

MOVING BEYOND BILATERALISM? JAPAN AND THE ASIAN MONETARY FUND

This paper examines the political dynamics surrounding the Japanese government's initial proposal for the creation of an Asian Monetary Fund (AMF) in 1997 and the arrangements that have emerged in its place. Specifically, the paper delves into why Japan attempted to embark on regional institution building independent of the United States and the International Monetary Fund (IMF) in 1997 but has since supported the close linkage to the IMF of a network of bilateral currency swap arrangements in the region. The findings reveal the formidable difficulties Japan faces in circumventing the activities of US-dominated multilateral institutions to play a greater leadership role in financial crisis management in Asia.

Introduction

Financial crises are endemic to capitalism, striking both advanced industrial economies and emerging market economies. They have become particularly frequent in recent decades, raising the issue of international financial crisis management. Some governments are able to resolve their crises without external intervention; many others must rely on outside assistance. This assistance has typically come from the International Monetary Fund (IMF), a multilateral institution established in 1944 and dominated since its founding by the United States. The United States alone holds enough votes to prevent a change in the Fund's organisational structure or in the distribution of quotas (Babai 1993: 449). Japan is the second largest paid-in capital contributor to the Fund, and thus plays an indirect role in international financial crisis management, but its voice within the organisation has historically been weak.¹

In August 1997, in the wake of Thailand's financial crisis, Japanese officials put forward a proposal to establish a new regional monetary fund – temporarily called the Asian Monetary Fund (AMF). This move drew a great deal of attention and signalled an important departure in both substance and style from Japan's prior regional institution-building initiatives that

included the United States. Japan's proposal to establish the Asian Development Bank (ADB) in 1966, for example, called for the United States to assume equivalent equity and voting standing with Japan.² More recently, when Malaysia's Prime Minister called in 1990 for the establishment of an East Asian Economic Caucus (EAEC) that excluded the United States, Japan's reluctance to join doomed the idea to failure for the time being.³ Implicit in Japan's 1997 AMF proposal, however, was the creation of a regional institution absent the United States.

The AMF proposal also seemed to signal an aberration in Japan's style of economic diplomacy in the region. Japan has been characterised as exercising 'leadership from behind', inhibited from taking a more overt leadership role by lingering memories of its invasion and colonisation of many Asian nations (Rix 1993). This leadership style was reflected, for example, in Japan's critical behind-the-scenes role with Australia in establishing the Asia Pacific Economic Cooperation (APEC) forum (Terada 1999). With the bold AMF initiative, however, Japanese government officials made little attempt to mask Japan's leadership role.

To many observers, Japan's pursuit of an AMF independent of US influence signalled a possible turning point in Japan's foreign economic diplomacy. Some also interpreted the proposal to mean that Japan was assuming a competitive stance vis-a-vis the IMF and the United States in the management of financial relationships in the region. After all, philosophical and policy disagreements within the World Bank between the United States and Japan are well documented (Rapkin and Strand 1997). With Japan's distinctive development model largely discredited by the nation's prolonged economic stagnation, might Japan be attempting to present instead a distinctive model of financial crisis management or regulation to its Asian neighbours? Some observers suggested that such philosophical motivations lay behind the AMF idea.

Japan's AMF proposal encountered a number of obstacles, the most formidable of which was opposition by the United States and the IMF. Consequently, in 1997 Japanese officials aborted the initiative for a new region-based multilateral monetary institution. The notion of an AMF resurfaced in a variety of forms thereafter, however, and a top-ranking Ministry of Finance (MOF) official would later describe a network of bilateral currency swap arrangements agreed to by the ASEAN+3 nations in May 2000 as a 'functional equivalent' to the original AMF idea.⁴ In an ironic twist, however, when the ASEAN+3 nations announced more details of this swap facility in April 2001, they revealed a key point of departure from the original AMF plan. Under a proposal put forward by Japan, the release of all but 10 per cent of the funds in the facility will be contingent on recipient countries having an IMF program in place. Thus, rather than

representing an IMF alternative or a new regional institution devoid of US influence, the currency swap arrangements reassert the IMF's centrality in international financial crisis management and ensure continued American influence over the way such crises are managed.

On the surface, therefore, it would appear that Japan has come full circle, attempting to embark on regional institution-building independent of the United States but acquiescing in the end to US desires to be included in the arrangement. The realist, focusing on simple power relations, might argue that Japan's desire to play a greater leadership role in the region – and in regional multilateralism in particular – remains stifled by the power imbalance in US–Japan relations. In this interpretation, the US–Japan alliance continues to constrain Japanese behaviour in critical ways, despite the end of the Cold War and the decline of US hegemony.

Determining the true motivations for Japan's shift first to exclude and then to indirectly include the United States in regional institution-building efforts is important. Different motivations not only imply different directions for US–Japan relations but also imply different expectations for Japan's role in multilateral institutions in the years to come. It would be difficult to point to another policy realm where Japan is better positioned to assume a leadership role on the international stage. In international finance, the types of domestic constraints that hinder Japan from taking a greater leadership role in many other multilateral institutions are noticeably absent. We know, for example, that Japan's distinctive peace constitution has constrained it from taking a greater leadership role in the United Nations (UN) by impeding full Japanese participation in peacekeeping operations. And we know that domestic political structures and the configuration of domestic interests impose considerable constraints on government leaders in multilateral trade forums such as the World Trade Organization (WTO), leading to Japan being labelled a 'reactive state' in the realm of foreign economic policy (Calder 1988). Japanese elected officials pay little attention to issues of exchange rates or international financial crisis management, however, granting the MOF and the Bank of Japan considerable policy autonomy in these areas.⁵ And Japan's status as the world's largest holder of foreign exchange reserves suggests that, if there is any policy arena where Japan might take a leading role, international financial crisis management is it. Accordingly, if the message from recent developments is simply that Japan has bowed to US pressure, the prospects for moving beyond bilateralism appear extremely bleak.

This paper argues that underneath the appearance of simple power politics, there is a more complex story to be told. Through an examination of the political dynamics surrounding the Japanese government's initial proposal for the creation of an AMF in 1997 and the arrangements

that emerged in its place, the paper argues that Japan has not simply ‘given in’ to its more powerful alliance partner. Rather, the outcomes to date reflect two equally important forces.

First, the outcomes reflect a redefinition of national interests vis-à-vis international financial crisis management by both the US and Japanese governments in the period since the outbreak of the Asian financial crisis. This process of redefinition, in turn, has led to a converging of preferences concerning the nature and desirability of a regional monetary institution. Although differences remain in the stances of American and Japanese officials, these differences are much smaller today than they were in 1997. Changed conditions in the international system, lessons learned from IMF policy mistakes, and innovations and reforms in the IMF and other existing institutions have helped shape this redefinition.

Second, the close linkage of regional financial arrangements to the IMF reflects Japan’s attempt to reconcile the wide range of preferences within Asia concerning the functions of a regional monetary institution. The evolution of a more independent regional institution is hindered as much by widely divergent views held by countries within the region as it is by US objections. In this way, the outcomes to date cannot be fully understood only through the lens of the bilateral US–Japan relationship. Analysis of the interaction of interests among the potential members of the new regional monetary institution is also necessary.

The emergence of the Asian Monetary Fund proposal

Pre-crisis roots

The idea for creating a regional monetary fund first arose with the establishment of the ADB in 1966. Proponents of the idea suggested that an IMF equivalent in Asia would complement the activities of the ADB in the same way as the IMF complemented the activities of the World Bank. The idea failed to gain currency, however, and was not actively pursued for some decades. While the demand for a development fund was constant and the need obvious, the various actors involved in the founding of the ADB found it difficult to envision clearly the role that a regional monetary fund would play. In the early years of the ADB, the pattern of currency crises seemed to suggest that such crises were limited to industrialised countries. Most of Asia did not yet fit into this category.⁶

As Asia’s emerging markets began to attract capital in the late 1980s, the idea of an AMF re-emerged within Japan’s MOF. By 1995, a group of incumbent and former MOF officials met

regularly in private forums to discuss the idea.⁷ Within the ministry – and even within the ministry’s International Finance Bureau – there were a variety of views on what an AMF would be like and how it would function. Differences of opinion centred primarily on whether the United States should be included.⁸ Some in the MOF sought to preclude involvement by the US Treasury, resentful of American domination of the IMF and perceiving the United States to be a competitor in the financial arena, hindering the pursuit of Japanese national interests in Asia. Others in the ministry felt that the United States ought to be included in a regional fund, viewing America as more of a cooperative ally in the region. Thus, while the idea for an AMF was brewing within the Japanese government long before the eruption of financial crisis, consensus was lacking on the scope of the fund’s membership and what the precise nature of the fund would be.

Crisis provides a rationale

The collapse of the Thai baht in the summer of 1997 created an opportunity to move forward with the AMF idea because the IMF was unable to alone provide funds sufficient to rescue the nation from the throes of crisis. The amount of aid an IMF member country could obtain from the Fund was determined according to a country’s quota. The amount of funding needed by Thailand was more than three times its quota, and the Thai government appealed to Japan for assistance. Japan responded by taking the lead in organising bilateral aid packages to make up the difference. This effort complemented the IMF response;⁹ Japan and the other bilateral aid donors relied on IMF information gained through its regular surveillance of member countries as they worked out these aid packages.

The ad hoc effort to organise bilateral aid packages proved successful in quelling the Thai crisis. However, other countries in the region feared attacks on their own currencies. Setting up individual aid packages and accumulating money to fend off currency attacks were time-consuming endeavours, and a great deal of economic and financial damage could be incurred as arrangements were being made. Furthermore, it was clear that, just as in the case of Thailand, the IMF quota on aid amounts would be too small to prevent crisis if the currencies of other nations in the region were similarly attacked. Given this situation, Japanese officials thought the time seemed ripe for advancing the AMF idea.

The domestic and international situations in August 1997 helped determine which conceptualisation of an AMF emerged as the official government proposal. Japan’s Vice Minister for International Finance at the time was Eisuke Sakakibara, whose personal view was

that Japan should pursue a greater leadership role in Asia, independent of the United States. Sakakibara's ascension to the position of Vice Minister for International Affairs was due in at least some part to domestic political events that spurred an unusual political intervention in MOF personnel affairs. While this intervention was made with little – if any – consideration of policy issues, it would have a significant impact on the evolution of the AMF idea.

The United States refrained from contributing to the bilateral aid effort for Thailand, lending support to Sakakibara's personal preference to set up a regional institution absent the United States. The American government's passive stance surprised MOF officials, particularly since the United States had played the key role in providing bridging funds to IMF loans for Mexico in 1995.¹⁰ However, securing the funds for the Mexican peso bailout had involved a tough political battle in the United States; another substantial commitment to bailing out an economy in which America clearly had a lesser stake would have been hard to sell to Congress (Altbach 1997: 9).

The initial proposal for an AMF also came when the Japanese government was increasingly resentful of US criticism of Japan's own financial and economic problems. For most of the postwar period, US–Japan financial relations focused on exchange rate management; while sound management of national financial systems was considered important, it was simply not part of the bilateral agenda. Japan's irresolution of its non-performing loan problem after six years, however, was now a topic pursued by American officials in bilateral meetings. An increasingly defensive mood within the bureaucracy thus provided a supportive context for an initiative that excluded the United States.

Thus, Japan initially pursued Sakakibara's conceptualisation of an AMF absent the United States. The idea was first put forward on 11 August 1997 at a meeting in Tokyo of the countries that had contributed to the rescue package for Thailand. Since the United States was not a contributor, American officials were left out of these initial discussions. During the rest of August and into September 1997, Sakakibara informally raised the idea with other financial agencies and central banks in the region. The idea was that a \$US100 billion fund would provide trade finance and balance of payments support to the Asian economies hit by crisis, while also acting as a pooled reserve for currency defence.

The opposition

Malaysia enthusiastically embraced the AMF idea, and most ASEAN countries were generally supportive, but China and Singapore did not lend their support. As the second-largest holder

of foreign exchange reserves in the region, China's participation in any regional fund was particularly important. China's failure to lend support was interpreted as opposition to the creation of a regional institution minus the United States. Some other countries in the region with close ties to the United States also had concerns about the exclusion of the United States and informed American officials of Japan's lobbying activities within the region.¹¹

When Japanese officials presented the idea at the G-7 and IMF meetings in Hong Kong in September 1997, they also met strong opposition from their US and European counterparts. For the IMF and the US government, fear that the importance of their respective roles in Asia would diminish with the advent of such a fund provided one unspoken motivation to object. Since the Mexican peso bailout in 1995, the White House had become increasingly constrained by Congress in committing financial resources to international initiatives. As a result, the IMF had become increasingly important as a mechanism for US influence in international monetary affairs and international financial crisis management (Altbach 1997: 9). In addition, the presence of an alternative funding source threatened IMF potency.

Formally, the United States and the IMF gave the proposed fund's duplication of IMF functions as the main reason for their opposition. An increase in IMF resources was pending for 1998, so IMF officials argued that the need to augment the IMF with a separate fund was unnecessary (Altbach 1997: 9). The United States, as well as many European nations, also suspected that Japan would attach softer conditionality to aid and argued that doing so would simply promote moral hazard and do little to help the crisis countries in the long run. At this point, Sakakibara's idea had moved little beyond an abstract concept; as a result, the details of the proposal were unavailable to the public and unclear to its architects. There was increasing suspicion that the new fund might bypass the IMF. MOF officials downplayed the possibility of weaker conditionality attached to an AMF, but conditions within Japan lent credibility to the suspicion.¹² Many of Japan's own standards of financial regulation failed to conform to internationally recognised best standards in 1997. And, while the government officially embraced market capitalism when it adopted legislation to move forward the so-called Big Bang financial reforms, these reforms had yet to be implemented.¹³ Moreover, many of the 'fundamentals' the IMF focused on in establishing conditions for the receipt of funds had fallen into severe disrepair in Japan.¹⁴

After the meeting of G-7 finance ministers, Japanese officials relayed to their Asian counterparts the resistance encountered in pursuing the idea for a regional fund. Few countries wished to move forward with the idea in the face of strong US objections, fearing a souring of

relations with the United States. This was even true of Malaysia, initially the most enthusiastic supporters of the idea.¹⁵ After all, US–ASEAN relations were seen to be just as important as Japan–ASEAN relations. Chinese opposition compounded the difficulty of moving forward. Plans to make a formal proposal for the AMF were therefore abandoned – at least temporarily. Importantly, contagion had not yet surfaced in Asia at this time, and the Russian and Brazilian crises had not yet occurred.

A more inclusive guise for regional cooperation: the Manila Framework

With the spread of crisis to Indonesia in October, concerns about the adequacy of the IMF resurfaced, spurring 14 countries representing the Asia Pacific region to gather in Manila in November 1997. This group, which included the United States, Canada, Australia and New Zealand, met to discuss a framework for strengthening Asian regional cooperation towards currency stability. With the spread of crisis beyond Thailand, the IMF's weakness in carrying out regional surveillance was becoming increasingly evident. The countries gathered decided that deputy finance ministers and central bank deputies of their countries would meet semi-annually to discuss international finance and the conduct of monetary surveillance in the region. Programs of technical support to strengthen the financial sectors and market management in member nations were also proposed.

The most notable development to come out of the Manila Framework, however, was the establishment of a Cooperative Financing Arrangement (CFA). This 'arrangement' was essentially an understanding among members of the group that each would assist others who fell into crisis: the Manila Framework Group would help to coordinate bilateral support if future crises erupted. All assistance would be carried out after an IMF agreement was in place and the CFA would be activated only if IMF resources were inadequate.

Although the CFA involved no permanent pool of funds – or even a secretariat to coordinate responses – it addressed to a limited extent the two problems that had generated the earlier demand for a regional fund. These were the problems of resource inadequacy and the speed at which financing could be provided in times of crisis. Japanese officials stated that they considered 'the objective of the Asian Monetary Fund concept to be in line with the newly agreed Cooperative Financing Arrangement'.¹⁶ They would reiterate this sentiment in January 1998.

Resurgence of support for a more exclusive regional fund

As 1998 progressed, the idea of establishing a framework that did not rely on US involvement began to re-emerge in Asia. Although the United States participated in the Manila Framework Group, American officials were seen to convey little 'softness' toward the crisis-hit countries.¹⁷ Asian countries perceived the US government's attitude towards Indonesia – as expressed through the IMF – to be particularly harsh. In Indonesia, the IMF allowed banks to fail without any system of deposit insurance in place, thus triggering a major financial panic. As a result, many banks not initially in dire straits collapsed, with significant repercussions for the populace, a large proportion of whom were just above the poverty line prior to the onset of crisis. Thus, conditions imposed by the IMF in return for providing assistance increasingly became a focus of criticism within the region. Furthermore, by late 1998 and early 1999 there was a perception within Asia that US concern about the crisis in Asia deepened only when problems spread beyond the region to affect Russia and Brazil.¹⁸

In 1998, Japanese officials became increasingly outspoken in their criticisms of the IMF. Toyo Gyohten, a former MOF Vice Minister for International Finance, wrote an article arguing that Japan should play a more prominent role in regional affairs (Gyohten 1999). He noted that the \$US600 billion in total reserves in Asia would have been sufficient to deal with problems in the region if there had been a framework for cooperation prior to the collapse of the baht. In July 1998, Japan's Ambassador to Korea also wrote an article advocating the creation of a new Asian fund in which he argued that the crisis showed the need for East Asian countries to come together (Ogura 1999). This article was the first written by an incumbent government official to argue that the United States had no right to protest against being left out of such an arrangement.

Japan's diplomatic efforts in 1998 revealed government attempts to draw closer to its Asian neighbours. In March 1998, Japanese Prime Minister Ryutaro Hashimoto became the first head of state to visit Indonesia after the crisis (the United States sent a senior cabinet minister). In May of the same year, then Foreign Minister Keiso Obuchi visited Thailand, Malaysia and Singapore. Through such actions, Japan drew closer to Asia at the same time as Finance Minister Kiichi Miyazawa hotly contested the IMF's revised growth projections for Japan, announced in July 1998. The IMF's downward revision to zero per cent growth for Japan came just as the Liberal Democratic Party headed into a tough battle in the upper house Diet

elections. Such pessimistic growth outlooks undermined the credibility of the government's less than aggressive policies towards the banking sector's non-performing loan problem.

Criticism of the IMF's handling of the crisis in Asia and perceptions that America lacked appropriate levels of concern for the crisis-stricken countries thus helped revive regional interest in establishing a non-US-dominated lender of last resort. In 1997, many countries in the region had been wary of excluding the United States from a new regional institution; these same countries now welcomed Japanese leadership in setting up an institution focused more narrowly on Asia. There was the feeling that Asia needed a champion with a loud voice, and this champion could only be Japan.

The New Miyazawa Initiative

Following the outbreak of crisis in Thailand in July 1997, Japan funnelled huge amounts of aid to the crisis-stricken countries through the IMF and existing aid mechanisms.¹⁹ In October 1998, Finance Minister Kiichi Miyazawa announced a new program of bilateral aid – the New Miyazawa Initiative – providing up to US\$30 billion in loans and loan guarantees to help revive the five countries hit by crisis.²⁰ By this time, most countries were out of acute crisis but still in need of funds to proceed with economic development and deal with ongoing economic difficulties.

The New Miyazawa Initiative was seen as an initial step towards the revival of the AMF idea. Japanese officials hoped to foster greater trust between Japan and countries in the region through bilateral programs of aid. Strengthened trust, in turn, was seen as a prerequisite for the realisation of a Japan-led multilateral regional institution in the future (Kishimoto 1999: 42).

The new program of aid was seen as furthering more tangible Japanese interests. In aiming to strengthen market confidence in recipient countries and thereby spur the resumption of private lending in these economies, the aid was intended to help restore sound trade and investment ties between Japan and the crisis-hit countries. Through the extension of yen-denominated loans to the region, the initiative was also seen as furthering longstanding efforts to internationalise the yen. Since the 1980s, MOF officials had argued for the need to encourage more widespread use of the yen around the globe. Despite having the number two economy in the world, Japan's currency failed to figure prominently in international financial markets, and the launching of the euro set for January 1999 heightened fears that the yen would be marginalised.

A prerequisite for the receipt of support through the New Miyazawa Initiative was simply 'economic reform, taking into account the situation in each country'.²¹ In countries with IMF programs in place, this new source of aid complemented IMF assistance. Funds dispersed to Malaysia, Vietnam and Myanmar, where IMF programs were not in place, however, substituted for IMF aid, rather than supplementing it. Malaysian officials, having rejected IMF support and imposed capital controls in September 1998, were particularly eager to access another source of funds that could be disbursed quickly and was not linked to IMF conditionality.

Spreading financial weakness across the globe influenced the way in which US officials saw Japanese efforts relating to American interests. With the eruption of financial crisis in Russia in the summer of 1998, the rescue of the mammoth US hedge fund Long Term Capital Management in September 1998 and serious problems looming in Brazil, the United States now gave international financial system stability a higher priority than more dogmatic concerns. Furthermore, as the financial crisis widened and with the increasing threat that resources would be inadequate to deal with these crises, US officials began to better appreciate Japan's provision of financing to the region. Changed circumstances in the international system thus helped to muffle potential US or IMF criticism of Japan's new aid program.

Because the Miyazawa Initiative represented Japan going off on its own, however, American and Japanese officials concurred that it would be desirable to establish a cooperative scheme, even if in name only. Out of this sentiment arose the Asian Growth and Recovery Initiative, announced jointly by the United States and Japan in November 1998. A major component of the initiative was the establishment of an Asian Currency Crisis Support Facility within the ADB, funded solely by Japan, drawing on New Miyazawa Initiative funds. It was hoped that the cooperative nature of the Asian Growth and Recovery Initiative would counter perceptions of rising tensions between American and Japanese responses to the crisis. In April 1999, Japan and the United States announced new joint projects to address human security in Asia, as part of the US–Japan common agenda.

In the same period, the United States and Japan worked within the G-7 framework to enhance regional stability and reform the international financial architecture. In October 1998, the G-7 endorsed the creation of a new contingency credit line (CCL) within the IMF. This mechanism, aimed primarily at crisis prevention, was established in April 1999. In the same month, financial authorities from the G-7 countries held the first meeting of the Financial Stability Forum (FSF), aimed at making the international system less vulnerable by strengthening regulatory and supervisory measures on highly leveraged hedge funds, offshore markets and short-term capital flows.

ASEAN+3 and the Chiang Mai Initiative

In 1999, the New Miyazawa Initiative was expanded beyond loans and credit guarantees to include the establishment of backup facilities, in the form of currency swap agreements, with the central banks of South Korea and Malaysia. The currency swap innovation represented a shift from simply providing aid to assist the crisis-stricken countries to overcome ongoing economic difficulties to establishing an institutional framework to prevent contagion. This development thus represented another step towards the realisation of an AMF as originally conceptualised.

Enhanced sentiment in favour of cooperation within the region in 1998 and 1999 also encouraged the strengthening of a new regional grouping that brought the ASEAN member countries together with Japan, China and South Korea into the 'ASEAN+3'. ASEAN member countries were particularly interested in maximising the benefits from Japan for all members – including those not hit by crisis. And the multilateral platform of ASEAN+3 was seen as a springboard for strengthened bilateral ties in the region – particularly between Japan and South Korea and Japan and China. This strengthening, in turn, was seen to provide greater overall regional stability.

In January 1999, the ASEAN+3 first met to discuss the establishment of a permanent regional fund. While the ASEAN nations increasingly welcomed a greater leadership role for Japan, they at the same time heightened their expectations that Japanese officials would consult more actively with regional leaders so as to represent the region in G-7 discussions. The administration of Prime Minister Keiso Obuchi was the first to respond to these expectations; Obuchi's decision in April 1999 to hold the July 2000 G-7 summit in Okinawa, closer to the ASEAN nations, was interpreted as being symbolic of a shift in Japanese attitudes.

In August 1999, Prime Minister Obuchi also dispatched the Mission for Revitalisation of the Asian Economy to the countries hit by crisis, to assess Japan's aid programs and identify the key issues that Japan could help to address. The mission's findings led Obuchi to announce at the end of November 1999 the 'Plan for Enhancing Human Resource Development and Human Resource Exchange in East Asia' – otherwise known as the 'Obuchi Plan'. This aid plan would support more people-focused cooperation and aid in the region. Thus, Japan's ties with its Asian neighbours deepened in 1999 as the AMF idea was reconsidered within the region.

Beginning in 1999, the ASEAN+3 countries expanded their level of cooperation to include an annual Finance Ministers Meeting held back to back with the annual ADB meeting. At the annual ASEAN+3 Summit meeting in November 1999 in Manila, leaders of member countries

also issued a 'Joint Statement on East Asia Cooperation' that articulated the desire to enhance self-help mechanisms and a cooperative regional framework. This joint agreement called upon the region's finance ministers to produce something tangible when they met the following year. While countries in the region recognised that the original AMF idea had problems, they now called on Japan for leadership in establishing a regional fund that would supplement the IMF.

Two of the greatest criticisms of the IMF were its template used for all countries and its lack of country expertise. It was thought that a regional arrangement would incorporate superior knowledge of specific events and needs within the region, enabling prescriptions for crisis management to be written more accurately. In this way, a regional fund was envisioned as being more receptive to Asian needs – in contrast to the generic prescription used by the IMF.²² A report issued in January 2000 by the Prime Minister's Commission on Japan's Goals in the 21st Century reinforced this sentiment:

If the IMF can be likened to a major hospital caring for the world as a whole, then we should consider supplementing it with the establishment of an Asian Monetary Fund to serve as a 'family physician' to provide care at a more intimate level. We have reached the stage at which we should take a multilevel approach in the field of finance as well, responding both globally and locally.²³

At the ASEAN + 3 Finance Ministers Meeting in Chiang Mai, Thailand in May 2000, views on economic and financial cooperation were exchanged and a framework for strengthening East Asian financial cooperation announced. This framework had two components: an expansion of an existing ASEAN swap agreement (ASA) and the establishment of a network of bilateral currency swap arrangements (BSA). Both components were seen to aid in protecting against future speculative currency attacks. The first component was more symbolic than substantial. The ASA expanded an existing swap network among the top four ASEAN countries to all 10 ASEAN member nations and increased the amount of funds in this network from \$200 million to \$1 billion. However, the amount was still very small and the conditions undermined any credible defence against a speculative attack. For example, once one country in the network withdrew funds, other countries in the network had to wait for six months before they could withdraw funds.²⁴ Thus, the arrangement did little to stem the chances of contagion. The critical advance of the Chiang Mai Initiative was its second component: the network of bilateral currency swaps that included Japan, China and South Korea. Participation by these three countries enabled a considerable expansion in the scale of the swap facility.

The Chiang Mai Initiative stated that the arrangement would ‘supplement existing international facilities, including those provided by the IMF’.²⁵ At the same time, however, it stated that the purpose of the bilateral swap arrangement was to provide short-term financial assistance to a country ‘which is in need of balance of payment support or short-term liquidity support’. The former implied a situation in which something was wrong with the recipient country’s macroeconomic policy, and thereby implied that IMF programs had a relevant role to play. The latter implied that for some reason – perhaps unrelated to macroeconomic management – capital was rapidly leaving the country and thus a liquidity injection was required. In this case, having an IMF program in place was not necessarily a relevant condition. Japan’s position was that this second line of reasoning was invalid. In other words, Japanese officials adopted the stance that a crisis was never brought about solely by contagion without any relationship to macroeconomic mismanagement. Nevertheless, the provision for short-term liquidity support was included in the Chiang Mai Initiative because it was so strongly desired by the ASEAN countries.²⁶

Over the following year, the ASEAN+3 countries grappled with contentious issues related to the swap network, such as the degree of linkage with the IMF, the rate of interest and the strictness of guarantee and disclosure requirements. In April 2001, the finance ministers of the ASEAN+3 countries agreed that assistance through the bilateral swap arrangement would be conditioned on the swap partner borrowing the equivalent of 90 per cent of the swapped amount from the IMF. Only up to 10 per cent of the maximum amount drawn could be provided without linkage to IMF facilities; in such a case, the swap-providing countries must judge that the swap-requesting country was facing a short-term liquidity problem. Implicit in the conditions therefore is that recipient countries must fundamentally abide by the strict economic and fiscal conditions the IMF attaches to lending.

Explaining the reversion to close linkage with the IMF

What explains the close linkage today between the AMF-like regional monetary institution now evolving and the IMF? The change in approach from the initial AMF idea may seem even more puzzling following rising concerns within the region in 1998–99 about the appropriateness of IMF conditionality. The fact that the Chiang Mai Initiative built upon existing swap arrangements that were not explicitly linked to the IMF also suggests that the linkage was not a given. As noted above, a currency swap mechanism was already in place among ASEAN core member countries. Furthermore, bilateral swap arrangements were already in place between Malaysia

and Japan (in the amount of \$US2.5 billion) and between South Korea and Japan (in the amount of \$US5 billion) under the New Miyazawa Initiative.

The solution to this puzzle becomes clearer when we consider that Japan put forward the initial 1997 IMF proposal with very little prior consultation and communication with countries in the region. Countries in the region have widely differing views and positions on the nature of a regional monetary institution, depending on both their domestic politics and their financial capacity. Any attempts to explain outcomes to date solely by reference to US and Japanese interests miss a large part of the picture.

Preferences of regional actors

Under the bilateral swap arrangements, any ASEAN+3 country can receive funds and any can provide funds. Given economic realities, however, the potential donors are essentially limited to countries with substantial foreign exchange reserves – that is, Japan, China and South Korea. In the case of crisis, however, South Korea and China will also be called upon to mobilise their reserves. The maximum amount countries may draw from the swap facility is determined by bilateral negotiation, but if the swap mechanism is activated funds are drawn on a pro rata basis.²⁷ Thus, Japan will never be the sole donor in case of crisis.²⁸ China and South Korea adopted a more conservative stance in the negotiations among the ASEAN+3 countries, favouring close linkage to IMF programs. Doing so minimised the potential demand for capital from their own coffers and ensured that funds lent had a better chance of being repaid. China, in particular, stood firm in its insistence that the arrangements be closely linked to IMF programs and argued for 100 per cent linkage.²⁹

At the other end of the spectrum, Malaysia insisted that no linkage to the IMF was necessary. Malaysia already had in place a swap with Japan that was not linked to the IMF and had thus far been able to avoid IMF involvement in rebuilding after its crisis; therefore, Malaysian officials were particularly upset by the introduction of the IMF at this stage.

Most other ASEAN countries also preferred weak IMF linkage since the economic realities underlying the bilateral swap agreements meant that they were unlikely to be anything but recipients of funds. Given this fact, weaker rather than tougher conditions attached to funds meant less chance of impeded access in times of need. Yet the ASEAN countries were in a weak bargaining position. As noted earlier, the currency swap facility already in place among ASEAN member countries lacked anywhere near the level of funds – and hence the level of defence from contagion – that a swap arrangement involving Japan could provide. Thailand and the

Philippines knew that they had no possibility of mounting a credible currency defence without the completion of this agreement, and moved ahead, working on agreements with Japan. Malaysia therefore became totally isolated in its stance against IMF linkage.³⁰

As a compromise, 10 per cent of assets mobilised under the Chiang Mai Initiative were not linked to the IMF, placating Malaysia and the ASEAN member nations. As part of the compromise, Japanese officials pledged to work for reform in the IMF quota structure, voting system and composition of its board of directors. Currently, the quota system allocates much higher quotas to European countries than to countries in East Asia. Japan's efforts to spur review of the quota system are supported by the United States. Both countries wish to see an increase in the portion of IMF funding contributed by emerging market nations in Asia, Central America and South America.³¹ European nations have resisted this move, because such revisions would reduce their own quotas. Likewise, membership of the IMF's Executive Board is weighted in favour of Europe, with eight of the 24 executive directors from Europe. European nations rather than the United States therefore stand in the way of reform here.

Japanese officials have also sought a loosening of the conditions underlying use of the IMF's CCL by member countries. The CCL was established by the IMF in the wake of Brazil's crisis in April 1999 and is intended to provide precautionary short-term financing to countries with balance of payment problems arising from a sudden loss of market confidence. Its aim is to protect countries vulnerable to contagion. Yet countries must apply in order to have access to the CCL in a crisis, and the conditions are so unattractive that no country has yet applied. As with the quota issue, US officials have joined Japan in pushing hard to make the facility easier and more attractive for countries to use. In addition to working for IMF reforms, Japan has made concerted efforts to address problems with hedge funds and capital movement in its interactions with other G-7 nations within the FSF.

Japan, having proposed the Chiang Mai Initiative, played the pivotal role in arbitrating among the ASEAN+3 nations to work out the general conditions and principles for the currency swap network. Japanese officials initially assumed a stance in the middle, desiring some linkage to IMF programs but not necessarily full linkage. This stance itself represented a shift from attitudes reflected in the 1997 AMF proposal and reflected the influence of two factors on Japanese definitions of national interest. First, the IMF had undergone reform, so in 2001 IMF linkage meant something different from IMF linkage in 1997. In 2001, the official consensus on many crisis management issues in the IMF differed considerably from the official consensus within the Fund in 1997, when the IMF initially responded to the outbreak of crisis in the region.

Second, new leadership in Japan's MOF recognised how IMF linkage resonated with Japanese national interests.

Redefinition of Japanese national interests

New leadership within Japan's MOF also helped to redefine Japanese national interests in a way that converged with those of the United States. As noted earlier, when the initial proposal for the IMF was put forward in 1997, the MOF had different conceptualisations of how it would work. The domestic and international contexts of the time lent support to those who envisioned an AMF that would be independent of any US influence; it was this conceptualisation that Japan initially pursued. In 1999, however, Haruhiko Kuroda replaced Eisuke Sakakibara as the Vice Minister of International Finance in the MOF. Kuroda, too, has a longstanding interest in the establishment of an AMF – an interest that pre-dated Sakakibara's.³² However, his view of the IMF is less critical than that held by Sakakibara, and his conceptualisation of an AMF is of an institution that cooperates rather than competes with the IMF.

Kuroda, moreover, is widely recognised as being more pragmatic than Sakakibara. Sakakibara's tendency to focus on lofty ideals resulted in his original AMF proposal lacking the answers to many questions concerning the proposed fund's actual operation. Indeed, one of its weaknesses was its underdeveloped form. Kuroda felt that the IMF (and the US government) had learned lessons from their mistakes. The IMF's failures with conditionality in Asia were widely recognised, and reforms were under way by the time Japanese officials began to work out the terms of the bilateral swap arrangements. Kuroda and his MOF colleagues also acknowledged that IMF involvement was necessary for the success of any new institutional framework. Not only were the United States and Europe unlikely to support a new framework in the absence of any linkage, but a new regional fund would lack the capacity to carry out needed surveillance of member countries, at least initially. The IMF had institutionalised surveillance measures and better information on undertakings in particular countries. Since Japan would be the main provider of funds in a regional institution, having access to the best possible intelligence was in Japan's national interests. Understandably, concern over credible surveillance mechanisms was shared as well by China and South Korea; today the surveillance issue stands as perhaps the largest barrier to the evolution of a regional monetary institution that is relatively independent from the IMF.

Although the May 2000 joint ministerial statement of the ASEAN+3 finance ministers emphasised the important role of surveillance in strengthening East Asian financial cooperation, there was little progress in the area of surveillance between May 2000 and May 2001. In this period, negotiations among member countries focused almost exclusively on the issue of the use of fund resources. Member countries have been much less eager to tackle the surveillance issue. However necessary, surveillance such as that carried out by the IMF in its annual Article IV review of member countries is seen as intrusive and politically sensitive. It is extremely difficult to gain domestic support for another actor to carry out separate surveillance activities, particularly for countries such as China, Indonesia and Singapore. In lieu of such surveillance, the presence of a 'bad guy', in the form of the IMF, is seen as helpful in combating moral hazard and ensuring that borrowed funds are repaid.³³

In May 2001, Japan announced that it had reached substantial agreements over the terms and conditions for bilateral swap arrangements with Thailand, South Korea and Malaysia. Negotiations on a dollar–peso swap arrangement with the Philippines and a yen–renminbi swap arrangement with China are ongoing. Swap and repurchasing agreements among other ASEAN+3 member countries continue to be worked out.³⁴

Conclusions

Japan's 1997 AMF proposal did not come out of the blue but came at a time when regionalism was becoming increasingly fashionable across the globe. Yet the original conceptualisation of a regional monetary fund was put forward without serious consideration of the practical workings of this institution and without significant prior consultation with the potential member countries. Since 1997, there has been progress towards the creation of a new regional monetary institution, but the evolution of greater independence from the IMF for this institution remains impeded by several factors. In contrast to 1997, however, US objection to the creation of such an institution is one of the less formidable barriers. Although the press has placed a great deal of emphasis on US objections to greater independence by focusing on America's quick rejection of the initial 1997 AMF proposal, my study has found that the most prominent and lingering limitations to regional institution building are to be found within Asia. US officials have become increasingly appreciative of Japan's willingness to take a more proactive role in helping to maintain financial stability in the region; the absence of strong US objection to the evolving network of bilateral currency swap arrangements reflects this shift. Furthermore, the

evidence suggests that Japan has no intention to abandon participation in existing institutions such as the IMF. In fact, Japanese officials have actively worked to establish a new framework for regional monetary cooperation while at the same time working to reform and strengthen existing institutions such as the IMF.

Japan's Asian neighbours have increasingly welcomed a greater leadership role in the region in this area for Japan. A consensus has emerged within Asia that a global solution to financial problems in the region is insufficient and that some type of regional cooperation is absolutely necessary. The network of bilateral currency swaps evolving under the auspices of the Chiang Mai Initiative represents an institutional innovation in this direction. The debate over what type of regional arrangement is the most appropriate, however, has not been entirely settled. Capacity issues are central to the current arrangements. At present, regional actors lack the institutionalised mechanisms for surveillance of member countries; therefore, they need to rely on the IMF's information. Over time, capacity building in this area might be expected to decrease the need for a regional institution to rely on the IMF, but the prospects for capacity building in the near future are not particularly promising. A study group was established in May 2001 to engage in discussions on the creation of regional surveillance mechanisms, but many ASEAN+3 countries remain resistant to the entrance of another actor – in addition to the IMF – carrying out such activities. Surveillance is not the only capacity issue, however. In the near future, the amounts of foreign exchange reserves contained within the network of bilateral currency swap arrangements will not alone enable a regional group to credibly replace the IMF. In addition, the limited capacity of South Korea and China to mobilise capital means that in the meantime these countries shy away from any arrangement that attempts to place the regional monetary institution at the centre of a crisis response.

In drawing out the significance of the AMF idea and its institutional evolution for the US–Japan bilateral relationship and for US and Japanese roles in multilateral financial institutions today, this paper has suggested that cooperative and competitive dynamics coexist in this aspect of the relationship. The case of the AMF was not simply one of Japan 'giving in' to the United States. Crisis served as a catalyst to help both the United States and Japan work out what their national interests really were. Since the outbreak of crisis, official consensus within the IMF has also shifted considerably. Today the consensus view is much less dogmatic than the official pre-crisis line. The evolution of greater independence from the IMF for a new regional monetary institution remains impeded by a number of factors, but the most prominent limitations are to be found *within* Asia.

Notes

- 1 Japan joined the Fund in 1952.
- 2 Japan has staffed the top position of president since the ADB's creation; however, with the exception of one president, all have been former high-ranking MOF officials (Lincoln 2000).
- 3 Many see the ASEAN+3 framework for regional cooperation, discussed later in the paper, as a resurfacing of the EAEC in another form.
- 4 Remarks by Zenbee Misoguchi, International Bureau Director-General, Ministry of Finance, 'Gaikoku Kawase-to Shingikai Dai 53-kai Sokai Gijiroku' [Foreign Exchange, Etc. Deliberation Council's 53rd General Meeting Minutes], 17 October 2000, Ministry of Finance, Japan. Accessed at <<http://www.mof.go.jp/singikai/gaitame/gijiroku/a053.htm>>.
- 5 Author interviews with numerous Diet members and MOF officials, 2000.
- 6 For example, the United States experienced a dollar crisis in the early 1960s and the United Kingdom experienced a pound crisis in the early 1970s.
- 7 Author interview with MOF official, 2000.
- 8 Author interview with MOF official, 2000.
- 9 In fact, the IMF package agreed to by the Thai government was also a result of close Japanese collaboration between the Japanese and Thai governments, as the Japanese ambassador to Thailand had a close relationship with Prime Minister Chavalit Yonchaiyudh of Thailand (Press conference by the Press Secretary, 16 January 1998).
- 10 Author interview with MOF official, 2000. Notably, the IMF was not yet being showered in criticism concerning the conditions it attached to its rescue packages.
- 11 Author interview with MOF official, 2000.
- 12 IMF conditionality had not yet emerged as a major issue within the region.
- 13 Implementation of these reforms began in April 1998.
- 14 For example, the Japanese government had gone from having a balanced budget in 1990 to having one of the worst budget deficits in the advanced industrial world by 1997.
- 15 Author interview with official in Malaysia's Ministry of Finance, 2000.
- 16 Hiroshi Hashimoto, spokesman for the Prime Minister of Japan, Press Conference by the Japanese Delegation to the 1997 APEC Meetings in Vancouver, 21 November 1997, Vancouver. Accessed at <<http://www.mofa.go.jp/policy/economy/apec/1997/position.html>>.
- 17 Author interview with Dr. Stephen Leong, Deputy Director-General, ISIS, Malaysia, 2000.
- 18 Author interview with MOF officials, 2000.

- 19 Between July 1997 and November 1998, \$US44 billion of Japanese aid was funnelled through existing mechanisms.
- 20 The initial proposal for an AMF was considered to be the first 'Miyazawa Initiative'. In fact, both the initial proposal for an AMF and the New Miyazawa Initiative came from MOF bureaucrats in the International Finance Bureau. Haruhiko Kuroda, who would replace Sakakibara as Vice Minister for International Finance in 1999, was well versed in drafting such plans. At the time of the Mexican debt crisis in the 1980s when Kiichi Miyazawa was serving his first stint as Finance Minister, Kuroda drafted the 'Miyazawa Plan' proposed by Japan to deal with the Mexican crisis. The United States rejected the plan as too stringent but in the end put forward a very similar plan, dubbed the Brady Plan. (Author interview with MOF official, 2001.)
- 21 'Q&A about The New Initiative to Overcome the Asian Currency Crisis (New Miyazawa Initiative)', Ministry of Finance, Japan. Accessed at <<http://www.mof.go.jp/english/qa/my001.htm>>.
- 22 Asahi Shimbun, cited in Andrew Cornell, 'Japan pushes for Asian version of IMF', *Australian Financial Review*, 12 February 1999.
- 23 Prime Minister's Office, Government of Japan; Prime Minister's Commission on Japan's Goals in the 21st Century, *The Frontier Within: Individual Empowerment and Better Governance in the New Millennium*, 18 January 2000; accessed at <<http://www.kantei.go.jp/jp/21century/report/htmls/7chap6.html>>, 7 February 2003.
- 24 Author interview with MOF official, 2001.
- 25 See <<http://www.aseansec.org/635.htm>>.
- 26 Author interview with MOF official, 2001.
- 27 An exception is made if multiple countries including one of the donor countries is under attack. For example, if Thailand and South Korea were both hit by liquidity crises, then South Korea would withdraw as a donor to Thailand.
- 28 South Korea has accumulated over \$US90 billion in foreign exchange reserves and China holds even more. (Author interview with MOF official, 2001.)
- 29 Author interviews with Japanese MOF and Korean MOFE officials, 2001.
- 30 Author interview with MOF official, 2001.
- 31 'IMF Eyes Revising Formula for Member Contributions', *Nikkei Net Interactive*, 29 June 2000. Accessed at <<http://www.nni.nikkei.co.jp/AC/TNKS/ecopol.htm>>.
- 32 Author interview with MOF officials, 2001.
- 33 Author interview with MOF official seconded to the IMF, 2000.
- 34 Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting, 9 May 2001, Honolulu, USA.

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