"Japan's Rescue of the IMF"

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Abstract: When the 2008-2009 economic crisis hit, countries that had long dominated the IMF found themselves both the source of the financial problem and unable to provide financial assistance to major global governance organizations. With only $200 billion available to assist ailing countries, the International Monetary Fund found itself in difficulty. To the surprise of many observers, Japan made a bold commitment to lend $100 billion to the IMF, sending an unequivocal message that the IMF itself was solvent and that a global rescue plan was possible. The Japanese loan encouraged other countries to contribute and greatly stabilized the world's economic situation. This paper explains why the Japanese provided the IMF with the $100 billion in financing, despite both its past criticism of the IMF and the economic and political challenges facing the emerging countries requiring the loans. The essay argues that there were two major reasons for the intervention. Japanese officials felt that the crisis was one of financial liquidity and did not reflect a structural flaw in the global economy. Secondly, the government believed that the contribution to the IMF was a comparatively safe national investment. In addition, supporting the IMF allowed a "laundering of state preferences" by the Government of Japan, in that the IMF assumed the political difficulty task of imposing requirements on the receiving countries, freeing Japan for responsibilityto impose constraints on other nations..

Introduction

The global financial crisis of 2008-2009 tested the international financial system in ways not seen since the Asian fiscal meltdown of 1997. In 2008-09, the mismanagement of American banking and investment and overly aggressive financial strategies in countries around the world sparked a widespread economic crisis. For several months, the global economic system faced the prospect of a severe collapse, with several countries teetering on the brink of default. In this context, Japan's sudden and unexpected commitment of $100 billion to the International

Monetary Fund provided stability and reasons for optimism at a time of growing economic and fiscal despair.

The 2008-2009 financial crisis differed profoundly from previous crises. The fiscal problems started in the United States and spread rapidly to Western and Eastern Europe. In the past, the IMF had been accused of Western bias and was sharply criticized by developing and Asian nations for its aggressive free market ethos throughout the 1980s and 1990s (See Woods, 2006). In 2008, the countries that had long-dominated the IMF found themselves as the main culprits in the financial debacle, with highly suspect American mortgage and investment strategies fuelling the global fiscal contagion. The IMF was poised to act, but in this instance could not easily call on American financial and moral leadership in determining how and when to take action. By late 2008, the IMF was called on to rescue one member country after another, among them Iceland, Hungary, Ukraine, Pakistan, Serbia, Latvia, Turkey, and Belarus. With only $200 billion in its coffers to help these ailing countries, however, the IMF had to look to its benefactors once again to shore up its capital base.

Leaders of the world's largest economic powers, now expanded from the Group of 8 to the Group of 20, met in Washington, D.C. in November 2008 to find a means of recapitalizing the IMF and identifying how to remedy the international financial crisis. Analysts and pundits argued that the G20 needed to rewrite the rules of the global financial system and shore up the dwindling resources and legitimacy of the IMF and other international financial institutions (See Bradlow, 2009). In the new economic realities of the 21st century, attention turned to countries with relatively large current account reserves, such as China, Japan, and the oil-producing Gulf states. No one was surprised that the meeting did not result in a re-design of the original Bretton Woods approach, but there was both disappointment and dismay when it became clear that neither China and nor the capital-rich Gulf States intended to step forward with funding. Surprisingly, however, Japan, despite its own domestic fiscal challenges, quickly offered to assist with the effort to avert a deterioration of global financial conditions. The Japanese government offered to loan the IMF $100 billion. This injection of liquidity into the global financial system sent the unequivocal and important message that an IMF-led global rescue plan was possible. The additional liquidity offered immediate reassurance. It could be lent to countries in difficulty and would help ensure that the financial crisis did not continue to spread. As Grimes (2009) aptly notes:

> East Asia has come to the aid of the IMF. The most important action in this regard was the Japanese decision to lend the Fund $100 billion in the fall of 2008 at the height of global uncertainty about the crisis and its effects on financially vulnerable economies. This was a striking act of leadership in at least three respects. First, IMF access to $100 billion in additional funds at a crucial moment was significant in its own right. Second, the bold Japanese action inspired similar pledges from the United States, European Union, and China. It appears likely that the combined effects of these pledges were important in stabilizing global financial markets. Third, we should not forget that Japan made this decision in the midst of its own economic—and especially fiscal—challenges and in the face of significant domestic opposition. (p.44-45)

This article examines the Japanese decision to loan the IMF the $100 billion, despite past criticism of the Fund and despite Japanese concerns about the economic and political challenges facing emerging market economies. Many key foreign exchange reserve holders hesitated to contribute funding to the IMF without receiving added voting power at the Fund via the reallocation of IMF quotas (See Thimann, Just and Ritter 2009). Japan had long been lobbying for a greater role within the IMF – one commensurate with the funding that they provided to the organization in the past. The country, however, did not publicly make their $100 billion commitment contingent upon immediate reform. Moreover, because political and economic weight in the IMF is relative –in other words, for one member to gain added quota weight, another member must sacrifice some of its relative quota – it was possible that the scramble to find funds to meet the immediate needs of the crisis might result in a political effort by other foreign exchange holders to gain political and economic weight through their proposed financial contributions. Japan's decision not to tie any demands to the loan was, therefore, significant and politically conciliatory.

The IMF of 2008, of course, was not the same as the IMF of 1997. The Asian Financial Crisis produced extensive complaints about the International Monetary Fund and its aggressive conditionality. In Asia and elsewhere, the strict conditions imposed on national governments were blamed for prolonging the financial hardship and generated widespread support for IMF reform. As the 2008 financial crisis unfold, the IMF brought in more flexible and less demanding arrangements, designed to solve the immediate financial distress without exacerbating conditions. The 1997 arrangements, with their harsh requirements for policy reform, convinced national governments to shy away from international assistance, even when readily available aid could prevent more serious and rapid decline. To address these concerns, the IMF started a process before 2008 of liberalizing its loan arrangements and encouraging more early stage intervention to head off deeper and more serious fiscal problems. The Flexible Credit Line, for example, afforded countries with a solid record of economic management and appropriate financial systems to secure assured funding that could be called on if and when required. The FCL arrangement was often used to shore up public and financial confidence in a country's fiscal well-being without actually accessing IMF funds. As Japan contemplated a major contribution to the IMF in the wake of the 2008 financial crisis, therefore, the IMF was not the western-dominated, demand-heavy funding agency it had been only a decade earlier.

To determine why Japan demonstrated such leadership in contributing $100 billion to the IMF, we conducted semi-structured personal interviews with senior IMF staff and Japanese officials (conducted in January 2010 and in April 2010 in both Washington DC and Tokyo, Japan)[1] and asked them to explain Japan's rationale. We also examined Japanese newspapers, both in English and in Japanese, and international newspapers and primary IMF documents. This material, particularly the interviews with Japanese and IMF officials, provided valuable insights into the logic behind the Japanese decision during a time of rapid economic and financial change. The officials offered frank and clear assessments of the IMF situation and Japan's fiscal and political response to the financial crisis.

One issue was not clearly resolved through these interviews. We attempted to identify the mechanisms by which the Government of Japan came to the decision to fund the IMF. There were no substantive comments on the issues of process and decision-making from the first set of

[1] The interviews with a dozen senior former and current Japanese and IMF officials were conducted on January 28th and 29th, 2010 at the IMF headquarters in Washington, D.C. with staff of the Asia Pacific department at the IMF, Japanese IMF officials and senior staff at the Japanese embassy. On April 6th, 7th and 8th 2010, interviews were conducted in Tokyo with former Japanese IMF senior officials, officials from the Bank of Japan, officials from the Ministry of Finance and two Japanese academics. 3

interviews. We returned to close to half of the interview subjects with more specific questions on Japanese decision-making; on the second round, there were no additional comments that explained how the IMF decision was determined. Through all of the conversations, Japanese officials indicated that the issue was non-controversial and did not generate extensive debate within the civil service or the political arm of the government. At this juncture, it is not possible to incorporate an analysis of the political and administrative processes into this broader study of Japan and the IMF. However, the comments of the Japanese officials indicated that the decision to provide $100 billion to the IMF did not emerge in a highly contested or highly politicized environment.

Japanese-IMF Relations: A Troubled Journey

The International Monetary Fund (IMF), established as part of the Bretton Woods process in 1944, has had a central role in the stabilization of the post-war international economy. The IMF has been responsible for moving quickly and decisively to assist governments in fiscal distress. Over the years, it expanded its mandate to include directing the shape, structure and format of government involvement in the economic management of its member economies.

Japan has been a member of the IMF since 1952. Due to its economic successes throughout the 1960s and 1970s, Japan became a more engaged Fund member, albeit a passive rule-taker, as some have argued (Wan, 2001, Ch. 4). In the early years of its membership, Japan opted to remain relatively quiet on major IMF policy decisions. After Japan hosted the IMF and World Bank annual meeting in Tokyo in 1964 and as it 'came of age' in its domestic economic situation and in its external economic relations, it began to gradually request more IMF quota (although not always insisting on gaining more decision-making power within the organization) (Wan, p.128).

After Japan made significant financial contributions to the IMF, and as a consequence of its enhanced international economic role, it gradually became a serious force within the Fund. Consequently, other Fund members removed India from the top five seats reserved for large contributors on the IMF Executive Board in 1970, and gave Japan this prestigious and valuable seat by appointment—that is, without a requisite constituency requirement. Subsequently, Japan continued to negotiate with other major economic powers to increase its financial contributions to the IMF in order have its quota increased and to consequently raise its decision-making profile. (See Kojo, 1992; Wan, 2001, Ch. 4). This attempt to increase Japanese power at the IMF met continued resistance by countries fearful of Japanese competition; at various times this included the United States, the United Kingdom, and France (Kojo, 1992.). Following intense negotiations, the United States ceded some of its quota (from 19% to 17%) to Japan in exchange for Japanese financial support of the Brady plan for managing the debt of developing nations[2], but only after the US secured veto power at the board by dropping the majority threshold to 85% (Wan, 2001: 144). In effect, the US reserved for itself veto power on most issues. By 1990, Japan succeeded in raising its quota to the second largest position, after the United States, on the Executive Board. Japan continued to be a generous donor to the IMF, often adding to the Fund's capital without receiving added quota and consequent political and decision-making weight.

[2] The Brady plan was a new strategy for dealing with developing country debt. Named after then U.S. Treasury Secretary Nicholas Brady, the plan promoted debt reduction by commercial banks for debtor countries that implemented substantial economic reform programs.

Japan's passive approach to the IMF, however, changed by the mid-1980s. With Japanese economic success at home and abroad, Tokyo started to articulate within the IMF its vision of economic development, which remained distinct from US-dominated neoliberal ideas (Wan, 2001: 147). Both at home and at the Fund, Japanese officials were not satisfied with the continued contribution to IMF capital – effectively an act of 'burden sharing' – without added representation and voice at the Executive Board and within management (Rapkin et al, 1997: 178). Subsequently, the Japanese quota was raised slowly but commensurate with its international economic weight as the second largest economy in the world. In addition to already having one of the five appointed seats on the Board, Japan also acquired one of the three Deputy Managing Director positions in 1994. Both the prestigious seat and prominent management position were reflections of Japan's strong contributions to IMF capital and its increased involvement and voice in IMF affairs.[3] Moreover, Japan contributed bilateral funds to the IMF technical assistance program. This amounted to more than US$200 million between 1990 and 2010. The Japanese have also funded two scholarship programs for graduate economics students and hosted the IMF's Asian regional office in Tokyo (one of only five overseas IMF offices), where much of the technical training of regional members is done (IMF, 2010). The Japanese clearly have taken a key interest in not only funding the IMF, but also in guiding its decision-making and economic strategies.

Starting in the mid-1990s, however, Japan's economy began to show signs of fatigue. In 1997, the Japanese government intervened to support its banking system through a vital liquidity guarantee and then proceeded to restructure the banks through added regulations and oversight.

[3] The IMF's technical assistance program is used to train IMF members in improving domestic economic institutions, particularly in the area of 'training' government and bureaucratic employees in 'sound macroeconomics'.

The Asian financial crisis hit shortly after Japan's economic decline started. At the time, a number of Asian countries asked the IMF for help in shoring up their domestic liquidity. The IMF, however, was convinced that the Asian economic crisis was structural in nature and prescribed and demanded intrusive conditionality. It provided emergency assistance, but only after extracting major concessions from Asian governments on fiscal policy (See Noble and Ravenhill, 2000). The slow response of the IMF to the crisis and the Asian countries' reliance on contacts in Washington to force the IMF to pay closer attention to the crisis garnered increased criticism of the Fund from Asia (See Ito, 2007). As Sanger noted,

> South Korea slipped within days of running out of hard currency to pay its debts. In December, it sent a secret envoy, Kim Kihwan, to work out a rescue package. 'I didn't bother going to the IMF,' Mr. Kim recalled recently. 'I called Mr. Summers's office at the Treasury from my home in Seoul, flew to Washington and went directly there. I knew this would get done.' (1999:23)

Japan was critical, albeit in a quiet manner, of the IMF's handling of the Asian crisis. In particular, it criticized the IMF's loan conditions for being too austere and misguided. Japanese officials also criticised the IMF for its failure to predict and quickly react to the crisis. As the Japanese Finance Minister noted in his address to the IMF Annual Meetings in 1998:

> the Fund should perhaps reflect on the design of the past IMF-supported programs. The IMF may have damaged its own credibility when it demanded rather hastily program conditionality on structural measures that were neither necessary nor appropriate in the program design.(Miyazawa , 1998).

The United States, moreover, wielded a lot of power in the handling of the Asian financial crisis and in coordinating the IMF's response. Some even argued that the South Korean loan agreement with the IMF included conditions that liberalized automobile imports on the insistence of US policymakers, who wanted to assist their own auto interests (Nunnenkamp, 1998).

Although the immediate crisis was brought under control, it was at a formidable cost to the region, leaving a residue of anti-Western and anti-IMF sentiment in its wake (See Ito, 2007; Bowles 2002). The Japanese sought to prevent another Asian crisis and started to promote the idea of an Asian Monetary Fund (AMF). Japan's Finance Minister, Hiroshi Mitsuzuka, announced the AMF idea at the IMF/World Bank Annual Meetings in 1997. In explaining the motivations behind the AMF, some have argued that Japan was perturbed by the US Treasury department's implicit indication that East Asian economies were managed by 'casino capitalism' (See Hall 2004). Eisuke Sakakibara, Japanese Vice Minister of Finance for International Affairs during the crisis, reflected on the US' tunnel-vision at the time:

> As early as late August and early September of 1997, the Japanese government proposed the establishment of an Asian Monetary Fund. [US Treasury Secretary] Larry Summers

> was furious … but we had very different views of the world at that time. I was saying from the outset that this was a crisis of global capitalism. But in 1997 Larry's view and Bob Rubin's view was that it was an Asian crisis, and, essentially, Asian policy management was the problem—Asian governments and Asian corruptions and collusions and the Asian structured economic system, which is quite close to the structure of the Japanese. I admitted that was a part of the problem, but I said that the problems had arisen both on the part of the borrowers and lenders, and the lenders were mostly Wall Street, so it was a problem created by both the borrowers and lenders; it was a problem of global economy. (Quoted in PBS)

Japan was also concerned with Asia’s limited influence in the IMF relative to the region’s economic strength. It therefore promoted the idea of an independent Asian Monetary Fund that would cater to Asian needs and respond more quickly to financial crises in the region. Japan also worried about the US views on economic development (which adhered to a more market-driven model) and wanted to create an organization that could offer alternative funding and provide distinct economic ideas (namely, a more state-led model) to its regional neighbours (Lee, 2006). Japanese policy elites from both government officials and the economics community were the key drivers of the Asian Monetary Fund idea (See Tsunekawa, 2004). The US Treasury and IMF officials opposed it, fearing the AMF would undermine the IMF’s authority and legitimacy in the region. US opposition escalated. To Japan’s dismay, the AMF was crushed in its infancy (See Stiglitz, 2002: 112).

After the failed Asian Monetary Fund, Japan and its regional neighbours – ASEAN, China, and Korea – initiated a watered-down version of the AMF called the Chiang Mai Initiative. Under the agreement, regional governments could request currency swaps of more than 10% of the funds available (raised to 20% in 2005) but only with IMF programs in place. The Chiang Mai Initiative, therefore, did less to threaten IMF prominence in the international monetary system than the AMF. The possibility remained that the agreement would be strengthened over time, particularly if IMF legitimacy was increasingly questioned. The Chiang Mai Initiative Multilateralism (CMIM) Agreement re-enforced the Chiang Mai Initiative, adding a foreign exchange reserve pool of US$120 billion (which came into effect in March 2010) (See Sussangkarn, 2010). Moreover, the Asian Development Bank assumed an enhanced surveillance role, an area traditionally dominated by the IMF. Securing interregional surveillance powers was an important means of developing regional autonomy in making lending decisions (See Takaji, 2010). Japan continued to promote improved regional arrangements and institutions in response to declining faith in the IMF's ability to meet Asian needs (See Lee, 2006).

After the Asian crisis, Japanese exports and foreign currency reserves increased – especially after 2004, when the Japanese government intervened in the currency markets by buying dollars in an effort to devalue the yen, thereby stimulating its exports and lessening the negative impact of the depreciating yen on deflation. As a result, Japan had, prior to the 2008 international financial crisis, amassed large foreign exchange reserves, amounting to nearly $1 trillion. Throughout the 2000s, the success of the emerging market economies, including many of the former Asian tigers, allowed them to accumulate large foreign exchange reserves as well. Many of these countries had endured the 'Asian crisis' (dubbed the 'IMF crisis' by many in Asia) ten years earlier. Asian governments and were soured by years of ill-advised IMF policies. In essence, the amassing of their foreign exchange reserves was viewed by many analysts as a form of self-insurance against the need to resort to the IMF for financing in future crises (See Aizenman and Lee, 2008). Throughout 2006, some of the IMF's largest borrowers – Argentina, Brazil, and Indonesia – started to repay their loans and made bold pronouncements against returning to the IMF for assistance. Similarly, throughout the Asian region, countries expressed their desire to maintain a far distance from the IMF and started to accumulate foreign exchange reserves to protect their countries from currency speculators. Consequently, IMF lending fell from $107 billion in 2003 to $35 billion in 2006 (Snow, 2006). With the added inflow of private capital into emerging market economies – estimated at $491 billion – the amount of financing available from the IMF paled in comparison (World Bank, 2006).

The IMF's consequent loss of clientele and dwindling resources led some government officials in 2006 to pronounce the Fund as "irrelevant." Japanese officials added to the chorus of criticism against the Fund. Japanese Finance Minister Fukushiro Nukaga called on the Fund in 2007 to limit its budget and criticized IMF handling of the sub-prime mortgage problems then brewing in the United States:

> Japan strongly requests that the IMF initiate significant spending cuts by shedding noncore operations, organization and staff, based on a reappraisal of its core competencies and priorities...The IMF must realize that its credibility is at stake if it simply aims at an uncritical, supply-driven maintenance of operations and personnel

> through increased income without any progress on spending cuts...The IMF could have played a more active role in the run up to this summer's market turbulence...[What is needed is]...a more proactive response from the IMF on future occasions. (quoted in Japan Times, 2007).

Indeed a legitimacy crisis ran through the international financial system. In particular, the IMF's crisis of legitimacy reflected a growing shift in global economic power from the Western industrialized countries to the emerging market economies. The onset of the 2008 international financial crisis, however, returned stakeholders' attention to the IMF.

Japan's Early Response to IMF Funding Needs

As the international financial crisis started to unfold, Japan took the earliest and boldest steps to shore up the International Monetary Fund's finances. In mid-November, the Japanese government announced that it had offered the Fund $100 billion in loans of its US treasury notes – a sum equal to almost 10% of its vital foreign exchange reserves. The first mention of the IMF contribution came during the IMF meeting in Washington DC, in early September 2008, by the finance minister, Shoichi Nakagawa. Taro Aso, Japan's Prime Minister, officially announced the financial infusion to the Fund at the November meeting of the Group of 20 in Washington DC. As one Liberal Democratic Party MP noted, Aso was "preparing to demonstrate Japan's commitment to global financial stability through its foreign reserve strength," and that "the ability of the IMF to lend aggressively through this crisis must be a priority." (Timesonline, 2008). The Japanese lead was followed gradually by billions of dollars in contributions from the European Union, Norway, Canada, the United States and other nations. (IMF, 2010)

The rising economic powers, led by China, Brazil, India, and Russia, however, hesitated to contribute funds directly to the IMF. In particular, the emerging market economies did not want to contribute money to an IMF that would draw on the New Arrangements to Borrow (NAB) facility because such lending would have no affect on their relative quota weight in the organization. Instead, China, Russia, India, South Korea and Brazil agreed to inject money into the IMF through a new SDR bond system, which would involve a temporary purchase of SDR-denominated securities. Through this system, the IMF raised its capitalization by an additional $150 billion. China purchased $50 billion worth of the IMF bonds and many of the other emerging market economies bought $10 billion of IMF bonds, respectively. Importantly, these IMF bonds would be tradable and limited to a one-year maturity rate– a key condition demanded by the emerging market economies. The reason for the lack of contributions, it has been commonly argued, particularly of the Asian countries, is that these members had lost faith in the IMF after years of poor advice during the Asian crisis (Seabrooke, 2007). Without added political and economic voice in the IMF's decision-making bodies, the emerging market economies were unwilling to give capital unconditionally to the IMF (Truman, 2008).

Japan was forthcoming with its money in late 2008 despite its own frustrations with and concerns about the IMF. Then Prime Minister's Aso's speech at the G20 in November 2008 pointed out the need to restore faith in the IMF by strengthening the Fund's functions and by continuing to work towards reforming its governance (Aso, 2008). It is important to understand why the Japanese were motivated to expand the resources available to the IMF with $100 billion without added quota and voice. Moreover, that emerging market economies tactfully and strategically opted to contribute money only if their economic and political standing in the organization was increased, underscores the point that Japan's loan came without conditions.

Explaining Japanese Contributions to the IMF

Japan's timely and helpful contribution of $100 billion to IMF liquidity was motivated by a number of economic and political considerations. Senior IMF and Japanese officials we interviewed emphasized that Japan felt it was very important for both domestic (Japan is heavily dependent on a well functioning trading system) and international reasons to ensure that the economic crisis not worsen. The potential for global contagion could be headed off through the use of an expanded pool of Fund resources. Japan, as a major participant in both the global economy and the IMF, had an obligation to step in at a time of crisis and need, government officials reported.

Many Japanese officials were convinced that the global financial crisis was primarily one of liquidity and was not fundamentally structural in nature, a lesson learned firsthand in the Asian Financial Crisis. They were convinced that a capital injection could ward off global contagion. It was "common sense" in the words of one former Japanese official, to provide capital injections to the private banking sector when it is faltering, a hard lesson learned in the Japanese banking crisis of the mid-1990s. The country's memory of the Asian crisis was likewise fresh and painful. The government remembered too well how quickly the financial panic of the late 1990s spread to Japan.[4] In the wake of the Asian financial crisis, the yen weakened, stock and asset

[4] The crisis began in Thailand and that country, along with Indonesia and South Korea, were the most affected. However, Malaysia, Hong Kong, Laos and the Philippines were also badly hurt. Although the rest of the region from China to India suffered less, almost every country experienced a decline in consumer demand and confidence.

prices fell dramatically and consumer confidence quickly waned. Japan and the other leading nations learned a sobering lesson: when faced with a financial meltdown in a globalized and digitally interconnedted world, countries needed to move quickly and decisively to prevent a full-scale collapse. In 2008, Japanese officials believed that the crisis was attributable to shrinking liquidity, and was not a structural crisis. Similarly, Finance Minister Kan highlighted the Japanese perspective on the crisis in his address to the IMF committee during the Spring Meetings in 2010:

> The current crisis showed that the stability of the financial system of each country is an important element for the stability and growth of the macro economy, and that a problem associated with one country's financial system can destabilize the entire international financial system, as well as the global economy. Furthermore, the effects of the crisis instantly spread throughout the world, and manifested themselves, not in the form of a traditional balance of payments crisis or a currency crisis, but in the form of a short-term dollar liquidity shortage and the collapse of the financial sector, which in terms of size, exceeds that of a single country. (Kan, 2010)

As one of the few nations with sufficient fiscal resources to make a difference, Japan believed that it had an obligation to step in. As one Japanese Ministry of Finance official noted in a personal interview, "Japan can't be selfish and short-sighted. After all, we have had direct experience with spill over effects. Japan will never forget its direct experience with the spread of contagion during the Asian financial crisis."[5]

[5] Interview with official from the Japanese Ministry of Finance, February 2010.

In addition to having experienced a similar crisis in the past, the Japanese benefited from a more objective perspective of the crisis with its distance from the US epicentre. Japanese officials believed that the Asian banking sector would not be affected by the international financial crisis. Other than fears of a liquidity problem in Korea, the Japanese felt relatively secure about their own liquidity position. A former IMF official noted that Japan recognized the depth and severity of the crisis earlier than its counterparts in the G7. In many ways, Europe and the U.S. were overly focussed on the domestic front – this time it was, metaphorically, their houses that were burning – and responded by injecting liquidity into their national financial system through stimulus packages. The Europeans and Americans were not thinking of the international implications of the unfolding crisis. Japan, however, had the Asian financial crisis seared in its institutional memory and therefore recognized the seriousness of the situation more quickly than Europe or the U.S. In fact, the IMF initially viewed the international financial crisis as a limited one and did not foresee the potential global contagion. One of the IMF officials interviewed recollected that in the fall of 2008 the Fund appreciated Japan's loan offer, but at the time saw it more as a backstop facility to unlikely contagion. With only $250 billion to lend, the IMF did not immediately appreciate how much additional money would be needed to shore up its members' liquidity positions.

Japan's active intervention in the fall of 2008, focused on supporting the broader global economy and not, as through the Chiang Mai Initiative, on supporting its Asian neighbours. This larger objective reflected Japan's conviction that this liquidity crisis could spread quickly. Japan feared that if Eastern Europe collapsed, other European countries would be next. Worldwide contagion could follow. As one of the world's most important trading nations, Japan needed a functioning and liquid global marketplace. The world, in turn, needed quick action from Japan to support the

IMF in its attempt to stabilize the global economy by providing global liquidity to key importing nations and by shoring up confidence in the global economy to prevent trade protectionism.

Japan, indeed, had correctly foreshadowed the problem of diminishing global demand for its goods. In 2009, the sharp decline in global demand for Japanese exports became Japan's most significant economic problem. Thus, ensuring that the rest of the world had money to spend was crucial to Japan's recovery. As Hiroshi Yoshikawa, a Tokyo University professor in charge of a panel that evaluates Japan's business cycles had noted in early 2009, "Other countries' economies will be vital to the Japanese economy's fate." (Davis, 2009). Preventing the spread of a global recession was a matter of national economic interest for Japan. Its experience with the Asian crisis reminded it of the need to do so quickly, via the backing of capital liquidity. One Japanese analyst commented on Japan's strong belief in multilateralism and the prosperity that the country has gained from the global free market system. "Japan has benefitted more from free trade than perhaps any other nation," he commented, "and therefore it is just natural that we should respond when other nations are in trouble."

Upon recognizing the IMF's need for additional financing, Japan was fortunately able to find a way to contribute that carried few financial or political costs. Japan's $1 trillion dollar currency reserves, primarily held in US treasury bills and bonds, had been the largest in the world for decades and were, at the time, second only to China's. Japan had money it could lend. The difference between the rate of return on a contribution to the IMF and the extremely low interest rates then available in the market for short-term lending was and still is (as of January 2011) almost negligible. Equally significant, placing the capital contribution in IMF coffers was perceived to be as safe an investment as was available at the time. This is not to say that Japan saw the IMF as a safe national investment strategy. Rather, the government recognized that it could do what it felt it was imperative to do – lend money to the IMF – in a relatively low risk manner.

Although, Japan could have bilaterally loaned the money directly to countries in trouble, this would have been a much riskier option. The economic health of many countries at that time was uncertain and volatile. Japan was not particularly familiar with many of the countries in trouble, particularly in Eastern Europe, nor did it have much loan exposure to those countries. Government bureaucrats simply would not have been prepared to either monitor or assess loans to those countries, certainly not in the stressful, crisis environment that existed at the time. Moreover, giving bilateral loans to select countries would have involved making political choices between favoured and unfavoured nations, which would have incurred stronger domestic political scrutiny and, potentially, controversy. Japan wanted to assure the functioning of the international trading system as a whole more than they wanted to respond to the specific financial problems with any of the countries in crisis. And, put simply, providing capital to the IMF, with its preferred creditor status, offered security whereby sovereign states are expected to repay the IMF before all other creditors. Offering direct bilateral loans to countries that were at risk of default would have been considerably more problematic. Contributing massively to the IMF would also make it easier for Japan to say no to potential future bilateral requests.

The political cost of Japan's IMF contribution also appeared to be limited. The Japanese government capitalized on domestic laws that allowed it to reallocate money within its foreign exchange reserve portfolio to the IMF without seeking the formal approval of the Diet (the Japanese parliament). Depositing the foreign exchange reserves into the IMF was technically viewed as a re-labelling of foreign exchange assets. Simply, the transfer of funds from one set of foreign exchange reserve holdings (say US Treasury Bills or dollars) into another set of holdings (in this case an IMF deposit) was simply a shifting of money from one category into a different category or a reorganization, rather than a depletion, of foreign exchange reserves. The transfer of funds could be handled in a straightforward manner and would attract minor domestic attention. This stood in sharp contrast to a situation in which the government took money out of government coffers and placed it into another entity or account, as in the case of an increase in IMF quota or in making a contribution to official development assistance. This distinction proved to be important because the Japanese government was not at liberty, in the early days of the crisis with financial challenges growing inside Japan, to make bold bilateral commitments or to significantly alter the government's accounts. As the economic fallout unfolded, moreover, there were pressing domestic demands from prefectural governments, struggling small businesses, and the growing numbers of unemployed for government financial assistance. It is important to note that the Japanese government has been conservative in its use of foreign exchange reserves by complying with the best practices of using reserves to buy domestic currencies and not using reserves for domestic expenditures. Maintaining this conservative approach in the use of foreign exchange reserves facilitated the allocation of funds to the IMF while helping to explain the decision to both the Diet and to taxpayers.

Although Japanese newspapers reported on the IMF loan, there was relatively little public criticism. Inside the Diet, the opposition DPJ party criticized the government on many matters, but the subject of the IMF contribution was, in the words of an interviewee, "too technical to capture the imagination of the opposition." As such, the debate was limited. To be sure, there were prominent former officials who publicly argued that Japan's infusion of money into the IMF should come with more political clout like, for example, enhanced informal power in IMF decision-making. Eiji Hirano, executive vice president of Toyota Financial Services and former

Bank of Japan director for international affairs, noted: “Japan needs to exercise strong leadership over how to redesign the international financial architecture by offering fresh ideas...Japanese authorities have the rights and duty to express their thoughts in a neutral setting more on the international stage," he said. "If Japan does not step forward now, I wonder when it will?” (quoted in Karube, 2009) Like Hirano, some argued that Japan should use the added infusion into IMF liquidity to extract more decision-making power at the IMF, as China was pursuing. But while it was recognized, by officials that we interviewed, that Chinese ascension will challenge Japanese claims to regional leadership in financial matters, it was noted that China is still ten to fifteen years away from taking on this role. It was argued that Chinese leaders still do not ‘believe’ in free market economics despite China’s globalized position.

In response to the question of why Japan had chosen not to attach conditions to the IMF contribution, an overwhelming number of the Japanese officials we interviewed argued that it would simply not have been appropriate to link the contribution to conditions like increased IMF quota. And, by not pursuing conditions, Japan “strengthened its leadership credibility.” Japan had been pursuing an adjustment of quota shares to reflect the global economic weight of Fund members and to thereby increase its own underrepresented quota. But according to those interviewed in Tokyo, it was believed that the margin of underrepresentation was minor in Japan’s case. Japanese officials explained that, with Japan’s $1 trillion reserves, making the contribution to the IMF was the “right thing to do.” Japan could not sit idly by and let this crisis spread. Despite the regional criticism of the IMF after the Asian financial crisis, Japan historically had a positive view of the IMF and especially of the World Bank, which helped to rebuild Japan in the aftermath of World War II. Projects such as metro subways, dams, and other modern symbols of Japan’s infrastructural development were financed by the Bretton Woods institutions and were discussed favourably in Japanese history books. Ultimately, Japan was portrayed by the officials as inherently ‘internationalist’ and a supporter of ‘free markets’.

Most officials’ comments supported the contribution. Some explained the importance of the loan in terms of its global impact. Makoto Utsumi, president of Japan Credit Rating Agency and former vice finance minister for international affairs was quoted saying of Japan’s capital infusion: “It was very significant that Japan set a precedent for other economies over the reinforcement of the IMF,” (quoted in Karube, 2009). Furthermore, in our interviews with Japanese officials and Japanese academics attentive to the policy discourse at the time, it was noted that whatever mild domestic criticism that existed had subsided very quickly when the crisis spread throughout Europe, especially in the midst of the great anxiety in the winter 2009 over the real possibility of global contagion. In particular, as Lehman Brothers collapsed, those involved in the policy discourse recognized the severity of the crisis; this had muted the debate over Japan’s contribution to the IMF.

A variety of other factors also contributed to Japan’s decision. The international financial crisis provided Japan with “an opportunity to show global and Asian leadership,” in the words of one interviewee, and “to show that Asia was the third pillar [after US and Europe] in IMF stability,” in the words of another. The world needed Japanese financial assistance and the Japanese believed it was their responsibility to help. Prime Minister Aso also clearly wanted a big initiative with which to impress his G20 colleagues. (Earlier he had floated the idea of hosting a G20 Summit in Japan, which had not materialized because the U.S. had offered to host the event. Japan had been the G8 Chair country in 2008.) The Japanese also hoped their contribution would encourage other countries to follow suit, providing global leadership at a critical time. Indeed, several months later, other countries contributed to the IMF as well. Unlike the other countries, however, Japan did not place additional conditions on its loan. As we have noted, Japanese IMF officials did not believe that attaching an issue of self-interest, such as increasing Japanese quota, would have been an appropriate or an effective strategy in attaining greater influence. “Quota reform is a delicate issue and it would have made it difficult for the IMF if Japan had tied its loan to that issue”, said one Japanese official. Moreover, the G20 had agreed that the next quota review process would be finalized a few years earlier than previously agreed upon (January 2011). As such Japanese policy makers saw no need to instigate more turmoil in Fund governance at the time. Instead, the Japanese government hoped that its $100 billion contribution to the Fund would be remembered in subsequent discussions on quota reform and used to advance Japan’s objectives of raising Asian quotas in future quota reform forums.

Despite the absence of high profile and public Japanese loan conditions, a number of interviewees in the IMF mentioned that there had been internal IMF speculation that the $100 billion contribution gave an unofficial guarantee that the Deputy Managing Director position, held by Takatoshi Kato but set to expire at the end of January 2009 but extended to February 2010 due to Fund involvement in the global crisis, would be held for the subsequent term by another Japanese official. We found no support for this argument in Tokyo. Moreover, the timeline of the announced contribution (in Washington, D.C., at the IMFC meeting in early September) does not coincide with the announcement of a successor.

As a number of our interviewees noted, there were other factors in the IMF decision to give the Deputy Managing Director position to Mr. Naoyuki Shinohara. Mr. Shinohara was former Vice-Minister of Finance for International Affairs and had actively participated in numerous international economic forums (such as the IMFC, G7/G8, G20, ASEAN + 3), earning a positive international reputation with many ‘contact points’ in the right circles. To be sure, Mr. Shinohara was accepted as DMD for more than his personal involvement in Japan’s financing of the Fund. Another reason advanced by Japanese officials for this decision was simply that of merit. Japan had been a serious supporter of the IMF throughout recent discussions and decisions on both quota and voice reform in the IMF and had helped significantly in building consensus in Asia.

In addition, as a number of officials pointed out, there was no serious contender from other Asian countries at the time. Despite newspaper rumours in late 2009 of a possible Chinese official being offered the DMD post,[6] there was no appetite among G7 countries and in the upper echelons of IMF management to invite a Chinese candidate to take the position. China’s intransigent policy on currency manipulation, coupled with the fact that a Chinese individual would be unlikely to have much independence from Beijing, meant that few appreciated or trusted the idea of a Chinese DMD at this time. As a prominent former IMF official noted, China first needs a “different ideology” before it could assume management positions at the Fund. Moreover, it was pointed out by regional observers in the Japanese government that Chinese domestic considerations made the assumption of such a role unattractive to the Government of China itself. Finally, many of the Japanese officials we interviewed expressed their belief that after Mr. Shinohara, the DMD post will be held by a non-Japanese. It was understood that Japan had its fair run at the post and that it was time to allow other regional members to take the lead. Those interviewed agreed that China may not be ready to take regional leadership in 2015 when Mr. Shinohara’s term expires. They proposed that perhaps a Korean or an Indonesian candidate might be chosen instead. The Japanese would like to pursue regional and global leadership but are cognizant of their declining population and the accelerating

[6] It was rumoured in October 2009 that China’s central bank vice president Zhu Min had resigned to take “…a senior position at the International Monetary Fund” (see AFP, 2009)

economic growth of its regional neighbours. Japan would like to maintain its regional and global leadership position in financial affairs, but acknowledges that regional competitors have similar goals.

Japan was motivated to contribute the $100 billion to the IMF because this was a useful policy choice in what international organization theory calls the ’laundering of state preferences.’ By investing the capital in the IMF, the Japanese were ensured that the Fund would lend to countries in need while taking on the politically challenging role of ensuring that conditionality was met and that the monitoring of country progress was maintained. This ‘laundering of state preferences through international organizations’ was used as a way of achieving goals similar to bilateral lending without the international political risk of a damaged state reputation (see Abbott and Snidal, 1998). Japanese officials confirmed that internal discussions were held on whether or not to provide bilateral loans directly. It was agreed that Japan could not take the risks of sovereign default. In effect, the IMF provided necessary “firewall protection.” Moreover, the countries in need of financial aid were not ones on which the Japanese government or bureaucracy held detailed information. In effect, Japan needed the IMF’s expertise. In place of bilateral loans the Japanese could take the high road of contributing capital to the IMF, thereby gaining international legitimacy and reputation for its financial contribution. The IMF would absorb the international political costs and blowback related to the strict conditionality of IMF loans. It was confirmed with Japanese officials that they had no involvement in setting conditionality on the member states who accessed the Japanese funds in their IMF Stand-by Agreements (to a total of $4.32 billion dollars of the $100 billion as of April 2010).

This laundering and use of the IMF as the necessary political buffer had a special resonance with Japanese officials. After all, the Japanese had vivid memories of US-motivated IMF conditionality on neighbouring countries during the Asian financial crisis rescue. The American intervention in the aftermath of the Asian crisis had sparked a burst of anti-American feeling in the region and left lingering suspicions about the country's reasons for insisting on fiscal austerity measures (which, incidentally, the US administration had refused to enact domestically after the 2008-2009 financial crisis – a degree of hypocrisy that has not gone unnoticed in Asia). By using the IMF as an agent for national intervention in the global economy, Japan utilized IMF expertise, leaving the international institution to establish and enforce the rules of conditionality and to govern, oversee and monitor the progress of the loans to each individual country.

There are important implications of this case for a broader discussion of Japan's role in global economic governance. Japan and other leading financial nations learned important lessons during the Asian financial crisis and applied these ideas during the 2008-2009 economic debacle. Japan also had the experience of its own domestic financial crisis which enabled it to assess the magnitude of the problems facing the U.S. and other western nations and the risk of contagion for the global financial system.

More than two decades earlier, Japanese scholars Kosai and Murakami argued that Japan needed to assume a more active role in global financial affairs: "The first step Japan must take is to become a principal supporter of the collective management system, actively assuming its share in the burden of providing international public goods, as well as working for the maintenance and stability of the international system" (Murakami and Kosai 1986, 34). Indeed, Wan (2001: 126) foreshadowed Japan's active intervention in the 2008-2009 financial situation when he argued that the Japanese foreign economic policy has shifted in favour of international organizations and that Japan demonstrated a higher level of cooperation and collective action than it had in its earlier bilateral and regional economic policies.

Well before the 2008-2009 financial crisis, therefore, Japan demonstrated its interest in international financial governance organizations and tipped its hat at being well disposed toward financial intervention and participation at the global level. Many of the worries and concerns that Japan might have had about such engagement had been overshadowed by the mismanagement of the Asian financial crisis of 1997. This string of events left bitter memories throughout the region, sparked criticism of American high-handed and self-interested exploitation of Asia's economic despair and provided Japan with the outline for a plan of action for the next great financial disaster, which dawned suddenly in 2008-2009.

In sum, Japan's relationship with the IMF has had its volatile days, particularly when Japan sought enhanced power in IMF decision-making throughout the 1970s and into the 1980s. After the loss of Asian confidence in the IMF, resulting from the poor advice given during the management of the Asian crisis, one would have expected Japan to distance itself from the IMF and lose interest in promoting the Fund in global economic governance. But to the surprise of pundits and analysts of the IMF, the Japanese were the first to come forward with a major contribution to shore up IMF liquidity. This $100 billion contribution encouraged and even shamed other prominent IMF members to come forward with sizeable contributions.

The challenges and uncertainty within the global financial system continue to test Japan's approach to international engagement and strategic intervention. Early in 2011, the Greek fiscal crisis threatened the stability of the Euro and brought the entire European economy into near-collapse. Ireland, only a few years earlier the darling of the European Union and a flagship for proper national economic management, found itself in financial distress. Moving quickly yet again, albeit at a much smaller level, Japan purchased ¥100 billion ($1.2 billion US) of bonds through the European Financial Stability Facility. As with the IMF intervention, the contributions to the stability of the Euro and the European Union, achieved several objectives: preventing the financial crisis from escalating, ensuring the continued viability of the important European market for Japanese exporters, and jumping into the financial fray ahead of the Government of China. (Nikkei Weekly, 2011) This safe investment, rated as AAA and providing a favourable rate of return, represented a reallocation of Japanese reserves already committed to the European market, similar to the arrangements used during the 2008-2009 crisis. As with the IMF engagement, the effort to buttress Ireland’s teetering economy represented a financially sound, high profile, well-received and very strategic gambit by the Government of Japan. The prospect of financial crises, from the Asian debacle of 1997 through the American-focused chaos of 2008-2009 to the European fiscal nightmare of 2010-2011, the Government of Japan learned a great deal about best to respond to international financial uncertainty and how to use strategic engagement and investment to address short-term concerns while re-enforcing the country’s prominent role in re-enforcing the strength of the global financial and trading system. That both the IMF and the Euro interventions allowed Japan to top China in terms of speed and scale of support for the existing financial order remained a valuable side benefit from Japan’s continued efforts to contribute to world-wide financial stability and to maintain a prominent position as a leader in global economic management.

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