Conclusion

International Cooperation and Financial Crisis Management

Why do major powers engage in collective action to manage some financial crises but not others? How do nonhegemonic powers decide to support or not support such collective actions? With these questions in mind, this study has examined the factors that determined the behavior of the Japanese government and its private financial sector when confronted with major financial crises in the Pacific Rim over the past two decades. The cases include the Latin American debt crisis of the 1980s, the 1994–95 Mexican peso crisis, and the Asian economic crisis beginning in 1997.

This study has defined international financial stability as a prominent international public good that needs to be produced at the time of financial crises (see chap. 1). It also asserts that creditor government actions, particularly in the form of collective action, hold the key to some kinds of solutions to these crises. In crises arising from the middle-income countries incapable of stabilizing the situation by themselves, outside intervention and management is required. Otherwise, the crises could spread and destabilize the world of finance. In other words, the formation of collective action among the creditors is an important step toward providing international financial stability in the aftermath of a crisis.

Japan's involvement in crisis management has varied significantly across cases. Active involvement of the Japanese government, particularly in coordination with U.S. debt initiatives, helped solve the Latin American debt crisis by the early 1990s. But the Japanese government was reluctant to become involved in the Mexican peso crisis in the mid-1990s, despite substantial U.S. interest in resolving it. Finally, Japan's ambivalent and irresolute behavior during different phases of Asian crisis management has been puzzling, given Japan's much stronger interest in stabilizing Asian economic turmoil than in solving Latin America's economic problems. These observations of Japanese behavior led this study to analyze empirically the factors that determine these differences in Japan's behavior. Japan's collaboration is very important for the supply of international public goods. Japan has been a major provider of financial resources to middle-income developing countries over the past few decades (see chap. 2), and even during its prolonged recession beginning in the 1990s, Japan is still the largest creditor country in the world.

This study has organized around two interrelated hypotheses regarding various empirically specific factors that appeared to have influenced the behavior of creditor governments in financial crisis management. The first hypothesis states that financial crisis management often produces a joint product—a combination of private and public returns. The production of substantial private returns, such as domestic financial stability or improved bilateral relations with one's largest trading partner, would induce a creditor government to become actively involved in crisis management. The second hypothesis emphasizes the influence of transnational linkages among the private sectors of different creditor countries. In general, economic linkages arising from economic interdependence among major economic powers increase creditor governments' stakes in maintaining the economic stability of other countries, including major creditors affected by the financial crisis. The institutional linkages arising from international financial activities help establish subnational channels that transmit pressures from one part of the world to another; the strong domestic influence of these private financial sectors, in turn, affects the actions of the creditor governments in crisis management. This domestic dynamic also helps increase the private returns each creditor government receives from its active involvement.

As a result, the most favorable conditions for coherent collective action by creditor governments in financial crisis management arise when, on one hand, there are substantial private returns for a creditor government from its involvement and, on the other hand, there are strong and coherent transnational linkages among the private sectors, which augment pressure on the creditor governments to act collectively. The coalition of private sectors can transmit demands domestically to their respective home governments to obtain strong collective management of the crises.

The Latin American debt crisis provided these conditions for the Japanese government (see chap. 5), while the Mexican peso crisis lacked both of them (see chap. 6). The Asian financial crisis (see chap. 8), an additional case study of crisis management situated in a different region, has supported the thrust of two hypotheses but highlights the importance of the issue of power asymmetry between the two creditor governments, the United States and Japan. The regional contrast provides important insights into the dynamics among the major creditor powers interested, to a different degree, in their respective "backyards." This issue of regional arrangement is discussed further later in this conclusion.

In short, international cooperation or collective action among major powers for international solutions of financial crises emerges when the decision makers of the creditor countries find adequate private returns that drive their actions. The modality of crisis management needs to satisfy the creditor countries' private sector with its strong institutional linkage and domestic political power, adding significant private returns to the creditor governments' actions.

Other Explanations

Three common explanations regarding the possibility of collective action and public goods supply with particular focus on the number two power (like Japan in this study) are outlined in chapter 1. Having empirically examined the dynamics of the Japanese government's involvement in two financial crises in Latin America and one in Asia, it is time to revisit these theories to consider how they fare as explanations of creditor governments' behavior.

Systemic Explanation of International Cooperation

If international cooperation or supply of public goods in the world is maintained due to the emergence of an international regime, even after the relative decline of a hegemon, a pattern of financial crisis management should emerge under which any one of the major economic powers in the world would act consistently to resolve all crises. A particularly interesting puzzle that arises from this perspective is the Japanese government's active collaboration in the Latin American debt crisis case and its inactivity in the Mexican peso crisis. Furthermore, the shift of Japan's "leadership" position during different phases of the Asian crisis poses a challenge to the theory. These contrasts in Japan's behavior require a better explanation than the presence or absence of an international regime. Moreover, regime theory in the neoliberal institutionalist tradition states that an international regime should be strengthened through repeated interactions and accumulated experiences.[1] This did indeed take place through the IMF modality and other arrangements during the ten-year ordeal of the Latin American debt crisis and in the following crises. If such a regime existed and was strengthened through the Latin American debt crisis, becoming a major influence or intervening factor affecting the creditor governments' behavior, a stronger and more organized regime should have enhanced collaboration among the creditor governments at the time of the Mexican peso crisis and the Asian crisis. This did not happen.

Rational calculations by the members of a "k-group" might provide a basis for cooperation.[2] There are indications that the Japanese government deliberated the costs of international financial collapse, particularly in terms of the implications for Japan's vested economic interests. It seems apparent, however, that such an abstract, hypothetical notion of world financial collapse, with its unknown future costs, was not enough for the major powers in the "k-group" to act immediately or concertedly. Rather, the known and concrete private returns (which come from the calculation of the direct costs at the time of the crisis) and the tangible pressures thrust on creditor governments compelled their decisions.

As the contrast of the two Latin American crisis cases clarified, the Japanese government had much more to gain and faced stronger pressure—both domestically and externally—in the Latin American debt crisis. Staying aloof was relatively easy in the case of the Mexican peso crisis. This invites a modification of the "k-group" argument to include concrete and situation-specific diagnostics of costs and benefits for individual participants.

Japan's ambivalent position in the Asian crisis also casts doubt on the imminent formation of the "k-group." The Japanese government demonstrated, in the form of the AMF proposal, that a major power might sometimes initiate independent actions for the solution of crises without forming a "k-group." These plans could conceivably help manage the crisis (by providing public goods), but other powers could retreat from joining the scheme unless it satisfied their private interests. As discussed more extensively shortly, the very characteristics of power asymmetry among major participants in crisis management (the United States and Japan in this study) may occasionally deter the prospects of "k-group" formation.

Regionalism

If private returns gained through international financial crisis management drive the behavior of creditor governments, then when crises are regionally concentrated, a regional solution may be appropriate. But a few important factors could lead to cross-regional involvement of other creditor governments. These factors include strong institutional linkages among private financial sectors and the disproportionately strong impact many regionalized crises have with the region's major economic power. In addition, extraregional contagion, as it becomes apparent to extraregional powers, is an essential component of international finance.

As is evident from the case of the Latin American debt crisis, Japanese banks were heavily involved in Latin American lending due to supposedly risk-lowering financial instruments, such as syndicated loans and cross-default clauses. At the resolution stage of the crisis, such mechanisms as BACs prevented Japanese banks and many major banks from other parts of the world from exiting the Latin American debt. BACs successfully pressed the banks into minimum but meaningful involuntary lending. A mutually acceptable resolution of the Latin American debt crisis became the common goal for those private creditors involved, and such institutional linkage translated into pressures on their home governments, despite the regional unfamiliarity of these governments.

The second important factor leading to cross-regional involvement arises from the very fact that regional economies are much more integrated compared to cross-regional ones. The economic conditions and/or policies of major regional economic powers can trigger a regional crisis, and the regional crisis would be most detrimental to the economy of the regional superpower. In that sense, the Latin American debt crisis was typical in that the region was heavily influenced by U.S. economic policies but, at the same time, the crisis strained U.S. economic recovery in the late 1980s. The Asian crisis likewise illustrated the close economic linkages and interdependence between Japan and the Asian region.[3] In such circumstances, a regional solution that counts on unitary contributions from the regional power becomes more difficult, and support from other creditor governments, particularly those that have strong interests in the well-being of the regional power in question, becomes critical. In sum, in typical circumstances, the nature of regionalized crisis itself complicates a regional version of hegemonic stability theory as a valid solution. There are exceptions, however. The Mexican peso crisis was a case where, though it was partly brought on by the rise of interest rates in the United States in the spring of 1994, the regional power, the United States, was economically strong at the time it became involved in crisis management. In such a case, crisis management within the region is possible, and the need and ability of the regional power itself can deter others (with private returns in mind) from getting deeply involved.[4]

Additionally, two features of international finance make regionally based crisis management difficult. On one hand, the strong regional contagion of a financial crisis makes a regional fund like the AMF problematic at the time of crisis, as many countries in the region would be hit by market attacks at the same time.[5] On the other hand, the possibility of extraregional contagion makes it necessary for extraregional powers to intervene in the way a regional crisis is managed, though usually without providing major financial contributions to the solution. Furthermore, the strong ties among regional powers produce cross-regional ties, and the economic and political dynamics among these powers inhibit regional solutions (see the regional contrast later in this conclusion).

An Outside-In View of Foreign Policy Formation on the Unit Level

Overall, this study has supported the outside-in view, in which external environment and cross-border pressure has substantial impact on the behavior of major powers. It is evident that the financial crises forced the governments to react one way or the other. The policy outcome, however, results from a complex process through which effectiveness of transnational linkages and domestic political dynamics forms the direction of governmental interests.

Moreover, Japan is not always a reactive state. The case of the Mexican peso crisis has demonstrated that the Japanese government does opt not to follow or "react" to U.S. demands. Japan's move toward independent actions in the first phase of the Asian financial crisis and the emergence of management tensions between Japan and the United States in the third phase are additional examples of proactive or nonreactive moves by the Japanese. Common in these cases, when the Japanese government did not collaborate with the United States despite U.S. demand, are weak transnational linkages, in terms of both economic interdependence and institutional linkages among financial actors. Furthermore, Japan's occasionally ambivalent position in Asia also came from the country's diverse interests in Asian financial crisis management: Japan wanted both to support the U.S.-led solution and to demonstrate independent leadership by proposing alternative crisis solutions. The domestic political channels between Japan's financial sector and the government, which weakened in the latter half of the 1990s, made it even more difficult for Japan to adopt a coherent position as a creditor country, especially during the Asian financial crisis management (see chap. 8).

Regional Contrast

As the scope of the empirical cases expands from Latin American financial crises (see chaps. 3–6) to include the Asian crisis (see chaps. 7 and 8), a few important questions emerge. The questions have implications for the future refinement of the two major hypotheses of this study. One question regards the level of consistency in private returns produced through collective action in each case, and the other related question concerns the impact of the dynamics between the two regional powers, the United States and Japan, given the power asymmetry between them.

First, the Asian case has indicated that inconsistency in the set of private returns made it difficult for the Japanese government to form a solid crisis management position. The Latin American debt crisis case presented a straightforward set of consistent private returns that directed the Japanese government to act positively in crisis management in concert with the United States. Japanese banks (with strong transnational ties) demanded that the Japanese government support U.S. debt solutions, the U.S. pressured Japan to step up its commitment, and the Japanese government was interested in earning political points (both within the IMF and vis-à-vis the United States) through active involvement in support of the United States. The Japanese economic and central budgetary positions were quite strong, and the relationship between the majority party (LDP) and banks was close and stable. These Japanese actions faced no strong opposition among other, rather indifferent, private sectors.[6] Contributing to these factors was the time period of the crisis (the latter half of the 1980s): then, the Japanese economy was booming, creating strong trade tensions with the United States, and the Japanese government still had strong links to its private financial sector (see chaps. 5 and 6).

Another important element derives from regional variation. Japan's governmental and private sector interests in Latin America were historically limited (see chap. 2), and during the time of the crisis, Japan had very narrow and well-defined direct economic involvement in Latin America, consisting of scattered direct investment, but overwhelmingly large bank exposure throughout the region. In addition, Japan's concerns regarding the U.S. economy influenced the Japanese government's behavior during this crisis.

Asia presents a much more complex picture than Latin America, producing multiple and sometimes conflicting sets of private returns. In Asia, Japanese private sectors, both financial and real, have vital and vested interests (see chaps. 2, 7, and 8), and the Japanese government has economic and political ambitions to establish itself as an acknowledged leader in the region. Moreover, these various actors often enter into conflict in the context of deciding which type of returns should be pursued first and more vigorously. For example, at the time of the AMF proposal, the Japanese government wanted to demonstrate its resolute leadership role, in any way possible, before the Asian countries in crisis, particularly in the first phase, when U.S. presence was limited. The Japanese banks mostly hoped for added liquidity to Asia, allowing them to retreat from their exposure in the region without damaging these economies or their own long-term relationship with these countries. But some Japanese manufacturing firms, which have struggled to penetrate and compete in these Asian markets, expected increased liberalization via the IMF-led solution to the crisis. Such disagreement infused the Japanese government's action with surprising weakness and ambivalence, especially during the second phase of crisis management, when the AMF scheme was put to rest at least temporarily (see chap. 8).

In addition, the failure to establish the AMF exemplifies the existence of strong tensions between Japan's self-interests satisfied by its independent crisis management actions in the region and those satisfied by collective crisis management with the United States. This type of tension was never a prominent problem for crisis management cases in Latin America, in which Japan had a strong interest in improving U.S.-Japanese bilateral relations and in boosting U.S. economic health. In the Asian case, however, Japan as the regional power could not gain much support for its independent leadership to help solve the region's economic problems from the United States or, most of the time, from other creditor governments.

This leads to the second factor providing a clear regional contrast between Latin America and Asia: the dynamics between the two regional powers, the United States and Japan. As a financial crisis hits a region, a regional creditor government with higher stakes in the region first becomes engaged in crisis management. If this regional power can induce support from other creditor governments, collective action forms smoothly. If the power distribution among the major creditors is symmetrical, transnational linkages and economic interdependence should enhance creditor collaboration regardless of which major powers lead and which ones follow. But power distribution is rarely symmetrical, and in the five decades since the end of World War II, the United States has enjoyed unsurpassed structural power (see chap. 1). Collective action seems to emerge as long as the structural power leads and others follow. The leader-follower dynamic in the Latin America debt crisis was a clear case of this combination, in which Japan fairly consistently supported the U.S. leadership (see chap. 5).

The case of the Asian crisis introduces a reverse combination (see chap. 8). The United States, the structural power, is not the regional power in Asia, while Japan, a nonhegemon lacking structural power, is. As the crisis deepened, asymmetry of power frustrated the regional power, Japan, as it was forced to follow the lead of the United States in collective action. This frustration came about partly because Japan became torn between its interest in helping resolve the regional economic problem under its independent leadership and its interest in maintaining close relations with the United States. But the frustration also came from the fact that the Japanese government, despite its desire to present an alternative modality or solution to the Asian financial crisis, was highly constrained in doing so because there was no international institutional arrangement supporting Japan's initiatives.

Furthermore, taking advantage of the opportunity created by Asia's economic downturn, the IMF, with the support of the United States, actively attempted to "reform" the economic structures of many Asian countries to fit more closely "Western" models.[7] A bumper crop of discussions have emerged on how the "East Asian miracle" and the economic models that supported it failed and how "Western" models should become the dominant economic policy frameworks for these countries in the future.[8] Consequently, it has been argued, "[n]ot only will the new Asia that is struggling to be born look much more like America, but the United States will probably also find its international economic and political dominance enhanced."[9] As the Japanese government ventured to create a new modality to circumvent these challenges in the region, opposition from the established structural power was insurmountable.

The preceding discussion supports the validity of a triangular perspective as an analysis of the dynamics of international financial crisis management among creditor countries. Bilateral relationships (such as the one that exists between the United States and Mexico) can be a dominant factor in influencing creditor governments' decision making in crisis management, but the dynamics among creditor governments commonly shape the way an instance of crisis management, particularly a collective one, is conducted.

The regional contrast presents an interesting insight into the two hypotheses of this study. The case studies from the two Latin American financial crises (see chaps. 5 and 6) have demonstrated that two important factors—joint product and transnational linkages—are essential to understanding the determinants of Japanese collaboration with the United States. The first factor involves Japanese banks' exposure and Japan's direct stake in U.S. economic well-being, due to Japan's economic linkages and its desire to avoid excessive political pressure from the United States arising from Japan's significant trade surplus over the last few decades. The second factor involves the strength of institutional linkages that underscore the Japanese government's decision-making process, creating a unified front to pressure governments in the crisis. Both factors were strongly present in the Latin American debt crisis case, while there was only a weak presence of the first and near absence of the second in the Mexican peso crisis.

As the analysis of Japan's behavior extends to various phases of the Asian financial crisis management, direction as to how one can modify the hypothesis of joint product becomes clear. The Asian case adds support to the importance of the second factor, the presence of institutional linkages among creditors (see chap. 8). The impact of the first factor, however, becomes uncertain at best, because of the complexity of how one can define "private return." Japan's economic interdependence and linkages with the United States remain important for Japanese policymakers, but two elements made the Japanese actors less responsive to U.S. demands in the Asian crisis. On one hand, the United States did not require Japan's economic support at the time of the Asian crisis, because U.S. economic strength had consolidated by the mid-1990s. This is particularly so in comparison to Japan. Thus, economically supporting or boosting the U.S. economy became an unimportant factor for Japan's actions. The United States was not, however, very willing to support Japanese initiatives (such as the AMF) in the same way that Japan supported the U.S. solution in Latin America ten years earlier. On the other hand, Japan revealed an ambivalent attitude regarding crisis management modality, because the Japanese government became torn between its strong economic and political interests in Asia, divided interests among Japan's private actors, and its interests in maintaining its good relationship with the United States.

In short, the regional contrast in this study has helped illuminate how major nonhegemonic regional powers (i.e., major powers except for the United States) endure conflicting interests and structural pressures as they propose regional alternatives to preexisting international institutional, legal, and political arrangements. More research into this question would enhance our understanding of international public goods.

Looking into the Future

As financial globalization has closely integrated many economies in the world in the past two decades, concerns over international financial collapse have led policymakers to focus on the important question of how the world can manage the negative consequences of this process. Despite the continuing (or reemerging) dominance of the United States during this period, it is clear that the United States would not be able or willing to single-handedly manage major global (or even regional) economic crises, a reality that is reflected in the dynamics of both the Latin American debt crisis and the Asian financial crisis. The magnitude and multiplicity of financial transactions and the impact of resulting contemporary financial crises outstrip the management capacity of any single country. Although various international modalities and arrangements exist via IFIs to address international financial problems, the involvement and support of major financial powers is essential. International cooperation and collective action among major economic powers in international financial and monetary relations will thus remain crucial in the foreseeable future.

This study has found empirical evidence of a vital influence imposed by transnational linkages on the formation of collective action among creditor governments and of the strong incentives arising from the joint product nature of collective financial crisis management. These factors substantially influence the behavior of supporting powers, such as Japan. Furthermore, the power asymmetry among the major creditor countries and the associated possibility or impossibility of regional crisis management are intriguing issues when we think about the modality of future financial crisis management. The analysis of the Asian crisis has introduced us to these prominent new avenues for future research.

Although it is still premature to conclude where the tensions arising from this asymmetry will lead Japan, but one should not dismiss the role of nonhegemonic but major regional powers like Japan in formulating alternatives. The cold war is over, but at the same time, the "triumph of liberalism a la

Washington Consensus" seems still tentative.[10] Recent movement toward the establishment of a regional financial arrangement in Asia reveals that the Asian countries, particularly Japan, have learned from the experience of the Asian financial crisis of the detrimental consequences of lacking crisis management alternatives as they face the repercussions of increased financial globalization. In this context, the question of what constitutes an acceptable modality of financial crisis management or of international public goods provision among the major powers remains essential and in need of further investigation.