Repair of U.S.-Japanese relations key to solving financial crisis

by Our Special Correspondent

The state of the U.S.-Japanese partnership is a matter of constant concern to both parties. This concern is becoming quite serious now, as both sides trade accusations back and forth about the motives of their recent policy announcements. During the past several weeks, the United States government has exerted enormous pressure on Japan to change the direction of its financial and economic policies. Statements issued by Treasury Secretary Robert Rubin and other U.S. officials are aimed at pressuring Japan to "do more" to deal with aspects of the global financial breakdown.

To the Japanese, such pressure represents not only an "insensitivity" to Japan's problems, but is seen as intended to divert attention from the growing asset bubble in the U.S. stock market. Leading Japanese politicians from the ruling Liberal Democratic Party have publicly stated that the U.S. stock market is way overinflated. For example, Koichi Kato, secretary general of the LDP, recently visited Washington to discuss the Hashimoto government's stimulus package. On his return to Tokyo, he warned that one of the financial dangers is the U.S. stock market bubble, and that Japan may have to go for a yen bloc, in self-defense. The Japanese believe that they are being scapegoated by the Clinton administration, because of fear that the U.S. "bubble economy" may burst.

But, the tension between the two allies is not limited to financial and economic policy. President Clinton's announcement in early May that there would be no traditional courtesy stopover in Japan following his June trip to China, caused political tremors. Many wondered, "Was this decision a new policy, or another pressure tactic?"

CFR says, break with Japan

Before outlining the thinking behind the Clinton administration's actions, it is necessary to identify the debate taking place within U.S. policymaking circles. Certain factions within the establishment are trying to move U.S. policy toward Japan in a different direction, as reflected in an article in the New York Council of Foreign Relations' journal *Foreign Affairs* (May/June 1998).

In an article entitled "Japan's Financial Mess," Eric Lincoln, a Senior Fellow in Foreign Policy Studies at the Brookings Institution, called on the U.S. government to essentially abrogate its historic partnership with Japan. After a diatribe against Japan's unwillingness to face its financial crisis, Lincoln not only criticizes Japan, but attacks the U.S. government for not exerting even more pressure on Tokyo. Lincoln writes:

"Washington has found it difficult to exert pressure on Tokyo. It is time for the United States to send less-than-subtle signals in other areas of its relationship with Japan. The bilateral relationship includes broad consultative arrangements, within which American officials could simply stop consulting. Through cancelled meetings, unreturned phone calls, and a lack of advance notice of American policy moves, the United States can send the message that it no longer regards Japan as a global partner. This may seem like a heavy-handed way to treat the world's second largest economy, but under the present circumstances it may be the only way to move Japan off a path that is destructive for us all."

Although Lincoln's article does not represent the official policy of the Clinton administration, it has found a resonance among certain government officials. According to Japanese sources, the Japanese Embassy in Washington sent a flurry of diplomatic cables expressing outrage at the article. So upset were Japanese officials that State Department personnel were deployed to reassure the Japanese that this was *not* U.S. policy. However, most Japanese officials believe that when the CFR articulates a policy line, this means that U.S. government policy will soon follow. In fact, this simplistic interpretation of how policy is made does not accurately reflect the Clinton administration's thinking.

Adding fuel to the fire, was the publication of a more insightful, but also flawed examination of the so-called Asian financial crisis: a special report issued by the Congressionally funded United States Institute of Peace (USIP). Entitled "Beyond the Asian Crisis: Challenges and Opportunities for U.S. Leadership," the report emphasizes that "Asia's financial crisis may mark a shift in relative long-term influence in favor of China *at the expense of Japan*. An effective regional strategy that would avoid this outcome but respond to the crisis would mobilize Japan toward instituting market liberalization measures and growth-oriented policies" (emphasis added).

Again, a major policy-shaping institution is signalling that Japan may no longer play a dominant partnership role with the United States. However, the USIP's "market liberalization" formula fails to address for the Japanese, and for that matter, the rest of Asia, the real underlying reasons for the financial crisis: the unsustainable speculative bubble in the global markets and the launching of the European single currency, the euro. Athough the USIP report touches upon the "hot money flow" problem and the need to reform the International Monetary Fund (IMF), it misses the essential point about why the leading British and European financial institutions launched their offshore-hedge-fund attack against the Asian currencies.

The currency-bloc problem

Only from a strategic standpoint can this British-led geopolitical assault against Asia and the United States be properly understood. The move to establish a European Central Bank (ECB) and a single currency, was primarily aimed at challenging the supremacy of the U.S. global position and the dollar as a reserve currency. The British and their European partners, especially in France, eventually want the euro to function as an "alternative reserve currency." When British-directed speculator George Soros's Quantum Fund and other currency speculators attacked the dollar-peg system of the Asian countries in the summer of 1997, the primary aim was not only to force a devaluation of those currencies, but to target the United States' entire Pacific Basin strategy and its key trading partners, China and Japan.

Skeptics claim that this is just another "conspiracy theory," but the Bank for International Settlements (the central bankers' central bank) issued a report showing that the overwhelming majority of speculative funds came from British and European banks. These "hot money flows" not only wrecked the viable sectors of the Asian economies, but when the IMF imposed its draconian austerity measures to try to save the speculative bubble, the Asian currencies went through another round of devaluations.

Given the speed at which the international financial system is careening toward a catastrophic breakdown, the British scenario of using the euro to challenge the dollar as a reserve currency may very well end up in the dust-bin of history. But it would be foolish for American and Japanese policymakers to ignore the plan. Despite Secretary Rubin's public pronouncements about the euro not being a threat, any major shift of funds from the dollar into the euro could trigger a collapse. In this context, certain pro-British European and Japanese financial institutions are looking at the possibility of organizing a yen bloc to support the euro against the dollar. Historically, the "imperial impulse" of certain Japanese institutions would lead them to seek a return to a warmed-over version of an "Asian Co-Prosperity Sphere."

Clinton's dilemma

Notwithstanding the euro threat and the Japanese temptation to dump the dollar and go for a yen bloc, the systemic nature of the crisis may be dawning on President Clinton. Even though he continues to tout the non-existent expansion of the U.S. economy, Clinton acknowledged in an interview with the *Wall Street Journal* on May 3, that "Asia's financial crisis is the biggest threat to a vibrant U.S. economy."

And, all the latest statistics show that the physical productive capacities of the Asian countries are rapidly shrinking. The Clinton administration's response has been to try to get Japan to absorb Asian exports at a rapid rate. Clinton made this point in the *Wall Street Journal* interview, when he said if the $125 billion in spending and tax cuts were to be "implemented rapidly and vigorously—I think it will be a plus."

However, Eisuke Sakakibara, Japan's Vice Minister for International Financial Affairs, warned that if there is no improvement in the Japanese economy by October, "then the yen may drop to 150" to the dollar. In other words, the U.S. pressure to get Japan to "do more" may not work. Privately, Clinton administration officials have told the Japanese that only a reorganization of the entire financial sector, including getting rid of the huge bad bank debt (around $1.5 trillion), can turn this situation around. What the Japanese know is, that unless there is a serious proposal coming from the Clinton administration, along the lines of the proposal for a New Bretton Woods system put forward by Lyndon LaRouche, no amount of jerry-rigging will work.