Prospects for the Global Economic and Financial System in the 2030s

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The Reality and the Challenges of the Current Financial Crisis

The reality of the global financial crisis and its effects

With the collapse of Lehman Brothers in September 2008, the current chaos in the global economy (which had been spawned by the sub-prime loan problem) reached new depths of turmoil. There is now a widespread perception that a full-scale once-in-a-century depression has begun. It is not only the financial sector that is being affected by the economic chaos caused by the financial crisis. The real economy is now also suffering serious repercussions, with key national industries such as the automobile industry being destabilized—particularly in the USA, the epicenter of the crisis. Moreover, with the rapid globalization of markets today, the current crisis has spread like wildfire throughout the world and extended to the nations of Asia. In Japan too, the economy has rapidly deteriorated, and with the adverse effects extending to the corporate sector and the labor market, many predict that 2009 will show the worst negative growth since the war.

The essence of the current financial crisis lies in the lag in monitoring systems and market provisions such as transaction rules and information disclosure, and in numerous failings in the regulation of domestic market monitoring systems in various countries including the USA, as financial technology grew highly sophisticated through securitization (for example, of housing loans)—all this against a background of financial capitalism that was totally removed from the real economy of the USA. The actual development of these financial transactions was highly advantageous in making the overall economy more efficient; however, given the insufficient provision of market monitoring systems, they resulted in major economic distortions and plunged the economy into chaos. These fears have now manifested. Furthermore, international imbalances and the under-development of direct financial markets in Asia served to amplify the effect. This is not the first time that it has been necessary to pay a heavy price and expend great effort to fix matters after deficiencies in the market have led to lax risk management and excessive future expectations, asset prices have become completely divorced from the real economy, and in due course a slump has occurred. This has been seen in many bubble-like phenomena in the past, and Japan has been no exception. The sharp rise in asset prices in the 1980s and the subsequent slump led to the subdued growth of the latter half of the 1990s (the so-called "lost decade"), and over the past 20 years—from the slump to the 2000s—there has been no sign of any full-blown economic recovery. Despite having seen the pain that Japan experienced at close hand, and despite the fact that the memories of this are still fresh, the world has repeated this phenomenon a mere 20 years later.

Nevertheless, the current financial crisis has entailed astronomical losses on a hitherto unseen scale and has plunged the global economy into chaos. Excessive leverage (dependence on external liabilities)—achieved by means of new financial technology and financial products—has not been confined to the banking sector, and through securitization has resulted in adverse consequences for all markets. As a result, it is not yet even possible to fully comprehend the final total of the losses. According to statistics released by the International Monetary Fund (IMF) in October 2008, the current losses in the banking sector (of approximately 800 billion dollars) rival Japan's losses in the 1990s; however, when the losses of financial institutions other than banks are factored in, the total doubles (to approximately 1.4 trillion dollars). According to the very latest IMF statistics, released in January 2009, losses by all financial institutions have now grown to 2.2 trillion dollars. Meanwhile, the Bank of England estimates these losses at 2.8—far in excess of Japan's non-performing loans in the 1990s. However, an on-going vicious cycle, whereby further economic deterioration is being caused by non-performing assets created by the economic chaos so far, could result in total losses that amount to an even more staggering level.

Short-term challenges: construction of a framework for disclosure and oversight of non-performing assets

To overcome the impending crisis, there is an urgent need to embark on a path to global business recovery, by repairing the battered financial system, addressing the needs of low-wage earners who have lost houses and jobs, creating jobs, and engaging in pump-priming measures. The most important issue in the short term is to disseminate a sense of confidence and security to the players in the market, so as to reassure them that the economy will deteriorate no further and that there will be no increase in non-performing assets. One of the indicators of this will be movement in housing prices—the origin of the current crisis. Unless this sense that the bottom has been reached spreads, the market will persist in harboring nagging doubts that it will not be possible to break out of the vicious cycle of economic chaos and growing non-performing assets.

Under these conditions the major nations have engaged in lengthy discussion on currency and on how to deal with the financial crisis, and in November 2008 the first financial summit meeting was staged. However, the countermeasures proposed were inadequate to the task of resolving the current crisis. Resolution of the crisis urgently requires the creation and implementation of an international framework for quickly comprehending the scale of the non-performing loans generated by the current financial crisis, fully disclosing them, and placing them under the close oversight of the financial authorities. As long as the bottom remains out of sight, it will be impossible to shed the uneasy fear that the swamp is bottomless. Even if the total losses greatly exceed the predictions, frank disclosure of the losses in their entirety represents the first step towards a solution. This is because, in light of Japan's experiences in the 1990s, the disclosure of non-performing loans and thorough oversight by the financial authorities proved to be effective tools in the wake of the capital injection that was carried out in 1998.

It will then be necessary to coordinate all kinds of policy devices (such as capital injection, the buying up of non-performing assets, liquidity supply, expansion of deposit guarantees, and the promotion of bank mergers), to dispose effectively of non-performing loans as quickly as possible, and to spare no efforts in collaborating internationally to repair the battered financial system. It would probably be natural to allow at least five or six years for this process.

Furthermore, the current crisis has exposed the shortcomings of not only the international financial supervisory system but also of nations' domestic financial supervisory systems, and has fostered economic chaos. In an environment where financial technology itself has very rapidly attained a high level of sophistication and where financial transactions are both complex and conducted on an international scale, a new international framework for effective financial oversight is required. Failure to implement such a system—even if disposal of non-performing assets proceeds—could be to invite a repeat of this crisis. This is one of the key lessons to be drawn from the current crisis.

Medium-term challenges: reconstruction of the global economy and financial system

There is no doubt that the current financial crisis has had grave adverse effects on the global economy, and it goes without saying that it is vital that the task of bringing the chaos under control in the short term be swiftly addressed. At the same time, however, the current crisis is qualitatively different in nature from previous economic crises—not only in terms of its origin and the management of its aftermath, but also in that it harbors the potential to bring about historical reform to the shape of the global economic and financial system. To be bound to a short-sighted point of view could be to invite a repeat of the crisis in the near future. The required strategy must have an outlook that is long-term, global, and historical.

The current financial crisis has compelled many countries that are reliant on a market economy to reconsider the very nature of the market itself. The market economy is the least abused economic system imaginable; however, for some time now there have been indications of "market imperfections" and "failures of the market." The current crisis is an example of a kind of "market failure," and there is an urgent requirement for the development of a framework to ensure that the market economy functions smoothly. However, the necessary preconditions for making the market economy function smoothly are low participation costs, clear market transaction rules, legal powers for their enforcement, and in particular the abolition of informational asymmetry (uneven distribution of information to a subset of market participants). The present situation was provoked by a lack of these elements, which caused the market to malfunction. The market is in the nature of a public good, with there being little awareness of its provenance or costs; however, the maintenance of such an environment entails enormous costs.

These costs have grown dramatically, due to economic globalization and the more complex, internationalized nature of financial transactions. Up until now, for the 60-year time-span since World War Two, maintenance of the global market environment (including the provision of the key currency) has been carried out solely by the USA, in its capacity as a superpower. It is clear that the so-called Bretton Woods System, which constituted the basis of the post-war international economic and financial system, was formed and has been maintained under the leadership of the USA. On top of the relativization of the economy of the USA (which has been paying the cost of maintaining this market system), the oversight of international transactions also rapidly became more difficult as technology swiftly advanced, as typified by the case of financial transactions. With the USA unable to support the global market alone, the current crisis has exposed the need for regional financial oversight and support systems, as the effects of chaos in a specific region's financial markets have spread like wildfire throughout the world. Constructing a multi-tiered system consisting of regional markets and national markets as well as a global market will be an effective means of dealing with new situations like the current crisis. The costs involved in maintaining the global market environment will have to be shared by the entire world—not borne by the key-currency country alone.

Constructing an open and multi-tiered international economic and financial system

Given these major changes in the global economic environment, the future sustainable and secure development of the world will require the construction of an international economic and financial system that is open and multi-tiered (encompassing global, regional, and national tiers). In other words, it will be necessary to form regional markets consisting of several countries grouped together, in a manner that complements global and domestic markets, and to develop more efficient and effective market oversight functions and support systems for handling economic crises based on these regional units. The construction of such a multi-tiered system will also strengthen the global market, greatly benefiting the entire world. The construction of international economic and financial systems within regions would be an open process, and would not signify the formation of regional blocs, as in the 1930s. Their position will unfailingly be consistent with and complementary to the global market.

From this perspective, it is essential for the sustainable and stable development of the entire Asian region that a multi-tiered structure (encompassing mutually complementary global, regional, and national elements) be constructed, which would establish a third economic pole in Asia, with a view to the introduction in the future of a common Asian currency to rival the dollar and the euro, and so as to avoid any recurrence of this kind of global market crisis. Moreover, the environment in the Asian region, in which the web of trade and capital transactions is growing and mutual dependence is increasing but accounts are being settled in US dollars only serves to increase the region's vulnerability to the effects of economic fluctuations outside the region. The Asian region is removing obstacles in the realm of trade and capital transactions; however, the creation of a third economic pole would have the enormous benefit of mitigating exchange risks.

Still, as the key currency the US dollar is vital to the stable development of the global economy, and it is predicted that it will continue to enjoy this status. Thus, the creation of a third economic pole in Asia would not be a substitute for the current key-currency system, but would rather serve to complement it in conjunction with the euro. New international economic and financial systems will not be built overnight. However, it is precisely now, as the world looks for a new direction, that strong political collaboration is required within the region with a view to making this a reality.

The Nature of the International Economic and Financial Systems, and the Future of the Asian Region

The relativization of the USA's economic position and the Bretton Woods system

The medium-term objective arising out of the current crisis is the construction of an open and multi-tiered international economic and financial system. The premise of this discussion is the reality that the economic position of the USA—the post-war global economic framework—is undergoing relativization. There will inevitably have to be an accompanying revision of the post-war international economic and financial system, which has been chiefly supported by the USA—the so-called Bretton Woods system (involving the IMF and the World Bank).

Before envisaging a future international economic and financial system, it is important to first look at the merits and demerits of the Bretton Woods system and to draw lessons from them.

Strictly speaking, the Bretton Woods system refers to the IMF and World Bank system, which involved a fixed exchange rate system and which lasted from 1944 to 1971. A broader definition would also include the current system which is descended from it. The framework of the Bretton Woods system was based on the consideration that in the period before World War Two regulation of protectionist international trade and financial transactions provoked conflicting interests among nations and consequently led to war. Based on this lesson, the IMF and the World Bank were established, with a view to the construction of a stable international economic and financial system.

Up until 1971, the dollar, as the sole key currency, was linked to the value of gold and served as the anchor for every other nation's currency (known as the dollar peg). However, with the Nixon Shock of 1971, gold conversion was abandoned and the switch was made from a fixed exchange rate system to a floating exchange rate system. Under these conditions, Europe began to make specific moves towards the adoption of a common currency, spearheaded by the French and West German leaders. In 1979, Europe switched from individual currencies for each nation to a cooperative float system designed to stabilize the value against the dollar of the ECU—the weighted average value of all currencies that were part of the

European Monetary System (EMS). A further 20 years later in 1999, a common European currency, the euro, was introduced, and this has so far been adopted by 16 EU nations.

The advantages of the Bretton Woods system

In the broad scheme of things, the Bretton Woods system made several significant contributions to the global economy. First, not only was it designed to produce a stable international economic and financial system under a system that made the dollar the principal currency, it also made international trade and transactions more efficient, which contributed to the development of the post-war global economy. The establishment of the Bretton Woods system was also in large measure responsible for the high level of growth achieved in Japan and Europe. Against a backdrop of the USA's mighty military capacity and political influence, the dollar attained general acceptance as the means of settlement for international transactions. Once it had been accepted, competition between currencies died out as economies of scale came into effect through network externalities. With an inertial effect acting with regard to the dollar as key currency (that is, once it was in use, it was easy to keep using it), it survived a number of tests such as the transition to a floating exchange rate system and the Asian Currency Crisis, and still continues to serve as the key currency to this day. Second, with the IMF responsible for currency stabilization, the other pillar of the Bretton Woods system—the World Bank—played a major role in spreading the market economy system globally. The introduction of the market economy system generally makes economies more efficient and acts as a stimulus to the growth of the economies of developing nations. In addition to the IMF and the World Bank, free trade was promoted under GATT (the General Agreement on Tariffs and Trade), which supported diverse free-trade systems, and the benefits of trade became the driving force that supported remarkable post-war economic growth.

The drawbacks of the Bretton Woods system

While the Bretton Woods system was contributing enormously to the global economy in this way, there were undeniably also some negative aspects to it. First, under a system of multiple key currencies, currency competition provides the discipline necessary for the stabilization of the external value of the currencies; however, since the dollar enjoyed a monopoly as the international currency, this discipline broke down for the dollar. As a result, the world was occasionally at the mercy of the USA's domestic problems and domestic policies.

Furthermore, since each country's trade and capital transactions were carried out exclusively in dollars, when the world was plunged into a liquidity crisis like the current financial crisis, an international lender of last resort—amounting to a global central bank—was required. However, the IMF or the international agencies that represent alternatives to it do not have sufficient capacity to fulfill this function, and even the USA has not been completely supportive of this idea. There was also criticism that Latin American nations received preferential treatment in terms of IMF support solely because they enjoyed a close relationship with the USA.

Second, the reverse side of the spread of the market economy is the increase in the disparities seen worldwide. Disparities will inevitably occur in a market economy, which pursues efficiency; however, many countries were left out in terms of economic development. There is no cookie-cutter model of a "market economy"—although the term is used as a blanket description, market economies come in a number of different forms, varying according to region and for historical reasons. In this regard, the form of market economics that was spread to the world was the US brand, which proved to be less than optimal for the economies of many other countries. The imposition of the US brand of market economics, which ignored regional characteristics, invited a backlash from developing nations and greater economic confusion, and conversely hindered development in quite a number of ways. In this regard, the penetration of US-style market economics is clearly evident in the current crisis, which has plunged the global economy into chaos.

Two anticipated courses for the international economic and financial system over the next 20 years

Broadly speaking, the following two courses can probably be imagined for the international economic and financial system over the next 20 years. Both are based on the notions that the scale of the superpower USA's economy will be relativized and that the international economic and financial system cannot continue to be dependent on one nation—the USA. These two courses are not mutually exclusive—they are at worst complementary, and they differ in terms of points of emphasis.

First, the most likely course of action would be to ride out the crisis by reforming the current system of the IMF and the World Bank, strengthening it with multiple countries, and attempting to expand and reinforce it. Specifically, this scheme would involve replacing the dollar as the key currency with a basket of the principal countries' currencies known as the SDR (the IMF's Special Drawing Right), as well as increases to countries' financial contributions and advances to the IMF, and stronger guidelines on financial regulation and oversight.

The concept of making the SDR the key currency involves the principal countries' currencies supporting the SDR in combination with one another, without any particular single currency being the key currency. The new political framework proposed for promoting these reforms would involve a transition to a system of group leadership under the G20 (which consists of the G7 plus various emerging nations).

In contrast, instead of making these kinds of partial reforms to the existing system, an alternative course would be to aim to switch to a system of multiple key currencies. Specifically, this course anticipates the future introduction of a common Asian currency to go alongside the dollar and the euro, and would support the global economy and complement the USA and Europe through the formation of a third economic pole in Asia. There would be the disadvantage that the currency exchanges involved in a system of multiple key currencies would be inefficient; however, there is the major advantage that the system is intended to stabilize the external value of currencies through currency competition.

In addition, there will naturally be a requirement for cooperation between countries that join the common currency; however, cooperation between the key-currency countries on the formulation of monetary policy by each country's central bank as lender of last resort will result in discipline in terms of external monetary policy.

As the major currents in the global economy and the center of global economic growth now shift from west to east, it is vital that the Asian region strive to resolve the crisis with a common political will. To this end, it will be vital to shore up the existing system which revolves around the dollar; however, it will also be essential to create a third economic pole in Asia to complement it.

Moreover, since there is inertia in the key-currency system, the switchover to a system of multiple key currencies would not be immediate. In addition to the promotion of political dialogue, the introduction of a common currency will require a raft of processes including the strengthening of fiscal, monetary, and economic policy cooperation; the construction of a monitoring function for regional macro-economic and financial trends; and the introduction and use of a common currency unit.

The process for introducing a common Asian currency

In order to realize a common Asian currency, it would be desirable for the central players Japan (with the world's second largest economy) and China (with the world's third largest economy) to expand their collaboration and to cooperate with South Korea and other Asian countries.

However, there is enormous variety among the countries of Asia—not only in terms of the major differences in their respective levels of economic development and their economic systems, but also in terms of their political systems, history, and culture. In addition, if key currency inertia, the building of regional coordination mechanisms, institutional integration, and reconciliation of interests are all factored in, the introduction of a common Asian currency will necessitate the completion of many different processes. In Europe, the odyssey from the initial international integration of goods (with the European Coal and Steel Community in the 1950s) via the transition to more fluid movement of people and services, and finally to the realization of a unified monetary system (with the introduction of the euro in 1999) lasted approximately half a century. The background to this was that after the experience of two disastrous world wars, there was the political will to construct mechanisms to ensure that such a tragedy should never occur again between the nations of the region, and Europe progressed towards a European economic community through the introduction of various institutions.

Meanwhile, in present-day Asia FTAs are being concluded (mainly involving ASEAN), and due to the advance of globalization market mechanisms are creating a greater mutual dependence between the countries of the region. There are currently no FTAs between Japan, China, and South Korea, and it would be advisable for Asia to take a gradual approach (unlike Europe) that avoids introducing these institutions all at the same time, and to instead proceed with integration starting with countries and fields that are able to introduce these institutions. Overcoming the various obstacles on the path to introducing a common Asian currency will likely prove to be a major driving force in the realization of an East Asian community.

The introduction of a common Asian currency will be a long-term endeavor, requiring strong political will within the region and considerable time and effort. For this reason, in the course of the debate over the status of the common currency, and with the ultimate objective of its introduction, it will be necessary to proceed with the development of complementary economic institutions (including financial and trade institutions) that are appropriately oriented to them. For the next 20 years the emphasis should probably be placed on building relevant systems by way of preparation.

First, in the wake of the current financial crisis, a new multi-tiered framework for financial oversight and support must be constructed. Although there has been much discussion in the current crisis questioning the wisdom of proceeding with financial transactions, to impose tight controls on financial transactions could do more harm than good. Finance involves the lending of funds—undeniably the lifeblood of capitalism—by sectors which possess excess funds to sectors that have insufficient funds (either at the present time or inter-temporally), and thus markedly improves the efficiency of the entire economy. For this reason, within the new international economic and financial system it will be essential to earnestly address the issue starting afresh and build a framework which lays new foundations for a market economy, in which information flows properly and which prevents businesses that use the uneven distribution or manipulation of information from coming into being. Under these conditions it will first be necessary to proceed with strengthening the current IMF/World Bank system in parallel with the construction of a third economic pole in Asia, and with rebuilding a new framework within the G20.

In addition, it will be necessary to construct multi-tiered regional financial systems, as well as a global system. The first order of business will be to rebuild the Chiang Mai Initiative and to enhance and strengthen the Asian Development Bank. Under the Chiang Mai Initiative, which was based on the lessons learned from the Asian Currency Crisis in the latter half of the 1990s, 30-billion-dollars worth of swap agreements were concluded; however, 80% of these were linked to the IMF, making them difficult for Asian countries to use. It will be probably be necessary to develop a framework for loans and financial support in the Asian region, through rebuilding of the Chiang Mai Initiative and greater strengthening of the Asian Development Bank. The objective should probably be to create an open system that is designed to be consistent with the global financial system, and which is also based on a mode of financing in accord with Asian regional characteristics.

Moreover, taking the initial purpose of the IMF/World Bank system as a model, some have expressed the view that the unification of development and finance (the establishment of a world central bank) would be desirable, and this point of view has given rise to the same kind of discussion in Asia.

The strengthening of financial oversight and support systems in Asia will represent the first stage in realizing a common Asian currency and will consolidate the foundations for achieving this. As the second stage it will be necessary to coordinate countries' monetary and economic policies, while promoting political dialogue between them. At the same time it will be essential to establish a common Asian currency unit (ACU) that encompasses the yen, the yuan, the won, and other Asian currencies, and to aim to make its use effective.

It will also be necessary to construct a framework for harmonizing macro-economic policy on oversight of regional macro-economic and financial trends, a framework for a financial system involving ACU accounts settlements, and a framework for liberalizing the international movement of production factors such as trade and services, and at the same time to reconcile these frameworks with global systems. It will not be possible to introduce a common Asian currency until all these efforts have been made.

A common Asian currency as a third economic pole and the advantages within the region

The introduction of a common Asian currency will also involve a number of economic and political advantages for Asian countries. In economic terms, the advantages will be the greater efficiency and stability in the regional economy engendered by trade and capital transactions. Within the Asian region international trade has increased year by year, the web of the production network has extended, regional taxes have come down, and mutual economic dependence has grown. However, as was seen in the Asian Currency Crisis and in the present crisis, since most transactions are settled in dollars, the vulnerability of Asian economies is heightened in that they are subject to the effects of fluctuations in the exchange rate against the dollar. In Europe as well, during the current financial crisis the currencies of the UK and Iceland—countries that have not adopted the euro—have suffered greater depreciation than the euro itself. Joining a larger currency union reduces the risks from this kind of crisis.

The introduction of a common currency is enormously advantageous in reducing vulnerability to exchange rate fluctuation (currency exchange costs).

Moreover, since the domestic bond markets in the Asian region are still at the fledgling stage, most of the deposits that are placed domestically in Asian countries are put out to international financial centers, miring these countries in a flow-back arrangement. For this reason domestic investments as well as capital transactions within the region are often denominated in dollars, resulting in a double mismatch between "currency" and "expiration," and the vulnerability of the Asian region to various economic fluctuations outside the region is heightened. This structure also serves to foster disparity in that excess savings in the Asian region go to cover the USA's current account deficit. It is anticipated that the introduction of a common Asian currency would represent a path that enabled the issue of bonds denominated in the regional currency, mitigated vulnerability to exchange rate fluctuations outside the region, and served to rectify international disparities.

In addition, the independent construction by Asia of its own financial oversight and support systems on the path to the introduction of a common Asian currency will make the global economic and financial system more solid and enable the development of market economies in tune with Asian regional characteristics.

The political advantages would be that this would promote mutual understanding and lead to smoother political coordination within the region, and would contribute to a sense of Asian identity. The introduction of a common currency will not only strengthen the economic ties between the participating countries but will also enhance the political cohesion between them. Since political discord would lead to instability in the external value of the currency, the creation of a third economic pole in Asia will play an anchoring role in the promotion of political stability. There will be many shared hardships encountered on the road to achieving this; however, the process of political coordination will deepen mutual understanding and strengthen bonds between nations. Mechanisms for exchanges of views and coordination at the political and administrative levels with a view to the introduction of a common Asian currency will lead to smoother political coordination. This will have the dual political and diplomatic benefits of promoting and intensifying regional dialogue in the Asian region and contributing greatly to the stability of the Asian region.

Europe, which succeeded in realizing a common currency, engaged in political coordination with a view to fulfilling higher common interests which transcended the individual interests of the different countries involved.

The realization of this common currency—the euro—served to solidify a shared sense of European identify when it came into circulation. The introduction of a common currency in Asia will likely also contribute to the creation of an Asian identity.

Up until now, there has been no framework for establishing collective purpose among the nations of the Asian region, and this has prevented Asia from demonstrating the full measure of its influence in the formation of international rules. Fomenting a common Asian identity that smoothes political coordination in the Asian region will likely enable the formation of a unified political will (like that of Europe) in Asia, and facilitate the expression of Asia's political inclinations on the global political stage.

The advantages to the world from the introduction of a common Asian currency

Moves to implement a common Asian currency will also entail major economic and political benefits beyond the Asian region.

In terms of economic benefits, it will make economic growth in the Asian region more efficient and more stable, and will create more promising markets for the West. It can also be anticipated that the effects for countries with comparatively small-scale economies circulating a major currency will be to make it difficult for another event like the Asian Currency Crisis or the current crisis to occur, to stabilize trade and capital transactions with countries outside the Asian region, and to increase the stability of the entire global economy.

As the US economy undergoes relativization, there are indications that the appearance of the euro has helped to stabilize the global economy, and the implementation of a common Asian currency alongside the euro to complement the dollar would entail great economic benefits for the countries of the West as well as for Asian countries, in that it would stabilize economic transactions and contribute to the smooth running of the global economy. It would also bring about a higher level of global stability in currency values and instill discipline in countries' external currency policy.

It is also likely that in the course of the introduction of a common currency the process of liberalizing economies would be expedited (including the liberalization of regional trade and capital transactions), both regional nations and Western countries would gain increased access to Asian markets, and the liberalization of global trade and capital transactions would gain extra momentum.

Moreover, there are indications that one of the causes of the current financial crisis was the excess savings in the Asian region (in particular in Japan and China), which were poured into the world's financial centers as dollar assets, amplifying international current account balance disparities and helping to create a global bubble. The introduction of a common Asian currency would likely provide a means for these excess savings to be used within the region at first hand.

In terms of political advantages, since a common currency would serve as an anchor for regional political mechanisms, it would make it more difficult for political conflict to occur within the region, increase political stability within the Asian region, and contribute to global political stability. Specifically, since it would be necessary to try and stabilize the common currency's external value, it is anticipated that there would be smoother political coordination between fractious regional countries and that mutual political dependence as well as mutual economic dependence within the region would increase. The increased multi-level mutual dependence would also mean that mechanisms will operate to stimulate external activities rooted in the interests of all the countries in the region and not based on the interests of one country alone. As an extension of these mechanisms, the multilateral collaboration would likely enable the countries of Asia to take rational collective positions in negotiations with countries from outside the region.

If, in the process of the introduction of a common currency, the countries of the region collaborate on fiscal, monetary, and economic policy, this will at the same time necessitate greater transparency in each country's political decision-making and policy determination processes, and is thus likely to stimulate democratization and liberalization within the region's nations.

Moreover Japan is a country whose currency, monetary, and economic policy determination processes are clearly set out under distinct rules, and which, with its long traditions of democracy, liberalism, and free market economics, shares common values with the nations of the West. As China intensifies its economic relationship with the USA, which introduced the market economy, it is also playing a key role as a stakeholder in the international community. It will be important for countries with large-scale economies to show strong political will and cooperate with one another in realizing a common Asian currency. If Japan and China can walk in step with one another and take active roles in building a framework to achieve this goal, this would seem to hold enormous political significance for the achievement of global stability.

Japan’s role in bringing about greater stability and development in the global economy

However, for reasons of currency issues alone, it is unrealistic to expect long-term stability and growth in the global economy. As long as there is no world government, international cooperation can only ever be undertaken in terms of shared values. The three elements of liberalism, democracy, and capitalism will form the foundations of the future global economy; however, they are no more than the necessary conditions for it. Building it will require closer cooperation with international institutions such as the existing World Bank. In particular, it would be advisable for Japan to pursue its traditional fortes of environmental protection, development assistance, and the promotion of science and technology, in that they embody such shared values. The recent change of administration in the USA likely represents a favorable opportunity for doing so.

Japan’s role must include actively applying its experience and knowledge from the financial crisis of the 1990s in contributing to the construction of a new international financial oversight system. However, it is also anticipated that Japan will also contribute to the further development of the global economy of the future in the areas of science and technology and the environment.

As demonstrated by global warming, the global economy has reached a point at which long-term growth without some impact on the environment can no longer be expected. It will be necessary to rebuild the global economy around the environment and to switch to a set of values that emphasizes the environment. Japan’s major strengths are its enormous foreign currency reserves and savings, its expertise in the environment and science and technology, and its human capital (notably, in terms of higher education and ethics). Japan boasts the most advanced environmental technology in the world, and this constitutes the basis of joint efforts to resolve global environmental problems that are being undertaken by the entire world. However, in order for the world to address global environmental problems in earnest, it will not be enough to simply transfer the environmental technology that Japan has so far accumulated to the developing countries; it will also be necessary to reduce the increasing load on the environment caused by economic development. In this regard, Japan should take the initiative by building a system that shifts environmental costs into the prices of goods, either by creating an emissions trading market or by imposing environmental tariffs on traded commodities.

To this end, Japan must make a high-profile contribution by dispatching large numbers of highly specialized personnel—particularly in the fields of science and technology, the environment, and finance. The Japanese have a far-sighted tradition of free market economics, which places importance on the environment and is highly ethical. In environmental terms, Tokyo in the Edo period represented an advanced recycling society (even by global standards), and Eiichi Shibusawa, the father of Japanese capitalism, asserted that “the source of the nation’s wealth resides in benevolence, righteousness, and morality.” Against this backdrop of long tradition, establishing an independent strategy with a long-term, global, and historical perspective is exactly what is now required of Japan.

Future Prospects for the International Economic and Financial System, and Japan’s Role and Work Schedule

Short-term issues

The short-term issues that should be resolved during 2009 are the thorough disclosure and understanding of the non-performing loans that have surfaced during the current financial crisis, and the construction of an international framework under the close oversight of the financial authorities. Unfortunately, these matters were not fully dealt with at the first financial summit, which was held in November 2008. At the second financial summit, which is scheduled to take place in April of 2009, there must be agreement on the formulation of joint rules and of an effective framework for all countries for the thorough disclosure and oversight of non-performing assets. On the basis of this, work must proceed during 2009 to flesh out the technical details.

The first half of the 2010s (2010–2014) is designated as the period for the disposal of non-performing assets. Although it is widely thought that the slump in US housing prices—the origin of the current crisis—will continue until 2010, there is also a strong possibility that a prolonged economic downturn will delay the bottoming out even further. One turning point will be when there is consensus among the market players that housing prices have stopped falling and confidence spreads that the situation will grow no worse. In addition, it will be vital that these measures be carried out through international cooperation and the effective coordination of a whole raft of policy measures, including capital injection, the buying up of non-performing assets, supply of liquidity, increased deposit insurance, and the promotion of mergers between financial institutions. At the same time, the current IMF/World Bank system should be reinforced and a new framework developed within the G20, in view of the need to construct a new international financial oversight and support system and the need for uniform regulation standards based on a review of the current financial crisis. At the same time, a system must be arranged for providing rapid assistance to Asian countries plunged into crisis, through the rebuilding of the Chiang Mai initiative and the expansion and reinforcement of the Asian Development Bank, and efforts to establish a financial oversight and support system for the Asian region must proceed.

As well as actively applying its experience and knowledge from the 1990s, Japan must provide the key to resolving the financial crisis by communicating these lessons to the world. In addition, Japan probably needs to use its abundant foreign exchange reserves to supply liquidity in a flexible manner to countries that lack capital.

In the 2010s the global economy will probably emerge from the worst period. During the period for disposal of non-performing assets, many economic resources will be diverted into past liabilities, and it will be difficult to engage in forward-looking activities. Market sentiment has atrophied in the aftermath of the global financial crisis, and it is impossible to imagine that forward-looking activities will instantly blossom again. As long as there is no powerful driving force behind it, economic recovery will probably remain gradual. This is clear from the experiences of Japan in the 1990s; however, at this time the shoots of new growth will emerge without fail, and this is also probably the time to discern them. In this environment Japan will probably be a front-runner in the attainment of a full-blown economic recovery, and will probably have to contribute to the building of new financial systems.

Medium- and long-term term issues

In parallel with the short-term initiatives described above, from a longer-term perspective efforts should proceed in three stages: building of regional cooperation mechanisms during the 2010s, establishment of a common Asian currency unit (ACU) during the 2020s, and the introduction of a common Asian currency from the 2030s onwards.

The 2010s: Stage One—building regional cooperation mechanisms

Stage One must consist of building regional cooperation mechanisms during the 2010s. As the first order of business in political terms, it will be necessary to achieve firm agreement between Japan, China, and South Korea on the realization of a common Asian currency unit (ACU)—the first step towards the introduction of a common Asian currency. In order to popularize the move towards realization of a common Asian currency among other Asian countries (principally the ASEAN nations), it will be necessary to establish a council consisting of Asia’s central bank governors and finance ministers and to put the matter up for detailed discussion. This will represent a foundation for achieving agreement between Japan, China, and South Korea. As work progresses to build this framework, it will be necessary to strengthen cooperation on fiscal, monetary, and economic policy between countries, and to construct a monitoring function for regional macro-economic and financial trends and a financial support system. Meanwhile, in terms of economic issues, it will be essential to prepare the ground for the realization of a common Asian currency unit, by promoting the convertibility of countries’ currencies, minimizing exchange controls, changing over to a floating exchange rate system, and guaranteeing the independence of central banks. At the same time, conclusion of regional EPAs and FTAs (including agreements between Japan, China, and South Korea) should be promoted, barriers to the free movement of capital within the region should be eliminated, and Asian capital markets should be cultivated and strengthened.

Amid these efforts, and with a view to the introduction of a common Asian currency, in 2010 Japan itself will first establish a headquarters within the government for the promotion of a common Asian currency system, so as to give concrete form to these activities. Then, as early as possible during the 2010s, Japan must call for regular consultations between the economic ministers of Japan, China, and South Korea, and the three nations must attempt to reach agreement on a course towards introduction of a common Asian currency unit—as required for Stage Two. Japan will then promote the staging of meetings of the council of Asia’s central bank governors and finance ministers, so as to popularize the concept among other Asian countries (principally the ASEAN nations), establish a common Asian currency system task-force comprised of experts, and begin to investigate the technical issues and seek solutions to them. For its part, Japan will also work to gain the understanding of the West on the introduction of a common Asian currency and proceed to strengthen and support monitoring functions for regional macro-economic and financial trends, such as levels of fiscal discipline. At the same time, Japan will support structural changes geared towards liberalization in the countries of the region, encourage the relaxation of exchange controls, and attempt to conclude and promote EPAs and FTAs between Asian countries (particularly agreements involving Japan, China, and South Korea). To promote the development of direct financial markets in Asia, Japan will provide active support in areas where it can make a definite contribution, such as cultivating and strengthening the Tokyo market (for example, through the flotation of samurai bonds and bonds denominated in other Asian currencies) and supporting the development of regional business networks.

Thus, the whole of the 2010s represents a period of preparation and consolidation of the foundations for Stage Two, the introduction of an Asian currency unit, and Stage Three, the introduction of a common Asian currency.

The 2020s: Stage Two—introduction of an Asian currency unit (ACU)

The chief objective for the 2020s will be the realization of a common Asian currency unit. In addition to the Japanese yen, the Chinese yuan, and the South Korean won, it would be desirable for this currency unit to include the currencies of other Asian countries, such as the ASEAN nations. In parallel with the realization of a common Asian currency unit, it will be necessary to promote greater regional integration in terms of international trade and capital transactions.

It will be necessary to establish an Asian currency mechanism (the precursor to an Asian central bank), and to realize a common Asian currency unit (ACU). It would then be desirable to promote clarification, democratization, and liberalization of the political decision-making and policy determination processes in the participating countries. On the economic front, it will also be necessary to reduce exchange rate fluctuation bands, as well as regional budget deficits and government debts. In addition to the construction of an ACU settlement mechanism, the effectiveness of the ACU should be increased through promotion of its private use and the promotion of the issuance by international institutions of bonds denominated in the ACU. At the same time, consideration needs to be given to liberalization of international transactions in services and to freeing up the movement of skilled workers, as well as to trade.

For its part, Japan must expedite the flow of skilled workers and make use of its foreign currency reserves to actively invest in the newly established Asian currency mechanism. The regular meeting of finance ministers and central bank governors must be upgraded to an Asian summit meeting. In addition, Japan must switch over to denominating yen loans in ACUs and actively promote the issue of bonds denominated in ACUs, the use of domestic savings denominated in ACUs (such as pension funds), and overseas and domestic investment in ACUs, with a view to increasing the effectiveness of the ACU.

The 2020s is to be a final adjustment period before the realization of a common Asian currency, which is expected to take place in the 2030s. It will be necessary to continuously promote international accord within international finance and trade institutions. It will also probably be necessary to build consensus with countries outside the Asian region, such as the USA and the nations of Europe.

2030s onwards: Stage Three—introduction of a common Asian currency

The 2030s onwards represents the final step—Stage Three, the introduction of a common Asian currency. The countries concerned will first need to try to lay the groundwork and build domestic consensus for the introduction of a common Asian currency. When the euro was introduced in Europe, there were countries that could not obtain domestic agreement on joining the currency and so put it off. It would be advisable for any country finding itself in this position to fulfill its obligation to explain the pros and cons of introducing a common currency and to take its time in building a consensus. Once this has been done, the currency sovereignty of all participating countries will be transferred to the Asian central bank, and a common Asian currency will be created. Exchange rates will be frozen for a certain time and the rate of exchange between the common Asian currency and each country's currency will be fixed. Unified Asian central bank policies will then be formulated and the single currency introduced.

In order to build momentum for the introduction of a common Asian currency, it would be advisable for Japan to show other Asian countries the way in terms of building national accord for a common currency, and to attempt to achieve unity of purpose. As a country with long democratic and liberal traditions, Japan must also contribute by promoting understanding in the West for the introduction of a common Asian currency.

Realization of a common Asian currency represents a 50-year-long grand design. In light of the global situation in the twenty-first century, as Asia becomes the world's fulcrum, the key to global peace and stability resides in whether or not political and economic stability can be achieved in the region. Although there are various obstacles to the realization of a common currency, strong political leadership can likely overcome the hardships, and the creation of a common Asian symbol could be the perfect encapsulation of the next generation's aspirations for the future—not only in Asia but also throughout the entire world. It is precisely now, in the bleakest hours of the crisis, that national discussion must be sparked and hope for the future ignited.

Outlook for the Global Economic and Financial System	**Japan's Role**
Short term challenges	
• During 2009: International framework for understanding and disclosure of total losses from non-performing assets and oversight system	• Active application of Japan's experience and knowledge from the 1990s • Supply of liquidity using Japan's foreign-currency

• 2010–2014: Period for intensive disposal of non-performing assets, full-blown economic recovery, construction of new international financial oversight and support system, integration of regulatory standards	reserves • Rebuilding of the Chiang Mai Initiative and enhancement and strengthening of the Asian Development Bank • Leading the way globally in economic recovery and expansion of domestic demand
Medium- and long-term challenges	
The 2010s: Stage One—building regional cooperation mechanisms	
Political challenges • Building of consensus between Japan, China, and South Korea on realization of a common Asian currency unit • Establishment of a council consisting of Asian countries' central bank governors and finance ministers—principally those of Japan, China, South Korea, and ASEAN nations • Strengthening coordination of fiscal, monetary, and economic policy between countries, and creating monitoring function for regional macro-economic and financial trends *Economic challenges* • Laying the groundwork for realization of a common Asian currency unit (promotion of convertibility of each country's currency, minimization of exchange controls, transition to a floating exchange rate system, and guaranteeing of central banks' independence) • Conclusion and promotion of regional EPAs and FTAs • Removal of obstacles to the free flow of capital within the region; cultivation and strengthening of Asian capital markets	• 2010: Establishment within the government of a headquarters for promotion of common Asian currency system • Start of regular consultations between economic ministers of Japan, China, and South Korea • Establishment of council of Asian countries' central bank governors and finance ministers, and of common Asian currency system task-force • Strengthening of, and support for, monitoring function for regional macro-economic and financial trends, such as levels of fiscal restraint • Moves to support structural changes aimed at liberalizing the region's countries and to relax exchange controls • Promotion of understanding by the West with respect to the introduction of a common Asian currency • Conclusion and promotion of EPAs and FTAs between Asian countries (particularly agreements involving Japan, China, and South Korea) • Cultivation and strengthening of the Tokyo market (including flotation of samurai bonds and support for flotation of bonds denominated in other Asian currencies) and support for development of regional business networks
The 2020s: Stage Two—realization of a common Asian currency unit	
Political challenges	• Investment in Asian currency mechanism (contribution

• Establishment of an Asian currency mechanism as a precursor to an Asian central bank and realization of a common Asian currency unit • Promotion of clarification, democratization, and liberalization of political decision-making and policy determination processes *Economic challenges* • Reduction of budget deficits and government debts • Reduction of exchange rate fluctuation bands • Construction of ACU settlement mechanism • Promotion of private use of ACU and of issuing of bonds denominated in ACUs by international institutions • Liberalization of international transactions in services and freeing up of movement of skilled workers	from Japan's foreign-currency reserves) • Start of summits between Asian nations • Switch-over to denomination of yen loans within the Asian region in ACUs • Issuance of bonds denominated in ACUs and promotion of overseas and domestic investment in ACUs through the Tokyo market (including use of domestic savings)
The 2030s onwards: Stage Three—realization of a common Asian currency	
• Building of domestic consensus with regard to introduction of a common currency • Transfer of Asian countries' currency sovereignty to an Asian central bank; creation of a common Asian currency • Implementation of unified monetary policy by Asian central bank; introduction of single currency	• Setting an example to other Asia countries in building national consensus on introduction of a common Asian currency • Promotion of understanding in the West with respect to the introduction of a common Asian currency