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The introduction shows that there is indeed an exchange rate dilemma involving all the countries of East Asia as the scale and pace of their economic integration has increased dramatically over the past two decades. Because this increasingly integrated community does not have its own money—there is no “Asian euro”—the U.S. dollar plays a somewhat anomalous role as the region’s key currency. The peculiar nature of the foreign exchange risk facing both debtor and creditor countries under this East Asian dollar standard helps explain why the region remains so fragile financially.

This book is not about politics, nor is it critical of Asian politicians and their governments. In Japan, for example, politicians have been unfairly blamed for failing to take resolute action to clean up bad loans in the nation’s banks, restructure the industrial system, and avoid ongoing deflation by following a sufficiently expansionary domestic monetary policy. Instead, I shall argue that economists—outside commentators on Japan from the United States but also within Japan
itself—have failed to understand the foreign exchange origins of Japan’s deflation.

Similarly, governments in the smaller East Asian economies are unfairly criticized by the International Monetary Fund and foreign pundits for softly pegging their currencies to the dollar, which, it is alleged, contributed to the great crisis of 1997–1998. Like Japan in the 1980s and 1990s, China in the new millennium is under foreign mercantile pressure—to which it may or may not succumb—to appreciate its currency against the dollar.

This book develops a conceptual framework to show where conventional economic thinking on these important exchange rate and financial issues has gone off the rails. Although highly empirical in analyzing interactions among East Asian economies, it is also about economic ideas—both when they are right, and when they are wrong.

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