CHAPTER 4

Introduction to the Comparative Case Study of Latin America

The following two chapters focus on Japan's actions in financial crisis management in Latin America. Two qualitative case studies examine factors that led Japan to respond differently to two crises that hit Latin America in the 1980s and the 1990s. The first crisis was the Latin American debt crisis of the 1980s (discussed in chap. 5, with a main focus on Mexico), and the second was the Mexican peso crisis of 1994–95 (discussed in chap. 6), which had repercussion in the Latin American region, particularly in Argentina.[1] There is a noticeable contrast in the way the Japanese government became involved in and committed to the solution of the two crises, particularly regarding the Japanese government's engagement in collective action with the United States. The Japanese government was quite active and collaborative with the United States during the debt crisis, but its response was quite reluctant and weak vis-à-vis the Mexican peso crisis. An empirical puzzle arises: What made the Japanese government become actively involved in the resolution of the first crisis but not the second?

The two hypotheses discussed in chapter 1 are tested through these case studies. The first hypothesis argues that the presence of high private returns increases the Japanese government's commitment and action in financial crisis management. The second hypothesis analyzes the role of transnational linkages between Japan and its most important economic partner, the United States. When such linkages are strong and ample, the Japanese government tends to be more responsive to crisis.

The following two chapters indicate that the absence of several critical conditions in the 1994–95 currency crisis made the Japanese government reluctant to play a role as a collective manager of that financial crisis, unlike the case of the debt crisis of the 1980s. High expected private returns from the management of the crisis—for example, economic benefits to Japan's private financial sector and a satisfying transnational coalition between the American and Japanese private financial sectors involved in the crisis—urged the Japanese government to become actively involved in the debt crisis in the 1980s, while the lack of those very factors limited the Japanese government's action in the 1990s.

Methodology

The purpose of this comparative case study, along with the quantitative analysis in chapter 3, is to investigate the validity of my theoretical claims by taking advantage of the synergy created by the two empirical approaches. Admittedly, both the quantitative analysis and the comparative case study of this book lean toward the variable-oriented approach described by Charles Ragin, through which I aim to test my hypotheses.[2] Nevertheless, the following two case study chapters include a fair amount of contextual and historical material. Moreover, they provide a better understanding of where the theoretically important factors in the analysis of international financial crisis management fit within the overall international political and economic dynamics of the time and within Japan's changing domestic environment.

The comparison of cases in different historical periods (time series) adds to each case temporal elements that cannot easily be controlled. But many of these temporal changes influenced the nature of the joint product and the strength of transnational linkages and thus are subsumed under my two major hypotheses. The cases are taken from the same region and are relatively close in time periods; thus they allow the study to explore the validity and impact of several important factors that led to contrasting outcomes. Many variables and their contexts are taken into account. Methodologically speaking, these variables can be placed into three categories: those controlled by the case selection, those that are historically contextual and have some impact on the variables of theoretical interest (and that often cannot be controlled), and those of theoretical interest.

The first group of variables that conceivably made a difference in Japan's response are controlled (i.e., unchanged or changed very little) by the research design. They include the weak political importance of the Latin American region to Japan (with exception of the Japanese immigrants there, a situation still unchanged) and Japan's relatively limited trade relations with the region.

Second are variables that represent the environment or context in which the Japanese actors make decisions and that indirectly influence the calculation of the theoretical variables. Although the factors of this second category are not central to my theoretical discussion, they still need to be analyzed on some level to illustrate how their evolution influences the theoretically important variables and the outcome. The chapter on the Mexican peso crisis (chap. 6) includes a section explaining these contextual variables, enhancing the strength of the analysis by adding a holistic dimension. The variables include (a) the end of the cold war and changes in U.S. attitudes toward economic regionalization; (b) economic, political, and budgetary changes in Japan since the early 1990s; (c) the creditor governments' and international financial community's learning and institutionalization regarding financial crises of large magnitude; and, probably most importantly, (d) changes in the nature of financial crises emerging from middle-income countries, particularly in terms of the speed of crisis evolution and the type of private actors involved. These variables are connected to the variables of theoretical interest. Domestic economic and political difficulties in Japan in the 1990s, for example, decreased Japan's relative private return from engaging in the solution of the Mexican peso crisis. This is because the Japanese government's stake in Mexico has diminished, not in absolute terms, but in relation to stability of the domestic economy.

Finally, there are two variables of theoretical interest, derived from the theoretical discussion (chap. 1). The first is the measurement of private returns the Japanese government expected and managed to obtain from its active involvement in the collective management of these financial crises. These private returns include improvement of U.S.-Japan relations and economic benefits to Japan's private sector. The other variable of theoretical interest addresses the level of involvement of transnational coalitions among private financial actors and the importance of economic linkages, as well as the domestic pressure that moved the Japanese government to respond to the respective crises. These two hypotheses are reiterated in the following discussion.

Crisis Management as a Joint Product

As I discussed in chapter 1, creditor governments are much more likely to engage in the collective management of financial crises to secure international financial stability when these actions also produce private returns to their respective home countries. These private returns range widely, including, to name a few, protection of the home country's private financial sectors exposed to the crisis, evasion of disruption in bilateral trade or payments, and an increase in the home country's political presence in or leverage over the crisis countries or in the international financial world. The combination of public purposes (which provide international financial stability) and private purposes increases the incentives for a creditor government to engage in the collective management of a financial crisis, making a government's participation in international cooperation much more likely.

In this sense, the realist prediction of relative gains inhibiting the possibility is at best partially applicable. Particularly when the private returns for a creditor government can be obtained without taking away any gains from another creditor government (e.g., financial stability in its home country), the likelihood of cooperation increases significantly. At the same time, it is clear that some crises produce much greater private returns to certain creditor governments than do other crises. In an extreme case, a resolution of a major financial crisis can fail to increase private returns to some creditor governments, although the lack of a solution to the crisis would threaten international financial stability, undermining a public return of management. For Japan, the contrast of the implications of the two crises in Latin America fit these respective cases and suggests the motivations behind the Japanese government's contrasting behavior.

Transnational Linkages and Domestic Dynamics

Transnational linkages lead creditor governments to increase their incentives to engage in collective management of financial crisis. On one hand, strong economic linkages increase private returns to the Japanese government as it supports the U.S. economy, in which Japan's private sector has a substantial vested interest (discussed earlier). On the other hand, institutional linkages among subnational actors have played a major role in increasing the Japanese government's involvement. When the Japanese government became an active crisis manager for the Latin American debtors in the 1980s, a strong domestic force represented by Japanese banks compelled the Japanese government to act. Furthermore, the power of the banks came not only from their own economic and political power in the country but also from the fact that institutional linkages with transnational banks in other parts of the world urged them to do so. The domestic dynamics of the crisis management of the mid-1990s was somewhat different. As is noted in chapter 6, the financial actors involved in the two financial crises changed, leading to differences in the way private actors influenced the Japanese government.

The private financial actors deeply involved in the 1982 debt crisis were commercial banks that had high exposure to developing country debts on syndicated loans in the 1970s and 1980s. Both lenders and borrowers were locked into those long-term loans. In the early 1990s, a large portion of capital flows took the form of bond and equity investments in emerging markets in Latin America. In the case of Mexico, J. P. Morgan estimated that the country enjoyed $26 billion (1992), $30 billion (1993), and $10 billion (1994) in capital inflows, most of them through such mechanisms. This type of financial flow, carried out by institutional investors, is mostly short-term flow and is significantly more liquid and more volatile than syndicated loans. The nature of these new investments (which do not lock in investors in the crisis countries), coupled with minimal pressure from domestic actors in Japan, weakened the Japanese government's motivation for collective action with the United States in the 1990s.

Summary

What factors motivated the Japanese government to get involved in solving the Latin American debt crisis in the 1980s but were lacking in the 1994 Mexican peso crisis? The following two chapters begin with this empirical question, which has led me to an analysis of the complex dynamics of collective financial crisis management among major creditors. Because international financial stability rests on the appropriate management of major crises like these, the possibility of international public goods provision in the world of finance can be understood by examining the motivation of the major creditor governments for becoming actively involved in this type of crisis management.

The analysis indicates the importance of understanding the nature of public goods in terms of joint products. The private returns accrued (or expected to accrue) from the collective provision of public goods become a critical component in the creditor government's decisions. The Japanese government was concerned with (a) the involvement of the private financial sector in the crisis, (b) the repercussion of the crisis on the U.S. economy and hence on Japan's economic and political relationship with the United States, and (c) Japan's status in the international financial world. As the active involvement in the resolution of the Latin American debt crisis provided satisfactory private returns, the Japanese government was quite willing to commit to crisis management. Although these private goods could have been separately produced, the Japanese government's active involvement in the management of the Latin American debt crisis produced these goods much more efficiently.[3]

Transnational linkages, both economic and institutional linkages, were also important in increasing the government's motivation for its involvement. Since the 1970s, there has been a trend toward increased internationalization of the Japanese private sector, deriving from structural and inherent causes in the Japanese economy that have fostered the private sector's interest in international affairs. The private sector demanded that the Japanese government intervene in situations that were stated to have potentially damaging effects on economic activities and profits. Particularly in the case of the debt crisis of the 1980s, Japanese commercial banks influenced Japanese foreign policy: they used their power to influence the Japanese government. Furthermore, collective action between Japan and the United States was facilitated by the common interests and common constituencies among transnational banks from each country, which transmitted pressures from the United States to the Japanese government.

As both of these influential factors were not strong in the case of the 1994–95 Mexican peso crisis, the Japanese government was not sufficiently motivated to become involved in crisis management, particularly given the different domestic political and economic circumstances it faced in the mid-1990s. Furthermore, the U.S. government was in a relatively good position economically, and the Clinton administration had a significantly elevated political motivation to act quickly, even by itself, to manage the Mexican peso crisis.