Internationalising the yen, 1984–2003: unfinished agenda or mission impossible?

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1. Introduction

This paper reviews Japan's experience in its attempt to internationalise its currency, from 1984 to 2003. Although the efforts began reluctantly in 1984 under pressure from a foreign government, it soon became the stated policy of the Japanese government to "internationalise the yen". The government defined the internationalisation of the yen as "the expanding role of the yen in the international monetary system and the growing weight of the yen in current account transactions, capital account transactions, and foreign exchange reserves" (MoF (1999)). In an attempt to achieve this objective, efforts were made to ease restrictions on cross-border capital flows and to develop new yen-denominated markets and instruments. In 2003, however, the government's focus shifted to restoring Tokyo as a major international financial centre; more recently, the government has assumed an essentially laissez-faire attitude towards yen internationalisation.

Underlying the policy of promoting yen internationalisation was the view that the prevailing use of the yen in international transactions was not "commensurate with the share of the Japanese economy in the world and Japan's status as the world's largest net creditor nation" (MoF (1999)).[2] In pursuing the policy, moreover, the government stated that yen internationalisation would be beneficial to the country as it would: (i) reduce exchange rate risk for Japanese firms; (ii) strengthen the international competitiveness of Japanese financial institutions; and (iii) facilitate the development of Japanese markets as an international financial centre. Regional and international benefits were also claimed, such as: (i) greater use of the yen in Asia would lead to greater stability of exports from Asian countries, and contribute to their economic stability; and (ii) greater use of the yen internationally, supplementing the US dollar, would contribute to a more stable international monetary system as well as greater risk diversification for investors and central banks worldwide.

The Japanese government was not always in favour of promoting greater international use of the yen. Until 1964, Japan had restricted the international use of the yen, even for current international transactions (Takagi (1997)). The government had earlier, in 1960, permitted external current account convertibility (for non-residents), but full current account convertibility of the yen was only achieved when Japan accepted the obligations under Article VIII of the IMF Articles of Agreement in 1964. From then on, the government circumspectly eased remaining exchange and capital controls, including the 1972 abolishment of surrender requirements and the progressive liberalisation of foreign direct

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[2] The small share of yen invoicing in Japanese exports (less than 30% in 1980) was considered an anomaly in view of Grassman's Law, which states that contracts for trade in manufacturing goods tend to be denominated in exporters' currency (Grassman (1973)). Finland is said to be another well known industrial country which is an exception to the rule (Hartmann (1998)).

investment (FDI) under the code of the OECD. Even when inward FDI, except in certain designated sectors, was in principle liberalised in 1973, restrictions remained on outward FDI as well as on most external financial transactions.

Capital controls were not only a hindrance to promoting the international use of the yen but also an important tool of exchange rate policy well into the early 1980s (Takagi (2007)). The authorities, for example, eased outflow controls and tightened inflow controls when the yen was under appreciating pressure, while taking an opposite course of action when depreciating pressure was evident. Reflecting the policy of limiting the international use of the yen, the share of Japanese trade invoiced in the domestic currency remained small (eg 0.9% for exports and 0.3% for imports in 1970). The international use of the yen in financial transactions was virtually non-existent.

The rest of this paper discusses how the Japanese authorities began to promote greater international use of the yen in the mid-1980s and how successful subsequent government policy was in achieving the objective, in the following order. Section 2 reviews yen internationalisation efforts under the revised Foreign Exchange Law of 1980, with a special focus on the role played by the Yen/Dollar Working Group of the Japanese Ministry of Finance and the US Treasury. Section 3 discusses further efforts made under the new Foreign Exchange Law of 1998 (the so-called financial "big bang"), highlighting the initiatives to develop new yen-denominated markets and instruments. Section 4 makes an overall assessment of the Japanese efforts to internationalise the yen over the period 1984–2003. Finally, Section 5 presents concluding remarks.

2. Internationalisation under the revised Foreign Exchange Law

2.1 The revised Foreign Exchange Law

Until 1980, the Foreign Exchange and Foreign Trade Control Law (henceforth referred to as the Foreign Exchange Law) of 1949 regulated all external transactions, while the associated Foreign Investment Law of 1950 controlled, as transactions requiring approval, the acquisition of domestic equities by non-residents, transfers of technology, and financial inflows with maturities of more than one year. The purpose of the Foreign Exchange Law was to prohibit all capital flows except by explicit permission. The primary role of the Foreign Investment Law, under the foreign exchange control regime, was to guarantee the repatriation of principal or liquidation proceeds for investments approved under the law, thus promoting capital and technology imports deemed beneficial to the economy.

The subsequent transformation of the Japanese economy over a quarter of a century caused the Foreign Exchange Law and the associated Foreign Investment Law to become increasingly outdated. As foreign exchange restrictions were lifted over time and no binding restrictions remained on the amount that could be repatriated, the Foreign Investment Law became superfluous. Numerous revisions and ad hoc approvals made the application of the Foreign Exchange Law complicated and non-transparent. There emerged an obvious conflict between what the law said and what the government professed. The authorities thus announced, in 1978, that they intended to revise the laws, to change their legal basis from "prohibition in principle" to "permission in principle". In December 1980, a revised Foreign Exchange Law came into force, and the Foreign Investment Law was abolished.

While maintaining the principle that all external transactions could be conducted freely, the revised Foreign Exchange Law allowed the government to impose "minimum necessary controls" for balance of payments or exchange rate management purposes. The law classified capital transactions into four categories: (i) transactions that required approval; (ii) transactions that required prior notification but for which no government review was expected; (iii) transactions that required prior notification and for which government review was expected; and (iv) transactions that required neither approval nor notification. The first category represented transactions deemed controlled ex ante, such as: foreign currency transactions between residents; deposit and trust contracts between residents and non-residents; and issuance of euroyen bonds by non-residents in foreign countries.

Most transactions fell under the second and third categories. First, the second category, for example, included inward FDI, which required prior notification to the Minister of Finance and the minister responsible. Under normal cases, no government review was to be expected, but the foreign investor could not make the investment for 30 days, during which time the government could intervene. In the event of a potential problem, the ministers could extend the probationary period from 30 days up to four months (five months if requested by the Foreign Exchange Council). If the investment was judged to have a harmful impact, the ministers could advise an alteration or even a termination. Second, the third category included such transactions as outward FDI, external lending, debt guarantee by residents for securities issues by non-residents in foreign countries, and acquisition by non-residents of real estate in Japan. For such transactions, in addition to the requirement of prior notification, review by the government was to be expected as a matter of course.

A critical role was played in the new control regime by authorised foreign exchange banks and designated securities companies. Transactions that required neither approval nor notification – the fourth category of transactions – essentially involved these institutions, namely cross-border transactions intermediated by authorised foreign exchange banks and portfolio investments intermediated by designated securities companies. In fact, many of the transactions in the first category were made subject to control precisely to protect the integrity of the authorised foreign exchange bank system. Otherwise, the overall system of inward and outward investments was quite liberal, subject of course to the condition that the transactions were made through a bank or a securities company, thus allowing the government to monitor or intervene if necessary. In addition, the Minister of Finance retained the power to limit foreign exchange banks' open positions in foreign exchange, specify requirements for their foreign exchange business, and prohibit them from paying interest on yen deposits held by non-residents.

2.2 The Yen/Dollar Committee

The beginning of Japan's official policy to internationalise the yen can be traced to the establishment of an ad hoc Yen/Dollar Working Group (henceforth the Yen/Dollar Committee) by the Japanese Ministry of Finance and the US Treasury in late 1983. The Committee was set up against the background of a large and widening trade imbalance between the two countries and the argument put forward by some observers that a weak yen was the principal contributing factor. The US position, based on what Frankel (1984) calls "questionable economic logic", held that the yen was undervalued because: (i) Japan was not attractive to international investors; and (ii) the currency was not attractive to international users. The Japanese authorities did not necessarily agree with such an assessment, but went along because the alternatives (such as further trade concessions) were far worse.

The US position was not only to internationalise the yen (in the hope of appreciating the currency over the medium term) but also to open Tokyo's capital markets – to allow US financial firms greater business opportunities in the expanding market. In substance, the Japanese position differed little. Around the same time, yen internationalisation and financial liberalisation were beginning to be placed on the policy agenda of the Japanese government. In October 1983, for example, the Japanese Minister of Finance proposed "the internationalisation of the yen and the liberalisation of financial and capital markets" as future policy objectives. The Japanese, however, preferred a much slower pace of reform than the Americans were willing to accept. The Committee became a forum in which the two sides were to discuss the content and pace of financial market reforms that Japan would undertake in order to open its markets and internationalise the yen.

Although the discussions proceeded at the technical level, the work had a strong political dimension. In the first place, the creation of the Committee was conceived in the context of the November 1983 visit of President Ronald Reagan to Japan, when endorsement was given to the work of the Committee at the highest political level. On more than one occasion, Prime Minister Nakasone is said to have intervened to push the reluctant Ministry of Finance officials to move forward in reaching agreement with their US counterparts (Takita (2006)). In the event, the Committee met six times from February to May, and released its report on 30 May 1984. The Japanese Ministry of Finance, however, did everything to avoid the appearance of being forced to open the Japanese capital markets. The Ministry concurrently prepared a report for domestic consumption on financial liberalisation and yen internationalisation. The report, entitled *The present status and outlook on financial liberalisation and yen internationalisation*, was released to the public at the same time as the Yen/Dollar Committee report.[3]

During the course of 1984, either concurrent with or subsequent to the work of the Committee, a number of market-opening and liberalisation measures were announced or implemented. Those measures included: the elimination of the so-called "real demand rule" (whereby a forward exchange contract needed to correspond to a bona fide transaction) in April; the relaxation of the conditions for euroyen issues by residents in April; the abolishment of regulations on the share of foreign borrowing that can be lent out to domestic entities by banks (so-called "yen conversion") in June; and the relaxation of the conditions for euroyen issues by non-residents in December. Because euroyen transactions were among the transactions that required approval under the revised Foreign Exchange Law, the focus of efforts over the subsequent years was naturally placed on this market segment. Additional measures agreed in, or proposed by, the Yen/Dollar Committee report would be implemented over a longer time horizon.[4]

2.3 The 1985 Foreign Exchange Council report

According to the MoF (1995, p 41), the government's stance on yen internationalisation was neutral during the deliberations of the Yen/Dollar Committee. The stance became explicitly positive only in the work of the Council on Foreign Exchange and Other Transactions (henceforth referred to as the Foreign Exchange Council), an advisory body to the Minister of Finance. The Council's report, issued in March 1985, put forth the idea that internationalisation of the yen should be actively promoted and suggested as necessary steps: (i) domestic financial liberalisation as a means of providing attractive yen instruments to non-residents; (ii) the liberalisation of euroyen transactions; and (iii) the internationalisation of Tokyo as a major financial centre.

As noted, the liberalisation of euroyen transactions received special emphasis in the Yen/Dollar Committee report (see Table 1 for details). Specifically, the measures that were suggested by the report and were implemented over the coming years included: (i) easing

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3 Takita (2006) reviews the work of the Yen/Dollar Committee based on the memoirs and recollections of a number of Japanese officials who participated in the negotiations. He shows that there were two contentious issues. First, the Japanese side wanted to publish the domestic report before the Committee report, while the US side wanted the exact opposite. A compromise was reached to publish the two reports simultaneously. Second, debate within the Japanese Ministry of Finance concerned the sequencing of domestic financial liberalisation and yen internationalisation (ie liberalisation of euroyen transactions). The Ministry wanted to liberalise domestic markets before internationalising the currency, but yielded to US pressure by allowing both to proceed simultaneously.

4 Those measures included: the liberalisation of yen-denominated external lending; the relaxation of the eligibility of non-resident firms to issue yen-denominated (samurai) bonds in Japan and their terms; and the development of a short-term government bond market.

issuing terms for euroyen bonds and abolishing withholding tax for non-residents (implemented in April 1985); (ii) permitting medium- to long-term euroyen lending for Japanese banks (April 1985 for non-residents; May 1989 for residents); and (iii) extending the maturity of euroyen certificates of deposit (CDs) from less than six months to one year (April 1986) and then to two years (April 1989). In addition, as a measure to internationalise the Tokyo markets, the Tokyo Stock Exchange extended membership to foreign securities companies in December 1985. In 1986, the revised Foreign Exchange Law was modified to allow the establishment of offshore accounts, leading to the launch of an offshore market in December.

Additional government reports were prepared over the subsequent years, which all repeated the same theme with different variations. For example, the June 1987 report stressed the need to improve the attractiveness of instruments traded in the short-term government debt markets. The outcome of those efforts went beyond the progressive liberalisation of euroyen transactions, as noted above. Different segments of domestic financial and capital markets were developed over time, including the establishment of a yen-denominated bankers' acceptance (BA) market (ostensibly to promote the use of the yen in current international transactions) and various markets for financial futures and options (Table 2). Efforts to internationalise the yen during this period were part of the overall efforts to liberalise domestic financial transactions and to develop domestic financial markets.

3. Internationalisation efforts under the big bang

3.1 The new Foreign Exchange Law

The prolonged economic stagnation of the 1990s weakened the shackles of vested interests, allowing Prime Minister Hashimoto to announce a comprehensive deregulation of Japan's financial markets in November 1996. With macroeconomic policies obviously not working, it was thought, structural reforms, including in the financial sector, would help revitalise the Japanese economy. There was also awareness that the status of the Tokyo market as an international financial centre (and the share of the yen in global foreign exchange trading) might actually be declining from the heyday of the 1980s (Table 3). Called the financial "big bang", a term borrowed from the 1980s deregulation of the London financial markets, the plan sought to make Japan's financial markets and institutions more competitive and efficient ("fair, free and global", to use the government's slogan) by eliminating existing barriers and impediments. Reform of the foreign exchange market was to become the front runner of the comprehensive financial system reform.

To map out the course of action, in January 1997 the Foreign Exchange Council submitted a report to the Minister of Finance, stating that the goal of the reform was to restore the status of Tokyo as one of the world's leading international financial centres by 2001 (MoF (1997)). To achieve this objective, the report proposed a comprehensive overhaul of the Foreign Exchange Law. The report, recognising that increasing international competition had caused a shift in recent years of financial transactions from domestic to international markets, proposed: (i) the complete liberalisation of cross-border financial transactions through the abolishment of prior approval or notification requirements; (ii) the abolishment of authorised foreign exchange banks and designated securities companies in order to increase the depth of markets by allowing free entry and exit; and (iii) for outward FDI, the abolishment in principle of approval or notification requirements.[5]

The new Foreign Exchange and Foreign Trade Law came into force on 1 April 1998 (with the word "Control" removed from the title). As recommended by the 1997 Council report, prior approval or notification requirements were in principle abolished; instead, ex post facto reporting requirements were prescribed for transactions exceeding a stipulated amount for statistical purposes. Authorised foreign exchange banks, as well as designated securities companies, were abolished.[6] As a result, non-financial institutions were allowed to deal directly in foreign exchange transactions without the intermediation of authorised foreign exchange banks, and Japanese residents were allowed to open and maintain foreign currency accounts with financial institutions located in foreign countries. Japan became a financially open economy in the true sense of the word.

3.2 The Sub-Council on Yen Internationalisation

The subsequent five years (July 1998–January 2003) saw an intensification of government efforts to internationalise the yen. The work began in July 1998, when the Minister of Finance requested the Foreign Exchange Council to investigate and deliberate the internationalisation of the yen "from the perspective of the ongoing changes in the economic and financial conditions in Japan and abroad". Work was carried out by the Council's Sub-Council on Yen Internationalisation, whose interim report was issued in November (MoF (1998)). The full Council's final report, issued in April 1999, was almost entirely based on the November 1998 interim report, except for the measures taken immediately after the release of the interim report (MoF (1999)).

Though cross-border transactions had been fully liberalised under the new Foreign Exchange Law, the Sub-Council still recognised that there was room to improve the usability of the yen, especially in terms of providing risk-free, highly liquid financial products as well as a benchmark. From this standpoint, it stressed the importance of improving the market for government debt (bonds and bills). In particular, it noted that: (i) the markets for financing bills (FBs) and Treasury bills (TBs) lacked depth; (ii) the repo market in Japan was based on the borrowing and lending of bonds with cash collateral (whereas in the United States and Europe the repo market was based on the sale (purchase) of securities with a repurchase (resale) agreement; (iii) the long-term government bond market was not liquid across maturities and did not allow the efficient formation of a yield curve, thus limiting its usefulness as a risk hedging device; (iv) withholding tax on interest and capital gains affected cash flows and thus pricing, and discouraged non-residents from entering the market; and (v) the settlement system was not efficient.

To overcome these problems and thereby help improve the operation of the Japanese government debt markets, the Sub-Council made the following recommendations: (i) public auction of FBs; (ii) the abolishment of withholding tax on capital gains for TBs and FBs; (iii) the diversification of long-term government bond issues; (iv) the exemption of withholding tax on interest income for non-residents; and (v) the promotion of delivery versus payment (DVP) and real-time gross settlement (RTGS) to improve the settlement system. Decisions for some of these measures were implemented or announced even before the report of the

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5 For inward FDI, prior notification requirements had been abolished in principle in 1992, with only ex post reporting requirements retained.

6 At the same time, procedures were introduced whereby economic sanctions could be imposed in order to meet Japan's international obligations or for other political purposes. In 2001 and 2004, the law was further strengthened in this area, especially with regard to international terrorism and money laundering activities.

full Council was issued in April 1999, with the government making an announcement of "Measures to facilitate the internationalisation of the yen" in December 1998 (Table 4).

Early measures to improve the operation of the Japanese government debt markets were put in place in April 1999. With the commencement of a public auction for FBs, it was decided that their maturity would be 13 weeks; auctions were, in principle, to be held weekly; and FBs would no longer be underwritten by the Bank of Japan (BOJ) after the transitional period of about one year. Withholding tax on capital gains was exempted for foreign corporations (followed by the exemption of withholding tax on interest income for non-residents and foreign corporations in September 1999). Securities transactions and exchange taxes were abolished. Thirty-year Japanese government bonds (JGBs) and one-year TBs were introduced in order to diversify maturities.

The report of the full Foreign Exchange Council, issued in April 1999, outlined the tasks remaining in order to complete the development of the infrastructure needed to increase the convenience of using the yen. These measures included: (i) the development of a repo market (based on sales/purchases with repurchase/resale agreements); (ii) the introduction of five-year JGBs to serve as a benchmark for creating an efficient yield curve for government debt; (iii) the diversification of types of JGBs, including STRIPS[7] bonds; (iv) the introduction of RTGS to the BOJ-NET by the end of fiscal 2000 and the lengthening of operating hours; (v) the achievement of DVP for the settlement of CDs and commercial paper (CP) as early as possible (to enable full dematerialisation); and (vi) the promotion of yen invoicing in imports in order to increase the holding of yen by non-residents. The 1999 report further noted the need to provide yen funds to non-residents through capital transactions.

3.3 The Study Group on the Promotion of Yen Internationalisation

A Study Group on the Promotion of Yen Internationalisation was established in September 1999 to follow up on the recommendations of the April 1999 Foreign Exchange Council report. The Group, with some variations in membership, had three sessions over the subsequent four years (September 1999–June 2001, October 2001–June 2002 and September 2002–January 2003); it issued reports in June 2001 and June 2002 and the Chairman's summary in January 2003. The Study Group's orientation became increasingly pragmatic over time, as it began to focus on the specifics of how private sector firms chose which currency to use in international transactions.

The first report, issued in June 2001, stated that, despite some progress, the state of yen internationalisation had changed very little (MoF (2001)). It stated that the lack of progress was due to the lack of confidence in the Japanese economy and the limited need to use yen; the choice of currency was based on economic rationality. In order to further promote yen internationalisation, it would be necessary to restore Japan's economy and financial system, to further open the Japanese markets, and to establish the conditions necessary to improve the convenience of using the yen. The report still considered yen internationalisation as a long-term goal, as it was expected to contribute to greater exchange rate stability in Asia and hence to global monetary stability.

The second report, issued in June 2002, summarised the views expressed by Japanese private sector firms engaged in cross-border transactions and attempted to explain why yen internationalisation, as an outcome of market decisions, was difficult to achieve (IIMA (2002)). In terms of current transactions, the report noted that the choice of invoice currency was determined by various factors, including market power, matching of product exports and

7 Separate Trading of Registered Interest and Principal Securities.

material imports, international price setting practice (as in energy products), preferences of importers and exporters, and so forth; there was greater yen invoicing for products for which Japan had strong market power. The report also made mention of Japanese corporate governance practice (under which minority shareholder rights were not protected), high bank fees for converting euroyen into yen, the lack of a sufficient number of risk investors in the Japanese markets, the need to adopt international accounting standards, and the need to allow documents to be produced in English.

Finally, the Chairman's summary, issued in January 2003, reiterated the possibility that the progress of yen internationalisation was being slowed by Japan's prolonged recession and the resulting loss of confidence in the Japanese economy (MoF (2003a)). The summary further recognised the role of inertia in the choice of key currency – conventions favoured the use of the US dollar. The summary only made broad recommendations, such as: (i) identifying and removing obstacles to yen invoicing in specific transactions; (ii) providing technical support to develop the legal infrastructure in Asia needed to securitise export receivables from Japan (hence allowing the establishment of a market for CP collateralised by export receivables); (iii) developing a procedure to provide yen credits to Asian exporters through technical assistance; (iv) further expanding the scope for exemption of withholding tax on capital gains for TBs and FBs held by non-residents; and (v) allowing the offshore market to trade derivatives and JGBs. The summary had an Asia focus, suggesting the need for greater regional financial cooperation, including the development of Asian bond markets. Overall, it had few concrete measures that would be achievable in the short run.

3.4 Internationalising Tokyo's capital markets

In 2003, the focus of the Japanese government shifted from internationalising the yen to internationalising the Japanese capital markets. A study group was set up within the Ministry of Finance, with academic and private sector participation, to consider the internationalisation of Japanese capital markets from March to July 2003. The Chairman's summary (MoF (2003b)), however, differed little from the similar summary of the preceding yen internationalisation group issued in January, indicating that most of the measures perceived necessary to further internationalise the capital markets had already been implemented in the context of internationalising the yen (Table 5). Even so, the summary noted that the status of the Japanese capital markets had declined as an international financial centre, in terms of bond issues by non-residents, new listing of foreign stocks, and offshore trading. The share of the yen in global foreign exchange trading had also declined (Table 3).

The summary noted the need to improve the intermediary role of Japanese markets in cross-border capital flows, and began to see the legal, accounting, settlement and tax systems as areas for improvement. For example, the summary noted that the administrative cost of using the samurai bond market (yen-denominated bonds issued in Japan by non-residents) was high, relative to the euroyen bond market, and suggested that the Tokyo offshore market be used to issue samurai bonds. It also argued for creating a market for yen-denominated CP collateralised by export receivables by abolishing withholding tax on capital gains on electronic samurai CP issued by foreign corporations. Other proposals included the simplification of reporting requirements to promote foreign investment in Japanese capital markets, the adoption of a book-entry system for the settlement of cross-border securities transactions to promote such transactions, and greater cooperation with Asian counterparts to promote the development of bond and foreign exchange markets, including the eventual establishment of a settlement system in foreign exchange and securities (an "Asia Clear") and commencement of cross trading among Asia's currencies.

4. Assessing the Japanese efforts to internationalise the yen

By the end of 2003, it was clear that any further attempt to internationalise the yen – or internationalise the Japanese capital markets for that matter – would be futile without a fundamental change in the economic might of Japan or major cooperation efforts among Asian countries to promote the role of the yen in the region. When the big bang of 1998 did not produce the kind of result previously hoped for, those involved in policymaking began to advance reasons why the international status of the yen remained where it was, including: (i) raw materials (for which dollar invoicing is the norm) constituted a large share of Japan's imports; (ii) the currencies of Asia tended to fluctuate more with the yen than with the US dollar, with virtually no cross trading; and (iii) there was little need for yen loans because most trade was not denominated in yen. But these are reasons about which Japan alone could do very little.[8] It is possible that this realisation, along with the personality changes within the Ministry of Finance and the splitting of responsibilities between the Ministry and the Financial Services Agency, led to the apparent loss of interest in further internationalisation efforts in 2003.

At the beginning of the new millennium, the international status of the yen essentially remained where it had started two decades earlier, before the internationalisation efforts began in earnest (Table 6). The share of yen invoicing in Japanese trade did moderately rise, however, especially on the import side. The share in import invoicing, which stood at a mere 2.4% in 1980, rose to over 20% in the early 2000s (for export invoicing, the rise was a few percentage points). But the share of the yen in international financial transactions, including cross-border bank positions, external bond offerings and bank loans, and official foreign exchange reserves, either remained the same or declined over time after an initial increase in the mid- to late 1980s. For example, the share of the yen in official foreign exchange reserves rose from 4.4% in 1980 to peak at 8.5% in 1991, before declining to 3.9% in 2003 (though the balance of yen reserves held up in absolute value). Likewise, the share in global cross-border bank positions rose sharply in the 1980s to exceed 10% in the late 1980s or early 1990s before declining.

Academic research suggests the importance of network effects – positive externalities that come from "additional users of a medium of exchange increasing the utility of its incumbent users" (Hartmann (1998)) – and hence the role of inertia and history in explaining the choice of international currency (see also Fukuda and Ono (2006)). In terms of current transactions, Sato (1999) shows that Japanese exporters display significant pricing to market (PTM) behaviour even in high-tech trade within Asia, which runs counter to promoting yen invoicing. In explaining the pattern of official reserve holdings, the most important factor seems to be exchange rate management practice (Papaioannou et al (2006)).

In financial transactions more generally, the choice of denomination currency depends on many other factors, including the level of interest rates and market expectations about prospective exchange rate movements. These considerations may explain why the yen was more widely used in the late 1980s and early 1990s than it is today, according to the standard metrics of Table 6. In the 2000s, however, the yen has been an active borrowing currency, as international investors have reportedly borrowed in yen to take advantage of its low interest rates and have invested the proceeds in higher-yield currencies (Hattori and Shin (2009)). When Iceland, Hungary and other European countries were hard hit by the global financial crisis of 2008, some of the household debt was said to be denominated in yen.[9] The

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8 Out of this came the argument that Japan should strengthen its links with Asian currencies, including through the adoption by Asian countries of a basket consisting of the dollar, the euro and the yen (MoF (1999)).

9 See, for example, Forelle (2008) and Mayer (2009).

importance of the yen in such "carry trades" over the past decade, however, does not seem to show up in a standard metric of currency internationalisation.

To be sure, the yen has been an important international currency. Though its status does not match that of the US dollar or even the euro, it is no less important than the pound sterling or the Swiss franc. The yen is also a highly "internationalised" currency in the sense that more than half of its trading takes place offshore (BIS (2008)).[10] But this was not what the Japanese authorities had in mind when they embarked upon concerted efforts to "internationalise" the currency, namely to increase the use of the yen in international transactions to a scale perhaps more resembling the status of the Deutsche mark before the launch of the euro. Japan's concerted efforts may have enhanced the necessary conditions for making the yen a major international currency of that kind. But the lesson of 1984–2003 is that they were not sufficient to make it happen.

It is not warranted, however, to draw the conclusion that Japan's currency internationalisation efforts were a total failure. Rather, the proper conclusion to draw from the Japanese experience is that dictating the world's choice of key currency cannot be the feasible objective of any country's domestic public policy. Even so, the sustained yen internationalisation efforts from the mid-1980s were successful in another way: they freed the Japanese economy from regulatory barriers inhibiting the free movement of capital. The result was an accelerated financial integration of Japan with the rest of the industrial world, with the balance of cross-border assets and liabilities more than doubling over the period as a percentage of GDP (Figure 1). Japan is now a highly financially open economy, with cross-border assets and liabilities well exceeding the size of GDP. Yen internationalisation served as a banner under which parties of conflicting interests were brought together to create a highly deregulated financial system.

5. Conclusion

This paper has reviewed the experience of Japan in its attempt to internationalise its currency, from 1984 to 2003. Although the process began reluctantly under pressure from a foreign government, it soon became the stated policy of the Japanese government to "internationalise the yen", namely to expand the role of the yen in the international monetary system as well as in international transactions. The efforts essentially involved measures to ease restrictions on cross-border capital flows and to develop new yen-denominated markets and instruments.

By 2003, however, it was clear that any further attempt to internationalise the yen would be futile without a fundamental change in the economic might of Japan or major cooperation efforts among Asian countries to promote the role of the yen in the region. At the end of the internationalisation efforts, the international status of the yen essentially remained where it had started two decades earlier, for reasons about which Japan alone could do very little. This realisation, coupled with the personality and organisational changes within the Ministry of Finance, led to the apparent loss of interest in making further internationalisation efforts.

The sustained yen internationalisation efforts of 1994–2003 were successful in a different way: they freed the Japanese economy from regulatory barriers inhibiting the free movement of capital. The result was an accelerated financial integration of Japan with the rest of the industrial world, with the balance of cross-border assets and liabilities more than doubling

[10] In April 2007, the share of offshore trading in global foreign exchange trading for the yen was 67%, the same as for the Swiss franc but lower than for the US dollar (79%) and the euro (77%).

over the period. By then, Japan had become a highly financially open economy, with cross-border assets and liabilities well exceeding the size of GDP. In retrospect, yen internationalisation was a banner under which parties of various vested interests were brought together to benefit the whole society.

Table 1

Selected measures to liberalise euroyen transactions, 1984–98

Month of action	Measures taken
June 1984	Short-term euroyen loans to residents liberalised
December 1984	Foreign securities companies allowed to become lead manager of euroyen bonds
April 1985	Withholding tax on resident euroyen bonds abolished
April 1986	Issuing guidelines relaxed for non-resident euroyen bonds (henceforth eligibility based solely on credit rating)
July 1987	Issuing guidelines relaxed for resident euroyen bonds (credit rating introduced)
November 1987	Non-resident euroyen CP authorised
May 1989	Medium- to long-term euroyen loans to residents liberalised
June 1989	Further relaxation of eligibility criteria for non-resident euroyen bonds (credit rating no longer required)
June 1989	Non-resident euroyen bonds with maturities of less than four months authorised
July 1993	Eligibility criteria for non-resident euroyen bonds abolished
January 1994	Minimum repatriation period for sovereign euroyen bonds abolished
April 1995	Procedure for approval and notification made flexible for non-resident euroyen bonds
August 1995	Minimum repatriation period abolished for non-resident euroyen bonds
April 1996	Minimum repatriation period for resident euroyen bonds shortened from 90 to 40 days
April 1996	Issuing rules for euroyen CP abolished (virtual elimination of all restrictions on bringing proceeds back into the domestic market)
April 1998	Minimum repatriation period for resident euroyen bonds abolished

Source: Japanese Ministry of Finance.

Table 2

Selected measures to liberalise cross-border financial transactions and to develop domestic market segments, 1984–96[1]

Month of action	Measures taken
April 1984	Real demand rule abolished for forward exchange transactions
June 1984	Regulation on the share of foreign borrowing that can be lent out to domestic entities by banks (the so-called yen conversion) abolished
June 1985	Yen-denominated bankers' acceptance (BA) market established
December 1986	Tokyo offshore market established
June 1987	Trading in stock futures commenced (Osaka)
September 1988	Trading in Nikkei-225 futures commenced (Osaka)
April 1989	Tokyo Financial Futures Exchange established
June 1989	Trading in Nikkei-225 options commenced (Osaka)
July 1989	Liberalisation of resident foreign currency bank deposits abroad (no approval required for individuals holding less than the equivalent of JPY 5 million)
July 1990	Liberalisation of resident foreign currency bank deposits abroad (no approval required for either corporations or individuals holding less than the equivalent of JPY 30 million for portfolio investment purposes)
January 1994	Eligibility criteria relaxed for resident foreign bonds and samurai bonds
July 1994	Eligibility criteria relaxed for yen-denominated foreign bonds
April 1995	Procedure for approval and notification made flexible for non-resident domestic bonds
January 1996	Eligibility criteria abolished for non-resident domestic bonds

[1] Excluding measures related to euroyen transactions.

Source: Japanese Ministry of Finance.

Table 3

Share of the yen and of the Tokyo market in global foreign exchange trading

As percentages of the global total

	1989	1992	1995	1998	2001	2004
Share of yen	13.5	11.7	12.1	10.1	11.4	10.1
Share of Tokyo mkt	15.5	11.2	10.2	6.9	9.1	8.2

Source: BIS, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity*, issues, 1990–2005.

Table 4

Selected measures taken following the April 1999 report

Recommendations in the report	Measures taken and when
Public auction of FBs	Completed, April 1999
Abolish withholding tax related to public bonds	(i) Abolished for certain types of FBs and TBs issued after 1 April 1999; (ii) foreign corporations exempted from withholding tax, 1 April 1999; (iii) non-residents and foreign corporations exempted from withholding tax for certain JGBs whose interest is calculated after 1 September 1999; (iv) the scope for tax exemption expanded for non-residents and foreign corporations, effective April 2001
Develop a repo market	Repo transactions based on repurchase and resale agreements introduced in April 2001
Introduce five-year interest bearing JGBs	Introduced in February 2000
Introduce gross settlement into, and expand operating hours for, the BOJ-NET	Completed, 4 January 2001
Establish a DVP settlement system for CP	The enabling law was enacted in June 2001 (with the system coming into operation in March 2003)

Source: Japanese Ministry of Finance.

Table 5

Selected measures to internationalise the Japanese capital markets, 1999–2003

Month of action	Measures taken
March 1999	Securities transactions tax abolished
April 1999	Withholding tax abolished for capital gains on TBs and FBs
September 1999	Income tax exempted for non-residents on interest on certain JGBs
October 1999	Commissions fully deregulated in the equity market
January 2001	RTGS introduced to current accounts at the Bank of Japan and the settlement of JGBs
April 2001	Repo transactions (on the resale and repurchase basis) introduced
May 2001	DVP settlement introduced to listed stocks in Tokyo and Osaka
2003	Requirement of concurrent domestic exchange listing abolished for samurai bonds
2003	Non-residents allowed to participate in the private placement market for samurai bonds restricted to eligible institutional investors
January 2003	Book-entry system for settlement in securities
January 2003	STRIPS national bonds introduced
July 2003	Securities and insurance companies allowed to participate in the offshore market

Source: Japanese Ministry of Finance.

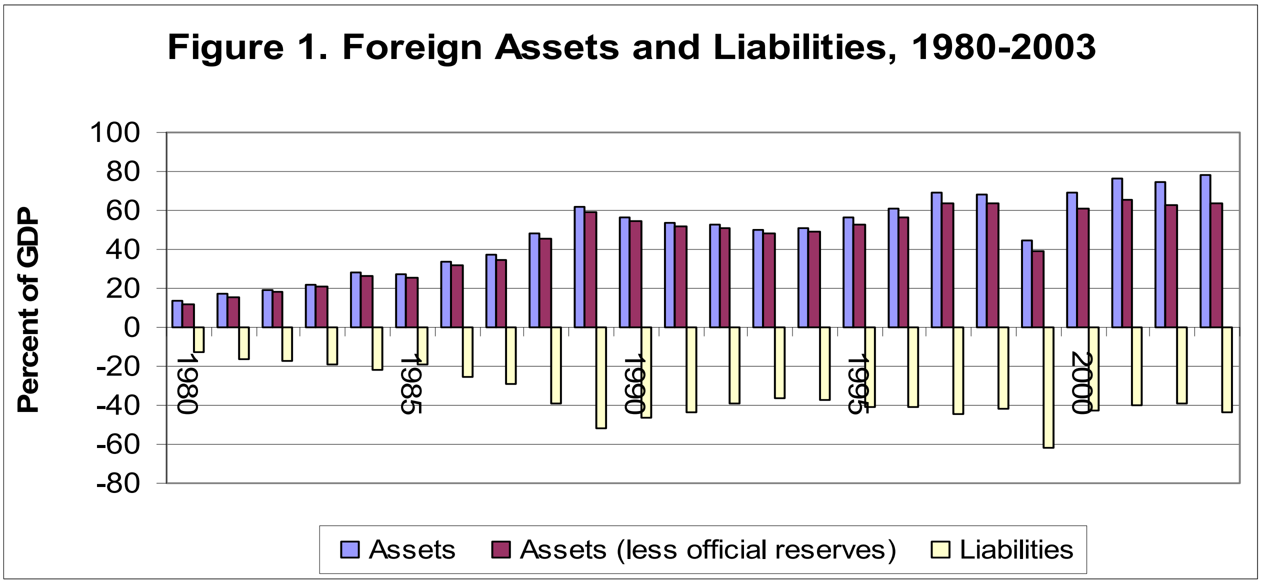
Table 6

International status of the yen, 1980–2003

Percentage shares of totals

Year	Japanese trade invoicing[1]		Global cross-border bank positions[2]		Global external bond offerings[3]	Global external bank loans[3]	Global official forex reserves[4]
	Exports	Imports	Assets	Liabilities			
1980	29.4	2.4	2.1	1.8	4.9	--	4.4
1981	31.2	--	2.4	1.9	6.6	--	4.2
1982	32.2	--	2.4	1.9	5.6	3.7	4.7
1983	34.5	--	2.3	1.8	5.5	7.4	5.0
1984	33.7	--	3.1	2.2	7.1	16.3	5.8
1985	36.0	7.0	5.1	4.2	9.1	18.5	8.0
1986	36.5	9.7	7.2	5.9	10.4	16.1	7.9
1987	33.4	10.6	11.3	9.5	13.7	10.8	7.0
1988	34.3	13.3	12.3	10.1	8.4	5.6	7.1
1989	34.7	14.1	11.2	8.9	8.3	4.7	7.3
1990	37.5	14.5	10.6	8.0	13.5	1.7	8.0
1991	39.4	15.6	11.3	7.4	12.6	1.1	8.5
1992	40.1	17.0	9.8	5.9	11.2	1.4	7.5
1993	39.9	20.9	10.1	6.3	9.6	0.7	7.6
1994	39.7	19.2	11.0	6.7	13.3	0.2	7.8
1995	36.0	22.7	11.3	7.3	12.6	0.2	6.8
1996	35.2	20.6	10.2	6.9	8.6	0.2	6.0
1997	35.8	22.6	10.1	6.9	4.5	0.2	5.3
1998	36.0	21.8	10.3	7.5	--	--	6.2
1999	--	--	9.2	7.2	--	--	6.4
2000	36.1	23.5	8.4	6.6	--	--	6.1
2001	35.6	23.6	6.2	4.9	--	--	5.0
2002	36.7	25.5	5.6	4.8	--	--	4.4
2003	39.3	25.3	4.9	3.9	--	--	3.9

Sources: [1] Japanese Ministry of Finance. [2] *BIS Quarterly Review*, March 2009, Table 5A (year-end values). [3] OECD, *Financial Market Trends,* various issues, 1981–98. [4] IMF, *Annual Report*, respective issues.



Source: Japanese Ministry of Finance.

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