Globalism Ascendant, Regionalism Stagnant: Japan’s Response to the Global Financial Crisis

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Received: 21 September 2010; revised: 11 March 2011; accepted: 17 March 2011

Summary
Japan’s response to the global financial crisis has emphasized global initiatives and downplayed the regional agenda, in sharp contrast with its approach to the Asian financial crisis. This rebalancing in Japan’s economic diplomacy reflects the greater political space that it has enjoyed at the global level since its long-held views on the benefits of flexible International Monetary Fund (IMF) lending practices and controls on volatile capital flows became mainstream. Meanwhile, at the regional level Japan faces stiff competition from China in shaping the regional integration agenda and unchartered territory in co-leading a multilateral Chiang Mai Initiative. Despite its enhanced profile, Japan’s new globalism is uneven: it has made a very significant financial contribution to expand the IMF’s resources and to restore trade financing; but Japan has not played a major role in the debate surrounding the most pressing issues of a future financial architecture, such as tackling global imbalances and promoting foreign exchange-rate cooperation. Japan’s muted voice, despite its large financial commitments, reflects its difficult adaptation to the G20 summity process, as well as political volatility at home, which prevents it from developing measures to deal with the global downturn.

Keywords
global financial crisis, Japanese economic diplomacy, regional integration, global financial architecture, free-trade agreements, Japanese politics

Introduction
The global financial crisis (GFC) of 2007-2009 greatly upset Japan, as the country experienced the worst economic contraction of the post-Second World War era and as the government was forced to reassess its priorities regarding global and

* The author would like to thank the anonymous reviewers and Saori Katada for their insightful comments, and Quinn Bernier for excellent research assistance. All remaining errors are mine.
** As this article went to press, a major earthquake and tsunami hit Japan on 11 March 2011. As Japan recovers from the tragic human loss and is confronted with the major task of domestic reconstruction, it is difficult to gauge the impact of these events on Japan’s economy and its economic diplomacy.
regional initiatives. The contrast with Japan’s response to the past episode of financial turmoil — the Asian financial crisis (AFC) of 1997-1998 — could not be starker. At that time, Japan openly sparred with the United States on the causes and optimal solutions to the financial crisis in Asia, was deeply sceptical of the *modus operandi* of the IMF and proposed an alternative regional institution (the Asian Monetary Fund, or AMF, which never came to fruition), and launched an unprecedented regional economic diplomacy for financial cooperation (the Chiang Mai Initiative, or CMI, for bilateral currency swaps) and trade integration through free-trade agreements (FTAs). Recently, however, Japan adopted a conciliatory position on the acrimonious debate on the causes of the GFC, staunchly defended the position of the US dollar as the key reserve currency, and came to the rescue of the IMF; meanwhile, its regional initiatives were lacklustre, as the CMI mechanism was not activated and a region-wide trade bloc seems a distant possibility.

Why has there been this transformation in Japan’s economic diplomacy? What kind of global contribution has Japan made to solving the crisis? Why has regionalism lost steam? In order to answer these questions, this article highlights the very different set of opportunities and constraints that Japan faces in this latest episode of global financial crisis.

Japan finds that while it has more space at the global level — since its long-held views on the benefits of flexible IMF lending practices and controls on volatile capital flows have now become mainstream — at the regional level it faces competition from China in shaping the regional integration agenda as well as unchartered territory in co-leading a newly multilateral Chiang Mai Initiative. Despite its enhanced profile, Japan’s new globalism is uneven. While Japan has made very significant financial contributions to expand the IMF’s resources and to restore trade financing, it has not, however, played a major role in the debate surrounding the most pressing issues of a future financial architecture, such as tackling global imbalances and promoting foreign exchange-rate cooperation. Japan’s muted voice, despite its large financial commitments, reflects its difficult adaptation to the G20 summity process, whereby Japan lost the privileged position that it had enjoyed in the G8 as the single Asian representative, as well as the political volatility at home that prevents long-term planning. Indeed, this article also underscores the domestic constraints that hamper Japan’s leadership potential at both the global and regional levels: the inability to shift to a domestic-demand growth model and to open the internal market to foreign imports to speed up global recovery, and the political paralysis that has engulfed Japan with a rapid succession of prime ministers and a gridlocked legislature.

The first section of this article explores the origins of the GFC and in particular highlights why a crisis that originated in the lack of prudential financial regulation in the United States ended up provoking one of the largest economic contractions for Japan’s post-war economy. Next, the article assesses Japan’s actions at the global level in diagnosing the crisis and advocating reforms to the