and foremost, it is

[7] Stated during the opening of a discussion with entrepreneurs at the Summer Davos meeting on September 12, 2009.

important that as a key currency country, the U.S. pursues appropriate macroeconomic policies including responsible fiscal management. In this regard, the U.S. Federal reserve Board Chairman Ben Bernanke himself said, there is no “immediate risk” that the dollar's position as the world's major reserve currency will be shaken. He also mentioned that “the most critical element there is long-term fiscal stability."[8]

Indeed, the most effective way to enhance stability of the international monetary system would be that major economies including the eurozone, Japan, and China manage their economies responsibly with due regard to the international impact of their economic policies, drawing on peer review frameworks such as IMF surveillance (monitoring of economic policy) and G20 mutual assessment.

## 4. The “internationalization of the yen”

### (1) Redefining the "internationalization of the yen"

How should we view the status of the yen in the international monetary system? Since the time of the “U.S.-Japan Yen Dollar Committee” in the early 1980s, the Japanese government has pursued the "internationalization of the yen" as a policy objective. I would like to pause here to review efforts made to date and to consider significance of the concept in the present context.

It seems that the term of "internationalization of the yen" has been used to indicate different levels of objectives.

(i) Securing and enhancing the yen's convertibility, not just for current account transactions, but including capital account transactions

(ii) Promoting yen's international use especially in Asia through eliminating obstacles, upgrading environments so that the yen will be freely selected in a manner that meets the needs of those engaged in transactions

(iii) Making the yen a global currency on par with the dollar, with an ultimate vision to transform the international monetary system to a "tripolar currency system"

Looking back on efforts on the first objective, the adoption of free yen accounts that allowed the yen to be used in trade in 1960 marked their beginning, followed by the liberalization of current transactions (to be an IMF Article VIII country in 1964) and liberalization of capital transactions (1980 revision of the Foreign Exchange Control Law). Institutional reforms to secure the yen's convertibility were finalized by complete liberalization of capital transactions in 1998.

As for the third objective, the yen becoming a global currency on par with the dollar was advocated from the 1980s into the 1990s in the context of envisioning a tripolar currency system. This enthusiasm can be associated with the pinnacle of Japan's economy, described "Japan as Number One" at that time. Unfortunately, however, in light of the recent sluggish growth and low returns on yen-denominated assets, it is difficult to conceive the yen becoming a global currency compared to the dollar.

[8] Chairman Bernanke's statement to a House of Representatives Finance Committee hearing on October 1, 2009.

## (2) Promotion of Japan's financial and capital markets

With regard to the above-mentioned second point, continued expansion of use of the yen in Asia is desirable. The Japanese government has worked to remove obstacles to managing yen assets and financing yen by non-residents. Measures include exempting non-residents from withholding taxes on interest from Japanese national and regional government bonds, and deregulation of the issuance of samurai bonds. We must continue such efforts. In fact, a bill to introduce tax exemptions on interest from corporate bonds for non-residents is now deliberated at the Diet as part of a 2010 revision to the tax code.

However, in considering the significance of the "internationalization of the yen" in the present context after implementation of the efforts to date, we have to rethink whether or not promotion of the international use of the yen, per se, deserves a status as a policy objective.

In theory, increase of international use of a country's currency carries some benefits such as larger seigniorage and protection of domestic economic entities from currency fluctuations. Furthermore, it could increase business opportunities for financial service industries of the country, thereby invigorating financial and capital markets. On the other hand, there are costs associated with international use of a country's currency. For example, autonomy of monetary policy can be adversely affected, increased short-term liabilities bring about greater vulnerability in the management of the country's economy, and greater demand for the country's currency can cause exchange rates to rise.

In the case of a large, mature economy like Japan, such costs are not seen as significant. That said, we should reexamine the question of whether the "internationalization of the yen" per se brings benefits sufficient to make it worth advocating as a policy objective. On this point, in the case of the euro, European Central Bank (ECB) Executive Board Member Lorenzo Bini Smaghi spoke as follows at a symposium called "The Euro at Ten" that marked the 10th anniversary of the establishment of that currency. "The ECB neither promotes nor hinders the international use of the euro. The international use of the euro is an entirely demand-driven process."[9]

On the other hand, invigorating Japanese financial and capital markets is an essential part of the nation's growth strategy. Obviously, it is necessary to strengthen financial function that intermediate domestic financial demands including those of emerging enterprises and households, and abundant domestic savings, thereby supporting a foundation for future growth. In addition, strengthening Japanese financial services to capture the needs of the dynamically growing Asian region is extremely important to Japan's ability to earn its living internationally.

To sum it up, we can say that policies for promoting "internationalization of the yen" should be the flip side of policies for vitalizing Japanese financial and capital markets, and that such policies should aim at consequential expansion of the international use of the yen reflecting free selection by parties involved.

The Financial Services Agency is in charge of revitalizing financial and capital markets. The FSA is actively working on reforming the financial system by upgrading financial and capital markets infrastructure, ensuring fairness and transparency of markets, and enhancing consumer protection and convenience. I want to emphasize that in addition to these efforts by the government, the Japanese financial industry itself should enhance its competitiveness and improve its fundamentals such as management skills and capital bases.

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[9] "The Internationalization of Currencies- A Central Banking Perspective" Lorenzo Bini Smaghi Conference "The euro at 10: The next global currency?" hosted by the Peterson Institute of International Economics and BRUEGEL Washington, October 10, 2008.

## 5. New mandate for the IMF after the crisis

Another important point of discussion regarding the international monetary system is the role of the IMF in the post-crisis. As the financial crisis beginning from the U.S. immediately spread around the world, the IMF has been playing a pivotal role in responding to the crisis by providing large amount of finance to countries slipping into the crisis, and has offered valuable input on macroeconomic policies at international conferences such as the G20. The Japanese government decided to lend to the IMF 100 billion dollars on a voluntary basis in order to replenish its financial resources. This decision led to agreement on a threefold increase in the IMF's financial resources. Furthermore, the IMF established a new lending facility, Flexible Credit Line (FCL), which can be used without ex-post conditionality for crisis prevention by countries showing good track records in their economic policy management. As I have mentioned, the IMF also allocated a large-scale SDRs.

The recent crisis has taught many lessons. The stability of member countries' domestic financial systems is an important element in their macroeconomic stability and growth. In addition, problems in one country's financial system can jeopardize the whole international financial system. Furthermore, in order for the IMF to play an effective role in response to a crisis, it must have a flexible and appropriate framework for supporting member countries and a solid financial foundation to enable such action.

Based on these lessons, I think it is time to add member countries' "financial stability" as a new mandate of the IMF, in addition to conventional missions such as responding to member countries' balance of payment difficulties, promoting stable foreign exchange regime, and monitoring countries' macroeconomic policy. In this vein, it needs to strengthen surveillance of member countries' financial sectors. It is also imperative to enhance its collaboration with the Financial Stability Board (FSB) made up of countries' finance ministries, central bankers, and financial regulatory authorities, as well as the Bank for International Settlement (BIS), based on the appropriate division of labor between these international bodies and the IMF.

In order for the IMF to continue providing sufficient foreign currency to emerging nations from the perspective of both preventing and responding to crises, it must work to tailor its lending facility to member countries’ needs. During this crisis, the U.S. Federal Reserve (the Fed) provided dollar swap arrangement with four emerging nations.[10] While the Fed played important roles, the IMF Managing Director Dominique Strauss-Kahn stated, "What assurances do we have that [the Fed] would be willing and able to provide such liquidity support in the future? We should not take this support for granted."[11]

As each country's supply of hard currency falls within the responsibilities of its central bank, it is difficult to picture the IMF becoming the "lender of last resort" for private-sector financial institutions. However, in a world in which large-scale capital movement across borders can take place in an instant, how to prepare for liquidity crises in light of the experience of the recent crisis will continue to be an important question for the international community.

I would like to touch on the IMF's views on capital control. Until the late 1990s, the IMF saw the free movement of capital as something to be promoted as intrinsically good, and capital controls as bad. It tended to disregard the risks of sudden capital movement. In contrast, Japan

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[10] On October 29, 2008, dollar swap lines of 30 billion dollars each were extended to South Korea, Singapore, Mexico, and Brazil.

[11] "An IMF for the 21st Century" Addressed by Dominique Strauss-Kahn At Bretton Woods Committee Annual Meeting Washington D.C., February 26, 2010

repeatedly argued that, adoption of some capital controls can be appropriate in emerging market countries under certain conditions, and that liberalization of capital accounts should take pace in the proper sequence. In a report released recently,[12] the IMF focused on the risks of the free movement of capital as well as its importance. With reference to the policies of emerging market countries since the Asian currency crisis, it admitted that under some circumstances, adoption of capital controls, particularly prudential regulations designed to handle sudden capital inflows, is appropriate. This sort of pragmatic stance from the IMF regarding capital controls, is very welcome.

## 6. Financial cooperation within the Asian region

Finally, I would like to discuss financial cooperation among currency authorities in the Asian region that should lay the foundation for sustained growth of the dynamic Asian economies.

Before I address that point, I would like to provide an overview of Asia's recent performance. There were questions whether the Asian region could sustain its growth even after the crisis and whether the region's growth could be decoupled from the ailing advanced economies. The fact is that, in 2009, Asian emerging countries such as India and China, Indonesia, the Philippines, Vietnam, and so on, kept strong growth while advance economies suffered from record negative growth. Although many used to argue that destination of Asian products is overwhelmingly the U.S., it is becoming clear that there is endogenous growth in the region as domestic demand and intra-regional production networks took root in Asian countries. The intra-region trade ratio within the ASEAN+3 is about 50 percent (in 2008 exports and imports combined). This is less than the EU's, but higher than NAFTA's.

One underlying factor of recent good performances of the Asian region is the pursuant of sound macroeconomic and financial sector policies based on the lessons learned from the Asian currency crisis of the late 1990s. But I also believe that financial and currency cooperation in Asia contributed to maintaining confidence and smooth flow of capital.

Before the Asian currency crisis, each country's currency had been practically pegged to the dollar. This was linked to attracting speculative capital inflow, inducing bubbles, and eventually causing rapid reverse of the capital flow once anxiety over the sustainability of the peg reached a critical point. On this problem, it seems that Asian countries are shifting towards a more flexible exchange system at large.

One of the lessons of the Asian currency crisis was that depending on short-term loans for long term investment creates a "maturity mismatch" and using foreign currency for domestic investment creates a "currency mismatch." This "double mismatch" worsened the crisis. Underlying this was the fact that Asian savings were not intermediated within the region, but instead flowed into places like London and New York, then back-flowed into the Asian region.

One of the initiatives on financial cooperation in Asia, based on the aforementioned lessons is the "Asian Bond Markets Initiative." The purpose of this initiative is to directly link regional savings with regional investments by promoting bond issuances denominated in local currency in capital markets in Asia. During the current crisis, many Asian countries could issue government bonds to finance their stimulus programs. This should be one of the real outcomes of the initiative.

[12] IMF Staff Position Note, "Capital Inflows: The Role of Controls," February 19, 2010

In ASEAN+3, what is called the “Chiang Mai Initiative”, the swap mechanism of foreign currency reserves, and concomitant strengthened surveillance within the region are also undertaken. The Chiang Mai Initiative will be multi-lateralized this month by incorporating shared decision making mechanism through merging multiple individual bilateral contracts into a single contract. At the same time, member countries aim for early establishment of a surveillance unit (secretariat) which should enable strengthened review of economic policies of members and lay the foundation for financial support. The Chiang Mai Initiative has been positioned as a regional effort to supplement the international arrangement of the IMF. As the IMF works to improve its financing and advising roles in light of experiences in the crisis, it is time to consider how to strengthen cooperation between the framework of the Chiang Mai Initiative and the IMF.

## 7. Conclusion

I joined the International Finance Bureau of the Ministry of Finance in 1978. Discussing challenges in the international monetary system such as reliability of the dollar as the key currency gives me a sense of déjà vu. At the same time, we are facing new kind of challenges such as financial and currency issues in China and Asia.

An important topic that I could not address in depth in this article was the exchange regimes. Under the Bretton Woods system of the dollar-based fixed exchange rate until the early 1970s, among the three objectives of the "international financial trilemma," that is, exchange rate stability, autonomy of monetary policy and free flow of capital, the former two were pursued and many believed that the free flow of capital across borders should be controlled. Subsequently, after it became difficult to maintain fixed exchange rate regime and floating rate regimes were implemented, the free flow of capital were actively promoted rather than just permitted.

The idea that free movement of capital across borders is intrinsically good and should be promoted was combined with another idea that financial innovations and free activities by financial institutions are intrinsically good and should be enabled by overall deregulation of the financial sector. These ideas can be seen as a hidden cause of the current financial crisis.

On the other hand, it is also true that free and active capital movement within and across borders has brought various benefits to corporations and households in need of financing, and has supported high growth of emerging market countries. It is not realistic anymore to envision returning to a world of fixed exchange rate regime and restricted capital movements. Hence, even though we make continuous efforts in implementing sound macroeconomic policies and credible regulations, we need to bear in mind that problems associated with major fluctuations in exchange rates and large-scale, rapid movements of capital will continue to pose challenges to the international community.

In the constantly changing international economic and financial environment, we must always strive to think from scratch in making choices on the reform of the international monetary and exchange systems, as well as on the better management of countries’ macroeconomic and financial sector policies.