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Japanese policy and the East Asian currency crisis: abject defeat or quiet victory?

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ABSTRACT

Japan stands accused of purveying a defective developmental state model of growth to the East Asian states which was responsible for the onset of the currency crises from 1997 onwards, and then of failing to provide the necessary leadership for the stabilization and recovery of the region. Japan's position of economic dominance and its nascent political leadership role in East Asia are now seen to be under attack. However, this article argues that over the longer term Japan is continuing to exercise considerable covert economic and political leadership in the region. Examination of Japanese policy makers' perceptions of the East Asian crisis reveals that they see the region as hit above all by currency crises which have transmuted into economic ones, but that the model of export and DFI-powered growth in the region is still fundamentally sound. Japanese policy makers contend that Japan is not responsible for the occurrence of the crises, nor are the USA- and IMF-prescribed solutions likely to hold the key to the restoration of growth in East Asia. Instead, they quietly lay the blame for the crises upon China for undercutting the competitiveness of East Asian exports and moving ahead of the ASEAN-4 in the regional production cycle. Hence, Japanese policy, as manifested in the New Miyazawa Initiative, has concentrated upon regearing existing developmental models, and has gradually begun to restore a measure of confidence in Japanese economic leadership and to set the agendas of both the USA and multilateral institutions towards the crises.

KEYWORDS

Japan; East Asia; China; currency crisis; developmental state; New Miyazawa Initiative.

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INTRODUCTION: JAPANESE ROUT OR RESURGENCE?

Japanese defeat

The abiding impression of Japan's involvement in and response to the East Asian currency and economic crises since mid-1997 has been one of sorry failure.[1] Mass media and academic opinion in much of the west, East Asia and even Japan itself has expressed disappointment (or perhaps in the case of certain western commentators, a sense of smug satisfaction) in the apparent failure of Japanese government and business to respond effectively to the crisis, despite Japan's vital geopolitical and economic interests in the region and emergent claims to regional leadership (Calder, 1998; Funabashi, 1998). Hence, although, as will be noted later, the definition of the term leadership may differ on the western and East Asian sides, Japan stands first accused of failing to provide appropriate leadership to halt the onset of the 'domino effect' of collapsing currencies, starting with Thailand, Malaysia and the Philippines in July 1997, and then spreading to Indonesia and South Korea in August and November of the same year. Japan's position as the largest donor of financial assistance to these countries, with pledges of up to US$42 billion bilaterally and via the International Monetary Fund (IMF) and World Bank, earned it little international praise. The failure of Japan's leadership was seen to be epitomized in its initial support for and then eventual abandonment of a regional response to the crisis in the guise of its proposal for a US$100 billion Asian Monetary Fund (AMF) in December 1997 (Hamad, 1999; Altbach, 1997). From USA and European Union (EU) perspectives, Japan's backing for the proposal demonstrated an irresponsible streak in its leadership aspirations in the region, as the AMF threatened to undermine the necessary conditionality of IMF financial assistance and international 'consensus' towards managing the currency crises (Johnstone, 1999: 125–6). From the perspective of the East Asian states, regardless of the varying degrees to which they genuinely expected a Japan or regional-led rescue package, Japan's decision to abort the AMF proposal in the face of US and IMF opposition, after having expended so much diplomatic energy upon it, signified another bungled Japanese attempt at leadership in the region.

In addition to the charge of neglecting to prevent the onset and deepening of the crisis, a common accusation levelled at Japan is that it has failed to outline a future pathway to allow the region to escape from the crisis and return to the high levels of economic growth witnessed in the early 1990s (Bevacqua, 1998: 411). Again, from the East Asian perspective, Japan's seeming submission to the USA- and IMF-dictated rescue packages represents its 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 growth in the new millennium. These sentiments are echoed by US and European observers – so recently keen to discover the secret of East Asian economic success, but now queuing up to point out to regional leaders how they have been sold a moribund economic model by Japan and to press for economic convergence on Anglo-American lines (Emmerson, 1998: 49–50).

The supposed failure of Japan's economic leadership also carries for many commentators the implication of the abdication of its political leadership role in organizing any nascent East Asian regional grouping. The extent of Japan's ambitions for regional leadership or hegemony should not be exaggerated. For it is clear that the underlying Japanese strategy has always been to maintain economic dominance in East Asia, but at the same time its has aimed to keep the USA and other 'non-Asian' powers engaged economically and politically in the region through the open regionalist project of Asia Pacific Economic Cooperation (APEC), rather than the closed East Asian Economic Caucus (EAEC) (Hook, 1996: 12–28). Nevertheless, Japanese policy makers and businessmen are still aware that the East Asian currency crises do involve a struggle between the major powers to shape the economic and political order in East Asia, and that in the aftermath of the crises Japan risks political marginalization as the USA and increasingly China exert their presence in the region. Thus, at the official unveiling of Japanese Finance Minister Miyazawa Kiichi's US$30 billion financial assistance package for East Asia at the G7 (Group of Seven Leading Industrial Nations) and Central Bank Governors meeting in Washington DC, in November 1998, one Japanese Ministry of Finance (MOF) official was reported to have remarked that: 'The USA, Japan and China are seeking influence over the region [East Asia]. . . . The New Miyazawa Initiative is certainly a policy that intends to return the focus on what Japan can do in Asia' (*Nikkei Weekly*, 16 November 1998: 27).[2]

Japanese resistance

Taken as a whole, then, these criticisms of Japan's role in the crisis indicate abject defeat for Japanese economic and political leadership in East Asia, and somewhat desperate Japanese attempts to claw back ground lost to regional rivals. However, the aim of this article, while being in agreement with many of the above sentiments concerning the shortcomings of Japanese leadership, is to step back from some of the criticisms levelled at Japan, and, with the benefit of a more sober perspective offered by the prolongation of the currency and economic crises into their third year, and knowledge of Japanese leadership style, to begin to re-evaluate the exact extent of Japan's defeat, as well as its successes, in determining the economic and political order in East Asia.

This investigation is prompted by the realization that, despite the initial triumphalism between late 1997 and mid-1998 of the IMF-designed package of measures to restructure the East Asian economies, since the second half of 1998 sites of quiet resistance to the comprehensive acceptance of IMF measures and sites showing the resilience of the East Asian developmental state model have begun to emerge. Prime Minister Mahathir Bin Mohamad's Malaysia stands at the extreme end of the spectrum of sites of resistance to the 'Washington Consensus' or 'Wall Street–Treasury Complex' (Bhagwati, 1998: 7–12) approach to the currency crises, with its bold, but as yet not fully tested, efforts to avoid IMF loans and conditionality by imposing exchange controls on the ringgit and massively reinflating the economy through government spending. But even those countries firmly under IMF economic tutelage – Thailand, Indonesia and South Korea – can perhaps be increasingly located on a middle level of resistance to the IMF. For although Thailand, Indonesia and South Korea have swallowed a good deal of IMF economic medicine since 1997, the evidence from IMF letters of intent in December 1998, allowing some loosening of fiscal and monetary policies in these states, suggests a troubled reaction to the IMF austerity measures and a limited rediagnosis by the IMF itself of the measures necessary to resolve the currency crises. Taken together, this mixture of active and passive resistance by the East Asian states to IMF-imposed rescue packages indicates a stubborn attachment to existing development models and the emergence of the type of counter-reaction that has been detected by Richard Higgott (Higgott, 1998) with regard to the East Asian rejection of convergence theory and a regional order guided by the USA and APEC.

In turn, it can argued that it is actually Japan which has done a good deal to undergird this campaign of resistance to the total ascendancy of the 'Washington Consensus' in the management of the East Asian crisis. This is partly evidenced by the positive reaction of the East Asian states to the New Miyazawa Initiative since November 1998. Encouraged by the promise of softer conditionality than in IMF loans, the Thai and Indonesian governments have secured loans under the Miyazawa plan worth US$1.85 billion and US$2.4 billion respectively. Meanwhile, the Japanese government has indirectly assisted Mahathir's economic programme and efforts to rebuff the IMF by guaranteeing the issue of US$570 million of Malaysian government bonds in December 1998, and by promising a further US$1 billion in short- and long-term financing. But Japan's provision of loans is arguably just the most prominent of a range of less visible, but nevertheless slowly effective, Japanese initiatives which have aimed to resuscitate the model of East Asian developmentalism and sustain over the long term Japan's economic and political presence in the region.

Therefore, this article argues that the battle for the economic and political soul of East Asia has not yet been lost by Japan, and, indeed, that in the year 2000 it may yet be possible to see a resurgence of Japanese influence. As stated above, this article certainly does not seek to argue that Japanese businessmen and, most particularly, policy makers have covered themselves in glory or have not encountered severe setbacks in their hesitant and distracted response to the currency crisis. However it is still possible to assert that Japan has exercised a vital leadership role in the crisis through both headline-making and cash-dispensing proposals such as the New Miyazawa Initiative, but even more importantly through Japan's distinctive style of low-key political and economic diplomacy in East Asia which has enabled it to begin to put in place the necessary conditions that its policy makers believe can rekick-start East Asian developmentalism. This style of leadership is in fact so low key that it can become indistinct, and resembles what has been termed as 'leading from behind' (Rix, 1993: 62–82) and 'leadership by stealth' (Drifte, 1996). Furthermore, it may be possible to argue that Japan's reaction to the East Asian currency crises reveals a depth of covert leadership which approximates to a form of structural power (Strange, 1994: 24–32), whereby Japan, by dint of its core position and presence in the East Asian regional economy, is able to set agenda not only of neighbouring states, but also imperceptibly even of the USA as well.

JAPAN'S ALLEGED FAILURE OF LEADERSHIP

Japan as a cause of the currency crisis

As noted above, the basic accusation that has been raised against Japan in much of the literature concerning the East Asian currency crises is that it has been responsible not only for laying the origins of and triggering the crises, but also for failing to take any effective steps to produce a solution to them and to assist the restart of growth in the region. Japan's role in the origins of the crisis is often ascribed to its transfer to East Asia of vulnerable and essentially unsustainable developmental state and 'flying geese' models of development. Elements of which were then legitimated by the Japanese government through its backing for the World Bank's 1993 *East Asian Miracle Report* (Wade, 1996) and the production of its own 'Vision for the economy of the Asia-Pacific region' paper of the same year (Funabashi, 1995: 286). Although this process of transfer had long been instigated in the post-war period through Japanese Official Development Assistance (ODA) and Direct Foreign Investment (DFI) strategies, its pace was seen to be quickened following the appreciation of the yen under the Plaza Accord of 1985, the rise of speculative bubbles in Japan, and the consequent massive increases in outflows of private sector Japanese capital seeking portfolio investment opportunities and lower-cost production and export bases, first in the newly industrializing economies (NIEs-4) and then the ASEAN-4 (Tables 1 and 2). The increases of Japanese DFI in East Asia, and the accompanying enhanced presence of Japanese manufacturing subsidiaries and the production networks which they established within the region and linking the region to export markets in the USA and elsewhere, boosted the developmental strategies of the East Asian states and propagated growth models characterized by high dependence upon investment and export-led growth. From the Japanese perspective these inflows of DFI and build-up of export industries in East Asia were justified by variants of the 'flying geese' and 'production cycles' models, whereby factors such as the appreciation of the yen and rising labour costs in Japan were expected to lead to shifts in comparative advantage and the transfer of technology and older exporting industries from Japan to East Asia. The East Asian states were then to utilize these investments and technologies to produce for export to Japan and other regions, and in turn move up the production cycle in Japan's wake. Japanese proponents of the 'flying geese' model also see it as sustainable over the long term. For even though they acknowledge that the East Asian states, in the same way as Japan, have relied during the initial stages of development upon access to the USA market to spur export growth, they also argue that increasing levels of East Asian intra-regional investment and trade, accounting for close to 47 percent of total investment in 1996 and 40 percent of total exports in 1997, and falling dependency on exports to the USA, at less than 20 percent of total exports in 1997, are indicative of the emergence of a self-sustaining model of growth in the region (JETRO, 1998a, 1998b).

However, critics of the production cycles and 'flying geese' models, while they agree that growth in the region has been powered by reliance on the demand side upon exports and on the supply side upon inward investment, also argue that these are shaky supports for development long term. On the export side, the 'complex production' links model contends that, even though in accordance with flows of DFI the transfer of production technology may also take place between Japan and East Asia, the cost of industry start-ups and the mastering of new technologies is so great that these countries ultimately remain dependent on Japanese technology and cannot close the production cycles to create their own fully fledged export industries (Mitchell and Ravenhill, 1995). Instead, they contend that Japan has put in place in East Asia a system of hierarchical complex production links which are connected vertically backwards to Japan due to the dependence on exports of Japanese technology, and vertically forwards to the USA due to its continuing position as the main extra-regional and most valuable export market for East Asian manufactures (Hatch and Yamamura, 1996). Thus, in accordance

Table 1 Japanese DFI, 1985–1998

	FY 1985		*FY 1986*		*FY 1987*		*FY 1988*		*FY 1989*	
	US$million	*% share*	*US$million*	*% share*	*US$million*	*% share*	*US$million*	*% share*	*US$million*	*% share*
NIEs-4	718	5.9	1,531	6.9	2,580	7.7	3,264	6.9	4,900	7.3
South Korea	134	1.1	436	2.0	647	1.9	483	1.0	606	0.9
Taiwan	114	0.9	291	1.3	367	1.1	372	0.8	494	0.7
Hong Kong	131	1.1	502	2.2	1,072	3.2	1,662	3.5	1,898	2.8
Singapore	339	2.8	302	1.4	494	1.5	747	1.6	1,902	2.8
ASEAN-4	596	4.9	553	2.5	1,030	3.1	1,966	4.2	2,782	4.1
Indonesia	408	3.3	250	1.1	545	1.6	586	1.2	631	0.9
Malaysia	79	0.6	158	0.7	163	0.5	387	0.8	673	1.0
Philippines	61	0.5	21	0.1	72	0.2	134	0.3	202	0.3
Thailand	48	0.4	124	0.6	250	0.7	859	1.8	1,276	1.9
China	100	0.8	226	1.0	1,226	3.7	296	0.6	438	0.6
East Asia total	1,414	11.6	2,310	10.4	4,836	14.5	5,526	11.8	8,120	12.0
USA	5,395	44.2	10,165	45.5	14,704	44.1	21,701	46.2	32,540	48.2
Europe	1,930	15.8	3,649	15.5	6,575	19.7	9,116	19.4	14,808	21.9
World total	12,217	100.0	22,320	100.0	33,364	100.0	47,022	100.0	67,540	100.0

Table 1 continued

	FY 1990		*FY 1991*		*FY 1992*		*FY 1993*		*FY 1994*	
	US$million	*% share*	*US$million*	*% share*	*US$million*	*% share*	*US$million*	*% share*	*US$million*	*% share*
NIEs-4	3,355	5.9	2,203	5.3	1,922	5.6	2,419	6.7	2,865	7.0
South Korea	284	0.5	260	0.6	225	0.7	245	0.7	400	1.0
Taiwan	446	0.8	405	1.0	292	0.9	292	0.8	278	0.7
Hong Kong	1,785	3.1	925	2.2	735	2.2	1,238	3.4	1,133	2.8
Singapore	840	1.5	613	1.5	670	2.0	644	1.8	1,054	2.6
ASEAN-4	3,242	5.7	3,083	7.4	3,197	9.4	2,398	6.7	3,888	9.5
Indonesia	1,105	1.9	1,193	2.9	1,676	4.9	813	2.3	1,759	4.3
Malaysia	725	1.3	880	2.1	704	2.1	800	2.2	742	1.8
Philippines	258	0.5	203	0.5	160	0.5	207	0.6	668	1.6
Thailand	1,154	2.0	807	1.9	657	1.9	578	1.6	719	1.8
China	349	0.6	579	1.4	1,070	3.1	1,691	4.7	2,565	6.2
East Asia	6,946	12.2	5,865	14.1	6,189	18.1	6,508	18.1	9,318	22.7
USA	26,128	45.9	18,026	43.3	13,819	40.5	14,725	40.9	17,331	42.2
Europe	14,294	25.1	9,371	22.5	7,061	20.7	7,940	22.0	6,230	15.2
World total	56,911	100.0	41,584	100.0	34,138	100.0	36,025	100.0	41,051	100.0

Table 1 continued

	FY 1995		*FY 1996*		*FY 1997*		*FY 1998 1st half*	
	US$million	*% share*	*US$million*	*% share*	*US$million*	*% share*	*US$million*	*% share*
NIEs-4	3,236	6.3	3,540	7.4	3,142	7.7	681	4.1
South Korea	449	0.9	416	0.9	443	1.0	175	1.0
Taiwan	455	0.9	521	1.1	450	1.0	112	0.7
Hong Kong	1,147	2.2	1,488	3.1	695	1.6	122	0.7
Singapore	1,185	2.3	1,115	2.3	1,824	4.1	272	1.6
ASEAN-4	4,138	8.1	4,951	10.3	5,695	12.9	1,754	10.5
Indonesia	1,605	3.1	2,416	5.0	2,514	5.7	635	3.8
Malaysia	575	1.1	572	1.2	791	1.8	274	1.6
Philippines	717	1.4	560	1.2	523	1.2	136	0.8
Thailand	1,240	2.4	1,404	2.9	1,867	4.2	709	4.2
China	4,478	8.7	2,512	5.2	1,987	4.5	435	2.6
East Asia	11,852	23.1	11,003	22.9	11,094	25.2	2,871	17.1
USA	22,649	44.1	22,015	45.8	20,203	45.8	4,282	25.5
Europe	8,586	16.7	7,376	15.4	6,769	15.4	3,630	21.6
World total	51,392	100.0	48,041	100.0	44,088	100.0	16,782	100.0

Source: Japanese Ministry of Finance.

Table 2 Japanese bank claims in East Asia, June 1995–December 1998 (US$million)

	June 1995	*December 1995*	*June 1996*	*December 1996*	*June 1997*	*December 1997*	*June 1998*	*December 1998*
South Korea	20,874	21,309	22,512	24,324	23,732	20,278	18,934	16,925
Taiwan	5,533	3,233	2,452	2,683	3,008	3,516	2,552	2,143
Hong Kong	158,975	133,893	91,042	87,462	87,354	76,272	54,623	38,669
Singapore	115,393	77,974	58,784	58,809	65,035	58,649	33,558	29,474
NIEs-4	300,775	236,409	174,790	173,278	179,129	158,715	109,667	87,211
Indonesia	20,512	21,297	21,622	22,035	23,153	22,018	19,030	16,402
Malaysia	6,091	7,289	8,131	8,210	10,489	8,551	7,905	6,623
Philippines	1,147	987	1,402	1,558	2,109	2,264	2,308	2,324
Thailand	32,628	37,056	37,552	37,525	37,749	33,180	26,120	22,437
ASEAN-4	60,378	66,629	68,707	69,328	73,500	66,013	55,363	47,786
China	16,426	17,668	17,383	17,792	18,731	19,859	17,485	15,115
East Asia	377,579	320,706	260,880	260,398	271,360	244,587	182,515	150,112

Source: Bank of International Settlements, *Consolidated International Banking Statistics; The Maturity, Sectoral and Nationality Distribution of International Bank Lending*, various years.

with this view, much of the intra-regional investment and trade within East Asia can actually be accounted for not by independent trade between individual states in finished products in which they enjoy a comparative advantage, but by trade controlled by or linked to Japanese subsidiaries based in East Asia and consisting of products such as components for eventual assembly in Japanese-made manufactures which are then exported to other regions. Thus, the implication of these criticisms of the 'flying geese' model is that it does not deliver complete economic development to those East Asian states to which Japanese DFI is directed, and brings with it an in-built vulnerability and lack of sustainability with regard to export demand due to its reliance on the USA as the export market of 'last resort' (Bevacqua, 1998: 420).

Likewise, on the supply side, Japan was seen to have fostered a vulnerable model of growth in the region due to the influx of Japanese portfolio and production DFI, which, although it enabled the states of the region to acquire some of the capital and technology necessary to overcome bottlenecks in production and raise their international competitiveness, also encouraged an unhealthy reliance on inward investment to finance current account deficits without resorting to government borrowing. Japan, it is argued, shifted its investment bubble to East Asia, with the states of the region becoming over-dependent on the supply of Japanese capital and vulnerable to any drop in its supply, and the massive inflows of Japanese investment working to compound the potential speculative bubbles in the region by creating the impression of economic dynamism which attracted volatile 'hot money' portfolio investments from other developed states taking advantage of the dollar-pegged currencies of East Asia and concomitant lack of exchange risk. In a sense, then, Japanese DFI provided the first 'hit' which was to turn the East Asian states into the type of unstable investment 'junkies' identified by Paul Krugman (1994).

Finally, to compound these inherent weaknesses in the growth strategies of East Asia, Japan is believed to have transferred the worst features of governance of the developmental state to East Asia. Japanese officials and businessmen deny that the developmental state models found in East Asia are specifically 'Japanese', given the diversity of political, social and economic systems in the region.[3] But they do recognize that Japan has been perceived very much as the economic leader and model for the region, and point to the similarities between Japan and the East Asian states in terms of the positive role of government in the promotion of private sector export industries. However, critics of the developmental state model (many with the benefit of hindsight after the events of 1997) argue that private–public sector cooperation is really only code-word for market imperfections, the protection of failing banks and corporations, barriers to free trade, endemic corruption and 'crony capitalism'

(Argogyaswamy, 1998) – all features of defective governance which undercut the World Bank and 'Washington Consensus'-favoured vision of growth in the region, based on sound financial management, the liberalization of markets, and removal of barriers to free trade.

Japan's critics next contend that having purveyed this precarious model of development to East Asia, it then was responsible for bringing the model crashing down by sweeping away its twin pillars of exports and investment flows. First, with regard to the export side of the model, the pattern of trade between Japan and East Asia was seen to be unsustainable and to have generated chronic current account deficits for states such as Malaysia and Thailand. This is due to the fact that Japan has exported high-cost production capital and technology to East Asia, but only in return for lower value-added imports from these states, such as components for screwdriver assembly. Japan was therefore seen to be a limited export market for the East Asian states in terms of achieving the types of high-value export remittances which can drive growth, forcing the states to rely more on export markets for their manufactured products within the region and in Europe and the USA. Second, the argument runs that Japan was also influential indirectly in reducing the export, and thereby growth, opportunities for the East Asian states in these key markets due to the near 60 percent decline in the value of the yen against the dollar between April 1995 and April 1996 (Johnson, 1998: 658; Wade and Venerosso, 1998: 42). The depreciation of the yen, following as it did the official 33 percent devaluation of the Chinese yuan in 1994, meant the relative appreciation of the East Asian states' dollar-pegged currencies, and a subsequent relative decline in the competitiveness of these states' exports versus Chinese and Japanese exports in all key markets (Bevacqua, 1998: 418). Third, Japan is seen to have narrowed further the opportunities for the East Asian states to export due to its own economic slowdown and reduced demand for products from the region following the collapse of its bubble economy and gradual slide into recession throughout the 1990s.

In turn, once Japan had created a situation whereby the East Asian states were increasingly unable to fuel growth through exports, it is then believed to have contributed to choking off the supply of their foreign investment lifeblood and to the undermining of their speculative bubbles. The repatriation of profits from Japanese TNCs operating in East Asia counterbalanced inflows of DFI and contributed to the general trend in the deterioration of the current account deficits of the East Asian states. Moreover, the collapse of Japan's own domestic bubble economy led to a general slowdown in the rate of growth of Japanese DFI in the region from 1995 onwards (Table 1); and between June 1995 and June 1997, while Japanese bank claims on the ASEAN-4 actually increased prior to the onset of the crises, claims on the NIEs-4 dropped from US$301 billion to US$180 billion, accounted for in particular by the drop in loans to the regional financing centres of Hong Kong and Singapore (Table 2). The end consequence of Japan's initial encouragement of increasing inflows of international capital into the region, but at the same time creating an environment which limited the prospects for the expansion of East Asian exports in order to pay for these inflows, was to indicate the possibility of balance-of-payments problems for each of the states of the region, to erode investor confidence, and then finally to act as one of the triggers for the currency crises of 1997 onwards. Furthermore, the inept response of the East Asian states to the systematic annihilation of their currencies by international speculators has been ascribed to the lack of flexibility and transparency in economic governance derived from the Japanese model.

Japan as a non-solution

After having demolished Japan's own model of developmentalism in the region, commentators next contend that the country has failed to provide the necessary leadership to restore stability and growth in the region and to guide the East Asian states out of the economic wilderness. Japan's perceived inability to provide a solution to the crisis has already been pointed out with regard to the abandonment of the AMF proposal in the face of US and European pressure. The image of Japan's weakness was reinforced by its acquiescence instead in the creation in November 1997 of the rather toothless 'Manila Framework': a regional body inspired by the APEC process and designed to coordinate financial assistance provided via the IMF.

Japanese failure to organize the bail-out package for East Asia was also matched between late 1997 and mid-1998 by an apparent disinclination to stimulate demand and supply conditions in the region along the lines envisaged by the USA, European states and a growing number of the East Asian states themselves. Earlier descriptions of the believed causes of the currency crises have emphasized the role of the depreciation of the yen in undercutting the export competitiveness of the economies in the region and bringing the model of East Asian development crashing down. But despite the economic havoc that the decline of the yen against the US dollar was thought to have wreaked upon East Asian exports, Japan appeared powerless to prevent further depreciation. By August 1998, the yen had reached a new eight-year low of Y147 to the dollar, and suspicions were raised that Japan's real policy was one of neglecting the decline of the yen in order to eliminate East Asian competition and export its way out of recession. The image of Japan's ruthless prioritization of its economic self-interest, even if it meant the sacrifice of former economic apprentices in East Asia, was reinforced by the Japanese government's obvious resistance to US demands that it should resolve the currency crises by increasing domestic demand and acting as the principal 'absorber' of exports in the region. The nagging US, European and East Asian request was for Japan to stimulate domestic demand through financial restructuring and fiscal expansion, and thereby act as the locomotive of growth to pull both the Japanese and East Asian economies free of recession. The incoming Obuchi Keizô government, formed in August 1998, eventually acceded to US pressure, with the announcement the following month of a new stimulus package. But this was not before Japanese leaders had endured the ritual humiliation at ASEAN, G8, Asia-Europe (ASEM) and APEC meetings of being forced to defend unsuccessfully their economic strategy in the face of near-total international condemnation. Similarly, Japan was seen to have done little to restore the supply side of the growth equation in East Asia. Japanese banks and manufacturing firms stayed engaged economically in the ASEAN-4 and NIEs-4 following the outbreak of the crises, but overall levels of investment began to stagnate by late 1997 and into the first half of 1998 (Table 1). Added to this, Japan's incompetent handling of domestic banking scandals and crashes seemed to deny it the credentials to advise in the financial recovery of the region.

Roll-back of the Japanese model?

The failure of Japanese efforts to restore growth in the ASEAN-4 and NIEs-4 started to signal the bankruptcy and abandonment of the Japanese-style growth model by the states of the region. The decline in Japan's physical, economic and even moral influence over the economic management of the region was represented by the failure of Prime Minister Hashimoto Ryûtarô's attempts to persuade President Suharto to adhere to IMF rescue packages. Despite Hashimoto's personal visit to Indonesia in March 1998, much shared discussion of the ability of 'Asian values' to overcome the crisis, and guarantees to Hashimoto of positive action from the Indonesian leadership (*Asahi Shimbun*, 14 March 1998, p. 2), Japan was eventually powerless to prevent Indonesia's descent into further economic and political chaos in May of the same year.

The exercise of Japan's leadership in the region reached an apparent nadir the following June when it was confronted over the issue of EVSL (Early Voluntary Sector Liberalization) at an APEC trade ministers' meeting in Kuala Lumpur. Japan found itself uncomfortably isolated as the USA and other East Asian states united to pressure it to liberalize its marine and forestry product markets, whereas it preferred to defer the issue to the World Trade Organization (WTO). Japanese Ministry of International Trade and Industry (MITI) officials at the meeting were reported to have expressed dismay that the USA had succeeded in bringing the East Asian states into line with its arguments for the rapid liberalization of trade in the region, and attributed this to the influence of the role of IMF restructuring plans in forcing upon the East Asian states a USA-inspired neoliberal trade agenda (*Asahi Shimbun*, 26 June 1998, p. 15). Thus, to Japanese government officials the EVSL negotiations represented a US-led attempt to divide the ASEAN-4 and NIEs-4 states from Japan and begin to roll back the Japanese model of growth. Japan's sense of humiliation was then compounded during the US–China summit in the same month, when Presidents Bill Clinton and Jiang Zemin took the extraordinary step of commenting in a bilateral setting on the deficient management of the yen and Japan's economy. At the same, China basked in its self-proclaimed stoicism in refusing to contemplate the devaluation of the yuan and any further damage to East Asia's recovery.

By mid-1998, then, Japan's diplomatic and economic defeat appeared to be total, as it was labelled as both a problem and a non-solution in the East Asian crisis. Japanese policy makers have certainly been aware of and resented the impression that they have been outplayed in the short-term contest for influence in East Asia. However, as the next sections will suggest, the differing Japanese perceptions of the origins of the crises have given its policy makers some confidence that over the long term Japan's influence may be resurgent.

JAPANESE VIEWS OF THE CAUSES OF THE CURRENCY CRISES

Declining export competitiveness

The division of responsibility between MITI, MOF and the Japanese Ministry of Foreign Affairs (MOFA) for dealing with political and economic relations in East Asia means that Japan's position regarding the currency crises has been opaque and subject to the usual type of immobilism identified in its policy making (Stockwin, 1988). However, most Japanese policy makers and analysts agree without hesitation that one of the twin factors which has triggered and prolonged the currency crises in East Asia has been the weakening export competitiveness of the states in the region. They concur that the model of growth, which Japan was partly responsible for transferring to the region, is reliant upon export-generated demand and that the inability of the states to export both in the run up to and immediately prior to the currency crisis has undermined investor confidence. In turn, they also acknowledge that lying behind the decline in exports has been a decline in competitiveness attributable to the pegging of the East Asian currencies to the dollar and to falling demand in markets such as Japan. Hence, there is some acceptance that the yen's depreciation and the recession in Japan contributed to the problems of East Asian exporters by undercutting their competitiveness in Japan and other markets, and, conversely, that a rise in the value of the yen and the stimulation of the domestic market in Japan to absorb East Asian exports would certainly be of benefit in restarting export-led growth in the region. In particular, the similarity of Japan's trade pattern to that of the NIEs-4, and especially South Korea, in manufactures such as electronics and automobiles, means that a falling yen could have contributed to a deterioration in the competitiveness and the current account deficit of these states.

But even though Japan is prepared to admit some responsibility for the weakening of the export-demand side of the model, it is not prepared to take it all, and offers a different interpretation of the region's economic difficulties. First, policy makers deny outright that the depreciation of the yen is a policy favoured by the government or one deliberately engineered by it in the late 1990s. They argue that the yen's rate is determined in the main by market forces (demonstrated by the limited and short-term effect of joint US and Japanese efforts to boost the value of the yen in June 1998), and that the flip-side of the low yen is a high dollar driven by the USA's own stock market and risky speculative boom. Second, they point out that the rapid depreciation of the yen, while certainly not desirable or helpful to the East Asian economy, is something of a 'red herring' in explaining the export problems of the region. As will be explained below, the Japanese government certainly sees the dollar peg as harmful to the East Asian economies because of its elimination of exchange risk and promotion of speculation, and because the growing shares of intra-regional trade argue that the individual states of the region would be better positioned to use a common unit or mixed basket of currency exchange which is not tied solely to one export market in the USA. However, MITI and MOFA stress that the depreciation of the yen relative to the dollar and East Asian currencies should not affect East Asian competitiveness so greatly, as Japan's exports both inside and outside East Asia consist primarily of technology and capital goods on the higher echelons of the production cycle, which do not compete directly with those goods produced by other states in the region, and especially by the ASEAN-4 where the currency crises originated in the first place.[4] It is probably only Malaysia, having shifted the share of its primary exports from nearly 70 percent in the 1980s to 20 percent in the 1990s, and having broken into export markets for those goods also produced by Japanese TNCs, such as colour television sets and air conditioners, which has been hit by the yen's depreciation (Kwan, 1998: 78–9). Third, in addition to its defence that Japan was not responsible for 'crowding out' East Asian exports, the Japanese government has attempted to argue that Japan was actually working to expand export opportunities for the region prior to the outbreak of the crises. Japanese imports from the NIEs-4 and ASEAN-4 were both gradually on the rise between 1995 and 1996, and only began to drop markedly in the second half of 1997 after the onset of crisis (JETRO 1998a) (Table 3).

The China factor

Japan's self-exoneration of major blame for the onset of the crisis is accompanied by a clear idea of where the true blame for the decline in East Asian competitiveness lies – China. Reluctant to spell this out explicitly for fear of a Chinese diplomatic backlash, MITI has resorted to implicit explanation by showing in the Japan External Trade Organization (JETRO) *White Paper on International Trade* that the decline which has taken place since 1995 in certain key ASEAN-4 exports to the USA and Japan, and especially in labour-intensive industries such as clothing and footwear, is matched by large Chinese increases in exports in the same areas (Table 4) (JETRO, 1999a: 44–5). Although there is not necessarily an identifiable or direct causal correlation between these increases and decreases in Chinese and ASEAN-4 exports, MITI's implicit point is that exports from China are seizing the ASEAN-4's traditional markets. The increases in Chinese exports are attributed by MITI in part to the devaluation of the yuan in 1994 (JETRO 1998a: 42–4).[5] MITI may not be entirely ingenuous to claim that it is Chinese products which are damaging the NIEs-4, as many of these Chinese exports may in fact be accounted for by exports from Japan's own TNCs producing offshore in China. But even so, the argument of MITI and a number of Japanese commentators is that as China slipstreams in the wake of the other Asian geese, protected by its relatively closed market and investment environment, it has at times managed to surge ahead of the ASEAN-4 in the production cycle, to capture their markets, and to cause a malfunctioning of the economic growth model (Watanabe, 1998: 53–5). Indeed, as a study by economists from Japan's Daiichi Kangyô Bank suggests (Hirata *et al.*, 1998: 225–7), if China's economy is disaggregated regionally, it can be seen that its rapidly developing coastal regions are likely to overtake the Philippines and Indonesia in terms of GNP per capita in the near future.

Nevertheless, despite this analysis of the problems of export competitiveness of the East Asian states, policy makers in Japan do not seem to see the model as a total write-off. The key to recovery is still the basic model of the developmental state in the region and export growth on the demand side. Export growth can be restarted through economic stimulus packages in Japan and continued growth in the USA, but even more importantly through the promotion of the intra-regional exports which

Table 3 Trends in Japanese trade with the USA, NIEs 4, ASEAN-4 and China between 1995 and first half of 1998 (US$million)

	1995	*1996*	*1997*	*1st half of 1997*	*2nd half of 1997*	*1st half of 1998*
World						
Exports	442,937	412,433	422,881	205,172	217,710	192,957
Imports	336,094	350,654	340,408	172,459	167,949	142,937
Total	779,031	763,087	763,289	377,631	385,659	335,894
Trade surplus	106,843	61,779	82,473	32,713	49,761	50,020
USA						
Exports to USA	120,859	112,277	117,669	57,437	60,321	58,655
% total exports	27.3	27.2	28.0	28.0	28.0	30.4
Imports from USA	75,408	79,724	76,051	38,919	37,133	35,248
% total imports	22.4	23.0	22.3	23.0	22.1	25.0
Total trade with USA	196,267	192,001	193,720	96,356	97,454	93,903
% total trade	25.2	25.2	25.4	26.0	25.3	28.0
Trade surplus	45,451	32,553	41,618	18,518	23,188	23,407
East Asia						
Exports to East Asia	186,547	174,925	171,591	84,033	87,557	65,157
% total exports	42.1	42.4	41.0	41.0	40.2	34.0
Imports from East Asia	115,520	123,397	118,267	59,436	58,831	48,919
% total imports	34.4	35.2	35.0	35.0	35.0	34.2
Total trade with East Asia	302,067	298,322	289,858	143,469	146,388	114,076
% total trade	39.0	39.1	38.0	38.0	38.0	34.0
Trade surplus with East Asia	71,027	51,528	53,324	24,597	28,726	16,238

Table 3 continued

	1995	*1996*	*1997*	*1st half of 1997*	*2nd half of 1997*	*1st half of 1998*
NIEs-4						
Exports to NIEs-4	111,037	101,792	101,592	49,398	52,194	40,208
% total exports	25.1	25.0	24.0	24.1	24.0	21.0
Imports from NIEs-4	41,219	41,006	35,389	18,173	17,216	14,728
% total imports	12.3	12.0	10.4	11.0	10.3	10.3
Total trade with NIEs-4	152,256	142,798	136,981	67,571	69,410	54,936
% total trade	20.0	19.0	18.0	18.0	18.0	16.4
Trade surplus with NIEs-4	69,818	60,786	66,203	31,225	34,978	25,480
ASEAN-4						
Exports to ASEAN-4	53,579	51,243	48,214	24,751	23,463	15,256
% total exports	12.1	12.4	11.4	12.1	11.0	8.0
Imports from ASEAN-4	38,379	41,841	40,812	21,244	19,568	16,357
% total imports	11.4	12.2	12.0	12.3	12.0	11.4
Total trade with ASEAN-4	91,958	93,084	89,026	45,995	43,031	31,613
% total trade	12.0	12.3	12.0	12.2	11.2	9.4
Trade surplus with ASEAN-4	15,200	9,402	7,402	3,507	3,895	–1,101
China						
Exports to China	21,931	21,890	21,785	9,884	11,900	9,693
% total exports	5.0	5.3	5.2	5.0	6.0	5.0
Imports from China	35,922	40,550	42,066	20,019	22,047	17,834
% total imports	11.0	12.0	12.4	12.0	13.1	13.0
Total trade with China	57,853	62,440	63,851	29,903	33,947	27,527
% total trade	7.4	8.2	8.4	8.0	9.0	8.2
Trade surplus with China	–13,991	–18,660	–20,281	–10,135	–10,147	–8,141

Source: JETRO (1995–98) *Sekai no Bôeki to Nihon*, Tokyo: JETRO.

Table 4 Competing categories of goods exported by ASEAN-4 and China

1. Categories of goods of which the export by the ASEAN-4 to the USA decreased by over US$1 million, and of which the export by China to the USA increased between 1995 and 1996 (unit: US$1 million)

Malaysia (16 items)

Categories of goods	*Decrease (Malaysia)*	*Increase (China)*
Synthetic fibre women's clothes	–3.13	2.23
Nightwear	–5.04	43.23
Woollen clothes	–19.52	2.26
Synthetic fibre infant clothes	–3.82	4.81
Men's coats	–2.17	31.96
Women's overcoats	–1.18	11.64
Women's coats and jackets	–1.01	1.99
Abrasion agents	–1.95	0.64
Table and kitchenware	–6.51	0.60
Non-industrial-use diamonds	–4.59	0.51
Iron and steel piping	–5.18	2.66
Tin alloys	–3.60	7.56
Metal paper clips	–7.74	22.12
Electric lamps	–1.11	121.16
Electrical switches	–33.68	2.56
Watches	–4.42	1.67

Thailand (23 items)

Categories of goods	*Decrease (Thailand)*	*Increase (China)*
Frozen fish fillets	–5.18	22.89
Sardines	–1.41	0.10
Silicon dioxide	–1.34	7.38
Plastic tubing and fittings	–1.98	2.44
Plastic sheeting	–1.23	5.03
Gloves	–3.81	13.86
Women's clothes	–1.60	8.81
Men's clothes	–2.71	26.70
Trousers and shorts	–3.57	15.20
Men's nightwear	–1.57	14.52
Women's nightwear	–2.67	19.60
Footwear	–2.31	28.78
Plastic soled footwear	–1.79	12.70
Steel wire	–1.97	3.34
Iron and steel piping	–1.29	10.89
Chain link	–1.23	3.62
Metal castings	–1.45	8.57
Valves	–2.76	9.33
DC motors	–1.94	8.32

Table 4 continued

Categories of goods	*Decrease (Thailand)*	*Increase (China)*
Seating	–1.72	19.21
Syringes	–1.06	2.66
Fishing reels	–19.01	8.67
Propelling pencils	–1.36	–3.32

Indonesia (12 items)

Categories of goods	*Decrease (Indonesia)*	*Increase (China)*
Hemp	–6.70	12.13
Printed matter	–7.51	13.40
Cotton fabrics	–1.13	5.88
Men's coats	–1.11	14.21
Menswear	–3.63	7.07
Footwear	–28.90	21.09
Copper piping	–2.26	7.56
Glass mirrors	–1.99	64.82
Taps and valves	–3.78	9.73
Bicycles	–2.46	3.39
Clocks	–18.37	4.84
Fasteners	–1.00	3.32

Philippines (5 items)

Categories of goods	*Decrease (Philippines)*	*Increase (China)*
Frozen crab	–3.90	15.93
Movie film	–7.21	0.82
Men's coats	–1.15	10.09
Office equipment and furniture	–1.71	0.81
Clock components	–1.16	0.16

2. Categories of goods of which the export by the ASEAN-4 to Japan decreased by over ¥100 million, and of which the export by China to Japan increased between 1995 and 1996 (unit: ¥100 million)

Malaysia (2 items)

Categories of goods	*Decrease (Malaysia)*	*Increase (China)*
Electrical circuits	–176	1,100
Lenses	–275	548

Table 4 continued

Thailand (7 items)		
Categories of goods	*Decrease (Thailand)*	*Increase (China)*
Fish products	–271	1,543
Tobacco	–414	17
Woollen clothes	–770	1,068
Assorted vehicle components	–178	1,649
Electric fans	–2,773	7,012
Lenses	–223	548
Keyboard instruments	–369	3,003

Source: JETRO (1998a: 44–5).

accounted for so much growth in the region prior to the currency crises and which could sustain growth long term. In turn, the ability of the East Asian states to access these internal and external markets is dependent on raising their export competitiveness. This can be done, not by abandoning the developmental model and moving towards full trade liberalization, as the ‘Washington Consensus’ would suggest, but by reordering the model in such a way that the region’s economies follow each other more smoothly up the production cycle without overtaking or colliding with each other as China has threatened to do with the ASEAN-4, and increasingly the NIEs-4. Thus, for Japanese policy makers the key to reordering the model and regaining export competitiveness is the further accumulation of production and technological capital in the region, and particularly in the ASEAN-4, in order to allow them to fly clear of Chinese competition.

Misuse of DFI

MITI and MOF agree that the rise and then sudden collapse of inflows of capital into the region was the second of the triggers of the crisis. But they stress that it is not the inflows of capital *per se* which represent a defect in the developmentalism model, but rather the misuse and misdirection of these inflows to unproductive uses (JETRO, 1999: 33). As the then Foreign Minister Kômura Masahiko noted at the July 1999 Japan–ASEAN meeting: ‘One of the causes of the Asian economic crisis was the creation of a bubble economy by inefficient investment of short-term capital in such areas as real estate, relegating the valuableness of manufacturing to the backseat. Asia must learn from these lessons and once again focus our capacity on manufacturing.’[6] In addition, the Japanese government maintains that, in contrast to inflows from other sources, Japanese capital (despite evidence of the tendency towards reckless investment in Japan itself in the late 1980s) bears little responsibility for creating dangerous speculative bubbles in the region. Government publications emphasize that a large proportion of Japanese DFI in East Asia has been directed to the formation of productive capital, either by the presence of Japanese subsidiaries in the region or by lending to East Asian banks for investment in domestic manufacturing firms (JETRO, 1997; JETRO, 1998b). They argue that the unstable speculative climate was created by East Asian states' policy of pegging their currencies to the dollar, which eliminated exchange risks for hedge funds based predominantly in the USA and Europe, and by US pressure for the states in the region to liberalize currency controls before they were fully equipped to deal with the pressures of global finance.

Furthermore, Japanese government sources suggest that, even though the rate of growth of Japanese DFI in the region and the overall scale of Japanese bank loans had both declined between 1995 and 1997, it is also the case that both had stabilized and were on the increase prior to the immediate outbreak of the Thai baht crisis (Tables 1 and 2), and therefore may not have been the initial trigger for the crisis on the supply side. JETRO publications point out that by comparison US DFI in the ASEAN-4 had virtually halved from around US$2.9 billion in 1996 to US$1.4 billion in 1997, so intimating that US private investors should take significant responsibility for pulling the 'investment rug' out from underneath the East Asian economies (JETRO, 1999: 41–2). Hence, for the Japanese side, their flows of DFI really were the 'virtuous' component of the supply side of the developmentalism model, as it furnished the East Asian economies with the tools for export-led growth, whereas the true responsibility for initiating the crisis lies with other investors and hedge funds who misdirected capital to non-productive uses.

Japanese criticisms of the IMF and US approach towards the crises

In line with its analysis of the misuse of DFI as one of the chief culprits for triggering the currency crises, the Japanese government has fully backed the IMF since mid-1997 in its attempts to restore immediate currency market stability and to stamp out further speculative bubbles. Hence, the Japanese government, whether through the agency of the IMF or the aborted AMF, has insisted that financial assistance should only be extended accompanied by measures of conditionality that implement banking reform and enhance transparency. But at the same time, as the crises have persisted, and despite Japan's usual reluctance to express anything but veiled criticism of the IMF, the differences between the Japanese and IMF-US approaches towards other aspects of the crisis have become clear.

The most basic difference is the Japanese perception that the onset of the currency crises in mid-1997 really reflected temporary problems in liquidity, rather than deep-seated problems in solvency, as the IMF has attempted to argue. As explained above, the Japanese government takes the view that export-led growth has been and continues to be sustainable in East Asia over the long term due to the expansion of intra-regional exports and investment, and thus that the states of the region should be able to earn sufficient foreign exchange remittances to sustain and correct current account deficits (JETRO, 1998a: 59). The Japanese government's firm belief in the past and future viability of the developmentalism model means that, although it acknowledges that the currency crises were certainly generated in their initial phase by investor anxiety about declining export growth, leading to the drying up of vital capital inflows on the supply side, this problem of liquidity should not equate to one of insolvency because of the long-term prospects for growth in the region. Hence, viewed from the Japanese perspective, the East Asian states in mid and late 1997 were really facing what should have been a temporary liquidity crunch and a slowdown in growth brought on by adverse, but transitory, export market conditions, misuse of DFI, the neglect of certain key components of international competitiveness, and poor financial governance and unregulated speculation. In turn, Japanese policy makers have viewed the developmentalism model as fundamentally sound and capable of continuing to deliver solvency and growth. As will be outlined below, they argue that growth could have been resumed soon after the onset of the currency crises, and indeed can still be resumed at the present time, with only limited modifications made to the developmentalism model, and with the provision of the necessary financial assistance, whether via the IMF or the AMF, to tide the East Asian economies over the worst of their liquidity problems.

From the Japanese perspective, then, the currency crises in mid-1997 should have been just temporary blips in the generally smooth progression of the developmentalism model in East Asia. However, the IMF's decision to regard the crises as originating in problems of insolvency, and to tackle them by insisting on major structural reforms and the virtual dismantling of the developmentalism model, has instilled in certain Japanese policy makers the suspicion that the IMF overstepped the mark and made the blunder of converting temporary currency crises into full-blown economic ones. The IMF's strategy to achieve currency stability and restart growth in the region has been to reduce private and public consumption and inflows of investment. This entails boosting exports and reducing imports through a combination of reduced government spending, higher taxation and higher interest rates – all orthodox IMF measures intended to eliminate insolvency. In addition, the IMF has insisted upon a range of structural reforms in the governance of the political economies of the region, including the break-up of industrial conglomerates, changes in banking practices, and price controls. The Japanese government has concurred with these reforms, so far as they have been designed to stamp out speculative bubbles, enhance transparency and redirect investment to more productive uses. But at the same time, the fear is that the IMF's macro and microeconomic reforms have actually compounded the crises short and long term. Over the short term, the IMF's insolvency-busting methods have been seen as simply inappropriate to deal with what was essentially a problem of liquidity. IMF policies of high interest rates and the break-up of domestic corporations are believed to have hampered the ability of the East Asian states to search for ways to boost exports, just at the very time when they were under pressure to do so in order to overcome the liquidity crunch. Instead, the East Asian states were forced to undertake structural reforms in the midst of the crisis, leading to a loss of export momentum, and pitching them from initial currency crises into economic crises. Moreover, the IMF's continued stress upon restructuring is believed to have hindered the chances for the economic recovery of the region because it has attacked the very foundations of the developmentalism model which had accounted so successfully for the expansion of East Asian exports in the past.

Thus, as the East Asian currency crises have developed into economic crises and IMF reforms have failed to provide a quick cure of the problems for the region, MITI and MOF have become more openly critical of the 'Washington Consensus'. The combative MITI minister, Yosano Kaoru, in an official speech in Singapore on 23 September 1998 designed to lay out Japanese plans for the revitalization of the ASEAN economies, remarked that the IMF had played an important role in the currency crisis, but that its response had been one of 'trial and error' and it needed to develop a more flexible policy towards the region (*Asahi Shimbun*, 24 September 1998, p. 9). Likewise the Economic Planning Agency (EPA) of Japan, under the management of MOF, noted in its annual *White Paper on the World Economy in 1988* that with regard to the East Asian currency crises:

> It may be questioned whether the remedies applied by the IMF were appropriate. Perhaps the policies for macroeconomic stabilization were too restrictive. Conversely, would economies have recovered without austerity programmes? Was it appropriate to demand structural reforms in the very midst of the crisis?[7]

Japanese dissatisfaction with the IMF was evident at the time of the G7 central bank governors' meeting held in Washington in October 1998. At that time MOF sources were quoted as stating that the IMF in East Asia had imposed 'inappropriate and unnecessary conditions which it should now reflect upon', and that its demands for 'reductions in government expenditure and the raising of interest rates invited a devastating chain reaction and made the economic confusion worse' (*Asahi Shimbun*, 7 October 1998, p. 11; author's translation). Hence, once the initial impact of the currency crises had settled, in various international fora since late 1998 Finance Minister Miyazawa has demanded IMF reform, centring on the regulation of short-term capital flows and hedge fund activities, the emphasis on sequential liberalization of capital markets in East Asia, and greater transparency for the IMF's own financial rescue packages in East Asia and Russia.[8]

Japanese scepticism about the merits of all IMF reforms has also been matched by scepticism about US-prescribed cures for the currency crises. Officials in Japan certainly acknowledge that the USA has performed an important service for East Asia in keeping its markets open and absorbing large quantities of imports from the region after the currency crises struck. However, they also perceive very clearly that the USA's role as an absorber of East Asian exports is the result not of economic altruism, but simply of the chronic imbalance in US domestic consumption and investment. Nor do the Japanese readily accept either the USA's reasoning that domestic stimulus packages in Japan will have the immediate effect of absorbing East Asian exports and pull the region out of trouble, given that Japan was not the major export market for these states even before the currency crises hit. US prescriptions are even harder to tolerate because of the USA's obvious unwillingness to provide from its own resources any significant amount of financial assistance to the region. The USA's total input into bail-out schemes for Thailand, Indonesia and South Korea at US$8 billion is less than a fifth of Japan's. In many ways, the currency crises have looked to be a repeat of the Gulf crisis of 1990–1, when, despite talk of global partnership, the USA dictated policy and Japan was expected to pay for it.

JAPANESE STRATEGY TO RESOLVE THE CURRENCY AND ECONOMIC CRISES

Japan's faith in the continued viability of the East Asian developmentalism model has meant that, while its policy makers have paid lip service to many of the IMF and USA long-term prescriptions, its own principal economic strategy for the region has been to jumpstart growth through efforts to regear the existing model and improve the general competitiveness of the NIEs-4, and especially the ASEAN-4. On the demand side, the Japanese blueprint for the region, as devised by MITI, has been to keep intra-regional exports ticking over and sustain manufacturing networks during the worst of the currency crises by the provision of large-scale trade credits. As of November 1998, the Japanese government had pledged US$22.5 billion via the Export-Import Bank of Japan for the facilitation of private sector regional trade, including two-step loans and short-term trade insurance. In addition, even though it argues that declining imports from East Asia may not have been the origin of the currency crisis, Japan has promised to take on an increased burden as the 'locomotive' of growth in the region in the future, with the announcement by the Obuchi government in November 1998 of a ¥16 trillion (US$124 billion) domestic stimulus package which promises to increase trade with the region.

In conjunction with these efforts to allow the developmentalism model to weather the initial shock of the currency crises, the next stage in MITI's plan has been to ensure the model's long-term recovery from economic crisis by upgrading the competitiveness of each of the economies of the region, so that they can move on to the next stage in the production cycle and move clear of damaging competition from below. The Japanese interpretation of shortfalls on the export-demand side caused by declining competitiveness, brought on by the misuse of investment and China's rapid climbing of the production cycle, dictates that the key to boosting growth is to restore competitiveness by the more efficient application of investment and education. As Japanese officials note, the fundamentals of the region, comprising openness to foreign investment and emphasis upon education, remain excellent, but assistance is still needed to enable each of the states to haul itself up onto the next technological rung of the development ladder. Hence, the Japanese government has launched a US$1.72 billion programme for structural reforms in the ASEAN states, which will pay for employment creation and the dispatch of policy advisers. Japan has also promised US$32 million under the Japan-ASEAN Programme for Comprehensive Human Resources, which will improve the technical skills of personnel in ASEAN countries and equip these states for industrial expansion in new industries. Furthermore, as Japan's own budget problems have increased since the 1990s and it has been forced to curb the rate of expansion of its ODA, the government has pledged that the emphasis of its aid programmes will shift from quantity to quality, and consequently from big ticket infrastructure projects to the development of human resources and industrial technology.

Much of Japan's strategy on the investment supply side overlaps with measures taken on the demand side. The first step has been to enable the East Asian states to overcome the credit crunch resulting from the currency crises by the extension of the trade insurance mentioned above and by the introduction of the New Miyazawa Initiative. Miyazawa's plan offers up to US$30 billion to guarantee sovereign bonds issued by East Asian states, which can then be used to recapitalize ailing banks and corporations in the region. The conditionality is less stringent than in IMF programmes and the clear intention of the New Miyazawa Initiative is not to seek massive structural reforms in line with the IMF, but to seek to give the East Asian states the necessary breathing space to reorganize their export and investment policies in order to relaunch a revamped developmentalism model.[9] Over the longer term, MITI and MOF are backing the continuation of the previous growth model by moves to redirect Japanese ODA and particularly yen loans towards the greater build-up of technology and productive capital in the region.

THE SUCCESS OF JAPANESE STRATEGY?

Japan's money may not always be able to buy it love in the battle to shape the future political economy of the East Asia region, but by the end of 1998 it certainly seems capable of at least buying it sufficient influence to reverse the string of diplomatic and economic reverses which it had been seen to experience since the onset of the currency crises. East Asian states have been and continue to be critical of Japan's seemingly inadequate response to the currency crises and abandonment of the AMF. But since the announcement of the New Miyazawa Initiative, Thailand (US$1.9 billion, December 1998), Malaysia (US$1.5 billion, December 1998; US$700 million, March 1999), Indonesia (US$2.4 billion, February 1999), the Philippines (US$1.6 billion, March 1999) and South Korea (US$5 billion, January 1999; US$1 billion, March 1999) have been queuing up for further Japanese financial assistance, and to some extent have shown their willingness to buy back into the developmentalism model purveyed by Japan.

Evidence of this is provided by the EVSL negotiations held at the APEC summit in Kuala Lumpur in November 1998. At the summit, the East Asian states continued to chastise Japan publicly for its reluctance to use its economic power to rescue the region economically, and for its continued opposition to EVSL in the marine and forestry sectors. But what was more significant from the Japanese perspective was that the East Asian states stopped short of forcing the EVSL issue onto the APEC agenda and secured the compromise of deferring a decision to the World Trade Organization (WTO). The EVSL compromise was portrayed as something of a diplomatic victory in the Japanese media as it enabled Japan and the other Asian states to resist effectively US pressure for convergence. MOFA denied that the offering of financial assistance to the East Asian states under the New Miyazawa Initiative and support on EVSL were related, but the Japanese government had clearly pursued a campaign to enlist the East Asian states on its side in the APEC forum by the dispatch the month before of the then MITI Minister Yosano to Indonesia, Malaysia and Singapore for talks with Asian leaders on

EVSL and to promote the Miyazawa plan (*Asahi Shimbun*, 21 September 1998, p. 3).

Thus, Japan was able eventually to assert its own agenda in APEC, to slow down the US push for the dismantling of the developmentalism model in the region, and to avert the diplomatic humiliation at the combined hands of the USA and East Asian states which it had so feared earlier in 1998. Having stopped the rot in its diplomatic and economic position, the Japanese government has also shown signs of regaining leadership in the region and facing down the USA and China. In December 1998 Obuchi Keizô visited Kuala Lumpur for the Japan-ASEAN summit meeting, bringing with him four new initiatives promising financial support worth US$5 billion for retraining human resources and reactivating industries in the ASEAN states. The initiative won approval in South-East Asia, and the degree of latent diplomatic support for resurgent Japanese financial leadership across the whole of the region was also shown by the proposal of South Korean Prime Minister Kim Jong Pil, when visiting Japan in December 1998, for a revival of the AMF with Japan at its head (a proposal that he later repeated on another official visit to Japan in August 1999), although the South Korean Finance Ministry later denied that this was an officially sanctioned idea. Encouraged by signs of new East Asian support for a regionally based response to the currency and economic crises, Miyazawa also hinted at the possibility of a new AMF proposal in December 1998 when he stated that in order to support the IMF there was still a need for a regional fund (*Yomiuri Shimbun*, 16 December 1998, p. 20).

In fact, it may even be the case that having been defied over the AMF proposal by the USA and the Europeans, Japanese policy makers are increasingly using the Asian Development Bank (ADB) – traditionally considered to be dominated by Japan – as some type of proxy regional fund. Japanese influence in the institution is not total (Ming, 1995–6) and a large part of the ADB's US$9 billion support for Thailand, Indonesia and South Korea has been disbursed in line with IMF measures. However, the East Asian crisis has accelerated the ADB's policy shift away from poverty alleviation programmes to financial reform packages, and since March 1999 the Japanese government under the New Miyazawa Initiative has established a US$3 billion Asian Currency Crisis Support Facility (ACCSF) within the ADB in order to provide Indonesia, Malaysia, the Philippines, Thailand and South Korea with interest payment assistance, technical grant assistance and guarantees to support resources for bank loans IMF (Tripathi, 1998; Keizai Kikakuchô Sôgô Keikakukyoku, 1999, p. 117).[10] In addition to using the ADB as a multilateral framework to channel Japanese financial assistance to East Asia free from IMF interference, Japan also appears to be using the ADB as a means to argue its case on the need for financial reform, as evidenced by the ADB's 1999 *Asian Development Outlook* report stressing the importance of the Japanese proposals for sequenced liberalization and the creation of regional financial institutions such as the AMF.[11]

The overall outcome of these Japanese initiatives has been that it has begun to forge ahead of the USA in the regional leadership stakes. The USA has been increasingly distracted by the spread of the currency crisis contagion to Brazil and across Latin America, and thus has been forced to yield more responsibility for organizing the East Asia region to Japan since mid-1998. Although the Japanese government made sure that there were more extensive bilateral consultations at the time of the announcement of the New Miyazawa Initiative than at that of the AMF, the initiative still seems to have caught the USA off guard. It was forced hurriedly to announce support for the plan, but also to try to match Japan with the launch of its own US$5 billion assistance fund, and with the proposal of a joint USA–Japan fund worth a further US$5 billion. But the USA's insistence on stronger conditionality compared to the New Miyazawa Initiative meant that its proposals did not have an enthusiastic reception, and, as the influential *Nihon Keizai Shimbun* remarked, all the USA was trying to do was to 'hitch a free ride on the back of Japan's ideas' (*Nihon Keizai Shimbun*, 19 November 1998, p. 12; author's translation). Indeed, the USA's belated support for, and 'free-riding' upon, the New Miyazawa Initiative looks very much like a repeat of the Latin American debt crisis in the mid-1980s, when the USA raised objections to the Japanese idea at the time (again proposed by Miyazawa, and now known as the first Miyazawa initiative) that debt could be swapped for bonds, but then hijacked the idea and made it its own with the creation of 'Brady Bonds' in 1989 (Helleiner, 1993: 218; Yasutomo, 1995: 71). The appreciation of the yen since late 1998 has also enabled Japan to deflect USA and Chinese criticisms of its exchange rate policy as a cause of the currency crises, and to put a damper on Jiang Zemin's claims to Chinese regional leadership when he paid his first state visit to Japan in December 1998. Finally, Japan has been able to influence the G7 debate over the future of the global and regional financial architecture, forcing the issue of the investigation of restrictions upon hedge fund activities onto the agenda of the G7 finance ministers' meeting in Washington in late April 1999 (*Yomiuri Shimbun*, 28 April 1999, p. 9).

Internationalization of the yen

Following its steady rehabilitation from economic defeat in East Asia since mid-1997, Japanese policy makers now seem increasingly ready to take another and more fundamental step to assert economic leadership in the region by allowing the further internationalization of the yen. Although the use of the yen in international trade has expanded by over three times in the period between 1985 and 1995 and accounted for 47 per cent and 25 percent respectively of export and import settlements between Japan and East Asia in 1997, the use of the dollar was still high at 50 percent and 25 percent for exports and imports.[12] The large proportion of dollar-denominated trade was partly a result of the large amount of primary imports from East Asia, traditionally calculated in dollars, but also the reluctance of the Japanese government to allow the greater use of the yen and lose control over macro-economic policy, as well as fears that it could be seen to be trying to rebuild a yen bloc and new Greater East Asian Co-Prosperity Sphere in the region. However, as outlined above, Japanese analyses attribute the outbreak of the currency crises to the policy of the East Asian states of pegging their currencies to the dollar. In order to prevent further currency crises, MITI and JETRO, as well MOF's International Finance Bureau, have advocated the increased use of the yen as a medium of exchange which reflects more accurately the growing importance of intra-regional trade and investment linkages. In May 1998 at the APEC finance ministers' meeting, the then MOF Minister, Matsunaga Hikaru, announced for the first time the Japanese government's official commitment to the internationalization of the yen. Reacting to this, in June of the same year the governing Liberal Democratic Party (LDP) established a subcommittee on financial issues which investigated a range of measures to internationalize the yen, including: the promotion of short-term money markets in Japan, tax reductions on transactions in yen, and the denomination of ODA in yen. MOF also established a committee of specialists to investigate the yen's internationalization, and the EPA's research group on international macroeconomic problems concluded in early 1999 that were was a need for greater use of the yen in the East Asia region (Keizai Kikakuchô Sôgô Keikakukyoku, 1999: 56–7). Prime Minister Obuchi on his visit to Europe in January 1999 stressed that the yen would become an international currency to balance the dollar and the newly introduced euro. The Japanese have pursued this plan through the agency of ASEM finance ministers' meetings, and in Frankfurt on 15 January 1999 Miyazawa proposed a dollar-euro-yen currency basket system for the emerging markets of East Asia and Latin America (*Yomiuri Shimbun*, 17 January 1999, p. 2). Consequently, rather than marking the defeat of Japan and the yen as the mainstay of financial and economic integration in the region, the currency crises seem to have finally convinced Japanese policy makers of the inevitability of the greater use of the yen and that this century will see a contest of strength in East Asia between the yen, the dollar and the newly introduced euro.

CONCLUSION: JAPANESE LEADERSHIP REVIVED

This article has demonstrated that in spite of the image of Japan's hapless diplomatic and economic defeat in the East Asian currency crises since mid-1997, the emerging reality since 1999 is that the country has recovered much of the diplomatic ground lost and is beginning to set once again the economic agenda in the region, not just for the East Asian states themselves but also for the USA. Japanese confidence in the validity of the developmental state concept has meant that it has worked quietly to rehabilitate the growth model through a mixture of demand and supply measures and that its relative financial generosity has begun to bring the East Asian states to share its vision of development. As the preceding sections of the article have made clear, Japan has been able to instrumentalize this policy through quiet but surprisingly adept forms of leadership: being at one time forced to submit to the IMF and G7 states in abandoning a regional and multilateral approach to the crisis in the shape of the AMF, but then proceeding to use its financial clout to implement alternative regional approaches to the crisis on the bilateral and multilateral levels under the camouflage of the New Miyazawa Initiative and the ADB. Moreover, it is likely that Japan will have greater freedom of action and the playing field to itself in East Asia as the USA and IMF become bogged down in the potential financial quagmire in Latin America.

Clearly it can still not be said yet with any confidence that Japan has succeeded fully in snatching victory from the jaws of defeat, and its credibility as a regional leader still hangs in the balance. Much will depend on whether or not Japanese analysts have the economic prescription for the region right – the general recovery seen in East Asian stock markets and Japan's own economy since early 1999 perhaps support Japan's case – and how far Japan has the political will to keep its promises to finance the region through the worst of the crisis and begin to assume a new role as an engine of growth. Certainly Japan has been known to disappoint before, with promises of ODA at times of crisis in the past often going eventually unfulfilled, as in the case of Prime Minister Fukuda Takeo's 1977 pledge of US$1 billion in aid to assuage South-East Asian concerns about Japan's growing dominance of its markets which had generated anti-Japanese riots in 1974. The suspicion this time around is that some of the financing under the Miyazawa plan is not as generous as its seems once double counting with other forms of assistance has been included.

Nevertheless, Japan may now be able to re-establish its position as a regional leader over the long term, and undeniably its position at the centre of the East Asian political economy is not easily lost and provides it with a good deal of structural power. For whether Japan is seen to possess or lack dynamism in setting policy for the region, its presence cannot be ignored and continues to shape the destiny of the states of the region. The actual outcome of the East Asian currency crisis may not be to undermine Japanese leadership and the model of the developmental state in the region, but, against all expectations, actually to consolidate them. Finally, Japan's reaction to the East Asian crisis argues that not only on the regional level, but also on the wider global level, and as indicated particularly by moves to internationalize the yen, it is not willing to surrender management of the global economy to the other developed economies and what it perceives as the socially destabilizing forces of unbridled liberalization.

NOTES

1 East Asia is defined here in accordance with the terminology of Japan's economic ministries as consisting geographically of North-East and South-East Asia, and economically of the Newly Industrialized Economies-4 (NIEs-4) (South Korea, Taiwan, Hong Kong, Singapore), the Association of South East Asian Nations-4 (ASEAN-4) (Malaysia, Thailand, Indonesia, Philippines) and China.
2 For details of the New Miyazawa Initiative, see Gaimushô Ajiakyoku Chiiki Keizaika (1999: 64–5).
3 http://mofa.go.jp/mofaj/gaiko/economy/asia/as_gs/index.html; Ohno and Ohno (1998: 2–3).
4 http://mofa.go.jp/mofaj/gaiko/economy/asia/as_gs/index.html
5 http://www.miti.go.jp/report-j/g82–2j.html.
6 http://www.mofa.go.jp/region/asia-pacific/asean/10meeting/state9907.html.
7 http://www.epa.go.jp/98/f/19981120f-kaigai-e.html [author's translation].
8 For example, see Statement at the World Bank Symposium on Global Finance and Development by Miyazawa Kiichi, 1 March 1999, http://www.mof.go.jp/english/daijin/e1e068.htm.
9 Interview with *Nihon Keizai Shimbun* journalist responsible for coverage of ASEAN, Tokyo, 12 April 1999.
10 http://www/mof.go.jp/english/if/e1b056.htm.
11 http://www/adb.org/Publications/Online/ado99.asp
12 http://www.miti.go.jp/press-j/f-menu-j.html.

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