

The East Asian Dollar Standard, Fear of Floating, and Original Sin

Ronald McKinnon and Gunther Schnabl¹
Stanford University Tübingen University

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Abstract:

Before the crisis of 1997-98, the East Asian economies—except for Japan but including China—pegged their currencies to the US dollar. To avoid further turmoil, the IMF now argues that these currencies should float more freely. However, our econometric estimations show that the dollar’s predominant weight in East Asian currency baskets has returned to its pre-crisis levels. By 2002, the day-to-day volatility of each country’s exchange rate against the dollar has again become negligible. In addition, most governments are rapidly accumulating a “war chest” of official dollar reserves, which portends that this exchange rate stabilization will come to extend over months or quarters. From the doctrine of “original sin” applied to emerging-market economies, we argue that this fear of floating is entirely rational from the perspective of each individual country. And their joint pegging to the dollar benefits the East Asian dollar bloc as a whole, although Japan remains an important outlier.

F3, F31, F32, F33

¹ E-mail: mckinnon@stanford.edu, gunther.schnabl@uni-tuebingen.de
URL: <http://www.stanford.edu/~mckinnon/>, <http://www.uni-tuebingen.de/uni/wwa/homegs.htm>.