

# Chapter 6

## **Adrift or adroit** **Japan and the Asian Financial Crisis (1996-2000)**

In the late 1990s, Japan faced the same questions and problems that had pursued it from the end of the Second World War. It had yet to find itself a role in the region with which it and the region were comfortable. Unlike the previous decades, when Japan was perceived as a potential leader within a unilateral, bilateral or multilateral framework, there was a noticeable decline in these discussions, to the point where Japan was viewed as the antithesis of regional leadership. Much of the optimism that had followed Japan into the decade quickly dissipated as its much vaunted economy sunk into bouts of prolonged recession. As much of the commentary discussing Japan and its potential for leadership in the region remained based on its economic performance. Once this aspect tarnished, perceptions of its role suffered, especially in East Asia where the Japanese model existed as an example of successful economic development. Even the US lost interest in Japan and its regional role, being interested in its own economic resurgence and the rise of China. Although Japan was still being mentioned as an 'honest-broker' and 'global civilian power', Much of the discussion moved to Japan's much maligned domestic political and economic structure.

This perception of being lost was in part driven by domestic soul searching. During the 1990s, political leaders found it difficult to "articulate a vision of the Japanese future

that the public found compelling"<sup>1</sup> after the end of the politics of high speed growth.

Views such as that of Liberal Party leader Ichiro Ozawa's vision of Japan for a more 'normal' nation, found more favour amongst foreigners and elements of bureaucracy than with the public.

The idea of Japan as a 'great civilian power' failed to capture the imagination of a public that was nervous about abandoning its 'low posture' in foreign policy to seek 'greatness' again, with or without military power. The opposite notion, that Japan should be a 'small and sparkling' environmentally conscious, postindustrial state that rejected involvement in great-power politics also failed to generate much interest. Nor was there public enthusiasm for Japan finding its place in the sun as a leader in Asia and exponent of Asian values: the suggestion brought forth too many unhappy memories of Japan's earlier attempts to lead Asia.<sup>2</sup>

As mentioned in Chapter 5, this struggle for an international Japanese domestic and foreign policy identity was a continuing aspect of Japan's self-image. Debate on Japan's role was fundamentally changed and influenced in the late 1990s by the impact of the Asian Financial Crisis. During this period of systemic stress, it became clear that each country and region possessed their own self-interested version of what Japanese leadership should or could be. For the US, Japanese leadership consisted of following US regional and global political, economic and strategic interests. East Asian countries, meanwhile, desired Japanese economic and regional policies that fitted their national interests and were supportive of state-based economic development. When Japan strayed from either of these interests, Japan was criticised and pressured for failing its perceived leadership responsibilities.

The Asian Financial Crisis became the formative event of the late 1990s in the Asia Pacific. A wave of wide ranging implications and changes in regional political and economic dynamics were set in train by the devaluation of the Thai baht during July 1997. The crisis quickly spread across borders to 'infect' most of East Asia, with subsequent crises ensuing in Latin America, Russia, Eastern Europe and the US (through the collapse of the LTCM hedge fund). More than just a purely economic phenomenon, the Asian

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<sup>1</sup> G. Curtis, *The Logic of Japanese Politics*, p. 41.

<sup>2</sup> G. Curtis, *The Logic of Japanese Politics*, p. 41.

Crisis was a similar crisis to that in Japan – going to the heart of national identity and the fundamental demand for economic development. The crisis occurred at a time when the regional sense of identity and hubris based on rapid economic growth was at its height, a movement pithily identified as the 'Asian Values' debate.<sup>3</sup> With the practical and wider sense of Asian achievement being eroded, as the premier economy in the region, there were joint US and East Asian expectations of Japan to act as a regional leader.

As it had tried to do for the majority of the postwar period, Japanese foreign policy up to 2000 tried to manage the gap between US and East Asian interests. Both the US and East Asia expected Japan to act in either mitigating the severity or preventing the spread of financial contagion and the impact on trade and investment. However, as is argued throughout this thesis, both the US and East Asia saw Japan's role in the crisis as acting in a way that would assist, protect and further their interests. They both attacked Japan's slow and limited reaction to the crisis, criticising either its lack of activism or overreaction to the range of problems faced after 1997. An example of this no-win situation could be seen through the proposals for an Asian Monetary Fund (AMF) that most East Asian countries supported, which the US (with Europe and the IMF) successfully opposed it in November 1997. When Japan followed US views of its leadership responsibilities, both in dropping the AMF proposal and largely deferring to IMF policies, many in Southeast Asia were disappointed at the lack of support of their plight, which they argued was Japan's responsibility as a regional economic leader.

In an historical irony, the late 1990s found Japan in the weakest economic condition since the First Oil Shocks of the early 1970s; yet Japan was expected to act more dynamically than at any other time since the end of the Second World War. As a de-facto leader in terms of its capacity for action, Japan took much of the blame for not only the Asian Crisis, but also the end of this phase of the Asian economic miracle. With economic

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<sup>3</sup> See M. Berger, 'The Triumph of the East? The East Asian Miracle and post-Cold War capitalism', in M. Berger and D. Borer (eds.), *The Rise of East Asia: Critical Visions of the Pacific Century*, Routledge, London, 1997, pp. 260-287.

and political troubles at home and abroad, the region looked to Japan for answers. Yet the answers that the region sought were either beyond the limited political reach of Japan's consensus-based governance or the limited state of Japan's governmental finance after a decade of domestic deflation. Japanese diplomacy lacked the capacity to find compromises between Western and Eastern views of Japan's responsibilities. In a number of instances like the AMF, Japan's response reverted to reactive diplomacy, leaving regional reconstruction efforts to either the US or other East Asian states.

Japan's relationship to East Asia as a de-facto economic model and economic bellwether was integral to the perceptions the United States and East Asian states had of Japan during this period. While the US had always been keen for Japan to become involved in regional economic development, the late 1990s saw US perceptions of Japan's role in the region tied to specific policies. The US argued that Japan could demonstrate regional leadership by pressuring East Asian states to reform the export-oriented model of East Asian economic development. Rather than being the exclusive target for US *gaiatsu*, Japan was now pressured to assume responsibility for regional policies that would further liberalise and deregulate regional markets. Alternately, East Asian states saw Japan's leadership responsibilities through acting as a potential barrier against US-led efforts. Debates over Japan as a good developmental example, IMF reform programs and the Japanese proposal for an Asian Monetary Fund (AMF) can be seen in this light.

While economics drove the interaction of these two concepts of Japan's leadership role in the Asia Pacific, political and security interests were also of considerable importance. Regionalism and the move towards frameworks that would replace or coexist with older Cold War institutions (like ASEAN and US bilateral alliances) sought to include Japan as a major contributor. While this process had given rise to cooperative institutions like APEC and ARF, the case of the AMF led a change in the nature of the interaction between the interests on either side of the Pacific. While both had broad shared interests in perpetuating economic development and regional stability, the Asian Crisis had the effect

of emphasising the differences. East Asia and US public diplomacy became more adversarial, often leaving Japan in difficult foreign policy predicaments. ASEAN+3, an expansion of ASEAN and a potential expression of Mahathir's vision of an EAEC (as seen in Chapter 5), was one such example. While positive conceptions of Japan's role saw it as a *torii* or bridge between East and West, the different conceptions of leadership often resulted in pressure on Japan to take on a leadership role that was at cross purposes.

The difficulty of this position became increasingly clear when portrayed against the rise of China to regional prominence. The continued growth in China's economy and its growing importance to Japan as a partner in economic development contrasted with a far more restricted political and strategic relationship. This dislocation between elements of the relationship also spread to the potential and merits of both Japan and China as major sources of regional leadership. An economically stronger China, despite its relative inaction during the Asian Financial Crisis, became lauded for its role vis-à-vis Japan, despite its far larger contribution to ASEAN and South Korea during and after the crisis. Questions of regional leadership became a new contest between two countries struggling to reconcile their differences. Such debate also juxtaposed the continuing significant role the US played in the region with these two countries, often pairing the US with China as sources of regional stability against vague Japanese policies.

Fears of political and potential economic exclusion from East Asia drove much of US policy towards Japan and framed its interests in Japan's role. In the face of growing trade deficits with the region, there was a strong US desire to reform East Asia's economic governance to reduce structural impediments to US export competitiveness and market access. Japan of the 1990s played a dual role for the US; as a cautionary tale to Southeast Asian states seeking to emulate Japan's growth model, and as a pressuring tool to speed the pace of deregulatory reform in these countries. On the strategic front, the long-standing US desire to see Japan as a loyal ally aiding US political and strategic interests continued through US *gaiatsu* to boost Japan's commitment to the alliance. The 1997 Revised

Guidelines moving the boundary of joint operations to "areas surrounding Taiwan", which shifted Japan from a passive base to an active participant in US regional security strategy. East Asia on the whole was unresponsive and hostile to either strategic or political attempts to boost Japan's capacity in these areas. Regional perceptions of Japan's role remained linked to its limited leadership through the economics of regional trade and investment relationships. And, despite the end of the Cold War and four decades of peaceful coexistence with Japan, the region was quick to remind Japan of the continuing legitimacy deficit that it faced anytime Japanese intent surpassed regional tolerance.

### ***Japan – Good Model, Bad Example***

After being seen through the 1980s as a regional economic leader, the ongoing relative decline of Japan's domestic economy seriously affected the perception and reality of Japan's regional position. In the late 1990s, Gerald Curtis noticed the change a decade made in perceptions of the state of the Japanese economy. In an interesting allusion, he noted that "Kevin Phillips's comment in 1990 that American politics was 'rudderless on a sea of compromise, caution and confusion' was an apt characterisation" of the 1990s Japan.<sup>4</sup> As noted in previous chapters, the basis of Japan's economic strength relied upon the amalgam between public and private enterprise called state-led economic development. Although the plan-rational Japanese system had a huge benefit through the promotion of a national ideology of growth, if there was confusion over the goal, "it [the plan rational economy] will appear to be quite adrift, incapable of coming to grips with basic problems and unable to place responsibility for failure".<sup>5</sup> The 1990s saw such a questioning of its economic underpinnings, with dramatic results. Up to 1995, Japan's regional economic growth had made greater political influence seem inevitable.<sup>6</sup> Yet this confidence in Japan's regional

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<sup>4</sup> K. Phillips, *The Politics of Rich and Poor: Wealth and the American Electorate in the Reagan Aftermath*, Random House, New York, 1990, p. ix cited in G. Curtis, *The Logic of Japanese Politics*, p. 37.

<sup>5</sup> C. Johnson, *MITI and the Japanese Miracle*, p. 22.

<sup>6</sup> H. Kato, 'Can Japan learn to lead?', *World Press Review*, 42(4), April 1995, p. 52.

progress seemed to be misplaced, as economically, Japan's Sun set and that of East Asia and the US rose.

A role for Japan conceived in the midst of its economic strength conflicted with Japan's relative decline throughout the 1990s. Both East Asia and the US began to utilise Japanese techniques, increasing their cost competitiveness through outsourcing and greater innovation. The regional environment was different from the one that Japan found itself in a decade ago.<sup>7</sup> As Pempel suggested, much of the region has been 'catching up', developing its own industries and interests.

It is clear that Japan stands at the economic centre of much that is happening in Asia, but at the same time, there are growing tiers of intra-Asian dependencies that bypass Japan completely. Any emerging Asian regional ties will surely include an important role for Japan as the region's most powerful economy. At the same time, future Asian regional developments are not likely to depend heavily on Japanese trade, technology, capital or culture.<sup>8</sup>

This latter point was especially important, given that the boom industry of the decade was Information Technology (IT). That this required flexibility and innovation, two aspects absent from Johnson's categorisation of Japan's 'developmental state', proved to be problematic for an economic system not designed to fulfil or pursue these attributes.

As mentioned in Chapter 5, the problems of the 1990s stemmed (partially) from the decisions made by Japan's government. In what was a pattern to be repeated during the Asian Crisis, rapid liberalisation and poor choices in regulation and de-regulation created what was euphemistically called 'market irregularities', which led to market excesses and moral hazards later seen at the heart of the crash. For the postwar period, the financial system was heavily controlled and regulated, enabling banks to lend with certainty, knowing that competition and interest rates were stable. There was little need to internationalise, improve efficiency or diversify risk and capital adequacy. Whilst reforms were made in the

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<sup>7</sup> R. Doner, 'Japan in East Asia: Institutions and Regional Leadership,' in P. J. Katzenstein and T. Shiraishi (eds.), *Network Power: Japan and Asia*, Cornell University Press, London, 1997, p. 219. Especially before 1985, Japanese companies made use of Overseas Chinese networks to gain access to markets in Southeast Asia and China. Since then, Japan has not made as good a use of these networks as the Americans have in the electronics industry, for example.

<sup>8</sup> T. J. Pempel, 'Transpacific Torii: Japan and the Emerging Asian Regionalism,' in P. J. Katzenstein and T. Shiraishi (eds.), *Network Power: Japan and Asia*, Cornell University Press, London, 1997, p. 81.

1980s, often after US *gaiatsu*, the regulatory frameworks used to demarcate regulatory standards fell short of those of other developed nations. When the Stockmarket crash occurred in 1989, with the attendant surge in 'bad debts', Japan's government struggled with the policies that should be implemented. Plans to force the banks to rid themselves of bad loans and recapitalise them with government funds conflicted with attempts to let troubled financial institutions 'grow out' of the problems caused by the loss of loan income, through general economic expansion in the Japanese economy.<sup>9</sup> Vested interests and divisions within the ranks of politicians, bureaucracy and businesses meant that a gap often existed between the reforms promised and their efforts at putting such rhetoric into practice.<sup>10</sup> The combination of a decade of economic decline and bureaucratic scandal drove a combined image of institutional deception and decline, from the LDP to the all important Ministry of Finance (MOF).<sup>11</sup>

Coupled with this was a general apathy from Japan's political leadership and voters. There was little impression of the need for drastic change to Japan's developmental state, considering that the system that had worked well for so long.<sup>12</sup> During the July 1998 election, all three presidential candidates used these problems, claiming that Japan faced destruction unless major reforms were made to the current situation; that Japan would have

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<sup>9</sup> D. Ostrom, 'Japan's Banks and the Bad-Loan Problem: The Nightmare Continues', [<http://www.jei.org/Archive/IEIR98/9825f.html>], Accessed 13/11/2001, T. J. Pempel, 'Structural Gaiatsu: International Finance and Political Change in Japan', p. 920 and U. Schaede, 'The 1995 Financial Crisis in Japan,' *Columbia International Affairs Online*, Columbia University Press, February 1996, [<https://www.cc.columbia.edu/sec/dlc/ciao/wps/scu01/scu01.html>], Accessed 5/11/2000.

<sup>10</sup> G. Curtis, *The Logic of Japanese Politics*, p. 39 and 236, A. Cornell, 'A country of shifting ground', *Australian Financial Review*, September 6<sup>th</sup> 2000, p. 8, and M. Kohno, 'In Search of Pro-active Diplomacy: Increasing Japan's International Role in the 1990s.' Tensions within the LDP were exacerbated by growing differences along generational and factional lines within Japan's dominant political party as well as the party's relationship with bureaucracy and business. See K. Calder, 'The Institutions of Japanese Foreign Policy', in R. L. Grant (ed.), *The Process of Japanese Foreign Policy: Focus on Asia*, Royal Institute of International Affairs, London, 1997, p. 12, K. Nakano, 'The Politics of Administrative Reform in Japan, 1993-1998', *Asian Survey*, 38(3), March 1998, p. 292, H. Fukai and S. Fukai, 'Japan in 1997: More Uncertain, Less Hopeful', *Asian Survey*, 37(1), January 1997, pp. 26-27, and K. Mishima, 'The Changing Relationship between the Japan's LDP and the Bureaucracy', *Asian Survey*, 38(10), October 1998, pp. 968-985.

<sup>11</sup> J. Stockwin, J. Amyx and G. Noble, 'Toward Reform and Transparency in Japanese Policymaking Processes', *Pacific Economic Papers*, No. 301, March 2000, p. 29.

<sup>12</sup> G. Curtis, *The Logic of Japanese Politics*, p. 38.

'no tomorrow' (*asu wa nai*).<sup>13</sup> Yet such language did not stir a similar reaction in the wider Japanese community.

The logic of the '55 system that guided the behaviour of LDP leaders was rooted in the belief that the more people that were convinced that the difficulties the country faced were serious and the result of forces beyond the governments control, the more likely that they would support the party. In 1998, LDP leaders, still captured by this logic, continued to employ a gloom-and-doom rhetoric, seemingly oblivious to the possibility that the public would hold them and their party responsible for having created the situation that they now decried. To take the rhetoric of the Japanese leaders at face value, one has to conclude that there is virtual unanimity among them and among the mass media as well, that Japan must revolutionise its current socio-economic system. It was nearly impossible in Japan in the late 1990s to find leaders with positive things to say about the Japanese system--a rather remarkable phenomenon considering that only a decade earlier Japanese political leaders and opinion makers were touting the Japanese model as superior to the kind of capitalism practiced in the West.<sup>14</sup>

Despite the leadership espousing the need to undertake a more Western system, there was little public support for replacing a 'good system' "that emphasised social equality with a more rough-edged economic competition that would clearly differentiate winners and losers".<sup>15</sup> Nevertheless such reforms were made, with a 'snowball effect' taking effect within Japan as changes led to the breaking of inter-societal linkages all the way through the Japanese 'developmental state'.<sup>16</sup> The often opaque system of governance in Japan, seen through examples like the complex *nemawashi* informal consultation system, the practice of *amakudari*, life-long employment and the promotion of seniority over skill, came under increased pressure to reform and boost competitiveness.<sup>17</sup>

While reform began, there was little overall direction to domestic changes, with the debate continuing to rage over changes to 'Japan Inc', as Uriu observed during 1997:

Japan continues to see itself at the proverbial crossroads, but no one seems to know which path to follow or who will take them there. How long before Japan restores its lost faith--confidence in its leaders and institutions, and even in the Japanese people

<sup>13</sup> G. Curtis, *The Logic of Japanese Politics*, p. 235.

<sup>14</sup> G. Curtis, *The Logic of Japanese Politics*, p. 235.

<sup>15</sup> G. Curtis, *The Logic of Japanese Politics*, p. 236.

<sup>16</sup> T. J. Pempel, 'Structural Gaiatsu: International Finance and Political Change in Japan', *Comparative Political Studies*, 32(8), December 1999, pp. 907-932.

<sup>17</sup> M. Tamamoto, 'The Privilege of Choosing: The Fallout from Japan's Economic Crisis', *World Policy Journal*, 15(3), Fall 1998, p. 25, G. Curtis, *The Logic of Japanese Politics*, p. 8 and The Daily Yomiuri Online, "Get rid of *amakudari* practice", [<http://www.yomiuri.co.jp/newse/20020217/wo02.htm>], Accessed 25/2/2002. Many of the public and private corporations affiliated with the government (as well as other NGOs with no government affiliation) and the major corruption scandals of the 1990s have been entities in which this 'descent from heaven' practice has occurred.

themselves—remains to be seen: only then will the country be able to re-establish the focus and determination that have served it so well in the past.<sup>18</sup>

The absence of consensus on reform was juxtaposed against a consensus amongst the majority of Japan's population that believed Japan faced fading into potential obscurity.<sup>19</sup> However, after 1995 and the last analyses that saw strength in 'soft' regional business linkages and influence, the more negative analysis coming out of Japan highlighting the doubt and difficulties in Japan's future found its way to the US, where newspapers and the Clinton Administration reiterated it.<sup>20</sup> After enduring years of US soul-searching during the 1980s and early 1990s, when Japanese leaders such as Nakasone pondered where the US could go, the US made light of Japan's growing difficulties.<sup>21</sup> In 1996, then Deputy Secretary of the Treasury Lawrence Summers commented to reporters that "Japan today is an island with 125 million people growing old, who haven't invented anything new since the Sony Walkman".<sup>22</sup>

Given the systemic implications of Japan's economic decline US analysts also devised and argued over specific reform programs to increase Japan's responsibilities to the global economy. Katz argued that large-scale reform and deregulation were needed to reinvigorate Japan's 'dual economy'; while Adam Posen believed that large scale macroeconomic stimulus should be enough.<sup>23</sup> Alexander argued that Japan inefficiently used its available capital, as the US generated 55-60 percent more GDP with the same amount of capital over the 1990s. Japan's economic problems with capital allocation were

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<sup>18</sup> R. Uriu, 'Japan in 1999: Ending the Century on an Uncertain Note,' *Asian Survey*, 40(1), January/February 2000, p. 150.

<sup>19</sup> J. Judis, "The Sun Also Rises," [<http://www.tnr.com/archive/11/110397/judis110397.html>], Accessed 5/11/2000.

<sup>20</sup> K. Pyle, 'America, Japan, and APEC: The Challenge Of Leadership in the Asia-Pacific', *NBR Analysis*, 6(3), November 1995, p. 42. He argued that "[w]hile the institutional legacies of the postwar experience continued to limit severely its competence in foreign policy, Japan moved swiftly and adeptly to seize a leadership role in Asia's economic dynamism once domestic and international structural change made it attractive...What began to emerge was a series of policies to promote a regional division of labour under quiet Japanese leadership - a strategy that sought to lay the basis for a 'soft', region-wide integration of economies under Japanese leadership". See also the book edited by Katzenstein and Shiraishi, *Network Power: Japan and Asia*, Cornell University Press, London, 1997.

<sup>21</sup> J. Judis, "The Sun Also Rises."

<sup>22</sup> J. Judis, "The Sun Also Rises."

<sup>23</sup> R. Katz, *Japan: The System that Soured* and A. Posen, "Japan 2001 - Decisive Action or Financial Panic".

compounded by the 60 percent decline in private investment between 1990 and 1995, with falls in loans largely responsible for that figure.<sup>24</sup> In other words, Japan had the capacity but not the leadership to revive its own economy, let alone provide leadership either regionally or around the world. It was this criticism that manifested itself in the US perception of Japan's role in the Asian Crisis as a potential liability, a position at odds with its historical demand that Japan fulfil a role commensurate with its economic size.

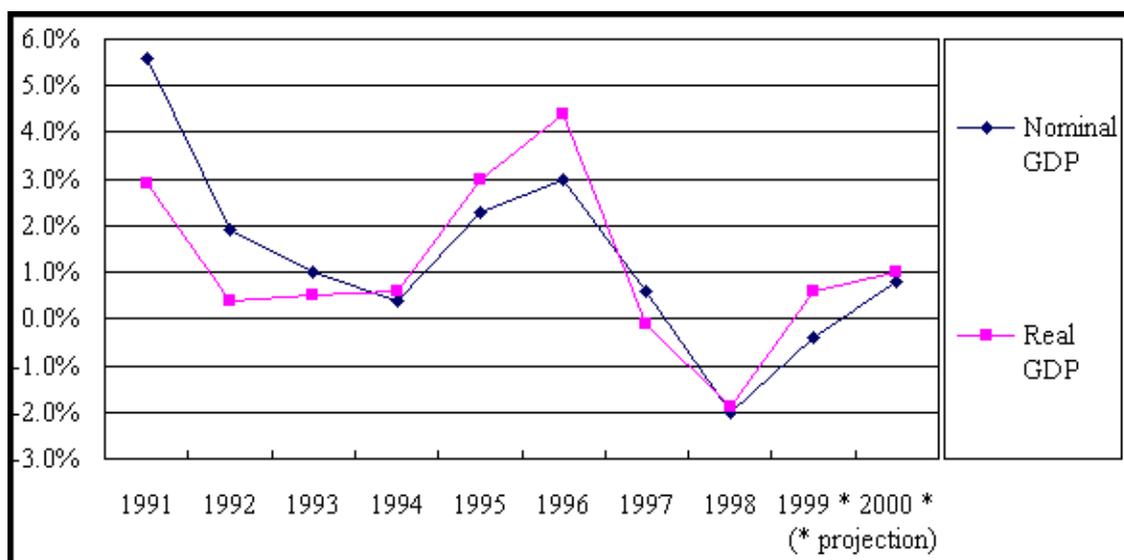
The answer that Japan turned to were fiscal bailout or support packages. This provided a provisional answer for this aspect of the wider regional problem of Japanese stagnation, Japan indicated that it was prepared to take on an increased burden as the future 'locomotive' of growth in the region. However, the amounts of these packages or 'supplementary budgets' began to rival ordinary budget spending. Amongst the reasons for this expenditure was to prevent a financial meltdown in Japan, a point highlighted by the Obuchi government's announcement in November 1998 of a ¥16 trillion (US\$124 billion) domestic stimulus package.<sup>25</sup> Unfortunately, as most previous domestic stimulus packages, the effects of this example were only enough to stop Japan's economy from sinking further into the fourth and deepest recession of the decade (see Figure 6.1).

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<sup>24</sup> A. Alexander, 'Has Japan's Economy Soured?', [<http://www.jci.org/Archive/JEIR98/9838f.html>], Accessed 12/11/2001.

<sup>25</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

**Figure 6.1: Japan's Gross Domestic Product (GDP) Growth, 1991-2000.**



Source: Japan Information Network, "Basic Economic Indices, 1991-2000," <http://jin.jcic.or.jp/stat/stats/05ECN11.html>, Accessed 4/8/2001.

Figures reinforced that this policy could not last. In March 1997, just before the Asian Crisis, state debt totalled ¥416 trillion (\$3.2 trillion) or 90 percent of GDP.<sup>26</sup> The huge public works projects commissioned to inject money into the Japanese economy, partially as a result of domestic pressure as well as to persuade international observers of Japan's will to be systemically responsible helped reinforce the complex pattern of official policy response and failure. Emblematic of this failure was the example of Osaka's Kansai International Airport. After costing \$17 billion, seven years and the construction of an offshore island, the much-touted 'gateway to Western Japan' began to sink. The subsidence that had occurred in six years surpassed what was expected after 50 years. While Kansai was operational in 1994, up to 2000 it had yet to make a profit, despite its rhetorical status as a major regional transportation hub.<sup>27</sup> Similarly, a program to boost IT spending was channelled through pre-existing candidates for projects such as the Construction sector.

<sup>26</sup> H. Fukai and S. Fukai, 'Japan in 1997: More Uncertain, Less Hopeful', p. 29.

<sup>27</sup> CNN, "Japan's new island airport is sinking fast--literally,"

<http://www.cnn.com/2000/ASIANOW/east/10/19/japan.sinkingairport.ap/index.html>, Accessed 19/10/2000.

Japan's new political venture, "e-Japan", ended up, amongst other projects, as a program to install fibre-optic cable in sewers to measure the flow rate and height of sewage.<sup>28</sup>

Examples of poor management and incompetence like this reinforced the criticism of Japan, both as a state with wider responsibilities and as a model for other states. Robert Feldman, chief economist for Japan at Morgan Stanley Dean Witter, argued that Japan had 'abdicated' its intellectual leadership in the region with the equity and real estate collapse of 1990. It had tried to export their state-led developmental model to the region rather than follow a more market-orientated approach that would have avoided the problems by allowing the market an efficient allocative function.<sup>29</sup> The argument that Japan's economic problems lay at the basis of the Asian Crisis gained impetus amongst Western analysts as it became clearer as to the influence Japanese finance had in Thailand and South Korea.<sup>30</sup> This not to say that Japan was completely moribund; deregulation and the opening of its markets created a new sight in Japan: inward FDI. It reached ¥1.4 trillion (\$22.7 billion) in 1999, 3.4 times the level of 1998. During 2000, it reached ¥2.4 trillion.<sup>31</sup> The takeover of Nissan by Renault and the re-emergence of a foreign-owned Shinsei Bank, part of the old Long Term Credit Bank of Japan, were some notable examples of a growing compromise made between Western efficiency and the developmental state.

Mirroring previous analyses commenting on the close relationship between economic development and societal change, darkening economic news came with pessimistic views of the capacity for Japanese society to change. What began as an exercise in economic analysis quickly morphed into a wider debate about reform in Japan, a process facing confidence-sapping news on a regular basis.

In fact, an outstanding characteristic of Japanese politics in 1996 was a spate of reports about official corruption, usually misappropriation of public monies, in prefectural and municipal governments. These reports came in such a steady stream

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<sup>28</sup> S. Lunn, 'Japan's e-funds land in sewage', *The Australian*, October 26<sup>th</sup> 2000, p. 24.

<sup>29</sup> R. A. Feldman, 'Sputter, Cough, Choke: Japan Misfires as the Engine of Asia', *The Brookings Review*, Summer 1998, p. 18.

<sup>30</sup> For a deeper exploration of Japan's decade-long role in the crisis, from domestic decisions to wider regional ramifications, see F. Godement, *The Downsizing of Asia*, Routledge, London, 1999, especially pp. 35-48.

<sup>31</sup> A. Cornell, 'Business under foreign pressure', *Australian Financial Review*, September 6<sup>th</sup> 2000, p. 9.

throughout the year that they made the whole nation look like a haven of salaried thieves and crooks.<sup>32</sup>

With the Kobe Earthquake, the subway attacks by Aum 'Supreme Truth' and the continuing issue of potential systemic failure of the entire banking system,<sup>33</sup> challenges came from a wide range of areas. Funabashi typified the feeling in Japan towards its capacity to recover the dynamism that drove its self-image and wider influence up to this point.

Japan is in a deep funk. Its economic debilitation, political gridlock and rapidly aging population all contribute to a pervasive pessimism and imperil its cherished identity as a non-nuclear, non-weapon exporting, economically dynamic, democratic, generous, civilian power... People genuinely fear the future. Political leaders have consistently failed to lead and the economy has deteriorated for seven years. Increasingly, however, the pessimism is the problem, with far reaching regional and global implications. Unless the psychological slump reverses, Japan's deflationary cycle will cripple Asian hopes for recovery and destabilise the global economy.<sup>34</sup>

Inoguchi noted that Japan could be the least capable state of understanding and undertaking globalisation because "it has simply been too good at functioning as a nation, politically, economically and culturally".<sup>35</sup>

This dark view contrasted with the pre-existing view that Japan could continue to act as an ideological and technological bridge between East and West. Sakakibara saw Japan as potentially the best of both economic worlds – between the boom and bust cycles of Anglo American capitalism and East Asian state-led development – with Japan leading the way in finding a new balance. He noted that this economic difficulty was not new to Japan: "As we have done for the 130 years since the Meiji Restoration, we will quickly absorb and become fully competitive with the Anglo-Saxon and other systems". Although his espousal of 'a middle road' between East and West was driven by his position as a senior member of

<sup>32</sup> H. Fukui and S. Fukui, 'Japan in 1996: Between Hope and Uncertainty', p. 23.

<sup>33</sup> H. Fukui and S. Fukui, 'Japan in 1996: Between Hope and Uncertainty', pp. 20-21. By the late 1990s, official 'bad' loans had reached ¥82 trillion (equal to \$832 billion or 16% of Japanese GDP), with unofficial figures suggesting that this could be ¥50 trillion higher. See also A. Posen, "Japan 2001 - Decisive Action or Financial Panic," [<http://www.iie.com/policybriefs/news01-4.htm>], Accessed 17/5/2001, *The Economist*, 'Chronic Sickness', June 2<sup>nd</sup> 2001, pp. 73-74. This debate often overlooked the fact that, according to the Financial Services Agency in 2000, Japanese banks had written off about ¥51 trillion (\$188 billion) in the previous eight years. See P. Cerny, "Financial Globalisation and Internalising Neoliberalism in Japan: A New Meiji Revolution," [<http://pro.harvard.edu/papers/016/016005CernyPhili.pdf>], Accessed 11/9/2001.

<sup>34</sup> Y. Funabashi, 'Tokyo's Depression Diplomacy', *Foreign Affairs*, 77(6), October/ November 1998, pp. 26-27.

Japan's government, this argument did perpetuate a long standing view that Japan could act as the *torii* or bridge over the Pacific.<sup>36</sup> Indeed he noted prior to the Asian Crisis, that the world witnessed an 'Asian Renaissance', "born of the fusion of Asian commercial globalism and western capitalism".<sup>37</sup> In doing so, Sakakibara added to the view, along with Taplin and Bello, that supported Funabashi's early 1990s image of Japan as a regional 'honest broker' (seen in Chapter 5), albeit an image reliant on the exorcism of the continued spectre of Japanese war crimes.<sup>38</sup>

The debates surrounding Japan's domestic strength and reform prospects fed directly into analysis of the Asian Crisis, either in defence of East Asian state-led development or as a reason for enacting Western, US-based liberal market reforms. For example, East Asian states criticised Japan for dropping proposals for an Asian Monetary Fund (AMF) at a time when the region required this assistance. On one hand, the AMF would undermine European and US calls for an international consensus in dealing with currency crises. On the other, abandoning the proposal in the face of US-IMF resistance signalled that Japan was unwilling to become a leader of the East Asian developmental model it had unofficially promoted in the face of US *gaiatsu*.<sup>39</sup> In particular, Malaysia wanted Japan to demonstrate the leadership that would lead to the creation of East Asian economic community.<sup>40</sup> So, from an East Asian perspective,

Japan's seeming submission to the US and IMF-dictated rescue packages represent[ed] Japan's inability to defend effectively its own model of the 'developmental state' which it is partly responsible for transferring to the region, and to guide the East Asian states to a new route for development in the next millennium.<sup>41</sup>

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<sup>35</sup> T. Inoguchi, 'Globalisation and Japanese Foreign Policy', *Japan Review of International Affairs*, 13(3), Fall 1999, p. 157.

<sup>36</sup> E. Sakakibara, 'The once and future boom', *The Economist*, March 22<sup>nd</sup> 1997, p. 79.

<sup>37</sup> E. Sakakibara, 'The once and future boom', p. 80.

<sup>38</sup> R. Taplin, 'Japan's Foreign Policy Towards Southeast Asia', in R. L. Grant (ed.), *The Process of Japanese Foreign Policy: Focus on Asia*, Royal Institute of International Affairs, London, 1997, p. 72 and W. Bello, 'East Asia: on the eve of the great transformation', *Review of International Political Economy*, 5(3), Autumn 1998, pp. 438-442.

<sup>39</sup> C. Hughes, 'Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?'

<sup>40</sup> Global Sources, "Malaysia asks Japan to rethink East Asian Caucus Proposal,"

[<http://www.asiansources.com/tntlist/apulse/0705/apn70502.htm>], Accessed 10/7/2000. Malaysia's Prime Minister Mahathir and his 'Look East' policy tried to emulate Japan's economic structure and philosophy.

<sup>41</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

As such, much as it had always done, Japan's reactive foreign policy helped mitigate aspects of the crisis, albeit in a way that did not please regional states.<sup>42</sup> The alternatively praised and criticised Miyazawa Initiative, that sunk \$70 billion (out of the \$80 billion that was promised) into the region after 1997 and was seen as a compromise on the earlier AMF, occurred at a time when it was desperately needed and with eased loan and grant conditionality.<sup>43</sup> Another example of reactive leadership was the Asia-Europe Meeting (ASEM) structure, where Japan attained an indirect leadership role within Asia without too much diplomatic risk; either in alienating Europe, Asia or the US.<sup>44</sup> The regional debate on Japan's role also extended to the question of how to make better use of Japan's available financial resources.<sup>45</sup> Regional diplomacy seemed to carry this attitude further. During 2000, Japan offered to be the voice for Asia at that year's G8 meeting in Okinawa, an offer that was accepted, albeit passively.

Other accusations levelled at Japan were that the Japanese inability or failure to stop the regional 'domino effect' in Thailand allowed the spread of the economic panic elsewhere, as well as neglecting to determine a future pathway to allow the region to escape from the crisis and return to pre-1997 levels of growth. Worse was the view that Japan was politically inconsequential to the prospects of East Asia. Green observed that "[t]he common wisdom in Washington is that Japan is incapable of 'leadership'. All eyes turn instead to the problem of managing Asia's new rising power -- China".<sup>46</sup> Given the inability of Japan and its network power to maintain the East Asian Miracle, the view of Japan as a leader beyond the size of its economic footprint shrunk from sight.

Much as it had always been, Japan remained caught between two casual definitions, both based on the respective interests of the actors involved. For the US, Japanese

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<sup>42</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

<sup>43</sup> *The Economist*, 'Can Japan find its voice?', p. 15 and C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

<sup>44</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting: Establishing an Interregional or Intraregional Agenda?' *Asia Survey*, 39(5), September/October 1999, p. 743.

<sup>45</sup> M. Green, "Why Tokyo Will be a Larger Player in Asia."

<sup>46</sup> M. Green, "Why Tokyo Will be a Larger Player in Asia,"

[<http://www.nyu.edu/globalbeat/pubs/napsnet073100.htm>], Accessed 18/8/2000.

leadership would pursue US interests, primarily in terms of maintaining global stability in the political, strategic and economic realms. In doing so, Japan would demonstrate its capability and 'responsibility' as an ally in a post-Cold War world and help reform East Asia to address long standing issues, such as the US trade and budget deficit. For many of the countries of East Asia, their perception of leadership was not consistent with Japan following US policies. For them, Japan could lead through defending the region's right to economic development, often using the same policies and economic management techniques that had propelled Japan. When it came to responsibilities, however, there was little or no overt mention or desire in East Asia for the political or strategic responsibility that the US sought through increasing Japanese alliance responsibility.

### **The Asian Financial Crisis**

The Asian Financial Crisis began in Korea and Thailand during 1997, when a number of large finance and construction companies became bankrupt. Their over-exposure to short-term loans, coupled with optimistic lending and forecasts for growth, were seen as being representative of other companies in the region. The specific cause of the crisis depended on the context of the critic, the circumstance and time period focused upon. Opinion varied as to whether the crisis was a regional event based on the usual factors of speculation and imbalances in supply and demand or a sign of greater problems in the modern international economy.<sup>47</sup> Over time, an increasing number of causes of the crisis were found. These varied from: China's devaluation of the yuan in 1994; the fluctuations in the value of the US dollar (to which many of the region's currencies were pegged) and the Japanese yen in the mid 1990s; the relatively unregulated nature of the markets in Southeast Asia; market panic in the face of growing over-production of consumer goods in the region; inexperienced financial and economic regional regulatory authorities; reliance on short-term external loans for economic growth; poor investment strategies; and the failure

of the World Bank, IMF, and Credit Rating Agencies to predict the crash.<sup>48</sup> Subsequently, MacIntyre argued that the economic causes were abetted by political decisions made in the affected countries.<sup>49</sup> With the speculative attack on the Thai Baht in July 1997, and the subsequent float of what was a managed currency a few months later, the Baht's devaluation sent shock waves through a market that saw risk when it had hitherto seen certainty. This had repercussions on currencies around the region, as other countries such as South Korea, Indonesia and Malaysia were seen by the market as experiencing the same problems as Thailand.

The subsequent expansion of the crisis to Russia, Eastern Europe and South America invited comparisons of the Great Depression. With countries and their private sectors experiencing problems repaying their external liabilities, external assistance was needed to restore confidence and liquidity. The IMF became involved in placating an increasingly skittish market and introducing reforms to South Korea, Thailand and Indonesia, thinking that this would re-introduce confidence into the regional economy. Although initially helpful, worsening circumstances saw IMF policy prescriptions adding to the economic and social dislocation, a point a growing number of vocal critics within East Asia made.<sup>50</sup> Sakakibara, the Japanese Vice-Minister of Finance during the crisis, argued that IMF-inspired policies of rapid liberalisation before the crisis lay behind the eventual collapse.<sup>51</sup> And, although its purpose was to restore market confidence in the region, even

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<sup>47</sup> On increased mobility of international capital and the threat to global growth and development, see J. Kirshner, 'Keynes, capital mobility and the crisis of embedded liberalism', *Review of International Political Economy*, 6(3), Autumn 1999, pp. 313-337.

<sup>48</sup> Given the confines of the thesis, this section is necessarily short. For a more complete version of events, Nouriel Roubini's website [[www.stern.nyu.edu/globalmacro/](http://www.stern.nyu.edu/globalmacro/)] is a good overview of much that has been written since. Of the many books that have been written over the past four years, François Godement's *Downsizing of Asia* (Routledge, London, 1999) is one of the best at covering the intricacies of the crisis in East Asia.

<sup>49</sup> A. MacIntyre, 'Institutions and Investors: The Politics of the Economic Crisis in Southeast Asia', *International Organization*, 55(1), Winter 2001, pp. 81-122. For more on the topic of governance and the power of institutions in East Asia, see A. MacIntyre, *The Power of Institutions: Political Architecture and Governance*, Cornell University Press, Ithaca, 2003.

<sup>50</sup> A. Singh, 'Asian Capitalism and the Financial Crisis,' CEPA Working Paper Series III, Working Paper No. 10, [<http://www.newschool.edu/cepa/papers/index.htm>], Accessed 24/5/2000. See also K. Jayasuriya and A. Rosser, *Economic Orthodoxy and the East Asian Crisis*, Asian Research Centre Working Paper No. 94, November 1999.

<sup>51</sup> E. Sakakibara, 'East Asian Crisis - Two Years Later', speech at the twelfth Annual Bank Conference on Developmental Economics by the World Bank, Washington D.C., April 18<sup>th</sup>-20<sup>th</sup>, 2000, p. 2.

after the IMF became involved, the emerging countries in the Asia Pacific suffered a \$12 billion net withdrawal of private funds in 1997, followed by a \$9 billion withdrawal for 1998. This compared to a \$93 billion inflow for 1996.<sup>52</sup>

During and after the crisis, much of the blame hit Japan, despite the widespread failure of agencies and governments to foresee or quickly halt the crisis. And, as with the causes of the crisis, there were numerous analyses of what Japan did and whether this helped cause or prevent the crash of 1997. Japan, as seen in Chapter 3 and 4, has been a major contributor in terms of financial capital to the region through ODA and FDI. After the Plaza Accord (covered in Chapter 5), the Japanese government and businesses acted to de-emphasise high volume exports to the US market, which forced Japan to look to domestic demand and low volume/high value exports to drive the economy.<sup>53</sup> It also drove the rapid expansion of keiretsu networks in East Asia. East Asian governments facilitated this investment, especially given that this investment increased the expansion of manufacturing and wider economic development.<sup>54</sup> About 40-60 percent of foreign investment within 'NIES-4' and 'ASEAN-4' was used for the formation of production capital in the electronics, car and metallurgy industries. As such, a growing number of mid-sized Japanese companies re-located to the region to take advantage of the cheaper operating costs (such as labour, land, skilled labour, existing infrastructure, built in some instances with ODA loans).<sup>55</sup>

Following the movement of Japanese manufacturers into Southeast Asia, Japanese banks started to invest in the region from 1985 onwards, loaning approximately \$275 billion to the region. In general, foreign banks were complacent about the risks faced

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<sup>52</sup> *Institute of International Finance*, 'Capital Flows to Emerging Market Economies- January 29, 1998', p. 2.

<sup>53</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>54</sup> W. Bello, 'East Asia: on the eve of the great transformation', *Review of International Political Economy*, 5(3), Autumn 1998, p. 424 and 426. Bello noted that Southeast and East Asian elites supported businesses that pursued high debt to equity business plans and "institutionalised a pattern of development that was greatly dependent on huge infusions of foreign capital".

<sup>55</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

through the regional allocation of loans, believing that stable currencies and future regional GDP growth made risk strategies unnecessary.<sup>56</sup> This confidence proved to be a mistake. Declines in exports in key commodities (semi-conductors for example) and the strong gains made in the US stockmarket (partially as a result of capital flight from the earlier 1995 Tequila Crisis in Mexico), led to a dramatic increase in bankruptcies amongst speculators and real estate developers. Seeing parallels with Japan's own bubble economy, "Japanese commercial banks saw what was coming and started to react. They retreated to their home market to protect their capital, while lobbying politicians for financial support". The increasingly fraught domestic economy, an agreement between the US Treasury and Bank of Japan and the addition of an episode of illegal trading at the New York offices of Daiwa Bank in October 1995 led to the depreciation of the yen, reaching ¥124 by the end of March 1997. As a result, it caused "many of the 'yen-carry' trades used by Japanese banks to become unprofitable".<sup>57</sup> Japan's banks then hurried to regain their loans, ending easy credit to Southeast Asian businesses reliant on this source of funding.<sup>58</sup>

With the 'contagion' following economic links through East Asia, Japanese 'network power' became a flaw. While seen positively during up to the mid 1990s, the movement of Japanese investment into the region after the high yen or *endaka* was seen to be one of the reasons for the crisis. Between 1995 and 1996, the yen declined 60 percent in value against the US dollar, which made Japanese keiretsu in Japan more competitive in producing goods against their competitors in East-Southeast Asia. This had the same effect as China's yuan devaluation in 1994, squeezing the markets for goods such as electronics, steel and cars. Coupled with the continued slow rate of growth in Japan's domestic

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<sup>56</sup> Michael King, 'Who triggered the Asian financial crisis?', *Review of International Political Economy*, 8(3), Autumn 2001, pp. 446-447.

<sup>57</sup> see Grenville, S, Address by Deputy Governor of Reserve Bank to the Credit Suisse First Boston Australia Conference, 'The Global Financial System – The Risks of Closure', 13 November 1998. [[www.rba.gov.au](http://www.rba.gov.au)], Accessed 14/6/2002. As Grenville noted, "the 'yen carry' trade – [related to] borrowing at low interest rates in yen, and on-lending at high returns in other currencies, particularly in Asia. When local-currency borrowing rates were around 20 per cent (which was the case, for example, in Indonesia), yen-based interest rates seemed extraordinarily attractive".

<sup>58</sup> Michael King, 'Who triggered the Asian financial crisis?', *Review of International Political Economy*, 8(3), Autumn 2001, p. 448.

economy, it also deprived the region of exports needed for continued economic growth.<sup>59</sup> Japan's involvement in speculative investment in the region added to the negative impressions of Japan's economic role. Japanese banks in particular saw the need for quick returns, given that after the domestic crash of 1989, they hoped to recoup their losses by channelling short-term investment to speculative sectors of the regional economy. They did this through short-term investment in the infrastructure, real estate and finance sectors, much as they had in Japan during the late 1980s.<sup>60</sup> The real estate boom in Bangkok became synonymous with large amounts of Japanese investment during the mid-1990s. Up to June 1997, Japanese banks had invested 109.7 percent of their capital in Asia's emerging economies, a level twice as high as their European or North American counterparts.<sup>61</sup> This left Japan's financial system in a delicate position, a position that would lead to greater governmental involvement.<sup>62</sup> It also helped inflate an already dangerously distended bubble in the wider regional economy. Given the national importance of Japanese financial institutions and their close links to MOF, they became powerful conduits of international pressure on the Japanese government.<sup>63</sup>

The role of Japanese banks in East Asia had been a continuing irritant between the US and Japan and fuelled debate over the role of state-led development in the region and its success. The crisis and this argument posited that Japanese banks at the centre of the crisis gave the US an opportunity to argue its case more pervasively.<sup>64</sup> The role of the state and its connections with 'crony capitalism' became an important argumentative basis for

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<sup>59</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>60</sup> R. Bevacqua, 'Whither the Japanese Model? The Asian economic crisis and the continuation of Cold War politics in the Pacific Rim', *Review of International Political Economy*, 5(3), Autumn 1998, p. 412.

<sup>61</sup> OECD, *OECD Economic Outlook June 1998*, p. 21.

<sup>62</sup> D. Ostrom, "Japan's Banks and the Bad-Loan Problem: The Nightmare Continues". Many of the major city banks (like the Bank of Tokyo-Mitsubishi as well as Fuji, Asahi and Sakura Banks) in Japan were just above the capital adequacy requirements the BIS set for international activity (8 percent of capital in reserve). If they were bereft of the means to maintain the level of reserves at 8 percent, they could retreat to the Japanese domestic market, where the capital adequacy ration was lower at 4 percent; however, this meant that banks had their futures tied to the moribund domestic economy.

<sup>63</sup> S. Katada, "The Japanese government in two Mexican financial crises: an emerging international lender of last resort", *Pacific Affairs*, 71(1), Spring 1998, p. 73.

<sup>64</sup> T. Cargill, "Asia's Financial Crisis and Japan," [<http://www.nmjc.org/jiap/events/papers/cardhout.html>], Accessed 12/2/2000.

allocating blame for the crisis.<sup>65</sup> In and of itself, this debate was not new. Demonstrated in Chapter 5, this debate had already existed since the 1980s within multilateral institutions such as the IMF and World Bank. At this stage, this pattern of trade and investment was a bilateral economic issue between Japan and the US with a trade focus. For the US in these previous debates, state-led development exported to the region relied on Japanese exports and inward foreign direct investment, creating an embedded nexus of dependence. In instigating this, Japan undermined their growth through their continued domestic problems and not progressing to the next stage of economic development through the IT and service sectors.<sup>66</sup>

The US post-crisis debate about the spread of the developmental model took on greater urgency as the US now saw the issue as one of major systemic importance and threat. This threat consisted of two parts. First were the cyclical implications of Japan's malaise for the wider global economy. The crisis also exacerbated the sense of threat, with Feldman noting that with 40 percent of its exports destined for East Asia before the crisis, the collapse of these economies would have strong repercussions for Japan.<sup>67</sup> Second, from the perspective of the US, concerns about international financial stability and reducing the burden on the US current account were the prime forces driving US policy. As Table 6.1 shows, the US was rightly concerned with the size of the bilateral trade deficit with Japan. After achieving a relatively stable level, 1996 began a period in which the deficit nearly doubled in four years, from \$47.6 billion to \$81.6 billion in 2000, although this also coincided with an overall increase in the trade deficit. A weakened, more competitive yen (down from ¥95 to ¥140 to the US\$), as well weakening internal demand, was culpable for the burgeoning trade deficit that became a prime reason for increasing US pressure that looked to Japan to reform. Coupled with the economic threat was the fear that another

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<sup>65</sup> P. Bustelo, "The Impact of the Financial Crises on East Asian Regionalism," <http://bustelo.homepage.com/ISEAS00.pdf>, Accessed 19/5/1999.

<sup>66</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

<sup>67</sup> R. Feldman, 'Sputter, Cough, Choke: Japan Misfires as the Engine of Asia', p. 19.

country could increase its influence in the post crisis period. The US State Department worried that a regional crisis might mean that either China or Japan would increase their influence in the region at the expense of the US.<sup>68</sup>

**Table 6.1: US Trade Balance with Japan (in millions of US\$)**

Year	Exports to Japan	Imports from Japan	Balance with Japan
1996	67607	115187	-47580
1997	65549	121663	-56115
1998	57831	121845	-64014
1999	57466	130864	-73398
2000	64924	146479	-81555

Source: US Census Bureau, "US Trade Balance with Japan."

Given the potential adverse effects, the US focused on using the crisis itself to achieve some longstanding goals. The US strengthened its demands that Japan support the US through boosting domestic demand and reforming its informal structural impediments to US competition through deregulation and liberalising the domestic economy. By reforming its economy and potentially recovering its economic health, Japan could act as an additional market to which regional countries could export. As Johnstone summarised,

[T]he American argument was straightforward: as Asia's largest economy, Japan could serve as the growth engine that would pull the region out of the crisis, much as the US economy had helped to spur Mexico's recovery during the 1994 peso crisis. With Japan mired in a period of virtual economic stagnation, however, its ability to absorb exports from Asia was severely constrained. The region's economies also suffered collateral damage from the high-profile struggles of Japanese banks, which had loaned heavily in Asia. As long as financial institutions in Japan were burdened with the massive portfolio of bad loans, Asia would have less access to much needed sources of credit. The region's prospects for recovery, according to the Clinton administration, were therefore intimately linked to Japan's ability to undertake economic reforms.<sup>69</sup>

Much like his former counterparts Baker and Brady in Chapters 4 and 5, US Deputy Treasury Secretary Summers (and later the Treasury Secretary with the retirement of Robert Rubin in 1998) argued that the US was taking on too much of the burden of global consumption with both Europe and Japan achieving disappointing growth in demand. The US current accounts experienced a jump in its deficit of more than \$80 billion whilst both Japan and Europe could expect current account surpluses of \$95 to \$115 billion. Summers

<sup>68</sup> K Muehring, 'It's Summers' Time', *Institutional Investor*, 31(12), December 1997, pp. 49-61. Accessed via Proquest, 27<sup>th</sup> February 2002.

<sup>69</sup> C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', p. 126.

argued that, despite a view that the US abdicated responsibility for the crisis, the region's largest economy absorbed an extra \$12 billion of 'emerging Asia's' exports since the Asian Crisis, whilst Japan's imports from the same area had fallen \$20 billion.<sup>70</sup> For the US, a leadership role for Japan involved it being 'responsible', in accepting exports and acting as a global/regional growth engine.<sup>71</sup>

And no country is more important to any effective global growth strategy than Japan - the second largest economy in the world and by far the major economic power in Asia. Even today, Japan accounts for two thirds of the Asian economy. A global economy simply cannot be fully successful without a successful Japan.<sup>72</sup>

Summers stressed the importance of structural reform and liberalisation/ deregulation of the Japanese economy, a position reinforced by Stanley Fischer, the First Deputy Managing Director of the IMF, who along with David Hale from Goldman Sachs, noted their concerns about Japan's economy and the necessity for a rapid Japanese recovery.<sup>73</sup>

While in the circumstances of the Asian Crisis, the US position on Japan's responsibility was understandable given Japan's de-facto position as the largest and most 'responsible' country economy. The attitude and actions of the US towards Japan however continued a long line of policy that had mixed and conflated US self-interest with systemic responsibility. Systemic responsibility was a criterion more or less decided by the US in this instance. Katada noted that Japanese attempts to increase its involvement in earlier economic crises were not met with positive feedback. Despite Japan's growing creditor status during the 1980s and 1990s to become the world's largest creditor by the mid 1980s, it has not enjoyed a similar increase in demands on it that would suggest that it was asked to increase its responsibilities, replacing or supplementing the US. In the Mexican crises of 1982 and 1994/5, Japan's involvement was limited to Japanese bank exposure. In these

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<sup>70</sup> Remarks by Lawrence H. Summers, [<http://www.coara.or.jp/~fac/summers.htm>].

<sup>71</sup> R. Bevacqua, 'Whither the Japanese Model? The Asian economic crisis and the continuation of Cold War politics in the Pacific Rim', *Review of International Political Economy*, 5(3), Autumn 1998, p. 411.

<sup>72</sup> Remarks by Lawrence H. Summers, [<http://www.coara.or.jp/~fac/summers.htm>].

<sup>73</sup> Stanley Fischer, "The Asian Crisis, the IMF and the Japanese Economy", [<http://www.imf.org/external/np/speeches/1998/040898.HTM>], Accessed 10/11/2001 and Alexander, A., interview with David Hale, 'The Financial Crisis in Japan and Asia: A Financial Insider's View', [<http://www.jei.org/Archive/IEIR98/9836f.html>], Accessed 10/11/2001. Fischer noted that Japan's economic problems remained "a matter of grave *domestic* concern...given the prominent role of Japan in the

crises, a regional response was favoured over an international effort.<sup>74</sup> The Clinton administration was merely following the well-travelled historical path that many of his predecessors had in asking Japan to solve its budgetary problems. Up until April 1998, Japan was bombarded by the US government and media about the state of its economy.<sup>75</sup> However, after a string of Japanese domestic stimulus packages, this criticism began to ease.

Japan did respond to the public criticisms of selfish policymaking and failing its regional responsibilities by providing up to \$19 billion in secondary packages to the original IMF packages to regional countries during the crisis.

**Table 6.2: IMF-organised Support Packages in 1997 (billions of dollars)**

	Thailand	Indonesia	South Korea
IMF	3.9	10.1	21.0
World Bank	1.5	4.5	10.0
Asian Development Bank	1.2	3.5	4.0
US	0.0	3.0	5.0
Europe	0.0	0.0	5.0
Japan	4.0	5.0	10.0
Other (incl. bilateral/ regional)	6.5	8.2	2.0
<b>Total</b>	<b>17.1</b>	<b>34.3</b>	<b>57.0</b>

Source: *Institute of International Finance*, 'Capital Flows to Emerging Market Economies- January 29, 1998', p. 4.

As seen in Table 6.2, Japan was the largest contributing country to the IMF-organised packages in South Korea, Thailand and Indonesia. However, it quickly became clear that the IMF packages were not having the desired outcomes of either increasing confidence or stability in the region. Japan's unease at supporting IMF 'structural adjustment' programs was evident in its proposals for an Asian Monetary Fund (AMF). Although initially rejected by the US and IMF during 1997, the AMF's continuance as a regional policy through the Miyazawa Initiative and other versions of the original proposal demonstrated the difference between East and West regarding the future path of regional economic development.

While Sudo and others saw opportunities for greater collaboration between the alliance

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world economy, and especially in Asia, it is also a legitimate matter of concern by Japan's neighbours and by the international community".

<sup>74</sup> S. Katada, 'The Japanese government in two Mexican financial crises', pp. 61-80.

<sup>75</sup> For an example of this, see R. Madsen, 'Expect No Help from Japan', *World Policy Journal*, 15(3), Fall 1998, pp. 50-55.

partners, as typified through the AMF and the polarised attitudes towards the domestic reforms in IMF programs, US and Japanese views of action and policy coordination were subsumed by inherent national and foreign policy differences.<sup>76</sup>

This clear difference between US and East Asian perceptions of this regional institution demonstrate the differences in the views of what constitute Japan's regional role, a point highlighted by Noland in 2001.<sup>77</sup> For the US, it expected Japan to support its wider interests beyond the immediate problems occurring in East Asia. The US responses to regionalism and APEC in the late 1980s are interesting here. Krauss noted that "key policymakers developing the US's response saw Japan's interest in regionalism as part of a push to extend their 'industrial policy' and influence throughout the region, while others were not even particularly aware of Japan's role in initiating the events that led to APEC".<sup>78</sup> From this basis, during the Asian Crisis, Japan could prove itself as a primary US ally through supporting IMF liberalisation programs. For East Asian states, Japan could prove itself as a regional leader by standing up for state-led development programs that had often seen regional states copy Japanese policy measures. Through the AMF, Japan could prevent the destruction of regional economic development and prevent the spread of market liberalisation which potentially benefited Western companies far more than those in the region.

### ***Responsibility and Leadership? The case of the Asian Monetary Fund***

Japan contributed more to the recovery of the three crisis-affected countries, seen in Table 6.2, than any other nation. Initially, the AMF was proposed to solve a number of problems that arose following the crisis. Such a fund could be used to deploy its resources when a currency was under sustained, massive speculative market attacks. It would also provide a

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<sup>76</sup> S. Sudo, 'Towards a Japan-US-ASEAN Nexus', in M. Nishihara (ed.), *Japan-US Alliance: New Challenges for the 21<sup>st</sup> Century*, Japan Centre for International Exchange, Tokyo/New York, 2000, pp. 103-121.

<sup>77</sup> M. Noland, 'Japan and the International Economic Institutions', [<http://www.iie.com/testmony/noland/0700.htm>], Accessed 10/2/2001.

<sup>78</sup> E. Krauss, 'Japan, the US and the emergence of multilateralism in Asia', *The Pacific Review*, 13(3), 2000, p. 482.

'cooperative framework for the region' that would provide emergency aid and a crisis management plan, something that was noticeably absent given the failure of APEC and ASEAN to contribute to the regional response. Such a regional fund aimed to increase international liquidity and act more quickly; for many, including Sakakibara, the IMF was too slow and the rescue package too small to sufficiently aid Thailand during the genesis of the crisis.<sup>79</sup> Contributions from the World Bank, ADB and other Asia-Pacific states accounted for one half of the IMF packages, whilst Europe and the US did not commit any direct assistance.<sup>80</sup> This lack of commitment by Europe and the US in particular was of concern to ASEAN states, who noted the quick intervention of the US and Europe in the Mexican crisis of 1994 at the annual IMF-World Bank and Central Bank Governors' meeting in September 1997. Intentional or not, President Clinton's description of the largest crisis to strike Asia since the Great Depression as 'a few little glitches in the road' during an APEC summit in Vancouver in November 1997 did not help promote US interests.<sup>81</sup> Johnstone saw a parallel between Japanese and US reactions to the Asian Crisis and the reactions that followed the Gulf War in 1991, seen in Chapter 4. Both crises gave the impression that the allies were not really allies at all. While the US expected Japan's help consistent with its interests, Japan's attempts received a far more limited response.<sup>82</sup>

Given the recent Mexican precedent in 1995, the AMF was a common sense regional response if there was confusion over whether a regional crisis was considered to be of enough importance to warrant a global response. If a regional response was necessary, Sakakibara argued, and given that Asia contributed "a substantial amount of liquidity to the world", it "becomes incumbent for the region, first, to avoid excessive

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<sup>79</sup> J. Enia and M. Karns, "Testing the Strength of Regional Cooperation: The Asian Financial Crisis as Threat or Opportunity?" [<http://pro.harvard.edu/abstracts/016/016001KarnsMarga.html>], Accessed 1/6/2000. Eisuke Sakakibara, *East Asian Crisis - Two Years Later*, p. 5. Sakakibara noted that Japan did not perceive the World Bank or IMF to be 'the lender of last resort'. Hence, regional responses were far better in terms of capacity and speed.

<sup>80</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

<sup>81</sup> C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', *Survival*, 41(2), Summer 1999, p. 125.

<sup>82</sup> C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', p. 121 and C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?"

swings in capital flows that generate boom and bust cycles and to use abundant regional liquidity to smoothly provide necessary capital needs of the region. One obvious solution to this situation is to create a well functioning capital market or more specifically debt markets in the region".<sup>83</sup> Such an AMF would act as a regional insurance package made up of a pool of regional reserves to be used under specific conditions, a point reiterated in early 1998 by Mathews and Weiss.<sup>84</sup> He subsequently argued that Japan tried to develop these markets through the Japan fund at the ADB and the Miyazawa Initiative.<sup>85</sup>

For Japan, the proposal had other benefits, some of which were adamantly opposed by the US. During the early stages of 1998, the Long-Term Credit Bank of Japan collapsed, threatening its entire banking system with collapse. The avoidance of region-wide bank collapses was necessary to avoid the drastic impact on its already weak banking system.<sup>86</sup> The AMF could have intervened to provide immediate capital to stabilise the market while other arrangements were considered. From a US perspective, the AMF was an elaborate ruse to recapitalise Japanese financial institutions caught up by the financial panic in the region, and at the very worst, provide the basis for regional economic hegemony.<sup>87</sup> When the AMF was first promoted publicly in August 1997, US Treasury "pulled out all the stops to kill the proposal, and it died".<sup>88</sup> The US produced its own counter-proposals to expand the IMF's capabilities in East Asia in November of that year, with the 'Manila Framework' being the result.<sup>89</sup>

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<sup>83</sup> E. Sakakibara, *'East Asian Crisis - Two Years Later'*, p. 14.

<sup>84</sup> J. Mathews and L. Weiss, 'The Case for an Asian Monetary Fund', *Japan Policy Research Institute Working Paper No. 55*, March 1999, p. 1 and 3. Mathews and Weiss argued that an AMF would be beneficial, as fears of greater 'moral hazard' would be offset by the stronger influence such a fund would have over creditors during a regional crisis. As such, it would act similarly to the Hong Kong Monetary Authority in its intervention against hedge funds during 1998 or the US Federal Reserve in the case of the collapse of Long Term Capital Management Hedge Fund in 1998.

<sup>85</sup> E. Sakakibara, *'East Asian Crisis - Two Years Later'*, p. 16, 18-22.

<sup>86</sup> E. Sakakibara, "Crossing Swords with the Three Marketeers," [\[http://www.japanecho.com/docs/html/260606.html\]](http://www.japanecho.com/docs/html/260606.html), Accessed 17/4/2000.

<sup>87</sup> F. Godement, *The Downsizing of Asia*, pp. 45-46 and C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>88</sup> *The Economist*, 'The case for an Asian Monetary Fund', November 1998, p. 18.

<sup>89</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?." Discussed in Manila during November 1997, the proposed 'New Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability' or 'Manila Framework', created a fourteen member regional body to coordinate, within the region, "methods and amounts of financial assistance to be provided by the IMF".

However, as the financial crisis and general economic conditions worsened in later months, the idea re-emerged as a viable option for regional states, caused in no small part by the inability of the IMF to stem the loss of capital from the region.

MOF embarked upon research into the establishment of a US\$100 billion AMF, again stressing that it was designed not to supplant but to supplement the IMF due to the tough conditionality that would be attached to any loans. Sakakibara was despatched to the Philippines, Indonesia, and Singapore in late October on a round of quiet shuttle diplomacy to investigate the depth of support for the AMF in the region, and Japan further hinted at its intent to provide financial leadership in the region following the Bank of Japan's (BOJ) joint intervention with the latter two states to buy the rupiah on 3 November. Sakakibara was also despatched to the US between 2 and 9 November to discuss the AMF proposal with his opposite number at the US Treasury Lawrence Summers.<sup>90</sup>

In what was to be the common response during the period, Japan moved to placate both sides, encouraging regional states to adhere to the harsh structural adjustment programs that the IMF offered Thailand, South Korea and Indonesia, while being low key about the AMF proposal to allay US concerns. Japan's reactive approach to US and IMF policies was despite its ongoing concerns about the nature and speed of the reforms being instituted whether supported the continuation of the IMF as the primary institutional tool for ameliorating the economic conditions within the region. It worried that the US-IMF coalition had not given enough thought to their actions in the region. It also feared that the states in question would dispute the reform 'medicine', a potential outcome that the former US Treasury Secretary Robert Rubin called 'reform shopping'.<sup>91</sup>

For Japan, the AMF proposal seemed to satisfy domestic and international concerns of its actions during the crisis so far. As Sakakibara noted later, the idea and motive behind the AMF lay in mitigating the threat posed to regional economic development from excessive global capital mobility rather than a regional economic grouping.<sup>92</sup> However, as noted above, US opposition waylaid this regionally popular

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<sup>90</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>91</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?" and Leaver, R., 'Moral (and Other) Hazards: The IMF and the systemic Asian Crisis', in R. Robison, M. Beeson, K. Jayasuriya and H. Kim (eds.), *Politics and Markets in the Wake of the Asian Crisis*, Routledge, London, 2000, p. 290.

<sup>92</sup> Sakakibara, *East Asian Crisis - Two Years Later*, p. 5 and 8. Although the imposition of defensive mechanisms, such as emergency or permanent capital controls, the latter with a regional lender of last resort would forsake the efficiency of the market, "given the fact that the globalised market, today, is far from

option, with opinions particularly fearful of a fund that could diminish the IMF's regulatory authority and eventually lead to the reduction of U.S. economic influence in Asia.<sup>93</sup> US commentators were largely critical of the proposal, with the idea of a regional fund perceived as a threat to the international political economy, the role of the IMF and the role of the US in East Asia. The AMF was seen as the tip of the iceberg of East Asian regionalism that would exclude the US. Lincoln saw that it had the potential to be a 'moral hazard' by bailing out Japanese banks in Thailand and Indonesia and conflicting with the conditionality of the IMF-US packages.<sup>94</sup> Globalbeat argued that "if Asia creates an Asian Monetary Fund, it will not stop until it creates an Asian currency bloc under Japanese leadership... We are entering a world of regions, replacing the much-vaunted global economy".<sup>95</sup> Similarly, Fred Bergsten argued that the original proposal risked dividing the region into opposing blocs, along the same lines of Mahathir's EAEC proposal, as "[i]t would be especially foolhardy to risk dividing Asia and the Americas at this time of global crisis, with its desperate need for leadership from the United States".<sup>96</sup> Chalmers Johnson agreed, suggesting that the US remained concerned

that Japan was about to try its hand at long promised but never delivered international leadership. If the Japanese had succeeded, they would have slipped the leash of the US Cold War system. Moreover, they would have started using their surplus capital to help countries in Asia rather than continuing to send it to the world's number one debtor nation, The United States.<sup>97</sup>

For the US, Japan was acting to pursue its power at the expense of the alliance and what could be broadly described as systemic responsibility.

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perfect and potential damage, both economic and social, from the next crisis may be huge, such defensive measures maybe the politically right choices".

<sup>93</sup> E. Altbach, 'Tokyo Pledges New Southeast Asian Aid, May Revive Regional Fund Plan', [\[http://www.jei.org/Archive/JEIR98/9837w4.html\]](http://www.jei.org/Archive/JEIR98/9837w4.html), Accessed 10/11/2000.

<sup>94</sup> The Indian Express, 'Miyazawa \$30 billion plan could bail out banks,' [\[http://www.expressindia.com/fe/daily/1998/112/31655044p.html\]](http://www.expressindia.com/fe/daily/1998/112/31655044p.html), Accessed 23/5/2000.

<sup>95</sup> Globalbeat, 'Obuchi Refloats Idea of Asian Monetary Fund.'

<sup>96</sup> C. Bergsten, 'Reviving the "Asian Monetary Fund"', [\[http://www.iie.com/NEWSLETTR/news98-8.html\]](http://www.iie.com/NEWSLETTR/news98-8.html), Accessed 23/5/2000. Bergsten argued that an Asia Pacific Monetary Fund (APMF) could cooperate with the IMF, along the same lines that the Asian Development Bank complements the World Bank.

<sup>97</sup> C. Johnson, 'Cold War economics melt Asia', *The Nation*, 23 February 1998 cited in F. Godement, *The Downsizing of Asia*, p. 47

Given the poor state of the region-wide economy and the failings of the IMF well into 1999, the idea of an AMF persisted after the initial proposal was rejected. With the critics came supporters of the idea, who saw the AMF as a useful tool for increasing financial and economic security in the region, as well as diffusing tensions between Asia, Europe and the US.<sup>98</sup> Even *The Economist* saw the need for a regional body, as the AMF

would be better able to appreciate and build on the distinctive strengths of Asian financial systems than the IMF has proven to be. It would allow Asian governments and companies to re-finance their expensive western loans and provide selective new loans for recovery programs. And the creation of the fund would send a signal that Asians were taking charge of their own destiny and no longer dependent on bailouts. This may prompt western bankers and portfolio managers to supply new finance helping to solve Asia's current short-term funding problems.<sup>99</sup>

The inadequacies of the IMF and the continued absence of a new global financial architecture that could stop future crises required that regional arrangements be made to facilitate a more comprehensive future effort.<sup>100</sup>

The regional reaction to Japan's inability to support its own plan under international pressure lamented the lack of Japanese determination. Given that the IMF's stabilisation plans constituted a major threat to the previous developmental model pursued in South Korea and Indonesia, the lack of official Japanese support undermined much of the previous effort Japan spent defending the economic model in the IMF and World Bank.<sup>101</sup> Bello argued that the US used the crisis to push through liberalisation measures to reduce its trade deficits with the region through the auspices of the IMF structural adjustment policies.<sup>102</sup> Generally, East Asia was disappointed that Japan dropped the AMF proposal as quickly as it did, with Mahathir being openly disappointed at the readiness of Japan to jettison the original policy. The US and Europe "chided Japan for what they saw as its misguided or even reckless policy to challenge the IMF. Japan was thus criticised for providing both too little and the incorrect type of leadership in the region", a position

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<sup>98</sup> *The Economist*, 'The case for an Asian Monetary Fund', November 1998, p. 19.

<sup>99</sup> *The Economist*, 'The case for an Asian Monetary Fund', p. 19.

<sup>100</sup> J. Mathews and L. Weiss, 'The Case for an Asian Monetary Fund', p. 2.

<sup>101</sup> See J. Rapkin, and J. R., Strand, 'The US and Japan in Bretton Woods institutions: sharing or contesting leadership?', *International Journal*, 52, Spring 1997, pp. 265-296.

<sup>102</sup> W. Bello, 'East Asia: on the eve of the great transformation', pp. 434-435.

joined by China, contradicting previous statements that chastised Japan for its reticence to act.<sup>103</sup> It also increased perceptions of Japanese decline and those of a rapid rise for China.

China's self-proclaimed stoicism in refusing to allow devaluation of the yuan, and rather hypocritical implied criticism of Japan for failing to act as a responsible member of the international economic community by allowing the yen to drop, all supported apparently by the US President's praise of China's role in the East Asian economic crisis, particularly rankled with Japan. In spite of its position as an economic superpower, Japan was made to look ineffectual by both the US and China, and the image of its total defeat consolidated both domestically and abroad.<sup>104</sup>

Noting regional support and the need for additional liquidity, Japan altered its policy response. MOF announced a 'diet-AMF' that would be named after the then Finance Minister Kiichi Miyazawa. Announced in October 1998, the Miyazawa Initiative (see Figure 2) set aside \$30 billion for crisis assistance, as well as numerous other facilities. Half of that figure would be available in the medium to long-term to assist the economic recovery of Asia, mainly through the provision of Japanese backed bonds and loans for export insurance.<sup>105</sup>

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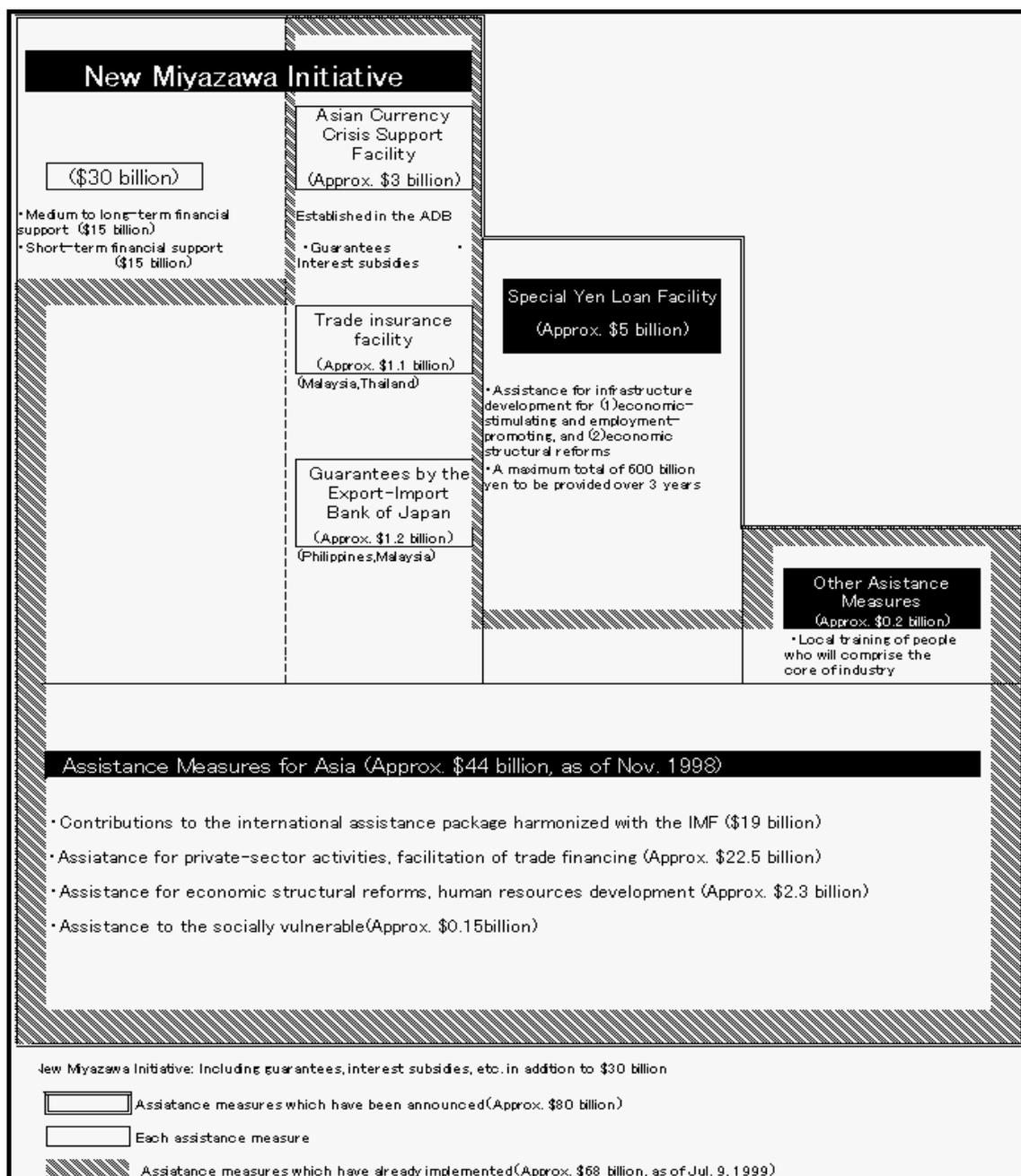
<sup>103</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>104</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

<sup>105</sup> T. Ito, "Japan seen going own way to help SE Asia,"

[<http://www.financialexpress.com/fe/daily/19980926/26955064.html>], Accessed 15/5/2000.

Figure 6.2: Japan's assistance in Asian Financial Crisis (up to 1998)



Source: MOFA, "Current Situation of the Asian Economic Crisis and Japan's Responses to it." <http://www.mofa.go.jp/policy/economy/asia/situ99.html>. Accessed 7/11/1999.

The remainder would be available in the short-term as swap arrangements to facilitate international liquidity in crisis-affected countries, as well as to facilitate trade financing, assist economic structural reform and human resource development.<sup>106</sup> The Initiative also had the ability to be a precursor to a more substantial regional organisation, a fact noted through anonymous statements from MOFA, especially through the relaxed conditions of

<sup>106</sup> MOFA, "Asian Economic Crisis and Japan's Contribution," <http://www.mofa.go.jp/policy/economy/asia/crisis99.html>, Accessed 7/11/1999 and C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Subject Defeat or Quiet Victory?."

the special yen loan facility.<sup>107</sup> Whether such an organisation would come in the form of an AMF was a moot point, given that even Mahathir was unhappy with the dispersal of funds from the Japanese fund and that more benefit would be gained from positive growth in the Japanese economy or through direct ex gratia payments to the countries involved in the crisis.<sup>108</sup> Nevertheless, aspects of the package, including the 'special yen-loan' program worth ¥600 million (approximately \$5 billion) were extended to March/April 2002 and included a low level of conditionality, partially realising US fears on this point.<sup>109</sup>

For all the disagreements and problems with the respective packages that Japan instigated, it was clear that there was regional support for Japan's initiatives during the crisis. Indeed, Bello argued that the failure of the Japanese government to follow through with the AMF proposal "missed a golden opportunity to move decisively into the role of Asia's economic leader" as there remained near unanimous regional support, absent the silent opposition from China.<sup>110</sup> By the December 1998, other states in the region started to pursue some of Japan's initiatives. The proposal of South Korean Prime Minister, Kim Jong Pil, when visiting Japan, to revive the AMF showed a "degree of latent diplomatic support for resurgent Japanese financial leadership" across the region. In turn, encouraged by signs of new East Asian support for a regionally-based response to the currency and economic crises, Miyazawa hinted at the possibility of a new AMF plan in December 1998. This possibility, however, arrived in a different form.<sup>111</sup>

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<sup>107</sup> M. Castellano, "Japanese Foreign Aid: A Lifesaver for East Asia?" and H. Masaki, "Special loan program in Asia may be extended", [<http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20011217a1.htm>], Accessed 17/12/2001. The 'special yen-loan' program was extended to March/April 2002, with loans "extended at the exceptionally low interest rate of 0.95 percent and they are repayable over 40 years, instead of the 30 years for ordinary yen loans".

<sup>108</sup> S. McNulty and M. Nakamoto, 'Mahathir criticises 'inaccessible' aid plan', *The Financial Times*, 13<sup>th</sup> January 1999 and M. Castellano, "Japanese Foreign Aid: A Lifesaver for East Asia?." The Third World Network based their figures on the potential benefits of spending \$100 billion in an AMF-like proposal for disbursing funds around the region against domestic spending or tax cuts of the same amount. See Third World Network, "The potential contribution of Japan to Asian recovery: external aid and domestic fiscal stimulus," [<http://www.twinside.org.sg/title/japan-cn.htm>], Accessed 8/3/2000.

<sup>109</sup> H. Masaki, "Special loan program in Asia may be extended". The loans "are extended at the exceptionally low interest rate of 0.95 percent and they are repayable over 40 years, including a 10-year grace period, instead of the 30 years for ordinary yen loans".

<sup>110</sup> W. Bello, 'East Asia: on the eve of the great transformation', p. 436.

<sup>111</sup> C. Hughes, "Japanese Policy and the East Asian Currency Crisis: Abject Defeat or Quiet Victory?."

The end result of the 'politics of resentment'<sup>112</sup> was the Chiang Mai Initiative, a series of currency swap agreements that began as the centre piece of a new organisation of East Asian States called ASEAN+3. With this organisation's origins in attempts by former Japanese Prime Minister Hashimoto in January 1997 to formulate a closer relationship with ASEAN pre-empting the crisis proper, ASEAN+3 took on new pathologies after the crisis. ASEAN accepted a proposal for regular summits and extended the offer to China and South Korea, creating a 'pan-Asian' grouping. The first of these meetings began in Malaysia during December 1997, at the height of the crisis.<sup>113</sup> In the November 1999 meeting of ASEAN, Japan, as well as South Korea and China, joined the discussions, adding size and political influence.<sup>114</sup> In March 2000, Singapore's Finance Minister Richard Hu said that the AMF was not dead and could be re-opened during their next meeting in Thailand but would require Japan to show some initiative on the proposal.<sup>115</sup> Japan was also conscious of the political effect such programs would have on the region. Helping its neighbours when under considerable stress was "an effective way for Japan to build goodwill in a region still characterised by sensitive bilateral relations".<sup>116</sup>

The 'politics of resentment' would also increase trans-Pacific fears of a return to the pre-APEC debates about the nature of regional economic development and the interaction between markets and producers in the Asia Pacific. Despite these obvious internal difficulties, perceptions persist that closed protectionism is a certain extension of

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<sup>112</sup> Higgott, R., 'The International Relations of the Asian Economic Crisis: A study in the politics of resentment', in R. Robison, M. Beeson, K. Jayasuriya and H. Kim (eds.), *Politics and Markets in the Wake of the Asian Crisis*, Routledge, London, 2000, pp. 261-282.

<sup>113</sup> J. Henderson, 'Reassessing ASEAN', *Adelphi Paper*, No. 328, International Institute of Strategic Studies, London, 1999, p. 64.

<sup>114</sup> CNN, "Obuchi set to push Japan's role in Asia,"

[<http://www.cnn.com/ASIANOW/business/01/09/japan.asia.reut/index.html>], Accessed 17/1/2000, The Straits Times, "Japan, China, Korea to bolster 3-way trade,"

[<http://www.staitstimes.asia1.com.sg/breakingnews/story/0,1895,5644,00.htm>], Accessed 14/11/2000 and H. Masaki, "Japan to propose culture exchange with South Korea, China," [<http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20001121b6.htm>], Accessed 14/11/2000.

<sup>115</sup> CNN, "ASEAN shelves fund plan, to expand currency swaps,"

[<http://cnn.com/2000/ASIANOW/business/03/26/economy.asean.reut/>], Accessed 26/3/2000.

<sup>116</sup> M. Castellano, "Japanese Foreign Aid: A Lifesaver for East Asia?"

ASEAN+3. While there were positive views of this proposal,<sup>117</sup> Bergsten saw it as the birth of a 3-way split in international economics and politics between Europe, the America's and Asia.<sup>118</sup> From this point of view, there was a clear expectation that Japan would act as a leader in East Asia and defend itself and its East Asian neighbours against the ravages of global capitalism, withdrawing into a scenario that Immanuel Wallerstein posited years before, whereby East Asia, North America and Europe would retreat into competitive protectionist economic blocs.<sup>119</sup> As Pempel suggested in 1997, Japan has been at the centre of Asia's postwar moves toward rapid economic advancement and greater integration, and promised to be a central player in future regional developments.<sup>120</sup>

### ***Japan's role and East Asian Regionalism in the late 1990s***

The sense of invulnerability that Asia had experienced before the crisis was gone.<sup>121</sup> Pre-existing institutions such as APEC and ASEAN proved to be ineffective at either preventing, diluting or compensating for the effects of the crisis on its members.<sup>122</sup> As Leaver argued in the case of APEC,

At root, [APECs] limitations arose out of the total failure of the free trade economists who stood behind APEC to appreciate the political structure upon which regional economic independence was founded. To them, the Asia Pacific was a *tabula rasa* on which they were free to draw Cobdenite designs, with political relations simply conforming to the pattern of multilateralised free trade.<sup>123</sup>

International relations scholars attempted to reconcile the economic crisis to the ongoing struggle to develop frameworks to explain evolving trends in post-Cold War East Asia.<sup>124</sup>

There was also interest in seeing what kind of role the larger states could undertake as a

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<sup>117</sup> H. Dieter, "Monetary Regionalism: Regional Integration without Financial Crises," CSGR Working Paper No. 52/00, [<http://www.warwick.ac.uk/fac/soc/CSGR/wpapers/wp5200.pdf>], Accessed 20/5/2000.

<sup>118</sup> F. Bergsten, 'Tigers throw off shackles', p. 44.

<sup>119</sup> see I. Wallerstein, 'Friends as Foes', *Foreign Policy*, 40, Fall 1980, pp. 119-131.

<sup>120</sup> T. Pempel, 'Gulliver in Lilliput: Japan and Asian economic regionalism', p. 14.

<sup>121</sup> A. Sen, *Beyond the Crisis: Development Strategies in Asia*, Asia & Pacific Lecture Series no. 2, ISEAS, Singapore, 1999, p. 29.

<sup>122</sup> B. Job, "ASEAN Stalled: Dilemmas and Tensions Over Conflicting Norms," [<http://pro.harvard.edu/abstracts/016/016001JobBrian00.html>], Accessed 3/6/2000.

<sup>123</sup> R. Leaver, 'New Security' in the 'New Dispensation': prospects and problems of Japanese–Australian cooperation', paper presented at *Australia, Japan and Regional Security in the Age of Global Terror* conference at the Monash Asia Institute, 26-27 February 2004, p. 7.

<sup>124</sup> See R. Higgott, 'Ideas, Identity and policy coordination in the Asia Pacific', *The Pacific Review*, 7(4), 1994, pp. 367-378, D. Kang, 'Getting Asia Wrong: The Need for New Analytical Frameworks', *International Security*,

result of the opportunities created in the wake of the crisis. Historically, regionalism offered Japan a means to overcome its postwar legitimacy deficit through weakening its relative bargaining position and building trust with East Asia. Similarly for Southeast Asia, organisations like ASEAN, ARF and Asia Europe Meeting (ASEM) provided collective bargaining against larger and potentially threatening neighbours while minimising internal inconsistencies and weakness. ASEAN+3 built upon foundations that had historically led to the proposals for the EAEC and an AMF – a general feeling of resentment against Western global capitalism, an emotion emboldened by the end of the East Asian Miracle.<sup>125</sup>

As mentioned in Chapter 5, the most prevalent view in the Asia Pacific saw APEC as the beginning of a new regional era, based on liberal ideas of freedom and compatible mutual interests. This fledgling organisation came to be seen as a panacea for all the building economic and political tensions in the region as well as stopping increasing protectionism in the rest of the globe which affected Japan's export industries and global investments.<sup>126</sup> Also mentioned previously was a longstanding theoretical competitor to APEC, that of closed regionalism typified by the European experience, linked with EAEC and the proposed AMF and nascent ASEAN+3 group.

While these competing visions fought for support, the Asian Crisis changed the landscape of the debate. Acharya noted just before the Asian Crisis,

to a large extent, the emergence of multilateralism in the Asia-Pacific region has been process-driven, rather than motivated by specific actors, challenges, or events. In this sense, developing a process consistent with existing regional norms and practices that makes participants comfortable interacting with each other has been more important than the substance of multilateral gatherings.<sup>127</sup>

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27(4), Spring 2003, pp. 57-85 and J. Rüländ, 'ASEAN and the Asian Crisis: theoretical implications and practical consequences for Southeast Asian regionalism', *The Pacific Review*, 13(3), 2000, pp. 421-451.

<sup>125</sup> see R. Higgott, 'The International Relations of the Asian Economic Crisis: A study in the politics of resentment', in R. Robison, M. Beeson, K. Jayasuriya and H. Kim (eds.), *Politics and Markets in the Wake of the Asian Crisis*, Routledge, London, 2000, pp. 261-282 and F. Bergsten, 'Tigers throw off shackles', *The Australian*, July 17<sup>th</sup> 2000, p. 44.

<sup>126</sup> Tsutomu Kikuchi and Akio Watanabe, 'Japan's Perspective on APEC: Community or Association?', in 'America, Japan, and APEC: The Challenge Of Leadership in the Asia-Pacific', *NBR Analysis*, 6(3), November 1995, pp. 24, 33-34.

<sup>127</sup> A Acharya, 'Multilateralism: Is There An Asia-Pacific Way?', *NBR Analysis*, 8(2) May 1997, pp. 1-18. Yukio Satoh, a senior Japanese Foreign Ministry official closely involved in the formative stages of regional security dialogues, provided a set of arguments as to why. He offered four reasons: (1) During the Cold War, Asia lacked clear bipolarity of Europe; (2) military conditions and alliances in each region were different; (3)

Japan played a major role in the crisis aftermath, where East Asia and the US support for the different variations of regionalism sought to co-opt Japan into supporting their plans. Yet, with the crisis, regional institutions such as APEC and ASEAN, the foundation stone of its diplomatic efforts in Southeast Asia since the mid-1970s, were inadequate in the prevailing crisis conditions.<sup>128</sup> As before, Japan and its leadership were very much linked to the self interests of those actors and countries driving the proposals.

The preferred means of US interaction in the region continued to be based upon either leveraging bilateral relationships or through multilateralism. APEC became part of a strategy to reform the region to reduce the structural imbalances between East Asia and the US. As mentioned earlier, US *gaiatsu* aimed at pressuring Japan to not only acquiesce to regional market liberalisation but also act to pressure the region for reforms, fulfilling Japan's role as a primary US ally and important structural power in the global economy. However, as mentioned in the previous chapter, APEC's role diminished as the Asian Crisis and other events conspired to upset the consensus that formed the organisation in 1989. Hellmann made it clear that Japan and China, due to legitimacy deficits (China's deficiencies included past attempts at regional hegemony and its Communist rule) and the lack of wider regional support, were unable to provide the leadership needed for the growth and stability of the wider region.<sup>129</sup> As a result, the US needed to pursue opportunities for action to fulfil its systemic interests in open markets through organisations such as APEC.<sup>130</sup>

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Asia had a larger number of unresolved conflicts and disputes; and (4) while Europe during the Cold War was preoccupied with the threat of nuclear war, Asia's main concern was with economic development; thus the primary aim of regional cooperation to date has been economic, not political or security. see Yukio Satoh, "Asian-Pacific Process for Stability and Security," paper prepared for the Manila Conference on Regional Security, sponsored by the Government of the Philippines, June 5–7, 1991, pp. 5–6 cited from Acharya, "Multilateralism: Is There An Asia-Pacific Way?"

<sup>128</sup> P. Bustelo, "The Impact of the Financial Crises on East Asian Regionalism."

<sup>129</sup> D. Hellmann, 'America, APEC, and the Road not Taken: International Leadership in the Post-Cold War Interregnum in the Asia-Pacific' in 'America, Japan, and APEC: The Challenge Of Leadership in the Asia-Pacific', *NBR Analysis*, Volume 6, Number 3, November 1995, p. 6.

<sup>130</sup> D. Hellmann, 'America, APEC, and the Road not Taken', pp. 12-16.

Yet, despite its interests, the US could not stop the drift away from open multilateralism, and a major element of the apathy attributed to APEC was driven by a lack of leadership by both Japan and the United States. By the late 1990s, there were few states willing to offer the support APEC needed to exist as a purely economic organisation. APEC was delayed by the refusal, led by Japan at the 1995 meeting in Osaka, to liberalise their markets, especially for agricultural goods, which halted the progress made after the Bogor Declaration a year before. The lack of widespread progress towards liberalisation within the time limits conspired to further weaken the organisation. The US practice of using the organisation as a bargaining tool for discussions with the European Union over trade liberalisation added to tensions. Economic liberals like Drysdale argued that wide scale liberalisation was in the 'regional interest', even when liberalisation was targeted in the region as one of the major reasons for the crisis. During the 1997 APEC meeting in Vancouver, little occurred to stop the spread or mitigate the crisis, other than support for widely criticised IMF packages. To further undermine relations between Southeast Asia and the US, the 1998 APEC summit in Kuala Lumpur saw the then US Vice-President Gore chide the host country for political oppression, famously calling for 'Reformasi' while his Malaysian hosts fumed and any chance for consensus ended.<sup>131</sup> The 1999 meeting in Auckland was again a major disappointment, with most of the discussions centring on Australia's efforts to gain regional support for its effort to resolve the issue of East Timor. As Ravenhill pointed out, APEC was no longer seen as the institution to undertake regional trade liberalisation, as countries eschewed the voluntary consensus in APEC for the clear, enforceable guidelines laid down by the WTO.<sup>132</sup> APEC became a place for regional consultation or an economic area increasingly typified through partial Regional Trade Agreements (RTAs) between members.<sup>133</sup>

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<sup>131</sup> E. Altbach, "APEC Squabbles Over Trade, Politics Overshadow U.S.-Japan Aid Plan".

<sup>132</sup> J. Ravenhill, "APEC and the WTO: Which way forward for Trade Liberalisation?," [\[http://www.iuj.ac.jp/research/wpap011.html\]](http://www.iuj.ac.jp/research/wpap011.html), Accessed 27/4/2001.

<sup>133</sup> See F. Bergsten, "Back to the Future: APEC looks at Subregional Trade Agreements to achieve Free Trade goal," [\[http://207.238.152.36/papers/bergsten1000.htm\]](http://207.238.152.36/papers/bergsten1000.htm), Accessed 28/6/2001.

South and Northeast Asian leaders, through the institutions of ASEAN, ARF, ASEM and ASEAN+3, expected more of Japan in this post crisis environment. The question of Japanese trade continued to rankle with regional leaders expecting Japan to fulfil its traditional role as a market for regional goods. Japan's trade with and investments in the countries of East and Southeast Asia were important to the future of its business interests as well as the interests of the regional economies of which large Japanese companies constituted major employers and sources of local tax revenue.<sup>134</sup> As Table 6.3 demonstrates, Japan's role as an export market did diminish for ASEAN-5, although not as much as would have been expected given continued ASEAN and US *gaiatsu* on the subject. What becomes clear is the reason for this pressure is that the US has become the region's market of last resort, rather than Japan. Also interesting in these figures is the substantial drop in imports from Japan, highlighting the currency effects of the crisis. It also hints at its diminishing role as a source of imported goods.

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<sup>134</sup> M. Castellano, "Japanese Foreign Aid: A Lifesaver for East Asia?."

**Figure 6.3: ASEAN-5 Balance of Trade with Japan, 1996-2000 (in US\$ millions)**

<b>Indonesia</b>	Exports	Imports	Balance	Exports to Japan as % of total exports	Imports from Japan as % of total imports	Exports to US as % of total exports	Imports from US as % of total imports
1996	12885.2	8504	4381.2	25.89	19.82	13.65	11.79
1997	12485	8252.3	4232.7	23.37	19.79	13.39	13.06
1998	9116	4292.4	4823.6	18.66	15.70	14.42	12.89
1999	11470.5	5399.1	6071.4	23.58	22.49	19.00	8.82
2000	14466	8154.2	6311.8	23.29	24.33	16.24	8.14
<b>Thailand</b>							
1996	9373	20449	-11076	16.81	27.88	17.99	12.59
1997	8733	16165	-7432	15.17	25.74	19.38	13.80
1998	7475	10175	-2700	13.71	23.60	22.34	14.04
1999	8259	12256	-3997	14.11	24.34	22.75	12.17
2000	10164	15315	-5151	14.74	24.73	21.34	10.72
<b>Malaysia</b>							
1996	10498	19241	-8743	13.42	24.53	18.22	15.46
1997	9983	17381	-7398	12.65	21.99	18.44	16.76
1998	7716	11470	-3754	10.50	19.66	21.62	19.62
1999	9839	13633	-3794	11.64	20.82	21.91	17.42
2000	12825	16787	-3962	13.06	20.42	22.69	15.94
<b>Singapore</b>							
1996	10253	23840	-13587	8.19	18.15	18.43	16.41
1997	8850	23282	-14432	7.06	17.56	18.45	16.88
1998	7226	17010	-9784	6.56	16.74	19.89	18.48
1999	8513	18505	-9992	7.42	16.66	19.22	17.12
2000	10034	23248	-13214	7.27	17.26	16.91	15.05
<b>Philippines</b>							
1996	3668	6916	-3248	17.85	21.78	33.91	19.66
1997	4194	7955	-3761	16.63	20.33	35.12	19.49
1998	4234	6371	-2137	14.35	21.58	34.39	23.33
1999	4660	6136	-1476	13.13	19.97	29.57	20.71
2000	6082	9067	-2985	15.98	28.89	32.91	28.15

Source: IMF, *Direction of Trade Statistics*, various issues. Excludes Brunei.

While the US and Australia feared a return of EAEC with its connotations of an adversarial 'pan Asian' formula and distinct Japanese economic guidance, despite public comments from Dr. Mahathir,<sup>135</sup> these fears overplayed the role that Japan had in the region. Closed regionalism's links to regional perceptions of Japan's role were the result of common economic circumstances and fears following the crisis. After 1997, ASEAN's response to Japan reflected a collective attempt to solve a collective problem, with the added incentive

<sup>135</sup> G. Sheridan, 'Stay away, arrogant Howard: Mahathir', *The Australian*, July 8<sup>th</sup> 2000, p. 8 and Global Sources, "Malaysia asks Japan to rethink East Asian Caucus Proposal."

of increased intra-regional dialogue in a region that still bore the US hub-and-spokes system of bilateral relationships.<sup>136</sup> ASEAN states, although they lacked cohesiveness for large sections of the post-crisis period, all shared fears that new markets and competitors (like China), a decline in FDI to ASEAN countries and a widening gap between ASEAN members were putting extra pressures on the organisation and "undermining regional solidarity".<sup>137</sup> In 1999, the expansion of Japan's regional economic role was one that gained broad acceptance as ASEAN leaders expressed their support for Japan's moves "to enhance and expand assistance in order to redress economic disparity within the ASEAN region and enhance the organisational capacity of ASEAN".<sup>138</sup> Initiatives like the skills-focused Obuchi Plan became a growing part of Japan's regional profile.<sup>139</sup>

Another element of Japan's leadership role during this period lay in the use of its financial strength to respond to the economic adversity facing the wider region. The main outcome from ASEAN+3 became an extended form of a currency swap arrangement within the regional grouping, with the initial \$200 million in agreements supplemented by bilateral agreements.<sup>140</sup> Japan agreed to arrangements with Thailand (\$3 billion), South Korea (\$2 billion) and Malaysia (\$1 billion) with the latter two already having swap arrangements under the Miyazawa Initiative. To allay US concerns, in all but crisis conditions, the IMF was to have supervision of the funds.<sup>141</sup>

However, there were limits to Japan's interaction with the region before the Asian Crisis, reinforcing the central argument of this thesis, that leadership roles in international affairs are determined by state self-interest. In January 1997, when visiting Southeast Asia,

<sup>136</sup> T. Pempel, 'Gulliver in Lilliput: Japan and Asian economic regionalism', p. 13.

<sup>137</sup> The Straits Times, "ASEAN keen on bolder trade link-ups", [<http://www.straitstimes.com.sg/storyprintfriendly/0,1887,82357,00.html>], Accessed 19/11/2001.

<sup>138</sup> MOFA, "Press Statement by Prime Minister Keizo Obuchi, Manila, The Republic of the Philippines, 28<sup>th</sup> November 1999," [[http://www.mofa.go.jp/region/asia-paci/asean/pmv9911/press\\_pm1.html](http://www.mofa.go.jp/region/asia-paci/asean/pmv9911/press_pm1.html)], Accessed 12/4/2000.

<sup>139</sup> MOFA, "Japan's Initiatives for the Human Resources Development in ASEAN Countries," [<http://www.mofa.go.jp/region/asia-paci/relation/human.html>], Accessed 22/8/2001.

<sup>140</sup> CNN, "ASEAN shelves fund plan, to expand currency swaps."

<sup>141</sup> The Japan Times, "Asian currency swap plan nears fruition," [<http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nb20010511a5.htm>], Accessed 13/5/2001.

PM Hashimoto pushed for an annual summit to be established between Japan and ASEAN. Yet ASEAN declined this proposal, much to the chagrin of MOFA and the rest of the Hashimoto Cabinet, instead preferring the multilateral to the bilateral approach.<sup>142</sup> ASEAN also realised the implications of keeping the US in regional dialogue and minimising its reliance on Japan, China and South Korea. At the November 2001 ASEAN+3 meeting, a East Asia Free Trade Zone (EAFTZ) and an annual East Asia Summit, were the main ideas discussed,<sup>143</sup> but were dropped due to earlier difficulties, such as the position of the US, discussed during Chapter 5.

### ***Japan's limited role beyond economic agency***

Although the Asian Crisis drew stronger qualified requests for an increased role in regional politics, political and strategic affairs was still seen as being too sensitive to contemplate. East Asian perceptions of Japanese leadership remained largely dependent on regional and individual state interest. ASEM and a greater willingness of the region to accede to Japan's actions in a multilateral regional response demonstrated the ongoing regional desire for Japan to fulfil a role supporting regional economic development and stability. Political leadership, one of the elements of responsibility commensurate with economic size, remained a fraught commodity for Japan and its role in the wider region. As noted previously, the diplomacy utilised in APEC, ASEAN+3, ASEM, ARF and regional UN actions were all focused on ASEAN. This is a point often overlooked in the wider literature. Because of long standing Southeast Asian fears of great power adventurism, regional agency often had to progress through ASEAN before being instituted in practice.<sup>144</sup>

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<sup>142</sup> S. Yamakage, "Japan-ASEAN Relations during and after the 1997-98 Crisis", [<http://www.warwick.ac.uk/fac/soc/CSGR/conf99/yamakage.pdf>], Accessed 22/8/2001.

<sup>143</sup> C. Lee Hoong, "Two Big Ideas' to boost East Asia," [<http://straitstimes.asia1.com.sg/storyprinterfriendly/0,1887,5860,00.html?>], Accessed 20/11/2000.

<sup>144</sup> See J. Henderson, 'Reassessing ASEAN', *Adelphi Paper*, No. 328, International Institute of Strategic Studies, London, 1999.

Given the ongoing debate about Japan and the dual struggle to manage its lack of commensurate state power and its legitimacy deficit, political activism by Japan was heavily scrutinised. While happy to support Japanese initiatives on regional foreign policy and UN-sponsored regional engagements, such proposals were treated far more cautiously than its economic initiatives. While Japan's UN-centred or multilateral diplomacy was not practiced until after the Cold War,<sup>145</sup> pronouncements by Japan promising it would engage the world as a 'responsible' global player,<sup>146</sup> were entirely dependent upon the strength of the region's faith in Japanese credibility. In some areas, given the region's desire for economic growth and strategic stability, a growing Japanese presence was anticipated. Japan's desire to contribute responsibly to international organisations and the UN Security Council (UNSC) was demonstrated through its involvement in UN actions in Cambodia and East Timor<sup>147</sup> amongst others (seen in Chapter 5), and Japan thereby demonstrated its increasing ability to act as a responsible member of the regional community. Amongst the states that had acted as non-permanent members of the UNSC, Japan had held a seat 14 times, the most frequent non-permanent member along side of Brazil.<sup>148</sup> At an estimated 20 percent and second only to the US in terms of total funding, Japan felt that its financial commitment to the UN should be formalised by its permanent admission into the UNSC Council, a point repeatedly emphasised by the Japanese.<sup>149</sup> The repetition did little to improve their candidacy, with little to no support from the region and outright opposition from China.<sup>150</sup>

Similarly, when it came to ASEM and other multilateral fora, Japan's role remained very much in step with regional interests. Formed in 1994, ASEM sought to increase political and economic links between Europe and ASEAN, with Japan and China as active

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<sup>145</sup> A. Fukushima, *Japanese Foreign Policy: The Emerging Logic of Multilateralism*, Macmillan, London, 1999, pp. 78-79.

<sup>146</sup> MOFA, "Challenge 2001 - Japan's Foreign Policy toward the 21<sup>st</sup> Century," [<http://www.infojapan.org/policy/other/challenge21.html>], Accessed 27/3/2000.

<sup>147</sup> See MOFA, "Emergency Aid to East Timor for Rehabilitation and Development," [<http://www.mofa.go.jp/announce/announce/2000/7/714-2.html>], Accessed 31/7/2001.

<sup>148</sup> A. Fukushima, *Japanese Foreign Policy: The Emerging Logic of Multilateralism*, p. 94.

<sup>149</sup> S. Simon, 'Multilateralism and Japan's Security Policy', *The Korean Journal of Defence Analysis*, 11(2), Winter 1999, pp. 83-84.

<sup>150</sup> G. Hook, J. Gilson, C. Hughes and H. Dobson, *Japan's International Relations*, p. 314.

participants albeit in supporting roles.<sup>151</sup> Previously, Japan constructed links with Europe through The Hague Declaration, itself a move to promote trade and offer developmental advice to East and Central Europe.<sup>152</sup> However, according to Gilson, despite some Japanese officials seeing it as a 'soft counterbalance' to perceptions of diminishing US regional interest, Japan's involvement in ASEM was aimed primarily at strengthening ties with its Asian neighbours.<sup>153</sup> Sensitive issues such as human rights and Japan's strategic regional role were excluded from the main dialogue during the summits.<sup>154</sup>

There were other instances of Japan acting to improve East Asia's economic and political position globally whilst simultaneously promoting the perception that Japan was a responsible state that could be trusted to make executive decisions unilaterally. Such an instance occurred before the G-8 summit held in Japan during July 2000, when the then Prime Minister Obuchi made a regional visit, putting Japan forward as a regional representative. Japan wanted "to have the voices and concerns of as many Asian countries as possible reflected in the discussions of the G-8 leaders", a desire that was received positively.<sup>155</sup> Another instance regarded the succession to the top position at the IMF. When the term of Michel Camdessus, the then head of the IMF who had presided over the Asian IMF packages, expired, Japan put forward Eisuke Sakakibara as his replacement, arguing that the old method of choosing the position<sup>156</sup> was outdated and needed reform. While his reputation as the former Vice-Minister for International Finance in MOF gave him credibility, he was also the originator of the AMF proposal in mid-1997 and, as such, a controversial candidate.<sup>157</sup> With regional support led by Thailand, this initiative saw regional identity and the 'politics of resentment' drive policy, an aspect that Thai Prime Minister Chuan Leekpai explained when he remarked that Thailand was supporting

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<sup>151</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting', p. 738.

<sup>152</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting', p. 739.

<sup>153</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting', p. 741.

<sup>154</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting', pp. 742-743.

<sup>155</sup> CNN, "Obuchi set to push Japan's role in Asia."

<sup>156</sup> It was customary for a European candidate to become the Managing Director of the IMF and an American candidate to be the President of the World Bank.

<sup>157</sup> Business Times, [<http://business-times.asia1.com.sg/1/focus/focus11.html>], Accessed 28/2/2000.

Eisuke's candidacy because Japan supported Thailand's candidate for Head of the WTO.<sup>158</sup> Japan's attempt at the IMF failed, but it did signify that regional support was available for a larger role for Japan, if those efforts coincided with regional interests.

For all of the support, Japan's past geopolitical misconduct continued to lie in the background, always ready to erupt as a mainstream issue. As noted earlier, although the 'history issue' was used as *gaiatsu* by members of the region to keep Japan on the diplomatic defensive, Japan's foreign policy choices were constantly constrained given Japan's implicit vulnerability to foreign pressure. In 1996, the issue of 'comfort women' erupted, even after the unprecedented intervention by Prime Minister Murayama to accept their existence. The Senkaku Islands dispute with China and Taiwan continued to be the most serious of sovereignty problems resulting from the legacy of Japan's wartime aggression and the inability of the postwar governments to entirely settle such problems.<sup>159</sup>

More troubling for the region was Japan's response to these issues. There was increased Japanese resistance to the notion of a continuing legitimacy deficit after Murayama's official, but limited, apology. A strong feeling in Japan existed in Japan that it had already apologised a number of times and that new attempts were unnecessary.<sup>160</sup> In a phrase that came to be used in the late 1990s frequently in communiqués between Japan, China and South Korea, discussions of future cooperation were conducted on the basis of 'future-oriented' diplomacy. Unfortunately, while such a view enabled new discussions on increased trade and cultural links up until 2001, without a common view of Japan's colonial legacy, this attempt stumbled over past misdeeds. The eruption of textbook controversies in Japanese secondary schools beginning in 2001 that drew a formal rebuke from South

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<sup>158</sup> BBC, "IMF leader battle heats up,"

[<http://news2.thls.bbc.co.uk/hi/english/business/newsid%5F655000/655765.stm>], Accessed 22/2/2000.

<sup>159</sup> H. Fukui and S. Fukui, 'Japan in 1996: Between Hope and Uncertainty', *Asian Survey*, 37(1), Jan 1997, p. 21.

<sup>160</sup> Symptomatic was this statement by Owada Hirashi: "You asked why is it that the Japanese have not made a complete, frank admission of the guilt and offered apologies. I think that that precisely is the program, because as far as Japan is concerned, and as far as the government of Japan is concerned, representing the nation of Japan as a whole, people feel that the government has offered apologies". See H. Owada, President of the Japan Institute of International Affairs and adviser to the Minister for Foreign Affairs of Japan, "Relations between Japan and Australia in the Context of the Evolving Situation in East Asia", speech to the National Press Club, Canberra, Tuesday 31 July 2001.

Korea was to be a near annual event.<sup>161</sup> Similarly, the visits of Prime Minister Mori and Koizumi to the Yasukuni Shrine which commemorated Class 'A' war criminals added to the ongoing regional perception of historical irresponsibility.<sup>162</sup>

### ***Leadership, Japan and the rise of China***

Interestingly, in this period, perceptions of Japanese leadership became linked with China and its increasingly influential economic position, in relation to Japan and the wider region. Like Southeast Asia, questions of role and responsibility occurred at a time of rapid increases in bilateral economic activity. Bilateral trade grew from \$5 billion in 1978, to \$64 billion in 1998, to \$88 billion in 2000, with Japan becoming China's biggest export market and China increasingly rivalling the US as Japan largest trade partner.<sup>163</sup> With its rapidly growing economy, military capacity and historical position as hegemon in the region, China considered itself to be the next regional leader; a view that grew stronger with Japan's economic and political limitations. Through the creation of organisations such as ASEM and ARF, it was widely hoped that tensions both within the region and between China and Japan could be diffused and cooperation enhanced at a time of regional weakness.<sup>164</sup> For Japan, by embedding itself within these regimes, China's rise to greater geopolitical significance could be accommodated without upsetting the existing regional balance. These regimes could also ease Chinese concern about Japan's relationship with the US. While US, European and some Japanese commentators still hung onto the vision of Japan as a 'global civilian power', the bilateral relationship between East Asian titans did not follow the path of Japan as a bridge or reconciliator.<sup>165</sup>

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<sup>161</sup> Republic of Korea Ministry of Foreign Affairs and Trade, "Review of the Japanese History Textbooks: Notes on Necessary Corrections Related to Korea", [<http://www.mofat.go.kr/main/etop.html>], Accessed 16/11/2001.

<sup>162</sup> M. O'Hanlon and G. Ikenberry, "Japan has Kept Asia Anxious too long", [<http://www.brook.edu/dybdocroot/views/op-ed/ohanlon/20010816.htm>], Accessed 3/2/2002.

<sup>163</sup> P. Drysdale and D. D. Zhang, 'Uneasy Bedfellows in East Asia', in Peter Drysdale and Dong Dong Zhang (eds.), *Japan and China: Rivalry or Cooperation in East Asia*, Asia Pacific Press, Canberra, 2000, p. 5.

<sup>164</sup> J. Wanandi, 'Boost ARF - and security', *Asiaweek*, 31<sup>st</sup> July 1998, p. 59.

<sup>165</sup> M. O'Hanlon and G. Ikenberry, "Japan has Kept Asia Anxious too long" and R. Drifte, *Japan's Security Relations with China since 1989: From Balancing to Bandwagoning*, RoutledgeCurzon, London, 2003, pp. 36-38, 75.

Despite Japan's intentions, China viewed Japan's regional role with suspicion, seeing Japan's hedging initiatives as another path towards economic gains by its neighbour and closely watched its leadership initiatives in the region.<sup>166</sup> It was also quick to use *gaiatsu* to pressure Japan, often highlighting its conflicted role as a US ally and an East Asian state. Deng suggested China viewed Japan's failure of leadership through the APEC process as further undermining its already tenuous diplomatic position between the interests of East Asia and the US. He also noted, following the conventional view of leadership, that Japan could not be a leader in regional affairs with a closed market, demonstrated with the continual difficulties posed by the agricultural sector in bilateral and multilateral trade negotiations with the surrounding region and the US.<sup>167</sup> Incomplete discussions on the postwar settlement left over from the initial 1972 framework, along with Chinese stipulations that Japan demonstrate ongoing remorse towards its war-time actions in China left bilateral relations unbalanced and open to conflict. While in 1972 both states committed to not seek regional hegemony, a policy that became part of the 1978 Treaty of Peace and Friendship, the change in relative bargaining positions of China and Japan made that pronouncement look increasingly tenuous.<sup>168</sup> For the first time in modern history, the Northeast Asian neighbours were rivals for a position that neither officially sought. However, it was clear that China, just through not having the same strictures on its regional role as Japan, was in a position to challenge Japan's regional influence.

Nevertheless, the tension continued to build as questions relating to the strategic capabilities or suitability for regional leadership for each grew.<sup>169</sup>

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<sup>166</sup> J. Gilson, 'Japan's Role in the Asia-Europe Meeting', p. 742.

<sup>167</sup> Y. Deng, 'Japan in APEC: The Problematic Leadership Role', *Asian Survey*, 37(4), April 1997, p. 357, 360-364.

<sup>168</sup> Wang Yi, 'Trends in Sino-Japanese Relations and the Challenges Ahead for Asia', *Columbia International Affairs Online*, Columbia University Press, August 1999, [<https://www.cc.columbia.edu/sec/dlc/ciao/wps/yiw01/>], Accessed 20/11/2000.

<sup>169</sup> P. Drysdale and D. D. Zhang, 'Uneasy Bedfellows in East Asia', p. 4, Y. Bin, 'Containment by Stealth: Chinese Views of and Policies toward America's Alliances with Japan and Korea after the Cold War,' [[http://www.stanford.edu/group/APARC/publications/papers/YuBin\\_final\\_PM.pdf](http://www.stanford.edu/group/APARC/publications/papers/YuBin_final_PM.pdf)], Accessed 14/3/2000 and D. Hellmann, 'America, APEC, and the Road not Taken: International Leadership in the Post-Cold War Interregnum in the Asia-Pacific' in 'America, Japan, and APEC: The Challenge Of Leadership in the Asia-Pacific', *NBR Analysis*, Volume 6, Number 3, November 1995, p. 6.

[T]he Japanese suspect that China still embraces the traditional 'Middle Kingdom mentality' (*chuka shiso*), a kind of Sino-centric view about East Asian relations that assumes a central position for China and assigns an inferior one to Japan. The Japanese also believe that China adopts a great-power approach to foreign policy and practices *Realpolitik* in the international arena, again to Japan's detriment... These views, combined with such factors as the [Peoples Republic of China] PRC's political system and the lack of transparency over its military modernisation drive, have sustained a distrust of China. Moreover, Japan remains anxious about how to deal with a China that continues to get stronger and is at a loss over how to manage relations with a power that had (and has) been the focus of the region for centuries.<sup>170</sup>

The question of regional economic, political and strategic leadership has also been a growing source of Japanese angst, as China began to eclipse Japan's role as a regional developmental model and catalyst. The METI 2001 White Paper described China as a threat to Japan's economic leadership in the region, as it became the world's largest destination of foreign investment, coupled with its increasing technical skill in textiles and machinery. The report also noted that this skill could soon be extended to electronics and IT.<sup>171</sup> China's nuclear 'posturing' in the mid 1990s and the growth of military spending in line with GDP growth (at a level of 8.5/9 percent) drove increasing fears of a 'China' threat, a threat that was responded to by cuts in Japan's discretionary aid budgets.<sup>172</sup> The fact that Robert Zoellick, an influential Republican, noted that "[i]t is generally felt that Japan has failed the test of leadership, while China, so far, has advanced its stature" during the Asian Crisis, accentuated fears of abandonment.<sup>173</sup>

Much of Japan's diplomacy from the late 1990s followed a path of minimising damage caused by an inability to match Chinese diplomatic flexibility, marrying its customary low foreign policy profile with vague pledges. For example, much of the major policy speech Koizumi made in 2002 argued that Japan remained central in the regional architecture, a position in question following China's offer of a China-ASEAN FTA in November 2001. Koizumi argued, "in the 21<sup>st</sup> Century, as sincere and open partners, Japan

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<sup>170</sup> W. Xinbo, 'The Security Dimensions of Sino-Japanese Relations', *Asian Survey*, 40(2), March/April 2000, p. 308.

<sup>171</sup> M. H. Armacost and K. B. Pyle, "Japan and the Engagement of China: Challenges for U.S. Policy Coordination", [<http://www.nbr.org/publications/analysis/vol12no5/essay.html>], Accessed 11/2/2002.

<sup>172</sup> R. Drifte, *Japan's Security Relations with China since 1989*, pp. 42, 44-46.

<sup>173</sup> R. Zoellick, 'The Political and Security Implications of the East Asian Crisis', in 'The East Asian Crisis: Implications for U.S. Policy', *NBR Analysis*, 9(4), December 1998, p. 6.

and ASEAN should strengthen their cooperation under the basic concept of 'acting together- advancing together'.<sup>174</sup> He matched the Chinese initiative with a 'Japan-ASEAN Comprehensive Economic Partnership', and an 'Initiative for Development in East Asia', yet both proposals lacked the clarity of China's earlier proposal. Efforts were made to reconcile differences in role. During October 2000, the Chinese Premier Zhu Rongji made visited Japan to ease tensions between the two, highlighting the economic links between the two countries as well as soothing the fear that Japan's donation of ¥2.6 trillion (\$24 billion) in ODA over the past 20 years could be used to update their military, which in turn threatened Japan.<sup>175</sup>

ASEAN was also aware of the potential switch in roles in the region. A Japan-sponsored conference in 2002 highlighted the potential for conflict between the two neighbours.<sup>176</sup> Despite its relative economic decline, East Asian states expected Japan to take a leadership role in the region's recovery. In a symposium titled 'Prospects for Japanese and ASEAN economies under the new paradigm of emerging China', regional economists looked to Japan to revive its own economy and renew the dynamism in Japan's economy to the rest of the region, both through FDI and trade.

Both countries felt threatened by each other's military capacity, with China uncomfortable about Japan taking on a growing political or strategic role in regional affairs. As Drifte noted, China often used 'preventative reminding' about Japan's past war crimes when it perceived Japan becoming too active in regional affairs.<sup>177</sup> China saw the Japan-America Security Agreement (JASA) as a tool that maintained US dominance over the region, constraining Chinese influence and actions as well as potentially allowing Japan to

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<sup>174</sup> Prime Minister's and Cabinet Office (*Kantei*), "Speech by Prime Minister of Japan Junichiro Koizumi; Japan and ASEAN in East Asia - A Sincere and Open Partnership", [[http://www.kantei.go.jp/foreign/koizumispeech/2002/01/14speech\\_e.html](http://www.kantei.go.jp/foreign/koizumispeech/2002/01/14speech_e.html)], Accessed 15/1/2002.

<sup>175</sup> CNN, "Chinese premier praises Japanese technology in visit", [<http://www.cnn.com/2000/ASIANOW/east/10/15/japan.china.ap/index.html>], Accessed 15/10/2000 and CNN, "Chinese premier highlights friendly image on TV show", [<http://www.cnn.com/2000/ASIANOW/east/10/14/japan.china.ap/index.html>], Accessed 14/10/2000.

<sup>176</sup> The Japan Times Online, "Asian states can beat crises: economists", [<http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20020131x1.htm>], Accessed 1/2/2002.

<sup>177</sup> R. Drifte, *Japan's Security Relations with China since 1989*, p. 18.

remilitarise with substantial indigenous power projection capabilities.<sup>178</sup> The cooperation between Japan and the US the development of a Theatre Missile Defense (TMD) system and the expansion of the US-Japan Defence Guidelines in 1997 to extend joint operations to areas 'surrounding Japan', taken to mean Taiwan and the Senkaku/Diaoyu Islands, reinforced these fears.<sup>179</sup> On the other hand, Japan's desire to push its interests in the region have been worrying for China, not least because of the reluctance of Japan to apologise for the past wrongs perpetrated in China during the Second World War.<sup>180</sup>

### ***The broader Japan-US partnership***

Despite previous wisdom, the 20<sup>th</sup> Century was indeed 'still the American Century',<sup>181</sup> belying commentators who predicted the irresistible rise of Japan and Asia as a whole. Japan, despite its trade and current account surplus, faced the 'end of the miracle' while the US gained influence, buoyant on the back of a 'high-tech' boom. Fears of China's re-emergence as the dominant power in East Asia, coupled with worries that the US was shifting away from the alliance, led Japan to seek a closer alliance with its long standing ally.<sup>182</sup> This became particularly acute when President Clinton bypassed Japan when he visited China in June 1998. With memories of 1972 still fresh in the minds of Japanese officials, fears of being ostracised persisted. This went to the heart of the US perception of what Japan's leadership role should be. As Armacost and Pyle remarked, US foreign policy geared towards the Asia Pacific needed to reconcile the growth of China and the

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<sup>178</sup> D. Okimoto, "The Japan-America Security Alliance: Prospects for the Twenty-First Century", [\[http://www.stanford.edu/group/APARC/publications/papers/okimoto.PM.pdf\]](http://www.stanford.edu/group/APARC/publications/papers/okimoto.PM.pdf), Accessed 16/1/2000 and Y. Bin, "Containment by Stealth" and W. Xinbo, "The Security Dimensions of Sino-Japanese Relations", p. 298.

<sup>179</sup> W. Xinbo, "The Security Dimensions of Sino-Japanese Relations", pp. 299-300, R. Li, 'Partners or Rivals? Chinese Perceptions of Japan's Security Strategy in the Asia Pacific Region', *The Journal of Strategic Studies*, 22(4), December 1999, p. 11 and E. Brown, 'Japanese security policy in the post-Cold War era', p. 435.

<sup>180</sup> R. Li, 'Partners or Rivals?', p. 10 and Wang Yi, "Trends in Sino-Japanese Relations and the Challenges Ahead for Asia."

<sup>181</sup> see B. Cumings, 'Still the American Century', *Review of International Studies*, 25(5), December 1999, pp. 271-299 for a lucid and perceptive account of this component of writing on the US.

<sup>182</sup> P. Drysdale and D. D. Zhang, 'Uneasy Bedfellows in East Asia', in P. Drysdale and D. D. Zhang (eds.), *Japan and China: Rivalry or Cooperation in East Asia*, Asia Pacific Press, Canberra, 2000, p. 8 and C. Johnstone, 'Clinching the Giant: Tokyo's China Strategy and Implications for US-Japan Relations', in Peter Drysdale and Dong Dong Zhang (eds.), *Japan and China: Rivalry or Cooperation in East Asia*, Asia Pacific Press, Canberra, 2000, pp. 119.

maintenance of the Japan alliance by providing a framework that would "draw emergent Chinese power into a stable regional order".<sup>183</sup> As noted earlier, since the end of the Second World War, the US presence in East Asia relied upon a flexible interpretation of what role Japan had in East Asia: either as a 'cap' on Japanese re-armament or as a stabiliser of the regional balance of power. This duality, useful depending on whom was the target of US diplomacy, had another element. Rather than a view of leadership prefaced on systemic responsibility, the US view of Japan's leading regional role reinforced US national self interests.

Their bilateral security relationship was the most important regional public good in the eyes of both countries, albeit for different reasons. For Japan, it had enabled them to not only reintegrate themselves back into the region after the Second World War but also share the burden of defence. For the US, the alliance solidified its regional position in the Cold War as regional security guarantor in the face of Communist aggression. Since the end of the Cold War, as mentioned in Chapter Five, the alliance did weaken as one of the elements no longer existed. While Japan did expand its regional interaction through ARF and the UN, its alliance with the US remained the central tenet to both states' foreign and strategic policy, in the face of the diplomatic strain of the crisis and particularly in lieu of China's growing geopolitical significance.<sup>184</sup> In 1996, despite isolated incidences of misconduct by US soldiers in Okinawa, meetings between Clinton and Hashimoto reaffirmed the position of the alliance and the continued stationing of US troops on Japanese soil.<sup>185</sup> 1997 and 2000 saw the redrafting of the US-Japan Security Agreement that expanded strategic cooperation to territorial waters surrounding Japan, which itself was a continuation of Bush and Miyazawa's 'global partnership' initiative started in 1992. The

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<sup>183</sup> M. Armacost and K. Pyle, "Japan and the Engagement of China ".

<sup>184</sup> Y. Sato, "Toward a Non-threatening US-Japan Alliance".

<sup>185</sup> H. Fukui and S. Fukui, 'Japan in 1996: Between Hope and Uncertainty', pp. 20-21.

expansion of joint operations to Japanese territorial waters and other areas such as terrorism became natural extensions of this policy.<sup>186</sup>

Certainly, given the divergence in economic affairs, the political and strategic elements of the alliance became more important. In a managerial sense, the revised guidelines of September 1997 also provided clear rules on coordination and cooperation and removed much of the previous ambiguity required to determine what actions lay within the scope of the alliance. It also expanded the range of actions included under the alliance and continued the movement of the Japanese Defence Agency (JDA) towards being included as a ministry in its own right.<sup>187</sup> However, the movement to fulfil long standing US interests in boosting the alliance also weakened the ambiguity that the alliance had previously relied upon to maintain regional support for Japan's re-integration into the region. It was this lack of doubt and the increased politicisation of Japan's security role that increasingly worried China in particular, and to a lesser extent, South Korea and ASEAN.

While it was mentioned that this 'normalisation' of Japan's regional role was conducted under the protective force of the alliance, this argument was undermined by the inherent logic of the alliance. As far as the US was concerned, the alliance with Japan maintained US regional influence and acted as a deterrent against North Korean or Chinese actions towards South Korea or Taiwan. Japan needed to contribute more to the strategic element of the alliance. The US, in pursuing its own self interest in increasing burden-sharing in the alliance, undermined the political ability of Japan to overcome its legitimacy deficit, giving credence to region-wide fears of growing strategic power. As Johnstone pointed out, the role of Japan remained defined by US expectations and its national interest.

Alliance dynamics during the financial crisis illustrate the repeating pattern. Japan appears unable to discern what is needed; domestic political actors all too often fail to

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<sup>186</sup> M. Nishihara, 'The Japan-US Alliance: Defence Cooperation and Beyond', in M. Nishihara (ed.), *Japan-US Alliance: New Challenges for the 21<sup>st</sup> Century*, Japan Centre for International Exchange, Tokyo/New York, 2000, p. 9.

<sup>187</sup> K. Murata, 'Do the New Guidelines Make the Japan-US Alliance more effective?', in M. Nishihara (ed.), *Japan-US Alliance: New Challenges for the 21<sup>st</sup> Century*, Japan Centre for International Exchange, Tokyo/New York, 2000, pp. 21-29.

understand the international consequences of their decisions - or of their indecision. Tokyo ultimately responds to calls for action only with reluctance and in the face of severe international pressure... For its part, the US openly presses for more leadership from Japan, but Washington's demands are frequently unclear, contradictory and intrusive. Indeed the substance of such pressure often seems to be aimed at making Japan a better follower of *American* leadership. In Washington, the script for Japan's role as a global leader at times appears to cast Tokyo as little more than a well-financed advocate of US objectives.<sup>188</sup>

Similarly, Green aptly argued that "the United States tends to define Japanese 'leadership' as Tokyo doing what Washington wants without Washington having to tell Tokyo to do so".<sup>189</sup> More worrying for the region, already concerned by developments in the late 1990s, was the push for greater alliance cohesion. Robert Zoellick, currently Deputy US Secretary of State, argued in 1998 for strengthened security aspects of the relationship with Japan to enable joint action and increased inter-operability in any potential military action regarding the Korean peninsula or China.<sup>190</sup> This argument seemed to ignore the inherent complexities of its prescriptions. Japan and South Korea's awkward relationship made a unified alliance response to a potential crisis on the Korean Peninsula politically charged and highly unlikely.<sup>191</sup>

The notion of what constituted international leadership saw the Clinton administration look to China as an increasingly important 'partner' in the region, despite the leadership being demonstrated by Japan, albeit contrary to some US interests. Undoubtedly in what was seen as a major shift in regional dynamics, Clinton engaged the Chinese government, hoping to integrate into the regional and global political economy rather than seek to contain Chinese growth. From Japan's perspective, there were fears of 'Japan-passing', that Japan had ceased to exert the same pull on the US consciousness as it had during the late 1980s. As noted earlier, China became a leader during the Asian Crisis, albeit for much less than what Japan had paid. Zoellick's comment was typical of this view.

China, in striking contrast to Japan, has enhanced its influence over the past year. It established a constructive posture by committing not to devalue the yuan in 1998, resolving to support the Hong Kong dollar peg, and contributing \$1 billion to the

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<sup>188</sup> C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', p. 132.

<sup>189</sup> M. Green, "Why Tokyo Will be a Larger Player in Asia."

<sup>190</sup> R. Zoellick, 'The Political and Security Implications of the East Asian Crisis', p. 10.

<sup>191</sup> K. Murata, 'Do the New Guidelines Make the Japan-US Alliance more effective?', pp. 30-31.

Thai bailout. U.S. Treasury officials have been impressed by their discussions with senior Chinese officials on how to address the financial crisis.<sup>192</sup>

In the face of this indirect criticism, Japan felt like it was being used as a scapegoat for the crisis, considering that it had outlaid \$19 billion in the three IMF multilateral rescue packages and was far more proactive in crisis mitigation planning.<sup>193</sup> It had also maintained its long-standing support of the US economy, despite a need to use that funding for its own domestic recapitalisation. Japan accumulated up to 40 percent of all new US treasury notes between 1994 and 1997, performing a role that maintained stability in US finance and the international economy. By financing the US debt and buying Treasury bills, it kept US interest rates low, allowing the US economy to keep on growing, absorbing more Japanese exports. But this system could not continue forever. When the then Japanese Prime Minister Hashimoto floated the idea of a US bond sell off in the face of Japan's worsening economic conditions after the Denver G-7 meeting in 1997, it had an immediate negative effect on the US stockmarket, the worst since the stockmarket crash of 1987.<sup>194</sup> In spite of Japan's systemic responsibility both in supporting the US economy and during the Asian Crisis, US leaders did not perceive Japan as a regional leader.

US interest in Japan faded in the late 1990s, but only as a major item in daily US politics. As previously, US policymakers still perceived Japan as a problem to be managed, both economically and systemically. Lincoln noted that Japan moved from being perhaps the biggest issue for the US in the late 1980s and early 1990s to being one of the smallest issues within a decade.<sup>195</sup> A growing Japanese economy is in the US interest, providing the export-oriented global economy with a second engine of growth, thereby allowing the US to reduce its current account deficit. Also its domestic economic problems with bad loans reverberated around the world, and were the basis for serious concern. Posen and Pyle

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<sup>192</sup> R. Zoellick, 'The Political and Security Implications of the East Asian Crisis', p. 8.

<sup>193</sup> C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', p. 129.

<sup>194</sup> J. Judis, 'The Sun Also Rises' and C. Johnstone, 'Strained Alliance: US-Japan diplomacy in the Asian Financial Crisis', p. 128.

<sup>195</sup> E. Lincoln, 'Japan: Nudging an Underachiever into a Greater Global Role', *Brookings Review*, 18(4), Fall 2000, p. 19.

argued that if Japan took no further action to reduce the number of these loans, money would soon start leaving the country, leading to either a controlled implosion of the Japanese banking system or a massive financial crisis that had direct implications for countries such as the US.<sup>196</sup> The US needed to use its influence and leadership to ensure the continued systemic health of the international political economy, especially if Japan was not acting in the interest of the United States or the conflated interests of the wider global economy.<sup>197</sup>

## Conclusion

During the late 1990s, as Japan prepared to enter the new century, academic and government observers still looked for it to act in a way that for the past decade seemed achievable, whether it was as either a 'Global Civilian Power' or as an 'honest-broking' regional leader. There was an expectation that Japan would continue to remain as the dominant economic force within the Asia Pacific. The rise of China and its Overseas Diaspora, coupled with the internet technology-led recovery of the US and the enlarged regional economy, saw Japan's economic pre-eminence challenged. Expectations of continued Japanese success existed as the foundation beneath all perceptions of Japan's leadership role. However, as the Asian Crisis showed, questions relating to Japanese leadership still remained an integral part of analytical and diplomatic interest.

Krauss noted in his 2000 article that Japan's distinct leadership role in the formation of APEC

...should begin to make us think about the question why and when Japan does exercise leadership but when it does, why it prefers such a covert style. There is also the question of why Americans in particular tend not to recognise Japan's quiet attempts at leadership even in those cases where it is exerted.<sup>198</sup>

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<sup>196</sup> A. Posen, 'Japan 2001 - Decisive Action or Financial Panic' and K. Pyle, 'Japan's Immobilism,' in 'The East Asian Crisis: Implications for U.S. Policy', *NBR Analysis*, 9(4), December 1998, pp. 1-39.

<sup>197</sup> K. Pyle, 'Japan's Immobilism,' in 'The East Asian Crisis: Implications for U.S. Policy', p. 27.

<sup>198</sup> E. Krauss, 'Japan, the US and the emergence of multilateralism in Asia', pp. 484-485.

While not seeking to answer his own question, he did explore the issue in greater detail and posited some areas of investigation.

Japanese foreign policy in the post-war era has been constantly pinned and wedged among three major constraints: domestic public opinion and constitutional limits against playing a major military role in the region again; Asian nations' fear of a resurgent dominant Japan; and America as the major global power in the region which would like Japan to play a 'leadership' role when it accords with American interests and strategy but is quick to nip that role in the bud when it does not. Indeed, American definitions of 'leadership' for Japan, for its own national interest and domestic reasons, sometimes has tended to be rather a form of 'follower-ship' to accomplish American goals with Japanese resources. Japan has had to manoeuvre its way carefully among these constraints and no nation operating under them could assert or project frequent 'leadership' influence as traditionally defined.<sup>199</sup>

This chapter attempted to outline and explore the differing and conflicting views of what Japanese leadership meant, both to the countries of East Asia and the United States. It became ever clearer that each country and region possessed their own self-interested version of what Japanese leadership should or could be. For the US, Japanese leadership constituted following US regional and global political, economic and strategic interests. As a major alliance partner, Japan was expected to act in concert with US interests, which were both linked to US strategic and economic policy on a systemic level. Japan's position as the world's second largest economy gave extra emphasis to this view of Japan's systemic responsibilities. But as became clear during the Asian Crisis, US interests conflated systemic with regional interests.

Japanese initiatives and actions during the crisis were consistent with its position in the regional economy and were in the interests of regional and global economic responsibility. East Asian countries, meanwhile, desired Japanese economic and regional policies that fitted their national interests and were supportive of state-based economic development. The bilateral contributions to the IMF Stabilisation Programs, the AMF proposal, and the aid delivered as part of the Miyazawa Initiative were examples of this. When Japan strayed from either of these interests, Japan was seen to be failing its

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<sup>199</sup> E. Krauss, 'Japan, the US and the emergence of multilateralism in Asia', pp. 484-485.

leadership responsibilities. On the other hand, China was praised, despite its relative inaction, for leadership in crisis by the US.

This difference in leadership continued into the political and strategic realms. On the strategic front, the long-standing US desire to see Japan as a loyal ally with a capacity to aid US political and strategic interests continued, through US *gaiatsu* and efforts to boost Japan's commitment to the alliance. The 1997 Revised Guidelines moved the boundary of joint operations to "areas surrounding Taiwan" promoting Japan from a passive base to an active participant in US regional security strategy. Japan was also pressured to emulate US policies on areas of regional domestic governance, particularly those associated with economic policies of liberalisation and 'good governance'. East Asia on the whole was unresponsive and hostile to either strategic or political attempts to boost Japan's capacity in these areas. Regional perceptions of Japan's role remained linked to its limited leadership through the economics of regional trade and investment relationships. And, despite the end of the Cold War and four decades of peaceful coexistence with Japan, the region was quick to remind Japan of the continuing legitimacy deficit that it faced anytime Japanese intent surpassed regional tolerance. Regional acceptance of Japan's role delivered the view, that whilst Japanese assistance during the crisis was appreciated, Japanese attempts at enhancing its regional role in regional politics were still limited by regional distrust and the individual and collective national interests of the region as a whole.