CHAPTER 8

Japan and the United States in the Asian Financial Crisis Management

Not even the Asian countries, with their "miracle economies," could escape the financial turmoil of the twenty-first century.[1] In 1997, Thailand, the Philippines, Malaysia, Indonesia, and Korea all experienced attacks on their currencies and stock markets, and their governments could not, on their own, manage these attacks or stabilize their economies. In response, the IMF, with the participation of Japan, the United States, and other governments, assembled international financial rescue packages in an effort to stabilize the international financial market. The combined total of aid committed through multilateral and bilateral channels reached more than $110 billion by the end of 1997.

Japan's involvement in the management of the Asian financial crisis[2] presents a much more complex picture than its involvement in the series of Latin American crises analyzed in chapters 5 and 6. First, the Japanese government's actions and the style of leadership in managing the Asian crisis shifted over time from active and independent (early summer through fall 1997), to passive but cooperative (fall 1997 to mid-1998), to active with cautious independence (mid-1998 through 1999). Second, the Japanese government demonstrated ambivalence in cooperating with the United States and the IMF, by sometimes fully supporting their initiatives (e.g., in the second phase) and sometimes providing (or attempting to provide) alternative solutions to the crisis. This chapter analyzes the reasons for the variance in the Japanese government's actions in Asian crisis management by applying the same theoretical framework as chapters 5 and 6: the importance of joint product and transnational linkages.

This chapter first introduces a historical narrative of Japan's behavior in the three phases of the Asian financial crisis, to explain what constitutes the dependent variable. The chapter continues by examining the actions and motivations of the Japanese government and its financial sector, based on the hypotheses posed in chapter 1, which were tested on the Latin American cases in chapters 5 (debt crisis) and 6 (peso crisis), as well as chapter 3 (quantitative analysis of the debt crisis). The joint product nature of crisis management

seems to provide a domestic and international environment for the Japanese government to act distinctively in different phases of the crisis. This hypothesis also provides a good basis for understanding Japan's ambivalence. Different levels of institutional linkages among transnational financial sectors operating in different countries—weak in Thailand and particularly strong in the case of South Korea—help explain the variance in Japan's behavior. Finally, this chapter concludes with a discussion of the lessons learned from the new Asian case study. The following conclusion to the book expands the discussion, explicitly contrasting Japan's actions in Latin America and Asia.

In relation to the Asian crisis, a great deal of academic and policy literature is being produced concerning (a) the causes of the Asian crisis; (b) appropriate solutions to the crisis, including questions about the role of the IMF; (c) implications of the crisis for the "Asian miracle" and the global economy; and (d) how to prevent future crises.[3] It is not in the scope of this study to discuss these issues; the focus here is the role of the Japanese government as a crisis manager in the Asian financial crisis.[4]

The Japanese Government in the Asian Financial Crisis (Dependent Variable)

Japan at Center Stage: The Thai Crisis and the Debate over the Asian Monetary Fund (Phase 1)

The first phase of the crisis represented a period of Japanese leadership. During this phase, the Japanese government undertook strong crisis management initiatives along with the IMF. The Japanese government promoted both multilateral and bilateral support to resolve the Thai crisis as promptly as possible, and Japan also helped assemble a financial rescue package of $17.2 billion for the country in August 1997. Furthermore, based on the Thai rescue format, a collective rescue package for which the United States did not provide any financial commitment, the Japanese government proposed, at the time of World Bank/IMF annual meeting in September 1997, a fund for balance-of-payments support to the countries in the region, the Asian Monetary Fund (AMF). This represented a new financial mechanism, understood as an Asian version of the IMF.

As the economic fundamentals and the country's ability to defend its peg were in doubt in May 1997, the Thai currency came under attack. The Bank of Thailand (central bank) spent billions of dollars to defend its pegged currency, but by May 15, the authorities had no alternative but to impose informal exchange controls to defend the baht. According to the promise made among the Asian countries eighteen months before,[5] the central banks of

Singapore, Malaysia, and Hong Kong also supported the baht in the currency market on May 14, but the attack continued. With its weakened economy, the Bank of Thailand could not help but let the baht float on July 2, 1997. The currency came under a severe attack on that day and lost about 17 percent of its value against the U.S. dollar. Contagion effects were a prominent feature of the crisis, as in the 1994–95 Mexican peso crisis. Within a few weeks, the Philippine peso and the Malaysian ringgit were forced to devalue, and ripple effects were also felt in the currency and stock markets of other Asian countries.[6]

Among these Asian countries, the Philippines was the only country that immediately turned to the IMF, because it had already agreed on an IMF program several years earlier. The Filipino government obtained an agreement with the IMF for $1 billion in the form of EFF credit and other financial programs on July 18, only a week after its peso came under severe attack. This support measure used the newly established New Arrangements to Borrow (NAB) under the Emergency Financing Mechanism of the IMF.[7]

The government of Thailand was initially reluctant to resort to IMF financial support, which comes with stringent conditionality. Thailand's new finance minister, Thanong Bidaya, and central bank governor, Rerngchai Marakanond, visited Tokyo on July 17 and 18, 1997, to meet with twenty-one Japanese commercial banks to explain the economic situation in Thailand. They also met with Japan's finance minister, Hiroshi Mitsuzuka. During that meeting, the Japanese government agreed that it would intervene in the foreign exchange markets to defend the baht. Even at this point, Thanong was reportedly explicit that he did not intend to request financial support from the IMF.[8] But as the attack on the Thai currency and outflow of foreign capital continued in the last week of July, the Thai government had no other alternative but to shift its policy and turn to the IMF. By August 4, 1997, the government of Thailand and the IMF reached a basic agreement. An international conference was held in Tokyo, led by the IMF, to hammer out concrete terms for the Thai rescue package. Japan's MOF was supportive of Thailand as it reached an agreement with the IMF. The package finally assembled totaled $17.2 billion, in which Japan (providing $4 billion through the JEXIM Bank untied loans) and the IMF (providing $4 billion) contributed the largest components. Many Asian countries also contributed to the package, as did the World Bank (with $1.5 billion) and the Asian Development Bank (ADB) (with $1.2 billion).[9] The United States was the one significant party that did not take part in this rescue package. Although an American delegate was present at the IMF-led conference in Tokyo, the U.S. government did not commit any financial support at the time.

There are two well-recognized reasons for the U.S. reluctance in the Thai case. The first was that many U.S. financial policymakers had an inaccurate un-

derstanding regarding the nature of the crisis at the time. The policymakers thought that the Thai crisis was an isolated incident and that the IMF package, with some help from Asian neighbors, would be enough to contain regional financial turmoil, without major contagion to emerging market countries in Asia or in other parts of the world. This U.S. behavior was described as follows:

> When the IMF put together a $17.2 billion bailout package for Thailand in August, the United States helped craft the conditions—including sharp austerity requirements that have sparked protests in Thailand—but did not contribute funds. Treasury Department officials argued that a direct financial contribution from Washington was not called for in Thailand's case because it appeared at the time that there was little risk that the country's financial troubles—fueled by speculative attacks on its currency—would spread to other markets.[10]

The second reason has to do with U.S. domestic politics. After the Mexican bailout of $20 billion in early 1995, for which the Clinton administration used the ESF, there were mounting criticisms from Congress on how the administration disregarded the congressional debate and unilaterally conducted the Mexican rescue (see chap. 6). Congressionally imposed restrictions on future use of the ESF made it difficult for the U.S. administration to provide bilateral financial contributions to the Thai rescue package.[11]

From the Thai currency crisis and the rescue in the summer (July/August) of 1997 through the Indonesian currency crisis and the rescue in the fall (October/November), an interesting tug-of-war emerged between AMF advocates and the IMF-centered Western coalition that opposed the AMF. In stark contrast to the 1995, American-led Mexican rescue package, Thailand's rescue package demonstrated collaborative action among Asian financial authorities, with a solid Japanese initiative and in the absence of U.S. leadership. This rescue package was seen by many as a "precursor of future standard arrangements"[12] for this type of crisis in the region; concomitantly, the lack of U.S. presence concerned the Asian countries. By August 18, the Thai foreign minister was reported as saying that he would like to propose the establishment of an ASEAN Monetary Fund (the name was tentative) to support Asian currencies against foreign speculators.[13] The finance secretary of the Philippines picked up the idea in September at an ASEAN finance ministers' meeting. The Asian Fund scheme was considered a counterpart to the IMF, with Japan as the major contributor.

Japan's finance minister at that time, Mitsuzuka, mentioned Japan's interest in collaborating if Asian governments put forth such requests.[14] Finally,

Mitsuzuka put the idea of an Asian Fund on the table at the World Bank/IMF annual meeting in Hong Kong on September 21. In his meeting with ASEAN financial ministers, he proposed the establishment of a fund of $100 billion (tentatively called the Asian Fund) that would be financed and run by Asian countries to help the region's governments cope with currency crises. The arrangement would be based on the Thai rescue package put together by the Asian countries and Australia. He also suggested that the IMF be the model for the operation of such a fund.[15]

The IMF and the governments of the United States and Europe did not react favorably to Japan's proposal. As is discussed later in this chapter, these entities considered that an alternative institutional mechanism aimed at solving the Asian financial crisis would jeopardize the effectiveness of the IMF programs and invite a moral hazard problem. The IMF and major creditor countries, other than Japan, were further agitated about the timing of the proposal. The G-7 finance ministers had recently reached a compromise agreement to increase the IMF's capital base by a more-than-expected 45 percent, precisely to prepare the IMF to address possible currency crises in emerging market countries—the type of crises that had just occurred in Asia. As a result of this capital increase, the IMF voting powers of Japan and many Asian countries, including Korea, Malaysia, and Thailand, were to be expanded.[16]

The AMF issue was continuously debated during October and November, as many Asian currencies, including those of Indonesia and Korea, became targets of attacks by the market. The Japanese government maintained its support for the Asian governments' idea, to counter "foreign speculators," the emergence of whom many believed was a result of liberal economic prescriptions designed by the IMF and the United States.[17] One of the most influential officials in Japan's MOF, Eisuke Sakakibara, became quite vocal in deploring the damage that the "Washington consensus" on development had caused. Although there was no explicit mention that the Asian Fund would be more lenient to the countries under crisis, Sakakibara emphasized the "flexibility" that such a fund could bring to the operation of emergency funding.[18]

As discussed more extensively later in this chapter, the lack of support from the financial community, both international and domestic, along with opposition from Washington, led to the retreat of the Japanese (and Asian) idea. The AMF proposal was finally put to rest, at least for the time being, at a meeting of APEC finance ministers in Manila on November 18–19,[19] before the APEC annual meeting in Vancouver. Although the participating finance ministers agreed on the need and desirability of a framework for regional cooperation to enhance prospects for financial stability, they basically concluded that the emergency funding scheme should be based solely on the IMF. Additional financial assistance would be possible for the countries in financial dis-

tress only after they fully negotiated conditionality with the IMF. This became known as the Manila Framework.[20] After the APEC meeting, ASEAN senior financial officials who met in Kuala Lumpur on November 30 affirmed, "at this level, [the proposal] is on the backburner."[21] The idea did not die but was "revived" a year later.

Despite its withdrawal from the AMF idea, the Japanese leadership and its active commitment to support Asian countries in financial crisis during the first four months after the outbreak in Thailand was significant. Successful or not, the Japanese government clearly demonstrated its willingness to become a lead crisis manager in the region, either regardless of the U.S. participation or because of its absence. This leadership position might, however, have reflected a default in a situation where there was a lack of involvement by other parties, particularly the United States. This circumstance made Japan's active engagement in crisis management far more essential. Note that although collective action among major creditor governments was present via IMF commitments, the U.S. reluctance to act bilaterally on the Thai rescue package came as a shock to many Asian countries.[22]

Japan Supports U.S. Leadership: The Indonesian and Korean Crises (Phase 2)

The Asian financial crisis spread to much larger economies in the region, such as Indonesia and Korea, during the fall of 1997. As Hong Kong's currency came under attack by speculators, the financial world, including the United States, began to recognize the risk of further contagion and the chilling fact that the Asian crisis was real and here to stay, at least for a while. This was when the second phase of Japan's involvement in the financial crisis management began to take shape. The role of the U.S. Treasury Department and the IMF became much more central during the process of assembling financial rescue packages for Indonesia and Korea to calm the market, deter attacks on their currencies, and stop or slow capital flight. Japan's role then became more subordinate, supporting solutions led by the IMF and the United States with major financial contributions but without strong alternative initiatives. A change in the U.S. government's attitude toward the Asian currency crises came, on one hand, as a response to the emerging regional schemes to address the Asian economic problem. On the other hand, it came from the realization by U.S. policymakers that Thailand was not going to be an isolated case and that there was a high risk of a contagion effect from the crisis. The United States also became particularly concerned when the Indonesian crisis pulled down prices in the stock markets of such Latin American countries as Brazil and Argentina.[23]

As Indonesia's currency came under attack and the Indonesian govern-

ment, after repeated attempts to avoid IMF involvement, finally turned to the IMF, leading to an agreement on October 31, 1997, the U.S. government promised to contribute $3 billion of the $14 billion in bilateral contribution pledges. This bilateral contribution was considered part of the "second line of defense,"[24] in case the first line of defense, consisting of $10 billion from the IMF, $4.5 billion from the World Bank, and $3.5 billion from the ADB, failed to stop the run on the Indonesian currency.[25] The Japanese government's financial contribution made Japan one of the two biggest bilateral contributors to the Indonesian rescue. Along with the government of Singapore, the Japanese government committed $5 billion dollars. In addition to such financial contributions, the Japanese and Singaporean monetary authorities stepped into the Singapore currency market in early November to prevent the Indonesian rupiah from falling further. Despite the IMF package agreed on, Indonesia's unwillingness to adjust its macroeconomic policies according to the IMF agreement caused its currency to continue its problematic course into the first half of 1998.

The last major IMF-led rescue package in the series of the Asian financial crises was assembled for Korea, the eleventh largest economy in the world. By November 1997, with a vicious attack on its currency and plummeting stock market prices, it was obvious that Korea needed some kind of financial help.[26] The Korean government and its policymakers, however, vehemently denied rumors that Korea would go to the IMF in the first weeks of November.[27] The Korean government, meanwhile, attempted to arrange financial rescue packages bilaterally with Tokyo and other creditor governments without turning to the IMF, but this effort failed.[28] As the Korean won dropped below 1,000 to the dollar from 910 just a month before, and as its financial stabilization package, announced on November 19, failed to restore overseas confidence, the Korean government turned to the IMF, asking for $20 billion in emergency loans on November 21, 1997. On the same day, Korea's deputy prime minister, Yim Chang-yol, called on Japanese finance minister Mitsuzuka, requesting additional financial support from Japan.[29]

Facing the biggest economic threat among the series of the Asian crises that occurred in 1997, and acknowledging that the Korean government finally decided to involve the IMF, the Japanese government responded quickly and positively. On November 24, during the APEC forum in Vancouver, Japanese prime minister Hashimoto met with outgoing Korean president Kim Young-sam and promised to assist South Korea financially in cooperation with the IMF. Furthermore, various high-ranking officials from Korea visited Japan during the last weeks of November to increase the chances and the amount of emergency funding from Japan. It is reported that the Korean government was hoping for a commitment of $20–30 billion from Japan.[30] The Korean rescue

package of $57 billion, the largest ever assembled, was agreed on with the IMF on December 3.[31] It included $21 billion from the IMF (which constituted 1,939 percent of Korea's quota, the highest ratio ever for IMF lending), and $10 billion and $4 billion from the World Bank and the ADB, respectively, as the first line of defense. In addition, more than $20 billion for a second line of defense came from Japan ($10 billion), the United States ($5 billion), and other OECD countries.[32] Korea also got some breathing space from external financial pressure as it secured agreements with foreign commercial bankers and investors to suspend temporarily the repayments of $15 billion in loans by the end of December and as it started to convert some of its short-term loans to bonds with long-term maturities.[33]

In both the Indonesian and Korean cases, the U.S. government's policies were clearly behind the IMF agreements. Unlike the Thai rescue package, the United States also committed a large bilateral financial contribution to a second line of defense, in case the crises deepened. Moreover, the Clinton administration began to put significant pressure on the Japanese government to support the ailing Asian economies both directly, by contributing financially to these countries and allowing some delay of repayments, and indirectly, by stimulating its own economy in recession with an expansionary fiscal package, preventing the Japanese yen from falling, and buying more from those countries in crisis. In the face of the U.S. assertion of its leadership role in the Asian currency crises, the retreat of the Japanese government's independent position, particularly after the failure of the AMF scheme, was quite striking. Only a limited version of the AMF idea was adopted as part of the Manila Framework. The framework outlined a form of response to this new type of financial crisis, including the Supplemental Reserve Facility (SRF), which would enable the IMF to respond to short-term financial crises with more flexibility. The Japanese government had to relinquish its own initiative—which, in exchange for a large financial commitment to the new regional funding mechanism, would have given Japan greater power in the region—because of strong opposition to the idea by the IMF and other creditor governments, including both the United States and China. Additionally, since the beginning of crisis management in the summer of 1997, the Japanese government consistently insisted that the reluctant Asian countries go through the IMF before Japan committed itself to help them financially. Japan even took a lead in assembling the IMF rescue package for Thailand, and Japan supported the crisis management operations for Indonesia and Korea led by the United States and the IMF.

This pattern of financial crisis management between the United States and Japan continued into early 1998 as the Indonesian government rebelled against the IMF-led solution to the country's economic crisis. Into 1998, the Japanese government remained supportive of initiatives by the United States

and U.S. efforts to revive the Asian economies. However, there were indications of subtle conflicts, disagreements, and resentments on the part of the Japanese, which materialized in the form of Japan's renewed assertiveness in late 1998.

The economic problems in the region continued into the early months of 1998 despite the efforts by creditor governments, their financial sectors, and the IFIs to stabilize the financial crises suffered by various Asian countries. Korea suffered from a significant illiquidity problem due to the country's massive short-term debt, until its government finally reached an agreement with a group of thirteen banks to extend the maturities of the short-term loans totaling $24 billion owed by the country's local banks.[34] The problems with Indonesia, however, were not so quickly or easily resolved. The tension between that country and the IMF emerged on January 6, 1998, as Indonesia's president, Suharto, announced the national budget for fiscal year 1998, which included a large public spending program against the budget austerity "medicine" given as a condition of the IMF loans. This led the currency to take a nosedive until a new agreement between the Indonesian government and the IMF was announced ten days later. This was but one of Indonesia's rebellious attempts against the IMF-led prescription to its economic crisis.

In February, economically damaged by the ever declining rupiah, Suharto revealed his interest in pursuing the idea of a "currency board," a foreign exchange pegging mechanism used by Argentina, Hong Kong, and others.[35] The plan was strongly criticized by the IMF and the United States as an infeasible scheme that would be detrimental to Indonesia's already depressed economy. There was also skepticism about Suharto's commitment to carry out the IMF-led reform, because the economic reforms Indonesia had agreed on under IMF loan conditions were not making progress. The IMF came to a decision on March 6 to suspend its second loan installments of $3 billion. Along with the IMF loan suspension, loans from the World Bank and other bilateral donors, such as Japan, were also frozen. Soon after, Suharto was forced to give up his pursuit of a currency board.

With the aim of persuading Suharto (who was reelected as Indonesia's president for the seventh time on March 10, 1998) to cooperate with the IMF, special envoys and top officials from both the United States and Japan flew to Jakarta during the first weeks of March. During these missions, both the United States and Japan urged Indonesia to stick to the IMF reforms so that the country could restore market confidence for its currency. Nevertheless, the manner in which this message was conveyed varied between the two creditor governments. When U.S. special envoy Walter Mondale, a former vice president, visited Jakarta, his message was strong and clear that the United States would not support Indonesia if it continued resisting the IMF reforms. In

comparison, at the time of his meeting with Suharto on March 14, Japanese prime minister Hashimoto promised Indonesia additional food and financial aid amounting to several billion dollars if Suharto cooperated with the IMF and smoothly enacted necessary economic reforms.[36] It took another three months—until June 4—to settle Indonesia's private debt problem. Various meetings between the Indonesian government and major foreign creditor banks, which formed a bank steering committee, occurred between March and June, and they finally reached an agreement in Frankfurt, Germany to restructure $80 billion of Indonesia's foreign debt.[37] Meanwhile, Indonesia's economic problems led to the demise of its long-term president: Suharto was forced to step down on May 21, naming as his successor his former vice president, B. J. Habibie.[38]

During the first half of 1998, criticism against Japan's lack of leadership in the resolution of the Asian crisis mounted both in Japan and abroad, coming especially from the United States.[39] At the meeting of G-7 finance ministers in London on February 21, 1998, the notion of the "threat of a weak Japan" *(Nihon-no fu-no kyoi)* was vigorously discussed. Foreign criticism focused on Japan's weak yen (which increased Japan's export competitiveness at the expense of the Asian exports) and its depressed economy (which further hindered Japan's imports from the Asian countries), both of which were allegedly derived from Tokyo's unwillingness to adequately stimulate its economy.[40]

The Japanese government struggled to defend its actions in helping the Asian countries, and it insisted that it was doing the best it could to assist these countries' economic recovery. It also sought to construct a solid consensus among creditor governments and IFIs toward an increased commitment to resolve the Asian crises. The Japanese government emphasized several aspects of past and future Japanese contributions to the resolution of the Asian crisis, and it increased its public relations campaign in its defense. Obviously, the first and foremost of the Japanese government's arguments was the sizable amount of money that Japan contributed to the financial rescue packages of the three Asian countries (Thailand, Indonesia, and Korea). Japan, until then, contributed a total of $19 billion in financial commitments for these emergency loans, while the United States, the second largest contributor, committed less than half of that—$8 billion in total.

At the G-7 meeting, the Japanese government demonstrated its active support of the Asian countries by responding to calls for extensive trade insurance and export credit to stabilize these economies. Two days before the G-7 London meeting, the Japanese government decided on its plan to help stabilize Asian economies by implementing economic policies. These measures included (a) more flexible use of Japan's Fiscal Investment and Loan Program to augment the pool of JEXIM untied loans by ¥30 billion ($2.5 billion) dur-

ing Japan's fiscal year 1997 (i.e., before March 1998); (b) easier access to JEXIM Bank's trade finance for the Japanese companies operating in Asian countries, particularly in Indonesia; and (c) provisions of at least $3 billion in trade insurance in fiscal year 1997. Increased technical cooperation and support to Southeast Asian students studying in Japan were also included in the support plan.[41]

Furthermore, the Japanese government included in the country's own fiscal stimulus package of $128 billion announced on April 24, 1998, about ¥700 billion ($5.8 billion) as part of a financial support plan for Asia. A special fund was again set up at the JEXIM Bank for fiscal year 1998, amounting to ¥650 billion ($5.4 billion), mostly to support Japanese companies operating in these Asian countries. In addition, increased policy-based yen loans are expected to be used to financially assist Asian countries that suffered a dramatic depreciation of their currencies of over 30 percent.[42]

Finally, and along with these financial measures to boost Japan's support to crisis countries, the MOFA published in April 1998 a report in English entitled "Misperception and Truth about the Economies of Asia and Japan," which emphasized Japan's contribution to Asia and defended Japan's position in Asian financial crisis management.[43] Despite efforts by the Japanese government, international criticism continued. Then, in June, concerns for the very weak yen (and for the possibility that, as a result, the Chinese government might devalue its currency) invited the United States to intervene in the foreign exchange market, jointly with Japan, in support of the Japanese yen.

Although the Japanese government was constantly put in the place where it had to defend its inaction, the Japanese government did not seem to have completely relinquished its desire to take a leading and independent role in the Asian crisis, even during this second phase. Many Japanese policymakers and analysts became forceful critics of the IMF conditionality imposed on the Asian countries in crisis.[44] They also denounced the failure of the Japanese government (particularly of the MOF) to establish what they considered a more appropriate framework for crisis management and economic recovery in the region.[45]

The U.S. administration, however, was concerned about the slow progress in containing the Asian crisis and its possible contagion of major Latin American economies, such as Brazil. Constrained by congressional checks on the use of taxpayers' money in bailout packages, the United States pressed Japan and other Asian countries to step up their efforts to contain the crisis, particularly through increased financial commitment. But it seemed quite obvious, especially after the AMF debate, that the United States was not willing to concede its ultimate power over the modality of Asian crisis management in exchange for financial contributions from Japan or other Asian countries.

Reemergence of Japan's Initiatives: The New Miyazawa Initiative and Beyond (Phase 3)

The third phase of Japan's involvement in the Asian crisis management, from the latter half of 1998 into 1999, reflects the undercurrents of the post-AMF controversy and Japan's frustration over repeated criticisms, mostly from the U.S. government, that Japan was not doing enough to help its Asian neighbors. In addition, as the hands of the IMF and the United States became tied by major financial crises taking place in Russia and Brazil in the fall of 1998, the Japanese government devised active policies in economic crisis management in Asia. These policies, during the third phase, constituted Japan's independent initiative in the region, albeit with coordination and consultation with the United States. The most prominent sign of Japan's move in this direction was the $30 billion in funds that the New Miyazawa Initiative targeted to six East and Southeast Asian countries, as announced at the World Bank/IMF annual meeting in Washington, D.C. in October 1998. Furthermore, various additional financial commitments aiming to support the Asian economic recovery were announced from 1998 through 1999.

In the months after July 1998, a sense of worldwide financial crisis became dramatically heightened. The Russian crisis came partly as the Asian crisis contagion threatened to make investors flee emerging markets all together, making it difficult for the Russians to attract foreign capital.[46] The crisis also stemmed from the many difficulties Russia has had in transforming its economy to capitalism, including the country's huge budget deficit and political problems. By May 1998, signs of Asian contagion were visible in Russia as it became impossible to attract external capital or even stop the capital outflow with exceptionally high interest rates, which soared as high as 150 percent. In efforts to contain this economic fallout, Russian president Boris Yeltsin signed an austerity package to stabilize the budget and cut spending at the end of the month. Foreign investors demanded a much stronger "shot in the arm" for the Russian economy through the IMF stabilization package. The IMF and Russia had already agreed to a loan package of $9.6 billion in March 1996, and $670 million of this package was to be disbursed, but it was not enough to calm the market. After repeated negotiations with the IMF in June, and with political support from the Clinton administration, Russia managed to secure an additional $17.1 billion from the IMF, the World Bank, and the Japanese government, $12.6 billion of which would be delivered during 1998.[47] Even international efforts like this did not manage to restore foreign investors' confidence in the country, and Russia was forced to devalue its currency, the ruble, and partially default on its external debt in August. The country's economic crisis continued into 1999.[48]

In addition to the Russian economic disaster, Brazil, another relatively large economy, experienced financial turmoil before and after its presidential election in October. In response to this crisis, U.S. Treasury secretary Robert Rubin noted: "Brazil is very important to the economic well-being of the region, the United States and the international community, and all of us are very much focused on seeing how we can be helpful."[49] Offering financial assistance to Brazil before its economic problem got out of hand—a so-called precautionary aid approach proposed by the United States—was touted as a new strategy to cope with instability in the world economy. The Brazilian government, the IMF, and other supporting governments came to an agreement on November 13, and announced a package of $41.5 billion to stabilize the country's economy. The IMF would contribute $18 billion (600 percent of Brazil's IMF quota), the United States promised $5 billion from its ESF, and Japan pledged $1.45 billion.[50] On January 13, 1999, "the gamble over Brazil" seemed to have failed as the country abandoned its currency peg and devalued its real, triggering further capital outflow and a decline in its stock market.[51] The Brazilian economic problem emerged, and it became obvious that the Brazilian government could not execute the fiscal discipline it promised as a condition for the IMF loan package.[52]

As the economic troubles of these relatively large economies and continuing concern about the more-than-yearlong Asian economic crisis pulled the U.S. stock market down in the summer months of 1998, concerns over a possible global depression emerged among policymakers. When Japan's new prime minister, Keizo Obuchi, met with U.S. president Clinton in New York on September 22, they reportedly agreed on an arrangement by which "Japan would draw up a blueprint of Asia's economic reconstruction."[53] The Japanese media interpreted this agreement as an indication of an emerging regional division of labor between Japan and the United States for rescue and reconstruction efforts to support the emerging market countries in economic distress. It was partly because the U.S. government and the IMF needed the Japanese government to take up more of the cost of Asian crisis management as they faced challenges from other parts of the world.

The Japanese government's willingness to support the Asian economies following the Obuchi-Clinton meeting was manifested in the New Miyazawa Initiative (formally called "A New Initiative to Overcome the Asian Currency Crisis"). On September 30, 1998, Japan's finance minister Kiichi Miyazawa (who was also the advocate of the 1988 Miyazawa Plan for the resolution of the Latin American debt crisis) unveiled a package of $30 billion consisting of medium- and long-term financial support ($15 billion) and short-term trade finance and currency swap arrangements ($15 billion). The fund aimed to aid six troubled Asian nations (Thailand, Indonesia, Malaysia, the Philippines,

Singapore, and Korea).[54] Like the AMF idea rejected a year earlier, the initiative aimed to protect Asian countries against speculative attacks and to provide financing for their long-term structural reform. The New Miyazawa Initiative was formally announced at World Bank/IMF annual meeting in Washington, D.C. three days later, and the G-7 finance ministers continued to discuss mechanisms to cope with existing and future international financial instability.[55] The entities that opposed the earlier Japanese AMF proposal—the U.S. government, the IMF, and the World Bank in particular—welcomed the initiative, partly because the announcement came at an opportune time when these entities were overwhelmed by Russia and Brazil, and partly because the Japanese government maneuvered carefully this time to earn solid support on the proposal before its announcement.[56]

While uncertainty lingered, the Japanese government's active financial engagement in the resolution of the Asian crisis continued, under some coordination with the United States, during the annual APEC summit held in Malaysia on November 14–18, 1998. During the summit, Washington and Tokyo announced a joint debt restructuring and refinancing initiative (the so-called Asia Growth and Recovery Initiative [AGRI]) that would provide an additional $10 billion to the Asian economies.[57] Furthermore, Japan's strong gestures continued as Prime Minister Obuchi announced at the ASEAN summit in Hanoi on December 16, 1998, the establishment of a special framework for yen loans, involving ¥600 billion ($5 billion), for Asia during the next three years. This fund was set up to incorporate part of the loans planned under the New Miyazawa Initiative, to support efforts both to internationalize the use of yen and to promote human capital development in the Asian countries.[58] Prime Minister Obuchi also pledged $20 million for establishing a Japan-ASEAN "solidarity fund." In the end of January 1999, the Japanese government announced the expansion of the amount committed to the New Miyazawa Initiative to accommodate the yen credit worth $2.4 billion and untied JEXIM loans requested by Indonesia. As the funds for the plan dried up in May of that year, the Japanese government announced its bond guarantee program of ¥2 trillion ($16 billion)—in addition to the New Miyazawa Initiative funds—through the Japan Bank for International Cooperation (JBIC), to support Asian governments issuing yen-denominated bonds.[59]

The Japanese government's financial support initiatives to the Asian countries during this phase and through the response of the Asian governments reveal that the core ideas of the AMF died hard. Occasional comments from the Asian leaders advocating a revival of the AMF by Japan circulated, and many inside and outside of Japan considered the New Miyazawa Initiative a watered-down version of the AMF, without a multilateral/regional institutional framework.[60] As of the end of 2000, two indications of alternative

(or supplementary) mechanisms to the IMF-led solution to financial crisis were emerging in Asia, slowly and cautiously. The first was the establishment of the Asian Currency Crisis Support Facility set up within the ADB in March 1999, with $3 billion in funds from Japan, to provide credit guarantees in the case of financial emergencies.[61] The second and more recent move was the establishment by the members of the ASEAN+3 (the ten ASEAN member countries plus China, Korea, and Japan) of regional swap facilities that member countries could tap during financial crises. This scheme was discussed at the APEC symposium in July 1999, supported by Asian deputy ministers at the ASEAN meeting in Manila in November, and finally and officially announced at the annual ASEAN+3 meeting in Brunei on March 24, 2000. The announcement stirred up further controversy between the regionalists in Asia and the "Washington consensus advocates," despite the Asian leaders' emphasis that this facility would not compete with the IMF but supplement it.[62] At the ASEAN+3 meeting in Thailand in May, the scheme was agreed upon in the form of expanded swap arrangement and repurchase agreement facilities among the participating countries. The agreement is currently called the Chiang Mai Initiative.[63]

In sum, even though the Japanese government's financial commitment in alleviating the Asian crisis has consistently been high, with more than $80 billion in contributions pledged in the two years after the onset of the crisis, the Japanese government's initiatives in managing the Asian crisis were not consistent over time. In Phase 1 (summer 1997 through fall 1997), the Japanese government was an active and independent leader from the time of the Thai crisis through the announcement of the AMF. During Phase 2 (fall 1997 through summer 1998), it was passive but cooperative as the world faced financial crises in Indonesia and Korea, leaving the leadership role to the IMF and the United States. Then, in Phase 3 (fall 1998 through 1999–2000), the Japanese government regained its active position with cautious independence as it announced the New Miyazawa Initiative and stepped up its financial assistance to Asian countries in distress. The following sections of this chapter examine the causes of this variance in Japan's behavior via two hypotheses: the joint product nature of public goods and the role of transnational linkages.

Asian Crisis Management as a Joint Product

Japanese Interests in Asia

A quick restoration of financial stability and vigorous economic recovery in Asia in the aftermath of the crisis would undoubtedly have provided critical

private benefits to Japan. As I have already discussed, the Japanese government considers Asia a region of critical importance in terms of Japan's economic and political interests. Successful Asian crisis management represents private returns to Japan in addition to producing international public goods in the form of international financial stability (i.e., joint products). According to the first hypothesis outlined in chapter 1, this should create a perfect condition for the Japanese government to become actively involved in crisis management, either with the United States or on its own. Thus, the Japanese government should have had strong incentives to be actively engaged in Asian crisis management and to do so consistently. The first phase of Japan's involvement in the Asian crisis management, for Thailand, supports this explanation. The Japanese government exhibited its initiative by putting together, along with the IMF, a financial rescue package for Thailand, and later Japan proposed regional mechanisms for responding to financial emergencies, even without the discernible involvement of the United States. Phase 3 also fits the picture. However, Japan's weaker initiative in the second phase as compared with the first and third phases is puzzling, particularly when we recall the growing perceptions of the Asian crisis as a major threat to the stability of global finance and to the world economy. What else shaped Japan's interests in Asian crisis management during this phase?

In contrast to the management cases of the series of Latin American financial crises, Japan's multidimensional interests in Asia make it difficult to clearly define what constituted private return for the Japanese government in the case of Asian crisis management. Disaggregating "Japan's interests" into at least two major components helps partially explain the changes in the Japanese government's attitudes during the different phases of Asian financial crisis management and its occasional ambivalence. The first factor is the desire and priority on the part of the Japanese government as it faced the opportunity to take a leadership role in the region when its own country was confronting the worst domestic economic crisis. The second factor involves the diverse interests of various private sectors in Japan in maintaining the profitability and stability of their business operations in the region.

The Japanese government has long striven to score high on the Asian "leadership" scale through its diplomatic support and foreign aid to the region, and its desire to pursue this private return was apparent in its support to Thailand and in its AMF proposal during the first phase. However, from late October to early November 1997, the Japanese government (particularly the bureaus of the MOF) was forced to give up ambitious regional leadership actions, because the country's domestic economy faced an eminent possibility of major financial turmoil. In early November 1997, two major financial institutions, Yamaichi Securities and Hokkaido Takushoku Bank, failed, causing

a large disruption in Japan's financial and real economy. As the domestic financial priority became urgent, the MOF had to suspend its financially burdensome fund idea, at least for awhile. Finally, Japan's active and independent initiatives were revived, including the announcement of the New Miyazawa Initiative in the latter half of 1998, as the Japanese government slowly emerged from the initial shock of the country's domestic financial crisis of 1997.[64]

The Japanese private sector, both finance and manufacturing, has maintained a high stake in procuring stability and prosperity in Asia. Confronting the Asian financial crisis, however, Japan's banking sector and manufacturing sector pursued different goals as management of Asia's financial crisis evolved. Japanese banks, already vulnerable because of their domestic bad loan problems, were highly exposed to these Asian countries in crisis in 1997 (see table 8.1), and they wished to exit from Asia as quickly and with as little harm done as possible. To achieve this goal, the Japanese banks needed the Japanese government to channel increased official funds to Asia, and they welcomed other measures to stop the financial run on these countries. The banks first applauded the Japanese government's active role in managing the Thai crisis and then quietly supported the government's initiative during the AMF debate (discussed later in this chapter). But the involvement of the United States and the IMF during the second phase, along with the transnational pressure from their counterpart banks in the United States and Europe (in dealing with Korea, in particular), made Japanese banks reluctant supporters of a multilateral solution. Even if the Japanese banks wished to act on their own to exit from Korea, strong institutional linkages among transnational banks would have made such a move impossible (as is discussed later in this chapter). Finally, with the crisis behind them, Japanese banks sought as much support as possible from the Japanese government as they rapidly exited from the Asian countries in 1998 and 1999. Their loan exposure to Asia decreased dramatically from 1997 to 1999 (see table 8.1). During this third phase, the dynamic between the Japanese banks and the government was similar to that of the later stage of the Latin American debt crisis. It paved the way for the Japanese financial sector to retreat from the region by contributing large official funding to Asia (see chap. 5).

Japan's manufacturing sector and trading companies maintained a long-term perspective on Asia as they faced the crisis. Although we observe a large decline in new FDI from Japan to the region in fiscal year 1998 (see table 8.2) due to the hardship the Asian economies were experiencing, the MITI's white paper on international trade indicates that the Japanese companies operating in Asia are there to stay.[65] Japan's manufacturing sector, in turn, hoped for restructuring of the Asian economies to suit their agenda when the Japanese

TABLE 8.1. Japan's Bank Claims in Asia, Year-End 1996 through Year-End 1999 (in millions of current dollars)

	1996		1997		1998		1999	
	(December)	Share (%)[a]	(December)	Share (%)[a]	(December)	Share (%)[a]	(December)	Share (%)[a]
All countries (excluding offshore)	169,999	17.1	163,435	14.6	127,533	11.8	102,813	9.2
Offshore banking centers	219,690	33.1	216,367	29.6	151,895	24.0	161,528	28.3
Asia[b]	264,847	34.7	249,666	31.7	154,065	27.8	122,407	25.4
Hong Kong	87,462	42.2	76,272	36.0	38,669	29.4	36,328	32.3
Singapore	58,809	31.1	58,649	30.1	29,474	23.6	21,029	21.4
Thailand	37,525	53.5	33,180	56.4	22,437	55.1	13,075	46.0
South Korea	24,324	24.3	20,278	21.5	16,925	25.9	12,592	20.8
Indonesia	22,035	39.7	22,018	37.7	16,402	36.6	12,491	30.7
People's Republic of China	17,792	32.3	19,589	31.0	15,115	26.0	11,789	25.3
Malaysia	8,210	36.9	8,551	31.1	6,623	31.8	6,029	33.3
Taiwan	2,683	12.0	3,516	13.4	2,143	10.2	2,652	13.2
Philippines	1,558	11.7	2,624	13.3	2,324	14.4	2,921	17.5

Source: Bank for International Settlements, *The Maturity, Sectoral, and Nationality Distribution of International Bank Lending.* The publication title changed in the November 1998 issue to *BIS Consolidated International Banking Statistics.*

[a] Share of Japan's bank claims to the country's total outstanding loans.

[b] Asia includes Hong Kong and Singapore, two countries categorized under offshore banking centers by the BIS.

government engaged in Asian crisis management. Rather than just bailing these economies out of the crisis through financial support, Japan's manufacturing sector wanted to use the situation to remove domestic obstacles to Japanese business operations in these countries, including corruption and traditional exclusion of foreigners (discussed later in this chapter). The Koreans, in particular, were quite disturbed as they sensed that the American and Japanese were taking advantage of the Korean crisis to pry open the country's economy and buy up its precious industrial base.[66] In addition, Japan's manufacturing sector, including the construction industry, urged the Japanese government to use its official fund exclusively for Japan, especially for the private sector, by "tying" the aid and by promoting infrastructure that would benefit these sectors.

The way in which the Japanese government has calculated its private return in managing the Asian financial crisis has been complex due to the strong, but not unified, interests that various Japanese actors have in Asia. The divergence of respective goals and of preferred methods regarding the crisis solution became most apparent during the second phase of the crisis, when (a) the Japanese government itself became immobilized due to the country's domestic financial crisis, (b) Japanese banks experienced high domestic and transnational pressure to cooperate with other international creditors, and (c) parts of the Japanese manufacturing sector sided with the Washington consensus to reform the economic environment of some of the Asian countries.

TABLE 8.2. Japan's Foreign Direct Investment in Asia, FY 1995–FY 1998 (in millions of current dollars)

	FY 1995	FY 1996	FY 1997	FY 1998	Accumulated by March 1999
Total	51,398	49,728	54,739	40,747	658,514
Asia	12,361	12,027	12,355	6,527	119,074
Indonesia	1,605	2,500	2,550	1,076	24,627
Hong Kong	1,147	1,540	705	601	17,821
People's Republic of China	4,478	2,600	2,015	1,065	18,798
Singapore	1,185	1,155	1,850	637	14,332
Thailand	1,240	1,453	1,894	1,371	13,093
Malaysia	575	592	803	514	8,821
South Korea	449	430	449	302	6,572
Taiwan	455	540	456	224	5,342
Philippines	718	579	531	379	5,004

Source: MOF, *Kokusai Kiyukyoku Nenpo.*

The U.S.-Japanese Relationship and the U.S. Presence in Crisis Management

The changes in U.S. presence during different phases of the Asian crisis are obviously a key to explaining shifts in Japanese behavior. The U.S. absence in the first phase and its presence and management initiatives, along with the IMF, during the second phase of the Asian crisis seem to have impacted the Japanese government's behavior. Analysis of the Latin American debt crisis in the 1980s (see chap. 5) suggests that the Japanese government might have been expected to step up its involvement in managing that crisis as the U.S. presence and the urgency of crisis management increased. In the Asian crisis, however, the increase in the U.S. presence from the first to the second phase deterred the Japanese government from taking a more active role in crisis management. As the IMF and the U.S. government became preoccupied with problems in Russia and Brazil during the third phase, Japan began to readdress the Asian crisis in an independent way that could have caused tension with the United States. The Japanese government was not solely reacting to U.S. demands but walked on a fine line between supporting the United States and emerging as the independent leader in Asia. Why did the Japanese government prefer a strategy that would make its attitude appear inconsistent and its leadership difficult?

To answer this question, it is important to examine the evolution of U.S.-Japanese relations in the 1990s, particularly in comparison to Japan's increasing involvement in Asia's regional economy. The intense economic interdependence and economic linkages between the United States and Japan, which created another important set of private returns, increased incentives for the Japanese government to cooperate closely with the United States during the Latin American debt crisis (see chap. 5). Some changes in the U.S.-Japanese economic relationship became noticeable, however, beginning in the early 1990s, due to the U.S. economic recovery and the reversal of the economic power balance between the United States and Japan. The U.S. economic recovery and the solution of its savings and loan problems in the early 1990s created a major economic boost for the country, and the U.S. economy entered the longest peacetime expansion in its history (see figs. 2.6 and 2.7). Despite some glitches, such as the summer of 1998 (the period of "correction in the market," according to investors), the U.S. stock market has continued to post record highs into the year 2000.[67]

The changes in the relative economic conditions between the two countries were first manifested in a gradual lowering of tensions in bilateral trade relations between the United States and Japan throughout the first half of the

1990s. Japan's large trade surplus vis-à-vis the United States increased the Japanese government's political sensitivity to U.S. demands in the 1980s (see chaps. 2 and 5), and this trade imbalance continued into and throughout the 1990s (see fig. 2.9). However, as the United States gradually recovered from its recession and its economy continued to boom, the Japanese share of the U.S. deficit decreased drastically from 69 percent in 1992 to approximately 30 percent in the mid-1990s. This was partly a result of greater U.S. trade diversification (see fig. 2.10 and table 8.3).

The weight and importance of U.S. trade with Japan decreased from the mid-1990s because of the booming U.S. economy (see table 8.3), and bilateral trade tensions between the United States and Japan became less of a political battlefield between the two countries. Some occasional and conspicuous bilateral disputes between the two countries occurred during this period, particularly in the areas of auto parts and dealerships (1995), photographic film (1996–97), steel, rice, forests, and fisheries (1998). Nevertheless, U.S.-Japanese trade issues began to take a backseat as Japanese economic problems worsened in 1997.[68]

The trading of economic places between the United States and Japan also affected the Japanese financial sector. As the Japanese banks faced severe domestic economic conditions and the worsening condition of their books, the capital flow trend from Japan into the United States in the 1990s reversed. Japanese bank money slowly retreated from the United States (see table 8.4), despite the fact that the Japanese private sector still had a higher accumulated direct investment in the United States than anywhere else in the world.[69]

Such factors as declining profits and the volatility of yen-dollar exchange rates have contributed to the Japanese financial sector's retreat from the United States. In addition, the BIS capital standard rules for asset positions of commercial banks operating abroad forced the Japanese financial sector to be more conservative and thus more reluctant to extend loans abroad.[70] Japanese banks, which agreed to comply with the BIS rules by March 1993, were under pressure to reduce their lending. Declining levels of capital, due to very low prices of shares and the bad loans banks had accumulated during the previous decade, made the BIS rules a high hurdle to clear.[71] The trend of decreasing Japanese financial presence in the United States was exacerbated by the Daiwa Bank incident. In 1995, Daiwa Bank became ineligible to operate in the United States after its bank manager was found to have hidden $1.1 billion of the banks' U.S. operational losses from unauthorized bond trading. It also turned out that Japan's MOF failed to inform U.S. financial regulators of the incident for forty days. Finally, during the Asian crisis and as the collapse of two major financial institutions in Japan was announced in November 1997, Japanese banks began suffering from higher "Japan Premium" on their loans

TABLE 8.3. Changes in US Total Trade with Different Regions, 1991–1997 (in billions of current US dollars)

Regions	1991		1992		1993		1994		1995		1996		1997	
Industrial countries	556.9	59.8%	580.5	58.1%	617.6	56.4%	686.6	57.1%	763.0	56.4%	794.9	55.2%	858.6	54.1%
Japan	143.1	15.4%	147.3	14.7%	158.4	14.5%	176.0	14.6%	191.5	14.2%	185.5	12.9%	189.9	12.0%
Africa	21.0	2.3%	21.5	2.2%	21.6	2.0%	20.9	1.7%	22.5	1.7%	26.1	1.8%	28.0	1.8%
Asia	176.2	18.9%	200.2	20.0%	246.3	22.5%	256.0	21.3%	305.8	22.6%	319.6	22.2%	348.1	21.9%
Developing Europe	11.7	1.3%	12.6	1.3%	15.8	1.4%	17.3	1.4%	19.6	1.4%	21.0	1.5%	24.1	1.5%
Middle East	35.5	3.8%	37.2	3.7%	36.8	3.4%	36.3	3.0%	38.4	2.8%	43.0	3.0%	47.3	3.0%
Western Hemisphere	129.3	13.9%	147.6	14.8%	156.3	14.3%	184.4	15.3%	203.4	15.0%	235.6	16.4%	278.7	17.6%
Total	930.6	100.0%	999.6	100.0%	1094.4	100.0%	1201.5	100.0%	1352.7	100.0%	1440.2	100.0%	1584.8	100.0%

Source: IMF, *Direction of Trade Statistics Yearbook.*
Note: Because of rounding, percentages do not always add up to 100.

(i.e., high interest rates were imposed on international borrowing by the Japanese financial sector), making it difficult for them to access dollar loans.

While the business activities of Japan's financial sector in the United States were declining, Japanese economic interests in the Asian region continued to increase (as I discussed earlier) up until the crisis. Thus, protecting Japan's vested interests in the U.S. economy directly and indirectly was no longer the only imperative for Japan's financial sector, nor was it the overriding concern of the Japanese government. The economic linkages that had tied the Japanese financial sector to the U.S. economy and to the fortune of the U.S. dollar so closely in the 1980s lost their dominant position of importance in the 1990s. The outbreak of the Asian crisis, particularly in light of its spread to Hong Kong, Indonesia, and Korea, raised major concerns among U.S. economic policymakers at the end of 1997, and it detrimentally affected the U.S. trade balance with the region. The U.S. trade deficit grew with an increase in imports from these countries coupled with a drastic decrease in U.S. exports to the region. Nevertheless, catastrophic economic repercussions did not reach the United States. The yen-dollar exchange rate, which Japanese policymakers frequently worry about, shifted temporarily in favor of a strong dollar and a weak yen under the crisis (see fig. 2.13). In short, Japan was affected much more severely by the Asian crisis than was the United States, and Japan's economy has become much weaker.[72] Since a large portion of Japan's manufacturing sector welcomed a weak yen, the shift in the exchange rate removed an-

TABLE 8.4. Changes in Japan's Financial Asset Position in the United States by Investment Category, 1980–1995 (in millions of current US dollars)

Year	Direct Investment	Security Investment	Trade Credits	Loans	Others	Total
1980	729	–3,001	–15	409	224	–1,654
1985	2,043	29,874	587	716	–57	33,163
1986	7,774	55,944	334	690	908	65,650
1987	9,018	48,223	489	1,663	1,637	61,030
1988	19,568	33,320	1,024	2,830	2,518	59,260
1989	22,768	22,074	1,255	4,761	3,003	53,861
1990	24,986	–19,849	633	2,783	3,166	11,719
1991	15,302	–1,045	–314	2,569	1,846	18,358
1992	8,914	8,490	–322	4,838	922	22,842
1993	6,755	21,957	–364	5,676	–143	33,881
1994	6,193	15,097	–308	2,006	348	23,336
1995	8,192	15,863	–771	–340	1,703	24,647

Source: Bank of Japan, International Department, *Balance of Payments Monthly,* various April issues; Kawai 1995, 96–98.

Note: Due to changes in the statistical compilation from the year, no comparable data are available from 1996.

other motive for the Japanese government to intervene in the crisis in support of the United States and its stronger dollar.

Such factors as decreased trade tensions, Japan's increased economic interests in Asia relative to the United States, and the reversed economic positions between the two countries were of course already present at the time of the 1994–95 Mexican currency crisis. These factors certainly contributed to discouraging Japan from actively collaborating with the United States in managing that situation. The decline of the Japanese financial sector's interests in the U.S. economy became even more prominent in 1997, when several Japanese banks failed and the real magnitude of their bad loan problems were revealed.

In sum, the economic tension between the United States and Japan that had enhanced Japan's willingness to collaborate closely with the United States in the 1980s evolved into something more complex in the 1990s, particularly in the face of the Asian financial crisis. The types of private returns accrued by Japan from engaging in crisis management, which used to converge toward an active engagement in and collaboration with the United States in the 1980s, become more diffuse in the 1990s. Both the regional shift of the crisis from Latin America to Asia and changes in U.S.-Japanese economic relations contributed to Japan's independent actions in the first and third phases of the Asian financial crisis management. In particular, the tension between Japan's regional interests in Asia and its economic interests in the United States seems to have caused the Japanese government to become ambivalent regarding the issue of collective management of the Asian crisis.

The Case of the AMF Scheme

The Japanese government's multiple private returns that produced a joint product from its management of the Asian financial crisis explain the curious way in which the AMF idea emerged in the summer of 1997 and then retreated by late fall. The Japanese government's expected private returns came from (a) its own economic and political interests in Asia, (b) its positive relationship with Japan's private sector, and (c) its positive relations with the United States. In addition, the relative weakness of transnational linkages among international financiers, particularly in the earliest phase of the Asian financial crisis, prevented the formation of a strong position among transnational banks.

First, the AMF idea appears to have been partially a construction of the MOF. It was specially formulated in the MOF's International Finance Bureau, with strong support from some Asian countries. China notably opposed it. One MOF official explained four major reasons for the emergence of the AMF around the time of the Thai crisis:

1. Concerns about the possibilities of contagion.
2. Awareness that there were limited money sources available outside of Asia.
3. Awareness that there was limited access to the IMF funds, particularly for Asian countries, due to their small IMF quotas.
4. Difficulty of some countries, like Australia, to justify case-by-case bilateral support of rescue packages in domestic political arenas, thus creating the need for an established regional fund for this purpose.[73]

In addition, the MOF took into consideration the interests and needs of Japan's private sector in its planning process, even though there was only limited consultation with Japan's financial sector (mostly "information exchange" *[joho kokan]*) and no vigorous input of ideas from it.[74] Of course, behind the official AMF initiative was a strong desire by the Japanese government to take a leadership role in Asia, particularly in the economic sphere.[75]

Second, Japan's private sector actors' ambivalent positions on the AMF during the first phase contributed to the uncoordinated way that the AMF idea emerged, as presented by Japan's finance minister in September 1997 in Hong Kong. Many Japanese bankers with high exposure to the Asian economies in trouble quietly welcomed the idea, hoping that the Japanese government would use such a fund to help them withdraw from Thailand and possibly from other financially troubled countries in Asia without accruing significant loan losses.[76] However, such support was rarely stated publicly. In contrast, many Japanese businessmen, particularly from the manufacturing and exporting sectors, demonstrated their doubts about the AMF. They were aware that it would be dangerous to provide easy money in the name of an Asian rescue that could undermine the reforms and adjustments usually demanded by the stringent conditionality of the IMF. They were also aware that support of the AMF might result in the loss of opportunities for further liberalization of the Asian markets.[77] Even in Japan's financial sector, those supporting the solutions through the IMF argued against the AMF because "such a fund as the financial last resort creates a psychology of dependence."[78]

Finally, the dynamics between the Japanese government and the major creditor governments of the United States and Europe seem to have impacted the fate of the AMF. As the AMF scheme was officially announced in late September, the reaction from IMF supporters in the United States and Europe and from the IMF itself was negative and skeptical. It was clear that the U.S. gov-

ernment and the IMF did not want to relinquish their powers to push the Washington consensus via the only international financial institution that could assist balance-of-payments problems. Western European countries, in addition, were concerned about the major moral hazard problem that such an arrangement could incur. They all were also worried about constructing a divided authority in international monetary matters, which would diminish the consistency and effectiveness of the IMF programs implemented in borrower countries, and which could also invite increased risk of moral hazard problems among the private lenders.[79] IMF deputy managing director Stanley Fischer criticized the proposal, stating that it could undermine the authority and effectiveness of the IMF itself. In addition, congressional constraints faced by the Clinton administration in allocating large funds to a new financial organization made the U.S. critical of the idea of a new fund, which, without active U.S. contributions, would threaten U.S. influence in Asia.[80]

This incoherence and opposition led to the "defeat" of the AMF in November 1997. Instead, the IMF-led solution to the Asian crisis emerged as the Manila Framework, preserving some components of the AMF idea.[81] Nevertheless, the idea of a regional fund did not die, and it has subsequently been revived both through the ADB and in the ASEAN+3 forum (discussed earlier in this chapter). There are indications that the Japanese government started to revive strong initiatives to resolve the Asian financial crisis—for example, through its announcement of the New Miyazawa Initiative. Unlike the case of the AMF debate, however, Japan's renewed initiative took a form that did not conflict directly with the creditor coalition or the United States—a mostly financial facility without establishing a new institution. Besides making financial contributions, Finance Minister Miyazawa has engaged himself in a debate on appropriate financial crisis solutions as part of a "new international financial architecture" discussion in international forums, such as the G-7 finance minister's meetings and APEC meetings.[82]

In sum, the independent initiative by the Japanese government in proposing the AMF emerged from the desire by the Japanese government (particularly the International Finance Bureau of the MOF, in this case) to show leadership in Asia at a time of apparent U.S. reluctance. But the Japanese government could not sustain this independent initiative, because of the fragmented position of the Japanese private sector on the issue and because of opposition from the Washington consensus. Meanwhile, tension between Japan's interests in Asia versus its interests in the United States remains and has led the Japanese government to resent the creditor coalition based on the Washington consensus, which was highly critical of Japan's contribution (or alleged lack thereof) and its failure to bolster the Asian countries' economic recovery. At the same time, the IMF-led reforms of the economies of the region seem to

have taken the opportunity of the Asian crisis, forcing the countries to restructure their economies.[83]

Institutional Linkages and Domestic Dynamics

Financial Actors in the Asian Crisis

The composition of capital flows to middle-income (or emerging market) countries changed between the 1970s–1980s and the 1990s. A prominent feature of the first Latin American debt crisis was the important role of commercial bank lending, particularly syndicated loans. The amount of these loans shrank in the 1990s, when other portfolio flows (bond purchase, equity investments) became the major financing instruments, particularly for Latin America (see table 6.1). I have argued in chapter 6 that this shift in the 1990s led to the changes in the cast of financial players, reducing the strength of transnational linkages among financial institutions, and weakening their power to induce collective action among creditor governments in financial crisis management.

The change in the composition of capital inflows to emerging market countries was not as marked in Asia as in Latin America. A comparison of the foreign capital inflow composition between Asia and Latin America in the 1990s reflects Asian countries' propensity for direct debt (see figs. 8.1a and 8.1b). This contrast arises partly from the fact that, unlike most of the Latin American countries, many Asian countries did not experience severe debt crises in the 1980s and thus had not suffered a major withdrawal of commercial banks and their loans from the region. The contrast is also partly due to the fact that many Asian economies have always depended more on debt financing (bank loans) than on financing from the market (securitized debt), making Asian firms much more reliant on bank lending than on stock or bond markets.[84]

Dominant participation of commercial banks tends to increase linkage, as was seen in the Latin American debt crisis, and thus it should increase the positive motivation toward collective action among creditor governments, particularly between Japan and the United States (see chaps. 1 and 5).[85] Indeed, one can observe examples of such institutional linkage in the management of the 1997–98 Asian financial crisis: in particular, the establishment of bank steering committees among international banks with outstanding loans to Indonesia and Korea during the first half of 1998, which enabled banks to deal collectively with these countries (see discussion earlier and later in this chapter).

The level of transnational institutional linkage among commercial banks provides one important element necessary to understanding the changes in

the nature of collective action between the Japanese government and the United States during the Asian crisis. Of the three phases outlined earlier in this chapter, the second phase, when creditor governments and the IFIs were faced with the financial crisis management of Indonesia and Korea, was the period when Japan showed the closest collaboration with U.S.-led financial crisis management. It does not appear to be a coincidence that during this phase, the creditor governments were dealing with the countries where a fairly tight institutional linkage existed among commercial bank creditors.[86]

This correlation is particularly interesting when the second phase is contrasted with the first instance of Asian financial crisis management—the Thai crisis—during which such close collaboration among transnational banks was not a prominent feature of the financial solution. As is shown in figure 8.2, Thailand accrued a disproportionately large debt to Japanese banks at the time of the crisis, while Indonesia and particularly Korea accrued foreign debts from banks in a wider range of major industrial countries.

Because of the wider range of lender country involvement, more creditor countries were interested in resolving the crises in Indonesia and Korea than in Thailand. Concomitantly, the institutional linkage and transmission of pressures on creditor governments to engage in collective action to stabilize the market was much stronger in these two countries. In some ways, the Thai crisis appeared to both private lenders in the United States and Europe and their creditor governments as a problem for the Japanese to solve, a situation that draws an ironic parallel to the case of Mexico and the United States in 1994–95 (see chap. 6). These circumstances enabled the Japanese government to take an independent stance because of the lack of intervention by other creditor governments except for the IMF, whose intervention, according to Japan's official perspectives, was absolutely necessary to stabilize the situation.[87]

Japan's Domestic Politics

An aspect of crisis management involvement that relates closely to the institutional linkages among financial institutions and loosely with my earlier discussion of the Japanese government's private returns is the level of political influence that various financial institutions can place on the Japanese government's foreign policy formulation at the time of crisis (and, occasionally, that the government can place on financial institutions). The level of such influence is derived from two factors: (1) how effectively the Japanese financial sector manages to transmit its demands, in accordance to its counterpart abroad, to its home government; and (2) how responsive the Japanese government is to these private institutions. These influences are always transmitted through Japan's domestic political process, and if both factors are high, they should af-

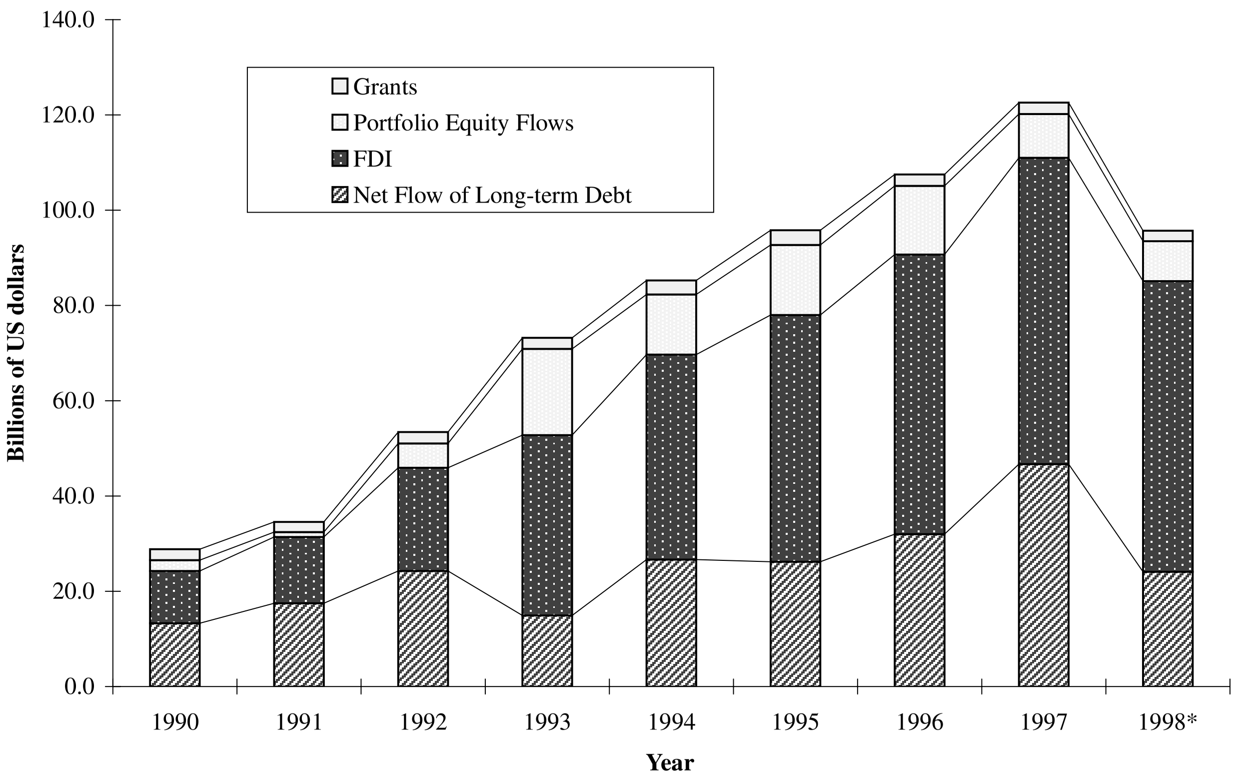

Fig. 8.1a. The composition of foreign capital inflows into Asia, 1990–98. (From World Bank, *World Debt Tables,* 1990–94, and *Global Development Finance,* 1995–98. *World Bank staff estimate for 1998.)

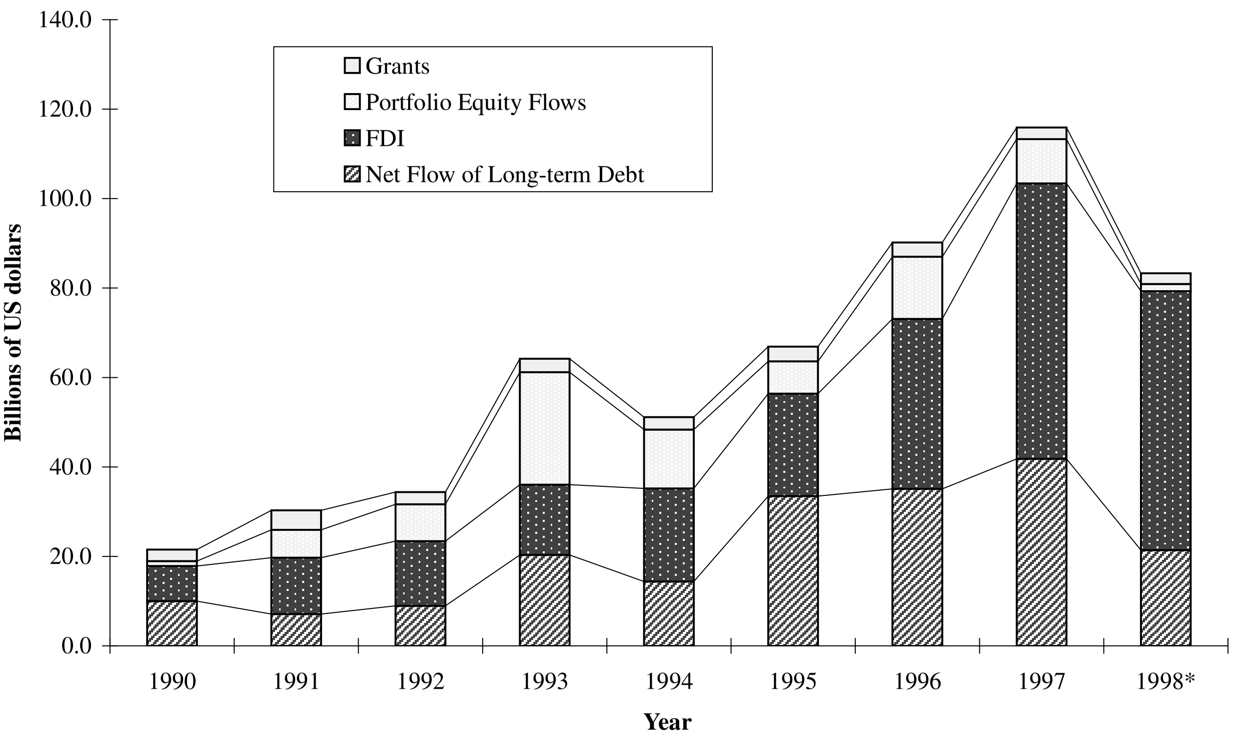

Fig. 8.1b. The composition of foreign capital inflows into Latin America, 1990–98. (From World Bank, *World Debt Tables,* 1990–94, and *Global Development Finance,* 1995–98. *World Bank staff estimate for 1998.)

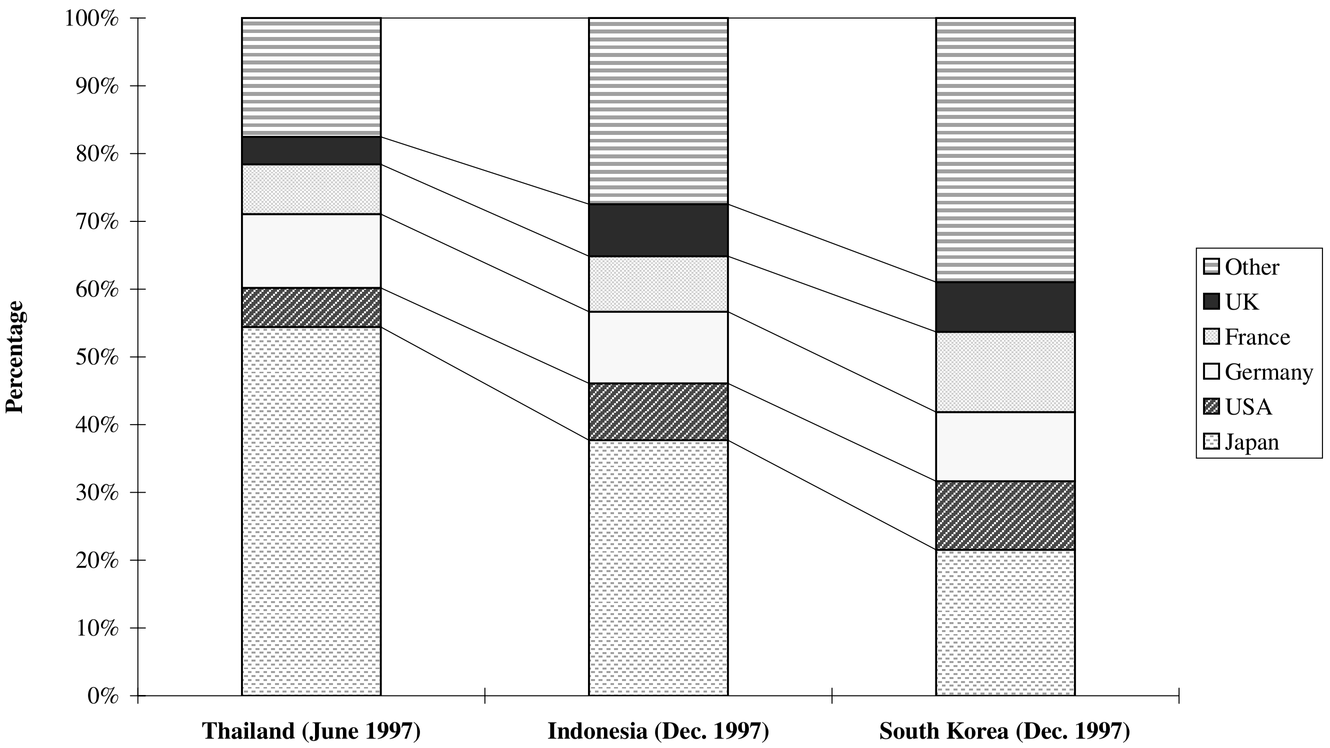

Fig. 8.2. Country origin of bank debt in Thailand, Indonesia, and South Korea in 1997. (From Bank for International Settlements, *The Maturity Distribution of International Bank Lending*, table 2.)

fect the Japanese government's behavior and involvement in Asian crisis management. The changing dynamics between Japan's financial sector and its ministry in charge, the MOF, in the 1990s, thus became a critical component.

Japan's financial sector and Japan's arguably most powerful ministry, the MOF, maintained a very close and symbiotic relationship throughout Japan's post–World War II economic recovery and into the 1980s. Many times, Japanese banks had been urged to make loans that served Japan's foreign policy purposes, and in return the MOF provided an implicit guarantee for Japanese banks against bankruptcy. This close relationship led the Japanese government to actively support Japanese banks during the Latin American debt crisis, as is supported quantitatively in chapter 3 and qualitatively in chapter 5. This so-called convoy approach *(goso sendan hoshiki)* under the MOF's careful protection of the Japanese financial sector, along with the close collaboration between the two sectors, faced a major challenge in the 1990s due to several changes taking place in Japanese economics and politics. These changes made it difficult for both the MOF and Japan's financial sector to transmit their usual influence or to exchange candid opinions and information during the Asian crisis, a factor that hindered the Japanese government from interpreting the banks' positions and desires accurately.

Some changes in the relationship between the MOF and Japan's financial sector have evolved gradually since the late 1970s. As I have already discussed, financial deregulation and the internationalization of the Japanese economy, particularly of its financial activities, tipped relative bargaining power in favor of Japan's financial sector (see chaps. 1 and 5). However, after the mid-1990s, the symbiotic relationship between the financial sector and the Japanese government (MOF) began to show signs of weakening. The early signs came slowly during the first few years of the 1990s. A collapse of the Tokyo Stock Exchange and of Japan's property market came soon after interventions by the MOF and the Bank of Japan in 1990 to deal with Japan's overheated economy. They raised discount rates and changed regulations to curb land speculation, interventions perceived to be failures.[88] To shed its tarnished reputation and revive the vigor of Japan's economy, the MOF intervened in Japan's stock market, financially assisted loans made in both corporate and household sectors, and changed regulatory and tax laws in favor of land purchased from 1993 through 1995.[89]

Thanks to this intervention, the MOF seemed to have regained its power by mid-1993. This recuperation was boosted particularly by the temporary demise of the LDP—the thirty-eight-year ally of the MOF that had also kept the MOF in check—as the party lost its majority status in the diet.[90] The powerful position of the MOF, however, did not last long. Various major scandals and mismanagement by the MOF shook Japan's financial circles between 1995 and 1998, and the trusted and close (and usually personal) linkages nurtured

between the MOF and Japan's financial institutions began to disconnect.[91] The MOF also began distancing itself by implying an end to the government's implicit guarantee of all banks. The MOF stated in 1995 that it would withdraw its guarantee of the security of all deposits after a five-year interval.[92]

The failure of two major financial institutions in Japan in November 1997 clearly led to a loss of mutual trust between the leading decision makers of the Japanese financial sector and the MOF and also to the loss of a close channel of communication between the two sets of actors. Furthermore, just when resolution of the Asian financial crisis became critical in early 1998, the financial sector lost its personal channels to the MOF as the ministry's corrupt relationship with banks and other financial institutions were revealed. Harsh public criticism of the collusion between the government and banks followed.[93] Public and media scrutiny inhibited Japan's financial circles from transmitting demands or even information to the Japanese government, making the Japanese position on the Asian financial crisis management less coherent.[94]

In addition to the loss of informal communication channels between the MOF and the banks, a mega–bank merger between the Bank of Tokyo and Mitsubishi Bank in April 1996 removed one of the established communication channels between the group of banks dealing with international financial issues and the MOF. As is noted in chapter 5 and discussed in detail by Stallings,[95] the role of the Bank of Tokyo had been critical in creating both a strong international channel with other transnational banks and a coordinated domestic pipeline to influence the Japanese government at the time of the 1980s debt crisis. The Bank of Tokyo was considered the bank with the strongest international outlook in Japan. It had fifty years of experience as a specialized foreign exchange bank, seventy offices overseas, and an average of 60 percent of its profits from international business. This bank merged with the "domestic" and dominant Mitsubishi Bank (with 70 percent of its total profits earned at home). The confusion at the time of this transition and the power dynamics within the new Bank of Tokyo-Mitsubishi removed some of the important functions previously performed by Bank of Tokyo managers and international experts.[96]

The Korean Crisis

Following the initial and possibly prematurely executed Japanese response during the first phase of the Asian crisis management, particularly represented by the first attempt at floating the AMF idea, the second phase included management of the Korean crisis. This represented a period of relatively strong collaboration, both among major creditor countries and between the Japanese government and its financial sector. The high level of collaboration during this

phase can be explained by the transnational pressure exerted by the United States and by the domestic dynamics between the Japanese government and its financial sector. Obviously, the magnitude and impact of the Korean crisis made a difference. As I noted earlier, Korea has a fairly large economy, and its decades of economic success had attracted investors. Hence, Korea's accrued debt from creditors was quite evenly distributed among many industrial countries (see fig. 8.2). In addition, the Korean crisis emerged after the U.S. government became seriously involved in Asian financial crisis management at the onset of the Indonesian crisis.

The response of Japan's financial sector to the Korean crisis revealed changes from the earlier crisis: Japan's financial sector was much more involved in the Korean crisis solution negotiated by the foreign banks in collaboration with the MOF. The pressure on Japanese banks apparently came both from the government and from transnational financial sector linkages. Japanese banks also had much to gain from successful collective management of the crisis, which enhanced their motivation to cooperate. The Japanese government, in turn, collaborated with the United States to support the actions of the private sector, thus strengthening collective action, though weakening its own independent initiatives.

Despite the large IMF rescue package, the Korean government had to approach international creditors again during the third week of December 1997 to inform them of the dire condition of Korean banks due to the massive exit of short-term capital, which had not halted. This led to actions by financial sectors from Japan, the United States, and Europe. Many of the Seoul-based foreign bankers, forty to fifty representatives from big international banks, began their own loan extension discussions for Korea in mid-December.[97] The deal was set, finally, on Christmas Day, and a formal agreement to roll over the country's $15 billion in outstanding loans, while the IMF released $2 billion in loans to the country, was finalized a few days later.[98]

The U.S. government was not unified. Actually U.S. Treasury secretary Robert Rubin was not in a hurry to rescue Korea in the middle of December, and he publicly noted that the economic problems of Korea would stabilize as soon as the Korean government faithfully implemented the IMF-reforms agreed on a few weeks earlier. Evidently, the security wing of the U.S. government (the State Department, the Department of Defense, and the national security advisor) was much more worried about the collapse of the Korean financial market and its negative implications for Korea's social and political conditions under the newly elected president, Kim Dae Jung. In particular, they were concerned that such instability would raise the risk of a major conflict between South and North Korea. Given this divided opinion on the Korean rescue, the strong lead taken by transnational banks with significant

stakes in Korea had an impact on America's Korean policy, making it imperative that the Treasury Department cooperate in the Korean rescue. Such a gesture by the private banks bearing some of the burdens of the rescue gave the U.S. administration a good incentive to become actively involved. The gesture thus deflected criticisms from U.S. taxpayers and from Congress, which had often opposed using U.S. money, on the ground that such an operation would only bail out rich bankers.[99]

This international coalition among actors in the private financial sector also had an impact on the way Japanese banks behaved toward the Korean financial crisis and on the Japanese government's willingness to follow the U.S. lead. Because of the business connection between Japanese banks and U.S. and European banks operating in Korea, transnational peer pressures on the Japanese banks in the case of the Korean rescue attempt were strong. In addition, the long-term interests of the Japanese banks in the stability and recovery of the Korean economy made it important for the Japanese banks to commit to the resolution of the country's financial crisis. Despite a major coordination problem among the banks, due to the "loss" of the Bank of Tokyo, ten major Japanese banks managed to commit to a united front, promising to maintain their current outstanding loan balance until the end of March 1998.[100]

A substantial part of the management of the Korean financial crisis was conducted through private sector channels in a way that paralleled the official rescues conducted by the IMF and by creditor governments. The coordinated position taken by the Japanese banks also came about with the help of the MOF and the Bank of Japan, which enhanced the incentives for banks to get actively involved in the crisis management and to avoid free-riding. In return for the Japanese banks' concessions on Korean loans, the MOF promised three things: (1) responsibility for increased debt would be absorbed by Japan's official sector, (2) the credibility of their performance in front of their shareholders would be supported by the MOF, and (3) there would be actions by G-7 countries to guarantee the recovery of extended outstanding loans.[101]

Furthermore, some Japanese banks were at that time suffering from the "Japan Premium," a condition that made the banks' access to U.S. dollars very expensive. This coincided with a period of a very weak yen in early December (see fig. 2.13). Thus, the banks were given temporary access to U.S. dollar deposits in the MOF's Foreign Exchange Fund Special Account *(gaikoku kawase shikin tokubetsu kaikei).* This measure aimed to relieve the pressure on major Japanese banks caused by insufficient U.S. dollars in their accounts. As the MOF granted such measures to Japanese banks, it hoped to prevent the banks from retrieving their dollar-based assets abroad, including assets from Asia, and to enable them to withstand issuing new loans or extending loan amortization periods to such countries as Korea.[102]

In short, strong institutional linkages enhanced Japan's involvement in Korean crisis management in collaboration with the U.S. actors during the second phase of the Asian crisis management. This dynamic closely resembles Japan's involvement in the Latin American debt crisis, where the coalition of transnational financial sectors bound the two creditor governments closer together toward collective action in crisis management. The difference between the two cases, however, comes from the change in the region, which altered Japan's independent and regional self-interests. The regional contrast is discussed further in this book's conclusion.

Summary

The 1997–98 Asian financial crisis has posed many challenges to the Japanese government. Despite the Japanese government's desire to show active, reliable, and consistent leadership in Asian crisis management, its behavior shifted over the course of two years, as the scope of the crisis and the IMF/U.S. policies to the region evolved. Japan's high stakes in the region arising from its close and historically important economic and political relationships have produced varied and sometimes conflicting private returns for the Japanese government. The Japanese government could not even induce a coherent position among Japan's private sector in relation to support on the AMF scheme, and thus any alternative to the IMF-led crisis solution led by Japan was slow in coming.

The changes in the level of U.S. presence in Asian financial crisis management were also influential on the Japanese government's behavior, although not in the determining way predicted by Japan's "reactive state" thesis (see chap. 1). Due to the structural power that the United States still disproportionately possesses in the world of finance, the alternative solution proposed by the Japanese government could not be sustained once the IMF and the United States (or Washington consensus actors) appeared on the scene during the second phase of crisis management. However, the central idea of the AMF—establishing a regional emergency fund—was never abandoned by the Japanese government or the governments of many Asian countries, and it reemerged in the third phase as the crises in Russia and Brazil took the focus of attention of the IMF and the U.S. government away from Asia.

Finally, institutional linkages seem to produce results in favor of transnational actors that can impose pressure across countries. The contrast between the Korean case and the Thai case has indicated that the interests of the transnational financial sector, especially commercial banks, swayed crisis management modality.