Introduction

Kunio Okina, Hiroshi Fujiki, and Akira Otani

The 10th International Conference of the Institute for Monetary and Economic Studies (IMES) of the Bank of Japan was held on July 1 and 2, 2002, on the theme of "Exchange Rate Regimes in the 21st Century." (See Appendix 1 for a list of the round-table participants.)

The currency regime has undergone major changes with the launch of circulation of euro banknotes and coinage in 2002 and an increased move toward dollarization in the Americas. The frequent currency crises occurring in the emerging market economies since the latter half of the 1990s have fueled an extensive debate among central banks, international organizations, and academic economists on the prevention of crises and the role of international organizations. The purpose of the conference was to discuss future currency regimes and the role of central banks, taking account of these changes in the currency regime and the subsequent debates on related subjects.

The conference focused on three regions—the Americas, Europe, and East Asia—and involved theoretical, empirical, and policy-oriented discussions of (1) the short- to medium-term possibilities for the development of currency areas in each of the three regions; (2) systems for achieving both exchange rate stability and domestic price stability among the three major currencies (the dollar, euro, and yen); and (3) the role to be played by central banks.

Having defined its theme, the conference began with an opening speech by Governor Masaru Hayami of the Bank of Japan, followed by keynote speeches by the two honorary advisors of IMES. The first session offered an overview of the issues to be discussed at the conference. The following sessions were devoted to papers concerning more specific issues. The conference closed with a panel discussion on price and exchange rate stability. (See Appendix 2 for the program.)

In Session 1, entitled "Do Currency Regimes Matter in the 21st Century? An Overview," the paper that was presented began with definitions of exchange rate regimes and a survey of their development. This was followed by an examination of the "bipolar view" that gained popularity in the second half of the 1990s.[1] The validity of the bipolar view was examined for the Americas, Europe, and East Asia,

1. The bipolar view is that the choice of an appropriate exchange rate regime, for economies with access to international capital markets, means a move away from the middle ground of pegged but adjustable fixed exchange rates toward the two corner regimes of either flexible exchange rates or a fixed exchange rate, supported by a commitment to give up altogether an independent monetary policy. Representative papers include Stanley Fischer, "Exchange Rate Regimes: Is the Bipolar View Correct?" *Journal of Economic Perspectives*, 15 (2), 2001, pp. 3–24, and Lawrence Summers, "International Financial Crises: Causes, Prevention and Cures," *American Economic Review*, Papers and Proceedings, 90, 2000, pp. 1–16.

followed by a review of the possibility of the establishment of regional currency areas in each of these regions.

In Session 2, entitled "Exchange Rate Regimes in the Americas: Is Dollarization the Solution?" the paper that was presented reviewed the current choice of exchange rate regimes in the Americas and presented a theoretical review of the background of these choices. Next, it mentioned countries gaining significant immediate advantages from dollarization and countries expected to maintain floating exchange rate regimes. Last, it touched upon the outlook for a regional currency area in the Americas.

In Session 3, entitled "Monetary and Fiscal Policy in the European Monetary Union," the paper that was presented examined monetary and fiscal policies following the establishment of the European Monetary Union (EMU). It was asserted that, while the management of monetary policy has thus far progressed smoothly, room for improvement remains in fiscal discipline under the Maastricht Treaty and the Stability and Growth Pact.

In Session 4, entitled "Exchange Rate Arrangements in East Asia: Lessons from the 1997–98 Currency Crisis," the paper that was presented asserted that, in view of the broad range of fluctuation in the yen-dollar exchange rate and the broad diversity in the region's trade and direct-investment partners, the economies of the region should stabilize their exchange rates by adopting currency baskets in which the yen, dollar, and euro are assigned equal weights. Furthermore, it was argued that, to stabilize the region's exchange rates, it was desirable to coordinate adoption of a regional currency-basket system, and that such coordination should be supplemented by improvements in the region's mutual surveillance and financing facilities.

In Session 5, entitled "Independent Currency Unions, Growth, and Inflation," the paper that was presented examined the effect of currency unions on macroeconomic performance. Using data from the period of 1970–98, the macroeconomic performances of the members of independent currency unions that issued a common currency and pegged their currency to that of an advanced country were compared to the performance of countries that maintained their own domestic currencies.

The concluding session featured a panel discussion of the theoretical and practical issues concerning price stability and exchange rate stability. Panelists consisted of the chairperson and three other central bankers, and the two honorary advisors of IMES. The panel discussion was concluded with comments by the chairperson.

The discussions of the conference covered a very broad spectrum of issues. Below is our summary of the main points.

(1) The evaluation of exchange rate regimes should be undertaken after giving due attention to the fiscal and structural policies, degree of international capital movements, and historical and political background of the country in question. For instance, a fixed exchange rate system does not in itself automatically generate the fiscal discipline needed to maintain parity, and thus it requires broad institutional support. Likewise, the achievement of price stability under a floating exchange rate system requires effective measures to increase the level of transparency in monetary policy.

(2) Regarding the choice of exchange rate regimes, hard pegs are viable options for small and highly open economies. On the other hand, for the following

reasons, floating rates are more desirable for countries that have already achieved price stability. Under conditions of active capital flow, the maintenance of hard pegs requires rigorous fiscal discipline that presents a very high political hurdle. Historically, it has been shown that it is difficult to find the right timing for exiting a peg.

(3) The “bipolar view” that gained popularity in the second half of the 1990s as a standard for choosing appropriate exchange rate regimes is conceptually clear. However, it is actually very difficult to maintain a hard peg, while various forms of floating-rate systems have been adopted in various regions based on the degree of capital controls. Thus, in reality, it is quite possible that the “size” of the two poles differs. Because of this asymmetry, the selection of exchange rate regimes cannot be presented as a simple choice between two polar options.

(4) Regarding the choice of exchange rate regimes in the Americas, among countries with the opportunity to participate in international capital markets, a clear bipolarity is emerging in the choice of floating rates and hard pegs. A consensus was reached on the following points. The larger countries of the Americas that satisfy the following three conditions should adopt floating exchange rate regimes and need not move toward dollarization: (1) diversity in the range of trading partners; (2) downward rigidity of nominal prices; and (3) stable monetary policies. On the other hand, dollarization is a viable option for countries with poor records of monetary policy credibility, and small countries whose current account and capital transactions are mostly conducted with the United States.

(5) Regarding the monetary policy in the EMU, results and interpretations of empirical studies concerning monetary policy by use of the Taylor rule and money-demand functions varied significantly because of the limited data that were accumulated. Regarding fiscal policy, a consensus was reached that fiscal policies of individual countries must be disciplined to support a common monetary policy. The opinion was voiced that fiscal policy management should be subjected to further study from a political and economic perspective.

(6) Regarding exchange rate regimes in East Asia, in view of the broad range of fluctuation in the yen-dollar exchange rate, the level of intra-regional concentration of trade, and the diversity of sources of foreign direct investment, it was suggested that the region should adopt a currency-basket system based on the yen, dollar, and euro. While some Asian participants expressed their support for the adoption of currency-basket systems, others disputed the suggestion on the following grounds: the use of the dollar in East Asia reflects various important advantages of the dollar, such as the depth of financial markets; and since the maintenance of a currency-basket system requires the resolution of a large number of practical problems pertaining to foreign exchange and monetary policies, floating rates are a more viable option over the medium to long term.

(7) Regarding exchange rate regimes in Japan, the United States, and Europe, it was agreed that it was generally desirable to maintain floating exchange

rate regimes for the foreseeable future. With reference to Japan under the special conditions generated by its liquidity trap, it was noted that the general discussions did not adequately address the question of how Japan could use exchange rates for domestic price stability. On this point, there was some discussion of the efficacy of guiding the yen's exchange rate downward and of unsterilized intervention. Differences of opinion remained between participants from the Bank of Japan who assumed a negative position and other participants who argued in favor of the possibilities of unsterilized intervention and depreciating the yen.

(8) Regarding empirical studies of the effects of the choice of exchange rate regimes on macroeconomic variables, it was agreed that it is difficult to extract general principles from such studies due to the following restrictions. (1) Because choices of exchange rate regimes are made simultaneously with changes in macroeconomic variables, it is hard to establish clear causality. (2) Exchange rate regimes do not undergo frequent changes. It was also noted that, from the observed exchange rate data, it was difficult to distinguish between underlying trends and temporary fluctuations resulting from the impact of market liquidity or the behavior of certain speculators.

(9) Regarding a framework for understanding the impact of foreign exchange fluctuations on domestic prices, desirable exchange rate regimes, and the economic effects of international coordination of monetary policies, attention was drawn to a new open-economy macroeconomics that would facilitate understanding of the impact of foreign exchange fluctuations with explicit consideration of market structure. However, it was pointed out that even such new theoretical approaches cannot adequately explain such essential questions as why only certain countries are able to borrow from overseas sources in their own domestic currencies.

APPENDIX 1: LIST OF ROUND-TABLE PARTICIPANTS

Ismail Alowi
Director, Monetary and Financial Policy Department, Central Bank of Malaysia

Jorge A. Braga de Macedo
President, OECD Development Centre

Chow Hwee Kwan
Lead Economist, Monetary Policy Division, Monetary Authority of Singapore

Vittorio Corbo
Professor of Economics, Pontificia Universidad Católica de Chile

Roger W. Ferguson, Jr.
Vice Chairman, Board of Governors of the Federal Reserve System

Pierre-Michel Fremann
Head of International Monetary Relations Division-SERMI, Banque de France

Hiroshi Fujiki
Manager and Senior Economist, Research Division I, Institute for Monetary and Economic Studies, and Money and Capital Markets Division, Financial Markets Department, Bank of Japan

Gabriele Galati
Head, Monetary Policy and Exchange Rates, Monetary and Economic Department, Bank for International Settlements

Stefan Gerlach
Executive Director, Research Department, Hong Kong Monetary Authority, and Director, Hong Kong Institute for Monetary Research

Reuven Glick
Vice President and Director, Center for Pacific Basin Studies, Federal Reserve Bank of San Francisco

Linda S. Goldberg
Vice President, International Research Function, Federal Reserve Bank of New York

Ruth C. Gonzaga
Bank Officer III, Department of Economic Research, Bangko Sentral ng Pilipinas

Jeong-Ho Hahm
Director General, Institute for Monetary and Economic Research, The Bank of Korea

Han Ming Zhi
Deputy Director General, International Department, The People's Bank of China

Masaru Hayami
Governor, Bank of Japan

Werner Hermann
Director, International Monetary Relations Section, Schweizerische Nationalbank

Eiji Hirano
Executive Director, Bank of Japan

Thomas M. Hoenig
President, Federal Reserve Bank of Kansas City

William C. Hunter
Senior Vice President and Director of Research, Federal Reserve Bank of Chicago

Nigel H. Jenkinson
Deputy Director, Monetary Analysis,
Bank of England

Jerry L. Jordan
President and Chief Executive Officer,
Federal Reserve Bank of Cleveland

Keimei Kaizuka
Professor, Faculty of Law,
Chuo University

Masahiro Kawai
Deputy Vice Minister for
International Affairs,
Ministry of Finance, Japan

Malcolm D. Knight
Senior Deputy Governor,
Bank of Canada

Richard W. Kopcke
Vice President and Economist,
Economic Research Department,
Federal Reserve Bank of Boston

Hans Lindblad
Deputy Director, Monetary Policy
Department, Sveriges Riksbank

I. Igal Magendzo
Senior Economist,
Central Bank of Chile

Allan H. Meltzer
The Allan H. Meltzer University
Professor of Political Economy,
Graduate School of Industrial
Administration, Carnegie Mellon
University

Hiroshi Nakaso
Associate Director, Financial Markets
Department, Bank of Japan

Maurice Obstfeld
Class of 1958 Professor of Economics,
Department of Economics, University
of California, Berkeley

Kunio Okina
Director, Institute for Monetary and
Economic Studies, Bank of Japan

Akira Otani
Assistant Manager and Economist,
Research Division I, Institute for
Monetary and Economic Studies,
Bank of Japan

Angel Palerm
Acting Deputy Director of
International Analysis,
Banco de México

Robert W. Rankin
Head of International Department,
Reserve Bank of Australia

Robert H. Rasche
Senior Vice President and Director of
Research, Federal Reserve Bank of
St. Louis

Michael Reddell
Head of Financial Markets
Department, Reserve Bank of
New Zealand

Roberto Rinaldi
Director, Head of the International
Division, Research Department,
Banca d'Italia

William T. Roberds
Vice President and Economist,
Research Department, Federal Reserve
Bank of Atlanta

Masaaki Shirakawa
Advisor to the Governor, Policy
Planning Office, Bank of Japan

Shigenori Shiratsuka
Manager and Senior Economist,
Research Division I, Institute for
Monetary and Economic Studies,
Bank of Japan

Amara Sriphayak
Director, Monetary Policy Department, Bank of Thailand

Miyako Suda
Member of the Policy Board, Bank of Japan

Wataru Takahashi
Associate Director, International Department, Bank of Japan

Kazuo Ueda
Member of the Policy Board, Bank of Japan

Pierre van der Haegen
Director General, Directorate-General International and European Relations, European Central Bank

Jürgen von Hagen
Professor of Economics and Director, Center for European Integration Studies, Rheinische Friedrich-Wilhelms-Universität Bonn

Perry Warjiyo
Deputy Director, Directorate of Economic Research and Monetary Policy, Bank Indonesia

Yutaka Yamaguchi
Deputy Governor, Bank of Japan

Tomoo Yoshida
Chief Manager, Research Division I, Institute for Monetary and Economic Studies, Bank of Japan

APPENDIX 2: PROGRAM

Date/Time		Session		Chairperson/Moderator	Paper Presenter/Panelist	Designated Discussant
Monday, July 1	9:00–11:55	Opening Speech			Masaru Hayami (Bank of Japan)	
		Keynote Speeches			Allan H. Meltzer (Carnegie Mellon University), Maurice Obstfeld (University of California, Berkeley)	
		1	Do Currency Regimes Matter in the 21st Century? An Overview	Miyako Suda (Bank of Japan)	Hiroshi Fujiki (Bank of Japan), Akira Otani (Bank of Japan)	Stefan Gerlach (Hong Kong Monetary Authority/Hong Kong Institute for Monetary Research), Reuven Glick (Federal Reserve Bank of San Francisco)
	13:30–16:45	2	Exchange Rate Regimes in the Americas: Is Dollarization the Solution?	Thomas M. Hoenig (Federal Reserve Bank of Kansas City)	Vittorio Corbo (Pontificia Universidad Católica de Chile)	Linda S. Goldberg (Federal Reserve Bank of New York), Angel Palerm (Banco de México)
		3	Monetary and Fiscal Policy in the European Monetary Union	Jorge A. Braga de Macedo (OECD)	Jürgen von Hagen (Rheinische Friedrich-Wilhelms-Universität Bonn)	Nigel H. Jenkinson (Bank of England), Stefan Schönberg (Deutsche Bundesbank, absent)
Tuesday, July 2	9:00–12:15	4	Exchange Rate Arrangements in East Asia: Lessons from the 1997–98 Currency Crisis	Malcolm D. Knight (Bank of Canada)	Masahiro Kawai (Ministry of Finance, Japan)	Chow Hwee Kwan (Monetary Authority of Singapore), Eiji Hirano (Bank of Japan)
		5	Independent Currency Unions, Growth, and Inflation	Jerry L. Jordan (Federal Reserve Bank of Cleveland)	I. Igal Magendzo (Central Bank of Chile)	Gabriele Galati (Bank for International Settlements), Robert W. Rankin (Reserve Bank of Australia)
	13:30–17:00	Concluding Panel Discussion: The Role of Central Banks in Exchange Rate Regimes in the 21st Century		Kazuo Ueda (Bank of Japan)	**Introductory Remarks**: Kunio Okina (Bank of Japan) **Panelists' Remarks**: Allan H. Meltzer, Maurice Obstfeld, Roger W. Ferguson, Jr. (Board of Governors of the Federal Reserve System), Pierre van der Haegen (European Central Bank), Yutaka Yamaguchi (Bank of Japan) **Final Remarks**: Kazuo Ueda	