The U.S.–Japanese Alliance and East Asian Booms and Busts

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Introduction

In May 2000 the Asian Development Bank's meeting of finance ministers in Chiang Mai agreed on a regional monetary co-operation arrangement. This framework would include the so-called ASEAN+3, i.e. the ASEAN countries, Japan, South Korea and China. The agreement would comprise of a network of bilateral currency swap arrangements to defend regional exchange rates.
Observers compared the proposal to the stillborn Asian Monetary Fund initiative of Japan's Ministry of Finance from autumn 1997. The Ministry of Finance is probably also playing a leading role in the new currency swap initiative. Since autumn 1998 it has also launched other initiatives with regard to aid and monetary regime with the aim of weakening U.S. monetary dominance in East Asia, and redirecting regional investment flows to go within the region, rather than to the United States. If this effort succeeds it would result in a strong break with the previous model of U.S.–Japanese economic co-operation, and challenge U.S. monetary *seigniorage* in East Asia.

U.S. seigniorage

In the post-Bretton Woods setting of the 1980s the Reagan administration learned that the United States did not face the same constraint as other countries to earn foreign exchange to pay for its import and foreign investment since most of its foreign trade was conducted in dollar. It could therefore endure large current account deficits. This could be combined with large federal deficits, since private and public investors in other countries preferred to keep a major share of their foreign currency reserves in dollars and liquid dollar-denominated government securities. The U.S. Treasury Department (hereafter referred to as the Treasury) could then finance the federal debt through the sale of Treasury securities (bills, notes and bonds, hereafter referred to as "Treasuries") to foreigners and bring much of the current account deficit back home to the United States. Transactions in Treasuries also allowed the U.S. financial community to borrow investment funds cheaply from the rest of the world.

As argued by Robert Wade in this volume, persistent U.S. current account deficits expanded foreign central banks' holding of dollar reserves, allowing for a swift increase in world credit creation and growing financialisation of the world economy.[1] These processes strengthened the role of Wall Street as the financial centre of the world, and helped to transform U.S. hegemony from being based on manufacturing strength to a new financial power base. Deficit spending allowed the federal government to finance an arms race that broke the spine of the Soviet Union. Eventually, the U.S. corporate sector regained much of its previous industrial strength in the 1990s after a tough restructuring process in the 1980s, while the Clinton administration succeeded in balancing the budget.

The realisation of the potentials of U.S. *seigniorage* relied on a symbiotic relationship with Japan, which can be seen as the complementary other to the United States. High U.S. consumption rates and ensuing low saving rates, reliance on foreign capital inflows to sustain domestic and foreign investment and major trade and current account deficits have been mirrored by Japan's low consumption rate, high saving rate, large trade and current account surpluses and a growing domestic saving-investment differential. Reaganomics relied on these structural features of Japanese capitalism to finance its deficits, while Japanese capitalism with its bias towards investment and export at the cost of consumption and import profited from access to U.S. export markets.

The effects of the U.S.–Japanese alliance on the economic development of the East Asian region have shifted. During 1985-95 East Asia benefited from the alliance, but during 1995-97 the alliance had a strong impact on the regional financial crisis. Since autumn 1997 the alliance has been substantially weakened, and Japan has attempted to establish a new regional monetary regime. In the present paper I discuss the prospects of this Japanese effort through a historical analysis of financial flows and political and economic power relations within the U.S.–Japanese–East Asian triangle. The argument of the paper is summarised below.

A summary of the argument

a. **The U.S.–Japanese alliance and East Asian ascendancy 1985-95.** Persistent trade deficits in the United States and trade surpluses in Japan during 1985-95 created an upward pressure on the yen exchange rate relatively to the dollar, which only partly was dampened by the demand for dollar created by Japanese purchases of Treasuries. A strong yen benefited the competitiveness of East Asian countries relatively to Japan, as most of them tied their currencies to the dollar. East Asian export competitiveness was further strengthened by Japan's regionalisation of key manufacturing exports through foreign direct investments in response to the soaring yen. The result was a regional division of labour with Japan at its core, with increasingly dense intra-regional trade in manufacturing inputs. Still, the region relied heavily on outside markets in finished goods, especially in the United States. The East Asian countries were running large current account surplus with the United States, and large deficits with Japan. China, Taiwan, Hong Kong and Singapore were running large total current account surpluses, and invested much of their foreign reserve holdings in U.S. government securities in the 1990s. The countries most severely affected by the crisis were Indonesia, Malaysia, Thailand and South Korea. They were running current account deficits and were not big investors in the United States. They counted to the United States as lucrative "emerging economies" with restrictions on imports and foreign investment.
b. **The U.S.–Japanese alliance fuelling East Asian bubbles, 1995-7** In 1995 U.S. authorities feared that Japan was close to a major banking crisis, which would trigger panic withdrawal of Japanese investments in the United States with serious consequences to the U.S. economy. That induced a dramatic change of monetary policies. The United States and Japan agreed on a number of emergency measures intended to boost the Japanese economy, including co-operation to lower the yen exchange rate and a loose Japanese monetary policy. The government promoted Japanese purchases of Treasuries. The low yen weakened the export competitiveness of other East Asian countries, since their currencies were tied to the dollar. More importantly, Japan's loose monetary policy created huge amounts of liquidity in the international credit market, much of which was exported to its East Asian neighbours as portfolio investment and short-term loans. This inflow fuelled East Asian over investment. The ensuing 1997 Asian crisis provided a golden opportunity for the Treasury to "open Asia" with the IMF as its battering ram. The IMF receipt of austerity policies, high interest rates, liberalisation of foreign take-over in combination with a regional liquidity crisis was likely to force liquidity-strapped regional corporations and financial institutions to accept foreign take-overs at a low price.

c. **U.S.–Japanese rivalry over regional financial and monetary hegemony 1997-.** After the outbreak of the crisis Japan proposed to establish an "Asian Monetary Fund" (AMF) financed mainly by Japan along with some other countries in the region. This initiative was in some respect a Japanese attempt at "exit" from the U.S.–Japanese alliance. The fund should provide swift disbursement of emergency credits to countries with major foreign balance problems without strict conditionalities. This was a challenge to U.S. investment interests, but also to U.S. *seigniorage*, since it might have redirected major East Asian central bank holdings of Treasuries to the AMF fund. The AMF initiative was however effectively blocked by the U.S. Treasury. Meanwhile the crisis continued as the IMF ignored the vital task of co-ordinating re-negotiation of outstanding debt. The spectre of a Japanese banking crisis forced a change of policy. By December 1997 the U.S. financial community and Treasury feared that the South Korean financial crisis would reinforce Japan's banking crisis, and provoke a Japanese panic sale of Treasuries. There was a change in policies towards South Korea. The IMF increased the pace of disbursement of credits to South Korea, and relaxed its demands for austerity policy and institutional reform somewhat. Most importantly, the Treasury and the IMF now focused on renegotiating outstanding debt. This new strategy dampened the crisis of East Asia during 1998. Since autumn 1998 Japan's Ministry of Finance has presented various regional initiatives with regard to aid, monetary co-operation, regional stabilisation funds and internalisation of the yen. These efforts challenge U.S. *seigniorage* in East Asia since they aim at enhancing the role of the yen in the region at the cost of the dollar, and at redirecting regional investment flows to go within the East Asian region, rather than to the United States.

The U.S.–Japanese alliance

Japan's post-war financial system developed under conditions of shortage of capital and a weakly developed equity market. It was constructed to absorb household savings and to convert these savings into industrial investment. Household saving deposits in banks were lent to Japanese corporations, mainly greater business groups, the so-called *keiretsu*. The companies were encouraged by tax incentives to take on large amounts of debts relatively to their equity. A number of state banks led by Japan's central bank (the Bank of Japan) controlled the credit lifelines of major banks and companies. This control was used to impose strict discipline on business. The Ministry of International Trade and Industry (MITI) co-ordinated industrial development strategies among the greater Japanese corporations. Foreign investors were effectively excluded by tight capital control, while import protection allowed the companies to "subsidise" their export offensives with high prices on the domestic

market.[2]

Economic growth and political stabilisation of Japan was a main U.S. foreign policy priority. Japan was able to benefit from the international trade boom that started in the late 1950s with the United States as her main export market. In the early 1970s this Cold War alliance became strained. The Nixon administration then restructured U.S. hegemony through mutually reinforcing policies of détente, the dismantling of the Bretton Woods system and tough economic warfare against its allies, not the least Japan. With the termination of the fixed dollar exchange rate the United States was free to pursue a lax monetary policy which sustained the competitiveness of U.S. exports by lowering the value of the dollar.

The loose dollar policy was reversed in summer 1979 when the Federal Reserve raised U.S. interest rates to unprecedented levels in order to bring inflation under control and restore confidence in the dollar. This policy of high interest rates continued during the early 1980s and attracted huge offshore dollar funds to the United States. As a result the dollar exchange rate started to climb.

During the Reagan period (1981-9) growing military spending and tax cuts pushed the budget deficit to record heights. This went along with enormous trade and current account deficits. U.S. export competitiveness declined and generous tax reductions for the well-to-do fuelled a consumption spree which inflated the import bill. Maintaining a strong dollar and a low level of inflation under conditions of soaring budget and trade deficits would apparently require very high interest rates which would strangle investment and lead to increased unemployment. However, the administration could escape from this predicament if it managed to attract sufficient foreign dollar funds to pay for the U.S. deficits.[3]

In the 1980s Japan became a major capital surplus country. Its rates of economic growth and investment had declined in the 1970s, but the high-saving pattern of Japanese households continued. Japanese banks were full of saving deposits and Japan's current account surplus was growing. A large proportion of this surplus was invested in U.S. securities. U.S. Treasuries were popular, especially long-term Treasury bonds.[4] Japanese investors, mainly insurance companies, accounted for about one quarter of foreign net purchases of Treasuries during 1981-9. Large proportions of Japan's dollar trade surplus, most of which came from its trade with the United States, helped to finance the double deficits of Reaganomics.

With a strong dollar the Japanese investments in U.S. Treasuries appeared safe, but this situation was unlikely to continue as large U.S. deficits of trade and current account destabilised the international trade balance. In September 1985 a meeting of finance ministers and central bank directors of the G-5 (United States, Japan, West Germany, France and United Kingdom) at the Plaza Hotel in New York agreed on concerted central bank intervention to bring down the dollar to a more competitive level. A steep decline of the dollar followed.[5]

Still the U.S. trade deficit with Japan and other East Asian countries as well as the total U.S. trade deficit continued to rise during 1985-7, and poor U.S. trade figures pushed the dollar further down. In October 1987 Japanese investors, seeing no end to

the decline of the dollar, dumped large amounts of Treasuries and other dollar-denominated assets. On "Black Monday", 19 October 1987, the New York stock exchange collapsed. The stock exchange of Tokyo almost followed suit. Japan's Ministry of Finance responded by organising a buying campaign of U.S. securities by the four greatest Japanese institutional investors, rescuing the tottering stock exchanges in New York, Tokyo and the rest of the world.[6]

The Japanese bubble and its collapse

Japanese current account surpluses, did not spill over into growing central bank reserves in the early 1980s, as they were neutralised by capital exports to the United States and elsewhere. Then during 1986-8, the growth of current account surpluses outpaced capital exports. There was a strong increase of central bank reserves, with a multiplier effect on domestic credit creation.[7]

The Bank of Japan successively lowered its discount rate from 5.0 percent by January 1986 to 2.5 percent by February 1987. The rate was kept at that level until May 1989 in response to the problems to Japanese exporters caused by the strong yen after the Plaza Accord. Cheap credits should promote purchases of Japanese stocks and assets and blow up their prices. This would expand the value of the collateral in stocks and real estate used by companies to obtain bank loans, so that they could finance the investments required for a massive industrial restructuring. A huge wave of investment in productive capacity now took place. Japanese authorities also attempted to develop a new economic strategy with greater reliance on domestic consumption. Rising asset values should translate into growing incomes, and increased personal expenditure on consumption and residential housing, thus enhancing domestic markets for the industry.[8] But this attempt to develop a new Japanese model was disturbed as the financial bubble went out of control.

The lax Japanese monetary policies were prolonged by Black Monday.[9] The Ministry of Finance decided to stimulate purchases of U.S. securities to put a floor under the declining dollar. The Bank of Japan was directed to maintain its low discount rate, although international interest rates were rising. The interest rate differential then pushed Japanese saving funds abroad to U.S. markets. A new Japanese buying spree in the United States led to an appreciation of the exchange rate of the dollar relatively to the yen in the late 1980s.

Low Japanese interest rates boosted domestic asset speculation to much greater proportions than had originally been conceived by the Ministry of Finance. This went along with a shift of enterprise financing from indirect financing by banks to stock and bond market financing. A large proportion of the companies' new equity capital went into financial investment unrelated to the corporation's core activities. Meanwhile the banks, which had lost previous markets in financing the great corporations, turned to the financing of small and medium size enterprises, and in particular to property financing.[10]

From December 1989 through August 1990 the Bank of Japan announced several discount rate increases in an attempt to cool down the Japanese economy. This coincided with reforms of Japanese banking. Japan had accepted to go along with the Bank of International Settlement (BIS) "Basle Accord" with a tightening of capital requirements in relation to the banks' assets (i.e. loans). In order to meet the new capital requirements the banks would have to issue more shares and sell from their so-called "hidden assets" of property and assets officially registered at prices far below current value. These sales along with interest rate increases triggered a price fall of the current value of assets and property, which served as the main collateral of bank loans. The banks were then forced to sell more assets, as the value of their collateral was depressed below BIS requirements. By September 1990 the Japanese financial system was caught in a vicious circle of falling asset prices and new selling of land and issuing of stocks by the banks that pushed asset values further down.[11]
Liberal accounting standards allowed the banks to refinance *de facto* insolvent borrowers in the hope that property and asset prices would start to rise again. These measures prevented the latent crisis of bad debts from becoming manifest at the cost of enduring stagnation and growing bad debt in the Japanese financial system during the 1990s.
Japan's bad debt problems also influenced the U.S. economy as Japanese investors sold off their holdings in the United States to hurry the money back home to Japan. Declining Japanese purchases of long-term Treasury Bonds pushed up interest rates on new long-term securities with an ensuing rise of long-term U.S. interest rates.[12]
The Clinton administration (1993-) attacked these problems by strategies to reduce the budget and trade deficits. The latter included a "result-oriented trade strategy" towards Japan, with specified numerical targets for the reduction of Japan's trade surplus along with efforts at "talking down the dollar". A declining dollar was actually a natural outcome of Japanese sales of U.S. assets and the exchange of the dollar proceeds for yen. The yen exchange rate increased from 125 to one dollar in January 1993 to 79/80 in March/April 1995.[13] The U.S.–Japanese alliance had now become substantially weakened.

Rescuing Japan

Japan's financial problems continued during the first half of the 1990s. From 1993 a soaring yen added stone to the burden. In 1995 several medium-sized Japanese financial institutions went bankrupt.[14] In the United States the new Treasury Secretary, Robert Rubin, and his deputy, Lawrence Summers, disagreed on the tough U.S. economic strategy towards Japan. They had become convinced that Japan was on the verge of a major financial crisis which would trigger large-scale dumping of Treasuries, push up U.S. long-term interest rates and halt U.S. recovery. Meanwhile the "result-oriented strategy" failed miserably in the negotiations with Japan over automobile parts during spring 1995. This failure allowed Rubin and Summers to

assume control over US trade policies and economic relations with Japan.[15]

During spring 1995 the Treasury and the Federal Reserve co-operated with their Japanese counterparts to prevent a Japanese meltdown. The Fed guaranteed a US$ 500 billion dollar credit line so that the Bank of Japan could absorb Treasuries in the event of dumping by Japanese investors. It was agreed that the Bank of Japan would lower its interest rate and inject huge amounts of money into the banking system to boost stock markets, weaken the yen and allow the banks to use cheap money to purchase safe government bonds, realising a practically risk free profit. Japan's discount rate was cut from 1.75 to 1.00 per cent in April 1995, and then to 0.50 per cent in August.

In August 1995 restrictions on foreign investments by Japanese financial institutions were liberalised, but they were reluctant to purchase Treasuries as they feared yen appreciation. They were relieved from their worries by the Bank of Japan, which purchased huge amounts of Treasuries, helping to bring down the yen in the process. Eventually private investors heeded the call. From April 1995 to May 1997 the yen declined nearly 40 per cent, from 80 to 127 yen to one dollar. A broad truce on trade conflicts between the two countries along with a declining yen should sustain Japanese exports.[16]

By 1996 the Japanese economy appeared to recover from its troubles. In the United States Japanese purchases of Treasuries held down interest rates. This boosted the U.S. economy and helped Clinton to be re-elected President. The U.S.–Japanese alliance had been revived, but cheap Japanese credits and a strengthening of the dollar had serious side effects on the economies of Japan's East Asian neighbours.

Regionalisation of Japanese production and finance

Large-scale Japanese foreign direct investment (FDI) in manufacturing and resource extraction in East- and Southeast Asia in the post-war period began in the late 1960s, increased throughout the 1970s and then stabilised during the low yen period of the first half of the 1980s. The appreciation of the yen after the 1985 Plaza agreement worsened the conditions of Japanese exporters. One response was to relocate production to its East Asian neighbours. Japanese FDI in manufacturing in South Korea, Taiwan, Singapore, Hong Kong, Indonesia, China, Thailand, Malaysia, Indonesia and the Philippines nearly quadrupled from a little above US$ 600 million per year during 1981-6 to US$ 2,370 million in 1987, and continued to expand at a slower pace thereafter.[17]

A new wave of Japanese FDI followed during the 1990s. Japan's manufacturing direct investment in Asia (mainly East Asia) nearly tripled from US$ 2.9 billion in 1991 to US$ 8.1 billion in 1995. A major redirection of Japanese exports took place during this process. Its export share to the United States was reduced from 40.2 per cent in 1985 to 28.9 per cent in 1995, while the export share to Asia increased from 18.8 to 43.6 per cent.[18]

The United States and other Western OECD countries were the main targets of the

export of finished goods resulting from this build-up of regional manufacturing capacity through Japanese FDI. Yet Japanese investments also stimulated inter-regional trade. Yen appreciation forced overseas affiliates of Japanese companies to cut their purchases of parts and components from Japan and to increase their purchases from local subcontractors. Japanese mother companies also promoted trade among their affiliates in the region in components and parts. Regional affiliates and a great number of locally owned companies relied on hi-tech inputs and technology controlled by the headquarters in Japan. The Japanese companies did normally not move the production for Japanese markets abroad, only their production for regional markets and for export to third countries. In result, export of finished manufactured goods from East Asia to Japan was depressed, while the region's imports of key inputs from the Japanese workshop increased.[19] The East Asian countries then relied on growing export markets in finished goods outside the region, especially in the United States, to cover their trade deficits with Japan.

Japan's strong position in regional production networks was not matched by monetary strength. Much of Japan's trade with her East Asian neighbours was conducted in dollars. Most regional currencies were tied to the dollar, not the yen. A dollar revaluation would reduce the export competitiveness of Japan's East Asian neighbours. This would also depress Japanese exports of inputs to East Asia's export industry, and the exports of Japanese-owned enterprises in the region.[20] The weakening of the yen relatively to the dollar from 1995 was therefore a mixed blessing to Japan as well as to her neighbours.

Japan's loose post-bubble monetary policies created surplus liquidity which "leaked out" to East Asia. Japanese banks lent heavily to Japanese subsidiaries and locally owned firms in the region. Japan dominated foreign direct investment and lending to East Asia, while most of the foreign portfolio investment came from the United States and Europe. Yet much of the funding of these portfolio investments came from Japan and East Asia. International investors engaged in the so-called yen carry trade through borrowing at low interest rates in Japan, exchanging yen into dollar and re-investing throughout the world, including East Asia. Investment from Japan and other major East Asian current account surplus countries in U.S. securities was a major source of U.S. portfolio capital investment.[21] Most East Asian countries (with exceptions such as China and Taiwan) liberalised their capital accounts to attract these funds from the early 1990s.

The 1997 Asian financial crisis

Net private foreign investment in South Korea, Indonesia, Malaysia, Thailand and the Philippines increased from US$ 40.5 billion in 1994 to 93.0 billion in 1996.[22] As these inflows of foreign capital were exchanged for domestic currencies, the resulting demand wielded an upward pressure on local currency exchange rates and created an inflationary pressure. Domestic monetary authorities attempted to neutralise this pressure by selling their currencies and buying dollars, which mainly were invested in Treasuries. Furthermore, they attempted to "sterilise" the

inflationary impact of the increased supply of local money generated by these capital inflows by high interest rates and tight fiscal policies. High interest rates increased the differential between domestic and international interest rates, encouraging more foreign borrowing and portfolio investment with further inflationary impact. The growth of money supply exceeded GDP growth. This resulted in excess liquidity, which in these economies with a high propensity to save and invest fuelled an extremely high level of investment. The ratios of gross domestic investment (GDI) to GDP were 5-10 percent higher during 1991-6 than in the previous 15 years. The result was a rise in the level of "bad investment": various kinds of asset speculation and investment in industrial over-capacity.[23]

East Asian foreign debt soared as a result of the inflow of loans. Large proportions of these loans were short-term (one year maturity or less) which were used to finance long-term investment, and renewed on a regular base. Most of the loans were not hedged against exchange rate changes. Growing foreign debt complicated a "soft landing" by abandoning the monetary pegs.

The defence lines of foreign reserves became increasingly thin. In Indonesia, Thailand and South Korea – which all would receive "rescue packages" from the IMF – short-term debts exceeded foreign reserves, and grew at a faster pace than these reserves.[24] Economic stability relied on the willingness of foreign lenders to renew short-term loans. As domestic bank lending was expanding at a fast pace, in part with financing through offshore borrowing, a foreign debt crisis would have strong domestic repercussions.[25]

The declining yen affected regional competitiveness within higher end East Asian manufacturing involved directly in competition with Japanese products, especially in South Korea. Regional exporters were possibly also affected by the devaluation of the Mexican peso in 1995 and growing Chinese competition. Most important, world manufactured export growth fell from 9 percent a year during 1990-5 to 2 percent during 1995-6. In Thailand export value declined 1.3 percent from 1995 to 1996, but export growth was above world average in South Korea, Malaysia and Indonesia. Nevertheless, declining export growth and growing current account deficits probably weakened foreign investor confidence, and the countries were becoming increasingly vulnerable to sudden capital outflows.[26]

In May 1997 Japanese officials hinted that they considered raising Japan's discount rate. This "threat" never materialised, but global investors who had been capitalising on the yen carry trade began to sell away Southeast Asian currencies. During May and June a number of major Thai financial institutions failed. By 2 July the Bank of Thailand was forced to float the baht.[27]

As the Thai crisis evolved, foreign investors took a closer look on the huge amounts of outstanding debt, modest currency reserves and high asset prices in the region. Lenders refused to renew loans falling due. Large-scale dumping of assets and currencies pushed down asset values and forced the central banks to let their currencies float. Speculators first attacked the currencies of the Philippines, Malaysia and Indonesia. All three countries gave up their currency pegs (or quasi pegs) in July

and August. In the next round the speculators turned against Taiwan and Hong Kong despite their huge foreign reserves. Taiwan floated the NT dollar in October 1997, leading to a moderate fall of its value. The speculators then shifted to Hong Kong, but failed to break the peg of the Hong Kong dollar. This was followed by an attack on the Korean won, which was floated in late November.[28]

A 1996 *net inflow* of private capital to South Korea, Thailand, Malaysia, Indonesia of US$ 93.0 billion changed to a US$ 12.1 billion *net outflow* in 1997.[29] The countries were now caught in vicious circles of currency depreciation, increased foreign debt and collapse of domestic financial institutions. They then had to go to the IMF to ask for emergency credits. Stand-by agreements were signed by Thailand (5 August), Indonesia (31 October) and South Korea (4 December), while the Philippines extended a previous IMF agreement.

Wrong medicine

The IMF stabilisation programmes were based on the assumption that wide-ranging institutional reform was needed. Accordingly, the IMF insisted on closing financial institutions and enforcing strict regulatory standards. These policies enhanced the investor panic. The most serious case was the abrupt closing of sixteen commercial banks in Indonesia during autumn 1997 without guarantees of deposits over 20 million Rupiah (approximately US$ 5,000 at that time). This caused a run, also on healthy banks.[30]

The IMF was also demanding policies of fiscal contraction and discount rate increases in a failed attempt to stabilise East Asian currencies. Zealous demands for budget surpluses, which the countries failed to meet, did not enhance investor confidence. High interest rates adversely affected the foreign investors' confidence, as they then had reason to expect growing domestic debt problems.[31]

The IMF attempted to act as an international lender of last resort, rather than mediating in the rescheduling of debt payment, as it had done in the Latin American crisis of the 1980s. Yet it failed to deliver on its promise. Emergency funds were sliced in tranches to be disbursed over the programme period, pending adjustment performance. These tranches were too small compared to the debt falling due to stem the panic, and disbursement was delayed by drawn-out complicated negotiations.[32]

The IMF was backed by the Clinton administration, which had developed a more pro-active, systematic and coherent foreign economic policy than its predecessors. The newly established "National Economic Council" (consciously modelled around the "National Security Council") co-ordinated U.S. government institutions involved in foreign economic policy-making. A number of "emerging markets", mainly in East Asia, were targeted for an offensive with increased emphasis on U.S. foreign investment interests. The administration actively supported multilateral agencies such as the IMF, OECD, WTO and APEC to promote international financial liberalisation. As these policy instruments, alliances and the strategy of targeting East Asia were in place, the administration was in a strong position to use the IMF to

promote liberalisation of trade, finance and institutional reforms according to the standards of Anglo-Saxon capitalism. This would "open Asia" and allow for U.S. take-overs of credit-starved companies.[33]

AMF vs. IMF

Some East Asian countries, notably China, Taiwan, Hong Kong and Singapore had large balance of payment surpluses and foreign exchange reserves. Like Japan, they had invested much of this surplus in Treasuries, especially in the 1990s. Regional central banks were major purchasers of Treasuries. By the autumn of 1997 the Hong Kong central bank alone held about 60 billion of its foreign exchange reserves in U.S. securities, mainly in U.S. Treasuries, while the Bank of Japan held a 170 billion dollars worth of Treasuries.[34] During the September 1997 IMF/World Bank meeting in Hong Kong Chief Executive of the Hong Kong Monetary authority, Joseph Yam, publicly questioned this investment of the region's foreign reserves:

Much of Asian savings, in particular official sector savings and private sector savings that have been institutionalised, are still invested in assets of OECD countries ... [M]ore than 80 per cent of total Asian foreign exchange reserves amounting to US$ 600 billion are invested largely in North America and Europe ... It can be argued therefore that Asia is financing much of the budget deficit of developed economies, particularly the United States, but has to try hard to attract money back into the region through foreign investments. And the volatility of foreign portfolio investments has been a major cause of disruptions to the monetary and financial systems of the Asian economies. Some have even gone so far as to say that the Asian economies are providing the funding to hedge funds in non-Asian countries to play havoc with their currencies and financial markets. This comment is a little unkind ... But there certainly is a problem with the effectiveness of the financial intermediation in this region, which is inhibiting the flow of long term savings into long term investments.[35]

But what would happen if East Asian central banks invested their reserves elsewhere? In August 1997 the ASEAN countries officially proposed a permanent regional Asian Monetary Fund (AMF) financed by the East Asian countries, but the real driving force was Japan's Ministry of Finance. The AMF should operate at the regional level to maintain monetary stability. Its total funding would be about US$ 100 billion with Japan as the main contributor.[36]
Tokyo had a strong interest in stabilising the financial systems of the region. In 1996 Japanese banks had US$ 265 billion in outstanding loans to East Asian countries, and US$ 83.9 billion to the three countries that eventually would have to be bailed out, Thailand, Indonesia and South Korea.[37] A regional financial collapse would enhance Japan's bad debt problem. Tokyo did apparently not trust the IMF to solve these

problems.

The AMF proposal was driven by the powerful Vice Finance Minister of International Affairs, Eisuke Sakakibara.[38] He had earlier argued that the "Asian model" was more favourable to developing countries than the liberal Anglo-Saxon model advocated by the IMF and the World Bank. The AMF would defend this "Asian model" through swift disbursement of emergency credits without strict demands for reform.[39]

Japan floated the AMF idea during a G7 meeting in Hong Kong in September 1997. The EU countries and the IMF immediately objected to the proposal. During the annual meeting of the IMF and the World Bank in Hong Kong in September/October U.S. Vice Secretary of the Treasury, Lawrence Summers, also strongly resisted the initiative.[40] It was argued that two rivalling monetary funds would create "moral hazard problems" by allowing countries access to emergency funds without adopting tough economic reform.[41]

From the Treasury's viewpoint the AMF would reduce the U.S. influence on the adjustment processes and impede liberalisation of trade and finance. Concern about East Asian holdings of Treasuries may have been equally important. If regional central banks led by the Bank of Japan had sold out from their holdings of Treasuries to finance this costly operation, U.S. long-term interest rates would probably have soared.[42]

Treasury attempted to accommodate the East Asian countries by assuming a greater responsibility for the emergency funds in return for an abandonment of the AMF plans. Japan withdrew from the AMF proposal and the other East Asian countries gradually followed suit. The AMF initiative was abandoned in November 1997. APEC's meeting in Vancouver 23-24 November backed IMF's leadership in the financial rescue operation. Shortly afterwards Tokyo announced that its contribution to the regional emergency fund "only" would be about US$ 20 billion.[43]

The "contagion" from the financial crisis in Thailand might had been significantly reduced if the AMF had been in place by September/October 1997. The foreign investors' knowledge of a US$ 100 billion defence line ready to be issued on short notice might had calmed down the market in a period when regional currencies, excepting the Thai baht, still were relatively stable.[44] Instead, the Asian financial crisis reinforced the Japanese crisis in late 1997.

Reverse course in South Korea

The United States had a strong influence on the 4 December IMF package to South Korea. Regional officials of the IMF were reportedly willing to accept more lenient fiscal policies and interest rate policies, but the Treasury objected and was supported by IMF's director Michel Camdessus.[45] As for institutional reform, South Korea was required to deregulate foreign investment and trade, undertake corporate reform, reform its financial institutions, end government intervention in credit institution

decisions, end public work programmes and remove employment protection.[46]
The emergency loans were too small and were issued too slowly to stem the panic. Soon after the emergency package the Korean won and asset prices once again declined. On 12 December Seoul began to hint that it considered suspending debt payment. The Treasury and the IMF insisted that South Korea would have to complete promised reforms before a new tranche would be released in January 1998, but then the Japanese bad debt problem once again emerged in 1997.
In fiscal year 1996 there was a 5 per cent GNP growth in Japan. The fall of Japanese land and asset prices had halted, and the financial position of Japanese banks appeared to have improved. Japan's government debt had expanded as a result of successive rounds of deficit spending to stimulate the economy. Now the Ministry of Finance was eager to improve the budget situation. In April 1997 a new tax was introduced on consumption in an attempt to balance the budget and hold down long-term interest rates. As it coincided with the regional crisis, this tax had a depressing impact on the economy. During autumn 1997 a major bank and security firm collapsed. The "stern austerity faction" which by then dominated the Ministry of Finance decided that it would not interfere. These developments enhanced the propensity of the ageing Japanese population to save, rather than spend, while gloomy industrialists held back their investment.[47]
The U.S. Treasury now feared that a South Korean collapse would trigger a financial meltdown in Japan, followed by a Japanese panic sale of Treasuries.[48] Yet it was uncertain that the IMF and Treasury would be able to stem the tide simply through fast disbursement of unconditional loans, making available the so-called second line of defence of US$ 10 billion from the United States and other countries. Eventually Treasury decided to speed up emergency credit disbursement in combination with an initiative to cajole major foreign creditors to re-negotiate outstanding debt. A new agreement with South Korea was signed on 24 December with a faster pace of loan disbursement.[49]
By then Treasury had started to pressurise U.S. commercial banks to roll over Korean short-term debt. The major debtor banks of Europe and Japan were mobilised by U.S. banks through the effective networks of international *haute finance*. An agreement to extend the maturity of Korean short-term debt held by 13 major international banks, accounting for 30-40 per cent of the Korean outstanding short-term debt was reached on 23 January.[50] This agreement was later extended to include smaller foreign creditors.

Fragile recovery

In 1998 the IMF changed its focus to the conversion of short-term debt into long-term debt. It no longer demanded the closing of financial institutions and accepted more relaxed fiscal policies. The situation stabilised in South Korea and Thailand, although they still were under pressure to undertake extensive institutional reforms

and retain high interest rates.[51] Malaysia, which had declined to undertake an IMF programme, and introduced capital control during autumn 1998 was also stabilising. The main "basket case" was Indonesia where debt restructuring was delayed by decentralised foreign debt and political instability. Yet with its build-up of manufacturing overcapacity, East Asian recovery depended on international export markets, especially in the United States. The extent of "recovery" has varied widely. In South Korea a GDP contraction of 5.8 percent in 1998 was turned into 10.7 percent growth in 1999, Indonesia turned from a catastrophic 13.7 percent contraction in 1998 to a pithy 0.5 percent growth in 1999. Malaysia and Thailand were in between these two extremes.

In 1998 the current account balances of Indonesia, South Korea, Thailand and Malaysia improved substantially due to a major cut in imports caused by the crisis and austerity policies. Yet export was also contracting, although not as strongly as import. Export incomes were depressed by low international prices of commodities and electronics and contraction of regional trade caused by simultaneous crisis and austerity policy in East Asia. The countries were able to service their external debt, but declining domestic and foreign sale, import shortages and high interest rates exasperated the domestic debt crisis.

Some recovery of exports took place in 1999 due to the delayed effects of currency depreciation, growing markets in the United States, strengthening of the yen during the second half of 1999 and renewed growth in world electronics markets. Exports to the United States played a major role. It expanded from US$ 63.0 billion in 1997 to 65.7 billion in 1998 and then leaped to 76.5 billion in 1999 for the four crisis countries.[52] Export growth interacted with rising stock markets, which improved the financial position of firms in the region.

The U.S. economy and East Asian recovery

During the 1980s U.S. budget deficits expanded effective demand in the world economy. This was ended when the Clinton administration balanced the budget in the mid-1990s. Yet, exporters in East Asia and elsewhere benefited from private U.S. demand as initial manufacturing growth boosted U.S. stock and bond markets from the mid-1990s, and growing asset values fed a domestic consumption boom.[53]

After the 1995 currency realignment the dollar soared, and the competitive edge of U.S. manufacturing exports vis-à-vis Japan and the EU declined. The Asian financial crisis and its "contagion" led to a sharp contraction of U.S. exports to East Asia and Latin America in 1998. U.S. manufacturing export growth fell to nearly zero, and manufacturing profits dropped. A 20 percent decline in U.S. stock markets followed between July and September 1998. Some heavily debt-leveraged U.S. investors, such as hedge fund Long Term Capital Management (LTCM), were caught in a liquidity squeeze. Reduced U.S. demand threatened to reinforce the international crisis to the point of a full-scale world depression.

The Federal Reserve responded with three successive reductions of the discount rate from late September through mid-November and organised a bailout of LTCM in late September. These actions calmed uneasy investors by signalling support of the U.S. stock market and consumption boom. During 1999 U.S. stock markets resumed their strong growth. GDP was growing 4.2 percent, and domestic consumption was growing even faster, expanding U.S. imports and promoting economic recovery throughout the world economy. This provided a main foundation of the bounce-back of East Asia in 1999.

Manufacturing profits and exports improved somewhat after the 1998 decline, but they have still not fully resumed as the limited recovery of the world economy failed to boost U.S. exports.[54] The U.S. current account deficit was growing from 2.5 percent of GDP in 1998 to 3.7 percent in 1999, and is expected to reach 4.3 percent in 2000, breaking the record of the Reagan period. The U.S. hope would be that growth in East Asia and elsewhere sustained by U.S. imports will translate into increased imports from the United States and lead to an improvement of U.S. manufacturing profitability. That would provide a sounder footing of U.S. stock markets. In the meantime U.S. authorities must handle the domestic asset bubble. A full East Asian recovery appears to hinge on the soundness of the U.S. economy.

A weakening of the U.S.–Japanese alliance

The U.S. economy relies heavily on foreign inflows of capital, but now the sale of Treasuries does not have much of an impact. A 1997 net foreign purchase of US$ 184 billion of Treasuries changed to a US$ 10,0 billion net foreign sale in 1999.[55] The foreign capital inflows go into private stock and bond markets. Japan's supply of foreign capital to the U.S. economy has been much reduced due to the weakness of Japanese banks.

Japanese banks have normally supplemented their dollar deposits from Japanese exporters with borrowing in offshore dollar markets. Their dollar demand helped to maintain a strong dollar. This arrangement was disturbed when international credit rating agencies lowered the ratings of Japanese banks so that they were prevented from raising dollar funds from non-Japanese sources. Reduced Japanese dollar demand pushed up the yen.[56] Meanwhile, the United States has been able to mobilise large capital inflows from other countries. Thus, the U.S.–Japanese alliance has been weakened.

There have also been several indications of friction between Japan and the United States after the financial crisis. During 1998 U.S. authorities criticised Japanese authorities' handling of the banking crisis as well as Japan's declining imports from the region and enlisted support from the G7 and East Asian countries in their critique. Japan came under strong pressure to expand spending and imports to promote regional recovery. During APEC's trade ministers' meeting at Kuala Lumpur in June 1998 an isolated Japan was pressured on "Early Voluntary Sector

Liberalisation" within marine and forestry products. Eventually, the Japanese government responded to the critique by launching a massive economic stimulus and bank bailout package in October 1998. The Ministry of Finance also launched new aid initiatives that diluted the pressure for trade liberalisation.[57]

The New Miyazawa Initiative

During autumn 1998 Japanese Ministry of Finance officials publicly began to critique the IMF's diagnosis of the crisis as an insolvency crisis with deep structural roots. They argued that the crisis rather was a short-term liquidity crisis and that the region would resume its growth and be able to service its debt. Accordingly the IMF's demands for austerity policies and structural reforms was misconceived.[58] Japanese authorities now expanded their aid to crisis countries to help them overcome these liquidity problems.

At a G7 meeting in Washington in October 1998 Japan's Minister of Finance, Kiichi Miyazawa presented a US$ 30 billion aid plan in soft credits to Indonesia, Malaysia, the Philippines, Thailand and South Korea. Loans made under the plan would be denominated in yen and tied to projects involving Japanese companies. Tokyo attempted to minimise resistance from Washington and the IMF by couching the idea in the context of a broader aid effort involving the G-7 countries, the IMF and the World Bank. The timing was favourable. The IMF was running out of funds and the U.S. Congress had still not approved a US$ 14.5 billion replenish of the IMF's funds. The initiative was even supported by the IMF. The US Treasury's response was tepid, but it did not attempt to shoot down the initiative. The Miyazawa Plan was followed by additional aid commitments in December 1998 and during spring 1999.[59] The funds provided an alternative source of emergency credits without the stringent conditions that accompanied IMF support. Christopher Hughes describes the programme as an attempt "to give the East Asian states the necessary breathing space to reorganise their export and investment policies in order to relaunch a revamped developmentalism model".[60] Japan's MITI and Ministry of Finance would assist through overseas developing assistance and yen loans oriented to technology development and productive capital investment.

Foreign policy interests were important. Japanese officials were concerned about the rivalry with the United States and China over regional influence. One indication of the success of the Miyazawa initiative was that East Asian countries in November 1998 declined to force the "Early Voluntary Sector Liberalisation" within marine and forestry products through APEC's agenda. The compromise solution was to defer a decision to the WTO.[61] Tokyo's regional aid policy was also closely related to its efforts to internationalise the yen.

Regionalisation of the yen

The yen has played a modest role in transactions outside the Japanese border as indicated by low and declining levels of international holdings of the yen, yen-denominated international bond issues and foreign exchange and trade transactions which involved the yen in the 1990s. Most of Japan's foreign trade is paid in dollar, rather than yen, not only in its trade with the United States, but also with third countries.[62] This has been a deliberate strategy from the side of the Ministry of Finance to hold down the yen exchange rate. However, during the past years there have been worries about the weak position of the yen. Since mid-1998 the Ministry of Finance has advocated the internationalisation of the yen. So far it has focused on promoting the yen in East Asia.

It is argued that an internationalisation of the yen will enhance the competitiveness of Japan's financial institutions, boost Japan's capital market with foreign yen investment and reduce foreign exchange risks of trade and capital transactions. These advantages are said to outweigh disadvantages such as the appreciation of the yen that would result from its internationalisation.[63] The pressure to market Japan's government debt may have played an important role in these deliberations.

The Ministry of Finance has managed the government debt through a controlled system of government bond purchases. The bonds are sold to banks and security firms with no choice but to follow the MOF's request and to the MOF's trust fund bureau, which is funded by the postal savings system. These measures have kept bond rates and long-term interest rates low. But the banking crisis has reduced the banks' capacity to purchase unprofitable bonds, and the postal saving system has become increasingly burdened. The government is then under pressure to turn to "real" bond markets at home and abroad. Bond rates and long-term interest rates must then be raised.[64] By internationalising the yen Japan may be able to attract East Asian current account surpluses into government bonds. Accordingly, the promotion of international markets in Japanese government securities has been a main concern.

The Ministry of Finance claims that the financial stability of East Asia has been weakened by the region's dependence on the dollar. The pegging of regional currencies to the dollar is seen as a major cause of the 1997 crisis. MOF expects that the Euro will weaken the international position of the dollar, and tries to respond by boosting the role of the yen in East Asia. The Asian crisis provided an opportunity for a change of monetary regime as most East Asian countries unlinked their currencies from the dollar in the course of the crisis. MOF recommends that East Asian currencies are tied to a basket mainly consisting of the U.S. dollar, the Euro, and the yen to reduce risks associated with changing exchange rates.

The Ministry of Finance is recommending a redirection of monetary flows. In a speech in April 1999 Miyazawa, much like Hong Kong's Central Bank Director Yam one-and-a-half year earlier, argued that East Asian savings are invested in the West and that the region relies on unstable capital flows from U.S. and European investors. These financial flows should be redirected to go within East Asia. Japan would play

a key role at the centre of the regional financial flows, channelling aid and public investment to the region. Internationalisation of the yen, financial liberalisation, the creation of new financial instruments and tax rebates would attract regional yen holdings into private and public securities.[65]

Regionalisation of the yen is also promoted by Japan's aid regime. Loans made under the Miyazawa plan have been denominated in yen. In addition, there are discussions about the use of aid loans to promote yen-denominated exports from poor East Asian countries to Japan to shield them from uncertainties relating to the volatile yen/dollar exchange rate.[66]

Regional currency swaps

In May 2000 a new regional initiative for monetary co-operation was launched. The Asian Development Bank's meeting of finance ministers in Chiang Mai agreed on a regional monetary co-operation arrangement. This framework would include the so-called ASEAN+3, i.e. the ASEAN countries, Japan, South Korea and China. Taiwan may also be included with the necessary arrangements to handle the "China issue".

A network of bilateral currency swap arrangements shall ensure that countries with significant currency reserves will lend foreign currency, mainly dollars, to defend the exchange rates of their neighbours. The currency swap initiative could draw on a similar, rather limited agreement among the five original members of ASEAN (Indonesia, Malaysia, the Philippines, Singapore, and Thailand). Under the new agreement the number of countries was expanded to ASEAN+3 and the scope was much enlarged.

Japan was a driving force. The New Miyazawa Initiative of autumn 1998 had included bilateral currency swap agreements with South Korea with a loan quota of US$7.5 billion and with Malaysia with a loan quota of US$5 billion. This kind of arrangement would be extended under the Chiang Mai framework. According to one estimate US$ 20-40 billion would have to be committed by Japan and the other countries with large foreign reserves.[67]

The Chinese side was actively supporting the monetary co-operation initiative unlike autumn 1997 when China resisted the AMF initiative as an effort to impose "yen hegemony" on East Asia. In addition to enlisting Chinese support, Japan also managed to bring the internationalisation of the yen on the agenda at Chiang Mai. A meeting was scheduled in China in 2001 to discuss whether Asian exchange rates should be pegged to the dollar, to a "basket" of the dollar, the yen and the Euro or if they should float freely.[68]

Still the American century?

It remains to be seen whether a new regional financial and monetary order under

Japanese leadership is feasible. This will require greater amounts of Japanese aid and loans than those committed so far. It may be hard to muster that money as the pressure for fiscal retrenchment on the heavily indebted Japanese government is increasing. The stability of the yen needed to ensure investor confidence, and the range and sophistication of Japanese financial instruments may also be insufficient to attract regional yen funds.[69] Internationalisation will induce an upward pressure on the yen at the cost of Japanese exporters. This may be politically unfeasible. Influential groups within the many-headed Japanese political-administrative establishment will be unwilling to adopt a new foreign economic policy which challenges the United States. If Tokyo could handle these difficulties it would still have to convince the countries of the region to go along with a change of monetary arrangements with considerable learning costs, which is likely to be resisted by the United States.

It is frequently argued that hegemony in the international system of states in addition to coercive power and bargaining leverage also requires "Gramscian" consensual power. As argued by Giovanni Arrighi and Beverly Silver the hegemon should supply solutions to serious international problems and rise above "the tyranny of small decisions".[70] They claim that this quality of U.S. dominance now is gone. The new power of the United States in the 1980s and 1990s rests on its capacity "... to outcompete most other states in global financial markets. A new tyranny of small decisions has been resurrected, in the context of even more pressing system-level problems."[71]

During the Asian crisis the Treasury's use of the IMF to promote U.S. investor interests demonstrated the darker side of the new U.S. strength and "the tyranny of small decisions". Nevertheless, the United States also provided solutions to serious international problems when the regional crisis threatened to evolve into a system-wide crisis. The Treasury – co-operating closely with Wall Street – initiated the re-negotiation of short-term debt in South Korea, and the Federal Reserve's lowering of interest rates during autumn 1998 helped East Asia to start exporting its way out of the crisis in 1999. In a longer time perspective *seigniorage* has allowed for two decades of huge U.S. current account deficits to the benefit of East Asian exports.

The U.S. role as East Asia's "consumer of last resort" may be the strongest impediment to the internationalisation of the yen. Regional arrangements which restrict capital flows from East Asia to the United States, and enables East Asian countries to restrain U.S. investment in East Asia might trigger retaliatory U.S. action, including trade restrictions. A challenge to U.S. *seigniorage* in East Asia appears remote unless there is a considerable change of the relative weight of Japan and the United States as export markets to the region.

Large-scale regionalisation of the yen may require increased intra-regional trade in finished goods driven by Japanese imports, but there are few indications that Japan will take on this burden. As noted above, the Miyazawa plan may have been undertaken in part to dispel U.S. pressure on Japan to open its domestic markets, and Japan's domestic markets are stagnating. Another option would be that Japan

assumed a greater relative weight to regional exports "by default" amid a major downturn of the U.S. economy and declining U.S. import, forcing a reorientation of economic relations and policies in Japan and East Asia.

When the Euro was launched Lester Thurow argued that central banks and international economic actors in the future might be less willing to conduct their transactions in dollar, hold dollar reserves and purchase Treasuries. The Euro backed by a positive balance of payment would be a more stable alternative. The United States would then come under pressure to balance its current account and maintain high interest rates to attract investments, and the ability of the U.S. government to promote counter-cyclical demand stabilisation of the world economy, as seen during autumn 1998, would be much reduced.[72]

Needless to say this scenario has not appeared. On the contrary the United States has attracted huge investment funds from Europe over the past years, while the G7 has intervened to halt the fall of the Euro. Monetary flows may however easily change if the United States fail to accomplish a "soft landing" of its overvalued asset markets, or the threat of monetary outflows may induce a U.S. interest rate hike which depresses imports. In that event, a greater share of East Asian flows of trade, finance and capital may have to go within the region, being sustained by new regional institutional arrangements. In the meantime the East Asians are still living in the American century.

Notes

[1] Robert Wade, "The US Role in the long Asian crisis" in this volume.

[2] Chalmers Johnson, MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975 (Stanford University Press, 1982), p. 203-6, 236-7; R. Taggart Murphy, The Weight of the Yen: How Denial Imperils America's Future and Ruins an Alliance (W.W. Norton & Co., 1996), p. 90-107.

[3] Peter Gowan, *The Global Gamble*, p. 40.

[4] Murphy, *The Weight of the Yen*, p. 129-34, 144-5.

[5] "Announcement of the Ministers of Finance and the Central Bank Governors of France, Germany, Japan, the United Kingdom, and the United States", in Yoichi Funabashi, Managing the Dollar: From the Plaza to the Louvre, second edition, (Washington: Institute for International Economics, 1989), p. 261-6.

[6] Murphy, *The Weight of the Yen*, p. 194, 226-7.

[7] Wade, "The US Role in the long Asian crisis".

[8] Robert Brenner, "Uneven development and the long downturn: The advanced capitalist economies from boom to stagnation, 1950-1998", New Left Review, No. 229, 1998, p. 215-6; Murphy, The Weight of the Yen, p. 199, 204, 217; Ron 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, Vol. 5, No. 3, 1998, p. 412.

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[9] For other explanations of the duration of these monetary policies in 1987-9 see Funabashi, *Managing the Dollar*, p. 61; Murphy, *The Weight of the Yen*, p. 185-7; Bevacqua, "Whither the Japanese model?", p. 413.

[10] D. H. Whittaker & Y Kurosawa, "Japan's crisis: evolution and implications", *Cambridge Journal of Economics*, Vol. 22, No. 6, 1998, p. 763.

[11] Murphy, *The Weight of the Yen*, p. 242-4; Whittaker & Kurosawa, "Japan's crisis", p. 763.

[12] Murphy, *The Weight of the Yen*, p. 272.

[13] Murphy, *The Weight of the Yen*, p. 286-7.

[14] William Engdahl, "Bank of Japan tries a 'backdoor bailout'", *Executive Intelligence Review*, 22 September 1995, p. 4-5.

[15] John B. Judis, "Dollar Foolish" *The New Republic*, 9 December 1996; John B. Judis, "The Second Rubin Administration", *The New Republic*, 10 February 1997.

[16] Klaus Engelen, "How Bill Clinton really won", *The European*, 14-20 November 1996; Engdahl, "Bank of Japan tries a 'backdoor bailout'", p. 5; Judis, "Dollar Foolish".

[17] T. J. Pempel, "Transpacific Torii: Japan and the Emerging Asian Regionalism", in Peter J. Katzenstein & Takashi Shiraishi eds., *Network Power: Japan and Asia* (Cornell University Press, 1997), p. 60. These and the following FDI figures underestimate the real investment level, as they do not include reinvestment of the affiliates' profit locally.

[18] Tabulated from *OECD economic surveys. Japan 1995*, p. 154-table K; *OECD economic surveys. Japan 1996*, p. 19-table 3, p. 229-table I.

[19] Mitchell Bernard & John Ravenhill, "Beyond Product Cycles and Flying Geese: Regionalisation, Hierarchy, and the Industrialisation of East Asia", *World Politics*, Vol. 47, No. 2, 1995; Walter Hatch & Kozo Yamamura, *Asia in Japan's Embrace: Building a Regional Production Alliance* (Cambridge University Press, 1996), chs. 1-2.

[20] Brenner, "Uneven development and the long downturn", p. 226.

[21] Bevacqua, "Whither the Japanese model?", p. 414-5; Gowan, *The Global Gamble*, p. 52.

[22] Steven Radelet & Jeffrey D. Sachs, *The East Asian Financial Crisis: Diagnosis, Remedies, Prospects*, Brooking Papers on Economic Activity, No. 1, 1998 [online] – URL: http://www.cid.harvard.edu/cidpublications/hiid/asiacrisis.html, appendix, table 1.

[23] Bevacqua, "Whither the Japanese model?", p. 416; Paul Krugman, *The Return of Depression Economics* (Penguin Books, 1999), p. 86; Robert Wade, "Wheels Within Wheels: Rethinking the Asian Crisis and the Asian Model", *Annual Review of Political Science*, vol. 3, 2000, p. 102.

[24] Radelet & Sachs, The East Asian Financial Crisis, appendix, table 3.

[25] Radelet & Sachs, *The East Asian Financial Crisis*, p. 14-15.

[26] Radelet & Sachs, *The East Asian Financial Crisis*, p. 14, appendix, table 6; Wade, "Wheels Within Wheels", p. 103.

[27] Jonathan Fuerbringer, "How Asian Currencies Tumbled So Quickly", *New York Times*, 10 December 1997; Nouriel Roubini, "Chronology of the Asian Currency Crisis and its Global Contagion", 1997 [online] - URL: http://www.stern.nyu.edu/globalmacro/, "A Chronology of the Crisis: 1997", entries "Early May", May 14-15, May 23, June 27, July 2.

[28] Stephan Haggard, *The Political Economy of the Asian Financial Crisis*. (Washington: Institute for International Economics), p. 3.

[29] Radelet & Sachs, *The East Asian Financial Crisis*, appendix, table 1.

[30] Radelet & Sachs, *The East Asian Financial Crisis*, p. 34.

[31] Radelet & Sachs, *The East Asian Financial Crisis*, p. 35-6.

[32] Radelet & Sachs, *The East Asian Financial Crisis*, p. 37.

[33] Gowan, *The Global Gamble*, ch. 5; David J. Rothkopf, "Beyond Manic Mercantilism" in Raymond J. Albright et al. *U.S. Commercial Diplomacy: Background Papers from the Study Group on American Commercial Diplomacy in Asia*, 1998, Council on Foreign Relations [online] - URL: http://www.foreignrelations.org/public/pubs/opic.html.

[34] William Engdahl, "Japan's crisis threatens global financial crash", *Executive Intelligence Review*, 28 November 1997, p. 5 for the figure on Japan; Gowan, *The Global Gamble*, p. 52 for the figure on Hong Kong.

[35] Joseph Yam cited in Gowan, *The Global Gamble*, p. 52.

[36] Anthony Rowley, "The Battle of Hong Kong", Capital Trends, Vol. 2, No. 13, 1997 [online] - URL: http://www.gwjapan.com/ftp/pub/nrca/ctv2n13b.html; Eric Altback, "The Asian Monetary Fund Proposal: A Case Study of Japanese Regional Leadership", Japan Economic Institute Report, 47A, 19 December 1997, p. 1. [online] – URL: http://www.jei.org/Archive/JEIRArchive97.html.

[37] Altback, "The Asian Monetary Fund Proposal", p. 5.

[38] Surprisingly, the idea for an AMF probably came from IMF's director Michel Camdessus, who was fearing a shortage of funding for the rescue operations as the United States declined to contribute funds during the early phase of the crisis. Sakakibara took up the idea and presented it as his own. Camdessus later changed his position as the U.S. Treasury, which had not been informed, began to resist the AMF and promised more generous U.S. emergency funds. I thank Robert Wade for this information.

[39] Richard Higgott, "The Asian Economic crisis: A Study in the Politics of Resentment", *New Political Economy*, Vol. 3, No. 3, 1998, p. 341; Altback, "The Asian Monetary Fund Proposal", p. 6.

[40] During the conference Sakakibara called a meeting of senior Asian officials to discuss the AMF proposal without informing the Americans. As Summers learned about this meeting he entered the room where the Asians were sitting, sat down at the table and said, "Now, where were we?" See Robert Wade, "Gestalt Shift: From Miracle to 'Cronyism' in the Asian Crisis", *IDS Bulletin* Vol. 30, No. 1, 1999, p. 147-note 46.

[41] Nouriel Roubini, "Chronology of the Asian Currency Crisis", 1997, entry: November 19.

[42] Higgott, "The Asian Economic crisis", p. 345-6; Johnson, "Economic crisis in East Asia", p. 658.

[43] Anthony Rowley, "Asian Fund, R.I.P.", Capital Trends, No. 14, Vol. 2, 1997 [online] - URL: http://www.gwjapan.com/ftp/pub/nrca/ctv2n14g.html.

[44] David Felix, "IMF: Still Bungling in Asia", *Journal of Commerce*, 9 July 1998.

[45] Gowan, *The Global Gamble*, p. 109.

[46] IMF, "Republic of Korea IMF Stand-By Arrangement, December 5, 1997" [online] - URL: http://www.imf.org/external/country/KOR/index.htm; Robert Wade & Frank Venoroso, "The Asian Crisis", p. 11-12; John A. Mathews, "Fashioning a new Korean model out of the crisis: the rebuilding of institutional capabilities", *Cambridge Journal of Economics*, Vol. 22, No. 6, 1998, p. 752; Gowan, *The Global Gamble*, p. 111.

[47] Wade, "The US role in the long Asian crisis".

[48] Peter Gowan argues that Wall Street was the main agent in this policy shift as it was lobbying the U.S. Treasury to change its tough position. See Gowan, *The Global Gamble*, p. 112-13. Jacob Weisberg's account indicates that the policy change took place within Treasury without outside interference. See Jacob Weisberg, "Keeping the Boom From Busting", *New York Times Magazine*, 19 July 1998.

[49] IMF, "Korea Letter of Intent, December 24, 1997", [online] - URL: http://www.imf.org/external/country/KOR/index.htm.

[50] "Korea stares into the abyss", *Euromoney*, March 1998.

[51] Radelet & Sachs, *The East Asian Financial Crisis*, p. 32; Sali Tripathi, "Rev Up Spending", *Far Eastern Economic Review*, 29 October 1998.

[52] IMF, *World Economic Outlook May 2000* [online]. - URL: http://www.imf.org/external/pubs/ft/weo/2000/01/index.htm, p. 69-70; "U.S. Trade by Country", U.S. Census Bureau [online] - URL: http://www.census.gov/foreign-trade/balance/index.html#T. The U.S. figures are not fully compatible with figures based on East Asian reporting.

[53] Robert Brenner, "Verdensøkonomien ved årtusenskiftet – I retning oppsving eller krise?" (in Norwegian), *Vardøger* no. 26, 2000, p. 60, 62.

[54] Brenner, "Verdensøkonomien ved årtusenskiftet", p. 67-8.

[55] In 1999 Japan once again assumed its traditional role as the main foreign purchaser of Treasuries with a net purchase of 20.1 billion after a period with European-dominated purchases. The other Asian countries accounted for another 9.3 billion net purchases. See *Treasury Bulletin*, March 2000, Table CM-V.3. [online]. - URL: http://www.fms.treas.gov/bulletin/b10.html.

[56] R. Taggart Murphy, "Japan's Economic Crisis", *New Left Review (2)*, 2000, p. 46-7.

[57] Christopher W. Hughes, "Japanese policy and the East Asian currency crisis: abject defeat or quiet victory", *Review of International Political Economy*, No. 2, Vol. 7, Summer 2000, 232-3.

[58] Hughes, "Japanese policy and the East Asian Currency Crisis", p. 242-3.

[59] Michael Vatikiotis with Murray Hiebert, "Help Yourself", Far Eastern Economic Review, 31 December 1998-7 January 1999; Marc Castellano, "Japan's Foreign Aid Program in the New Millennium: Rethinking 'Development'", Japan Economic Institute Report, 6A, 11 February 2000, p. 2. [online] - URL: http://www.jei.org/Archive/JEIRArchive99.html.

[60] Hughes, "Japanese policy and the East Asian Currency Crisis", p. 246. Hughes suggests that the competition from the Miyazawa plan has pressured the IMF to take a milder stance towards the East Asian countries. See ibid. p. 222.

[61] Hughes, "Japanese policy and the East Asian currency crisis, p. 246.

[62] Council on Foreign Exchange and Other Transactions, "Internationalization of the Yen for the 21st Century - Japan's Response to Changes in Global Economic and Financial Environments", 20 April, 1999, Appendices, [online] - URL: http://www.mof.go.jp/english/yen/itiran.htm; Marc Castellano, "Internationalization of the Yen: A Ministry of Finance Pipe Dream?", Japan Economic Institute Report, 23A, 18 June 1999, p.2-4. [online] - URL: http://www.jei.org/Archive/JEIRArchive99.html.

[63] Council on Foreign Exchange and Other Transactions, "Internationalization of the Yen (Interim Report)", Nov.12, 1998; "Internationalization of the Yen for the 21st Century –Japan's Response to Changes in Global Economic and Financial Environments", Apr.20,1999. Both on [online] - URL: http://www.mof.go.jp/english/yen/itiran.htm.

[64] Murphy, "Japan's Economic Crisis", p. 37-8-note 11, p. 50.

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