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G7 Reflections

One of the Plaza Accord's behind-the-scenes players offers his insights.

The International Economy magazine, now in its twentieth year of publication, has evolved in step with the G7, it seems.

The establishment of the G7 was agreed upon at the Tokyo Summit in 1986, one year after the Plaza Accord had been signed by the G5. The Tokyo declaration states:

> "…the Heads of State or Government: Request the seven Finance Ministers [including those of Italy and Canada] to review their individual economic objectives and forecasts collectively at least once a year, using the indicators specified below, with a particular view to examining their mutual compatibility;
>
> As for the G5, in view of the formation of the G7, [the Heads of State or Government] … Reaffirm the undertaking … to cooperate with the International Monetary Fund in strengthening multilateral surveillance, particularly among the countries whose currencies constitute the SDR [special drawing rights], and request that, in conducting such surveillance … their individual economic forecasts should be reviewed, taking into account indicators such as GNP growth rates, inflation rates, interest rates, unemployment rates, fiscal deficit ratios, current account and trade balances, monetary growth rates, reserves, and exchange rates."

In spite of the fact that the Tokyo declaration chose the expression, "countries whose currencies constitute the SDR" and did not use the "G5" designation, the G5 meeting was held first for the Louvre Accord in February 1987, and the G7 was treated as a forum for *ex post facto* authorization. So it seemed at least to the finance minister of Italy, who excused himself midway through the conference and returned home. The upshot was that it proved awkward to hold the G5 meeting thereafter.

By 2007, with the passage of twenty years, the G7 has changed its character significantly. First, the process of economic integration in the European Union has advanced and the euro has been introduced. And second, Russia and China have been invited to G7 meetings for the exchange of views. At the G7's Essen meeting in February 2007, the invitees included Brazil, India, South Africa, and Mexico, in addition to Russia and China.

As for the first change, I have been musing about the euro's strength these days. The market cites many reasons for the euro's strength, such as the economic growth rate of 2.7 percent in the euro zone, a rate approaching the 3.4 percent growth of the United States, and the narrowing of the interest rate gap between the United States and the euro zone.

Nevertheless, in my assessment, the primary reason lies in the fact that the entire euro region led by Germany is gathering strength, providing support to

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the euro. The strong euro is a reflection of the strength of the euro region that is now comparable to that of the dollar sphere. I think the euro will become a currency that may threaten the dollar in good time.

I am of the view that the strong euro is anchored on a strong euro region and especially on a strong Germany. Some, however, may take issue with this observation and say that political integration has not advanced far enough.

That the European constitution was rejected in referendums in France and the Netherlands in 2005, in particular, was a cause for bewilderment for many who had set their hopes on political integration. Nonetheless, the Maastricht, Amsterdam, and Nice Treaties all remain valid. One might argue that the European constitution containing hundreds of pages that even heads of state or cabinet ministers did not bother to look through was justifiably rejected by some Europeans. Suitable further tactical moves will be devised sooner or later. One can say that political integration was not really pushed back.

The creation of the euro itself represents, I think, an important step forward in political integration.

German Chancellor Angela Merkel and the finance ministers of Germany and Italy sounded critical about the weak yen and dollar shortly before the February G7 meeting. While they should have blamed the appreciating euro, they obviously shifted the aim of their attack in the interest of bolstering the authority of the European Central Bank. Granted, the yen and the dollar are growing weaker *vis-à-vis* the euro; still the yen is relatively stable in regard to the dollar. The two weak currencies stand equably with each other.

The increase in Japan's foreign reserves over the last two years was a mere $50 billion. Only the interest income on investments of the foreign reserves has risen. No intervention in the exchange market has been undertaken by our monetary authorities. Thus, the criticisms regarding yen depreciation by Germans and other Europeans are unfounded.

At the February meeting of the G7, the topic of how to define the position of hedge funds and whether to regulate them or not was reportedly on the agenda. The conclusion in favor of enhancing the transparency of hedge funds' trades seems appropriate.

It is desirable that the G7 continues exchanging views and consulting with the non-members on a limited range of issues including energy and environments. ◆

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