Japan’s Diplomacy at the G7 and G20: Supporting Global Economic Governance

By Sara Konoe

Introduction

The G7 was created in the 1970s as an informal meeting of the heads of state of the world’s leading industrialized economies to address international economic crises and manage the global economic order. Decades later, the 2008 global financial crisis led to the creation of a larger multilateral group, the G20, to include emerging economies in discussions about crisis response and managing international economic affairs. Japan, as a leading economic power, has been a member of both the G7 and G20, and regularly hosts their meetings. The accelerating trend of globalization and emergence of numerous policy issues across borders raised expectations for these forums to maintain the global economic order. Japan has assumed a leadership role in the G7 and G20 to ensure that its national interests and views are taken into consideration in the global policy-making arena, Asian voices are represented in global economic decision-making, and coordination among global economic institutions can help sustain a rules-based economic order.

This paper analyzes Japan’s role in forming and supporting global economic governance in the G7 (or G8 from 1998 to 2014) and the G20. Although the range of issues that are discussed in the G7 and G20 has been significantly broadened over time to include security, environmental, and global health issues, this paper focuses mainly on the original concentration of these institutions on macroeconomic and financial issues, including macroeconomic policy coordination, currency policy coordination, and financial stability. The paper also touches upon discussions related to trade negotiations. To investigate Japan’s role in the G7, the paper looks at three cases: two cases in which Japan accommodated other summit leaders’ demands, and another case in which Japan took a more proactive role in shaping economic policy recommendations. The paper also discusses the linkage between the G7 and G20 and Japan’s likely approach toward these economic institutions in the future.

Overall, the paper makes the following three points regarding Japan’s objectives in the G7 and G20 to support global economic governance. First, the G7 was an important forum for Japan to ensure fair treatment in the context of the postwar liberal order. It was a place for Japan to make its rapid growth compatible with other G7 partners’ interests and be accommodated by them. Second, Japan played a useful mediating role as the only Asian, or non-Western, member at the

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G7 to convey the views of emerging economies and other Asian economies. Third, the paper suggests that in recent years the G7 can be viewed as a springboard to find common ground and shared principles among members of the G20, which includes more diverse views, especially those of rising powers. This strategy can be utilized for Japan to address contentious issues affecting the global economy such as payment imbalances, digital governance, and infectious diseases.

**Historical Background**

The G7 was created in the 1970s for the leading economies of the world to address economic and financial challenges. It started with the Rambouillet meetings of the G6 countries (France, West Germany, Italy, Japan, the United Kingdom, and the United States) in 1975, before Canada joined the group to form the G7 in 1976. In response to economic turbulence after the collapse of the gold-dollar system from 1971–73 and damaging economic consequences from the oil shock, these countries had to tackle recession, inflation, and current account deficits, which destabilized the global macroeconomic environment and were all discussed at length during the first summit. During the 1970s-80s, Japan utilized the G7 as a forum to draw other summit members’ attention to economic development issues and the interests of Asia as the only non-Western country among the G7 member states. Over time, Japan utilized the G7 summits to address trade liberalization and mitigate criticism of Japan’s growing exports, as well as the other members’ demands for Japan to introduce restrictive measures, such as voluntary export restraints. However, from the 1990s to early 2000s, Japan’s leadership role was relatively limited due to its economic decline, while trade friction eventually attenuated in accordance with changes in world economic power. Although Japan, together with the United States and Germany, was once perceived to be a ‘locomotive’ for the world economy from the late 1970s to the 1980s, it no longer held that position in the 1990s and the early 2000s.

In addition, the end of the Cold War affected Japan’s international role at the G7, as the institution invited Russia to join, yielding the G8 in 1998. (Russia’s full participation, including on economic issues, began in 2003.) European countries especially supported this change despite Japan’s reluctance, which stemmed from the unresolved Northern Territories dispute with Russia. Despite these changes, Japan still played an active role at the G7 summit on some issues such as human security and the response to the Asian financial crisis of 1997–98. Moreover, in recent years, in the face of increasing tensions and confrontation over trade, security, and environment issues between the United States and other members at the G7, there is potential for Japan to

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undertake a mediating role among G7 members. More broadly, Japan’s geopolitical position enables it to play a role in keeping the United States engaged in global economic institutions.

Regarding the G7’s role in global financial and economic governance, the G7 functioned as an essential forum for currency market stabilization, macroeconomic policy coordination, and financial stability. The G7’s original mission was to restore stability in the global economy and finance and support basic conditions for economic growth. The G7 needed to address market disturbances in the aftermath of collapse of the Bretton Woods system (at least, its partial collapse) precipitated by the U.S. suspension of the dollar’s convertibility into gold in 1971. The group also had to discuss responses to the oil shock and subsequent high inflation in the 1970s.

Ministerial-level or expert-level meetings played a major role in handling such economic and financial issues. Finance ministers and central bank governors’ meetings started among the G5 (the United States, the United Kingdom, France, Germany, and Japan) and expanded to include the entire G7 (including Italy and Canada) in 1986, after approval of the U.S. proposal at the G7 Tokyo Summit. More recently, as emerging markets’ debt or financial crises impacted the global economy, finance ministers’ and central bank governors’ meetings of the G20 were convened from 1999 to supplement the G7/G8 meetings. In the same year, another multilateral forum called the Financial Stability Forum was created by the G7 finance ministers and central bank governors to enhance coordination among national authorities and international regulatory organizations regarding measures to ensure financial stability. After the 2008 global financial crisis, the G20 finance ministers’ and central bank governors’ meetings were upgraded from ministerial meetings to summits that built on pre-existing coordination mechanisms. Similarly, the Financial Stability Forum was upgraded to the Financial Stability Board with enhanced authority. The driving forces for the organization of the G20 were the need for rapid responses to financial crises and stability concerns, but the agenda expanded as those crises became more distant.

The G7’s role was not strictly limited to original themes such as currency, finance, and macroeconomic policy coordination. Until the 1990s, G7 meetings were often utilized as a facilitator for multilateral trade negotiations. Trade ministers met frequently to discuss progress in multilateral trade talks, and G7 summits functioned to provide a “deadline” for decisions at other bilateral or multilateral trade negotiations. For example, G7 summits around the early 1990s helped countries successfully conclude the Uruguay Round, the eighth round of multilateral trade negotiations, in 1993. This led to the creation of the World Trade Organization (WTO).

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5 In the gold-dollar system, the dollar held a constant convertible rate to gold, whereas other currencies’ values were pegged to the dollar yet adjustable in accordance with changes in economic fundamentals. The relative decline of the US economy vis-à-vis European and Japanese economies, increasing cross-national capital mobility, and the US’ expanding fiscal deficit led to this collapse, although the adjustable peg exchange rate system across many diverse economies was an unstable construct in the first place.
Multilateral trade negotiations then faced a stalemate in the 2000s, exemplified by the failure of the Doha Round, which started in 2001. Nonetheless, the main arenas for trade negotiation were more or less switched from multilateral to regional forums, and the G7/8 lost some of its importance with regards to trade issues. But leaders and officials from G7 member countries still used the G7 as an opportunity to informally discuss bilateral or regional trade arrangements on the margins of G7 meetings.

Though in the early stages of the G7 Japan often seemed reactive in response to other countries’ demands, the government did utilize the G7 strategically and even proactively. Japan made a series of economic adjustments, including expansionary policies and structural policies, to circumvent international criticism of Japan’s growing market share overseas and to mitigate trade protectionism by major trading partners. Japan emphasized the importance of free trade at the G7 to promote accommodation of its rapid growth by other summit leaders. The G7 gave Japan the opportunity to be accepted as one of the world’s leaders and to ensure fair treatment of Japan’s growing economy in the context of the post-war liberal order. Japan made a series of economic adjustments in a reactive manner, but this was based on strategic thinking on how to realize consistent growth without antagonizing other countries.

Japan also took advantage of G7 summits to demonstrate its global leadership role in the field of development assistance. Japan occasionally announced the doubling or tripling of Official Development Assistance (ODA) contributions around G7 summits, and ODA commitments often formed part of Japan’s “gift-bearing diplomacy” (omiyage gaiko), in which Japan increased ODA commitments to counter political pressure from other G7 members for Japan to increase its contributions. 8 However, it should be noted that Japan’s ODA policy was not merely reactive but also reflected Japan’s pride as a member of the G7 community and willingness to assume a mediating role between developed and developing countries in that context, especially as a representative of Asia. Japan’s mediating role became more prominent when the Asian financial crisis hit the region in 1997, as exemplified by its proposal for an Asian Monetary Fund, though it did not materialize due to opposition from the United States and China, and the New Miyazawa Initiative to provide financial support for Asian countries. This paper argues that Japan’s strategic and mediating role could have featured more prominently in the past and should be developed further in the future within the constructs of the G7 as well as the G20, which includes both developed and emerging economies.

8 For the example of gift-bearing diplomacy, see Dobson 2004, p. 70.
Key Issues

This section looks more deeply into specific negotiations in the economic and finance fields under the G7 and G20 constructs. First, it overviews principles, trends, and characteristics of economic governance in those institutions. Second, it analyzes two cases in which Japan faced significant pressures for economic adjustments in the G7. Third, it looks at a case in which Japan took initiative in formulating policies at the G7 in response to the Asian financial crisis. By shedding light on these three key cases, this section reveals both constraints and opportunities for Japan to utilize the G7 and G20 in formulating effective regional and global economic governance.

Contexts and Principles for Economic Governance in the G7 and G20

Before its collapse in 1971-73, the post-World War II Bretton Woods agreement embraced free trade and exchange rate stability as core principles. Important elements of this agreement, such as free trade and multilateralism, also continued to survive even after the collapse of the fixed exchange rate system, or the so-called gold-dollar system. The gold-dollar system intended to maintain exchange rate stability and, at the same time, give countries national autonomy over macroeconomic policies. Foreign exchange rates were adjustable to some extent in accordance with changes in economic fundamentals, whereas countries were initially allowed to impose restrictions on speculative and short-term cross-border capital movement. With these adjustments and control, a country was able to utilize macroeconomic policies for the purpose of its own economic management. Under perfect capital mobility and foreign exchange rate stability, a country would not have been able to lower interest rates below those of other countries, for example, as such change would cause a drop in its currency value. This postwar compromise between globalization and national sovereignty was called ‘embedded liberalism,’ which eventually faced a significant threat from a surge in short-term, cross-border money flows in the late 1960s.9

With growing cross-border activities in London mediated by large U.S. and UK financial firms in Eurocurrency markets, national economies and currencies became more directly exposed to global markets and market fluctuations. Restrictions on cross-border capital movement (i.e. capital controls) were already eroded on a de facto basis, before formal legal changes took place in the late 1970s. In response, the United States, followed by other industrial economies (despite initial resistance by some countries), opted for a flexible exchange rate system with enhanced national autonomy in monetary policy. Yet, currency stabilization mechanisms continued at bilateral and regional levels, as many Asian, Latin American, and Middle Eastern countries kept their currencies pegged to the dollar, while European countries adopted regional currency

stabilization systems, such as the Snake system from 1971 and the European Monetary System from 1979, to reduce fluctuation of their currency values within a narrow range.

As growing financial markets and freely flowing capital brought about huge profits to U.S. and UK firms and development opportunities to many emerging markets, strengthening capital controls to save the gold-dollar system seemed untenable. In a world of expanding financial markets, balance of payments restraints can be relaxed as vibrant financial markets enable debtors to consume and borrow more. The role of the dollar as the most prominent international currency granted a special status to the United States and enabled the United States to worsen its balance of payments deficit with low long-term interest rates (low financing cost) well beyond plausible constraints for other countries. Payment imbalances continued and became larger even after the collapse of the gold-dollar system and major countries’ adoptions of flexible exchange rate systems in 1973. A shift to a flexible exchange rate system helped exchange rates fluctuate in a direction for correcting trade imbalances to some degree. However, as currency markets are subject not only to trade flows but also to capital investments unrelated to trade, exchange rates did not always move in the direction of correcting imbalances.

Worsening and chronic payment imbalances need adjustments in the long term, as they can become a risk factor when combined with risk money, hyper-active boom and bust cycles, and rapid deterioration of credibility. To correct current account imbalances, countries in deficit need to tighten their macroeconomic policies, whereas countries in surplus need to adopt expansionary macroeconomic policies. While neither the G7 nor the G20 were able to agree on concrete principles and measures about how to correct long-term imbalances, demands for adjustments were expressed and accommodated only in a sporadic and asymmetrical manner, as seen in the cases of economic adjustments in Japan. As put by Andrew Baker, “little or no negotiation over the formal detail of macroeconomic policies takes place at G7 meetings and the kind of co-ordination that characterized the first decade of G7’s existence is largely off the agenda.”10 The G7 became more active in ‘exchange rate coordination’ in the 1980s as a way of adjusting their economies, as typically seen in the Plaza and Louvre Accords. As shown below, in the Japanese cases, the G7’s intervention in the 1980s and 1990s had limitations in terms of its compatibility with Japan’s sustainable economic management and correcting global imbalances.

Furthermore, cross-border capital mobility, which occasionally drove debt or financial crises, brought about another agenda for multilateral forums: an agreement on common prudential standards to ensure both equal footing and financial stability.11 One typical example is multilateral

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coordination in bank capital regulation. This has been mainly discussed and agreed upon among a group of representatives from G10 countries’ central banks and regulators, known as the Basel Committee on Banking Supervision (Basel Committee), since the late 1970s and has impacted the agenda of the G7 and G20. Multilateral coordination in bank capital regulation progressed in the 1980s against the background of Japan’s growing financial power, as well as ongoing financial stability concerns stemming from the Latin American debt crisis. Around that time, the Latin American debt crisis required the United States to increase its financial contributions to the International Monetary Fund (IMF). To respond to domestic criticism of the use of public money to compensate losses from the risky investments of U.S. banks, U.S. regulators had to strengthen prudential regulations over the banks. At the same time, the United States wanted to avoid putting their banks in a disadvantageous position vis-à-vis Japanese financial firms, which were encroaching into the U.S. market. Thus, U.S. regulators sought bilateral and multilateral cooperation in strengthening prudential regulations to achieve equal footing. As multilateral coordination in bank capital regulation at the Basel Committee was not making good progress, the United States formed a bilateral coalition with the United Kingdom, which faced the same dilemma as the United States, to devise a bilateral deal. The United States and the United Kingdom then forced the Basel Committee members to adopt their standards, while incorporating some of the other members’ demands and making compromises. This led to an agreement on the first mutual standard of bank capital regulation in 1988, called Basel I.12

Rapid developments in information technology and risk assessment methods in financial services later drove U.S. regulators to promote self-regulatory and risk-sensitive regulatory approaches at the Basel Committee. This led to the revision of Basel I in 1996, and later a second framework agreement in 2004, named Basel II, which relaxed regulatory requirements for large U.S. and European financial firms. The eruption of the global financial crisis in 2008, which was not foreseen at the preceding G7 meetings, led to the transformation of financial governance architecture, including creating G20 summits as a major pillar supported by the existing G20 Finance Ministers and Central Bank Governors meetings; upgrading the Financial Stability Forum to the Financial Stability Board with enhanced authority; and expanding the Basel Committee’s membership to emerging economies. A long-standing call for reforming the IMF to be more open and inclusive of emerging economies was in part also realized in the post-financial crisis context. Thus, the influence of emerging markets over global financial architecture was enhanced through post-2008 reforms.

Summits as Pressure on a ‘Reactive’ Japan

This subsection looks at two cases in which Japan was pressured for economic adjustments in the G7: (1) currency coordination and demand stimulus from the late-1970s to the late-1990s; and (2) multilateral coordination in bank capital regulation in the 1980s–90s. The first case brought about a mixture of positive and negative impacts on the Japanese economy. Japan’s structural problems in its economy and its overreliance on exports for growth were heavily criticized from other summit partners, as Japan became a major global economic power in the mid-1970s. The Japanese economy was plagued with moral hazard associated with relationship lending, weak corporate governance, due in part to cross-shareholding, and non-transparent business practices.13 Opaqueness in corporate practices and markets had been criticized as a cause of limited imports and foreign firms’ entry. Reform efforts to correct non-market and non-transparent practices accelerated as Japan faced economic stagnation and financial crisis in the 1990s after the bursting of its asset bubbles. International pressure, especially from the United States, helped Japan strengthen its competition law, introduce a more flexible labor market system, and restrain non-transparent and uncompetitive practices. Moreover, a series of financial reforms progressed due to pressure from the United States to open up Japanese capital markets to foreign investors and remove outdated regulatory barriers. Financial reforms also encouraged corporate reforms to make Japanese corporations more accountable to shareholders and stakeholders. Many of these structural reforms—while implemented in a limited manner—contributed to making Japanese markets and firms more profit-oriented and more accountable to outsiders.

However, some of the macroeconomic adjustments and currency coordination in this context may not have served the long-term sustainability of the Japanese economy. International demand, led by the United States, for appreciating the yen and stimulating domestic demand amplified Japan’s monetary easing in the 1980s, as well as expansionary fiscal measures in the 1980s–90s. Although yen appreciation had been a long-term trend, which duly reflected Japan’s economic growth, this trend was accelerated excessively due to international currency coordination in 1985 produced through the Plaza Accord. Against a backdrop of rising protectionist pressures within the United States to impose high tariffs on imports, Germany and Japan agreed to sell dollars and purchase their own currencies.

During the same period, G7 summits functioned as a facilitator to incentivize Japan to undertake structural reforms and stimulus plans. For example, the Maekawa report proposing a series of liberalization reforms under the Nakasone government was unveiled in April 1986, just before the G7 Tokyo summit that year. This was intended to assuage other summit countries’

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criticisms of Japan’s growing trade surplus.\textsuperscript{14} The Maekawa report accommodated a number of proposals made in 1984 by the U.S.-Japan joint committee, called the Yen-Dollar Committee, the content of which was also discussed at the 1985-1986 U.S.-Japan market-oriented sector-specific talks (MOSS).\textsuperscript{15} Nakasone also announced a six trillion yen package of economic measures before the G7 Venice summit in June 1987, another example of the aforementioned ‘gift-bearing diplomacy’ to preempt criticism toward Japan. The Venice Summit in 1987 confirmed an agreement among G6 finance ministers and central bank governors (including G7 representatives, except for those from Italy) in February 1987, called the Louvre Accord, to stabilize currency markets and avoid further dollar depreciation.\textsuperscript{16}

At the G7 Tokyo Summit in 1986, Japan called for other countries’ support for currency market intervention but regrettably failed to gather their support.\textsuperscript{17} Without multilateral support, Japan was left with a need to address the negative effects of rapid and continuous yen appreciation with only domestic macroeconomic measures, and it pursued expansionary monetary policy to keep the Japanese economy afloat. The asset bubble started in the late-1980s in Japan, and its burst caused economic stagnation and a financial crisis in the 1990s. A period of economic recovery in the early 2000s was long but not strong, and Japan has not regained its economic strength since, which it desperately needs to make its huge public debt sustainable in the long term. Japan’s case contrasts with that of Germany, which had the option of regional integration and adjustments to mitigate speculative pressures for currency appreciation and inflation. The European Monetary System enabled Germany to keep the Deutsche Mark lower than it would have been otherwise.\textsuperscript{18} But Japan had neither a regional option to mitigate currency fluctuations nor an anti-inflationary central bank comparable to the German Bundesbank and relied on expansionary monetary policy and fiscal stimulus, which may have only accelerated bubbles. Macroeconomic policies around that time should have been employed with more self-restraint to give Japan room to address major long-term policy agendas later on, such as the shrinking labor population and costs associated with an aging society.

Japan’s experience with currency coordination did not improve in the 1990s. From 1994 to 1995, the United States intervened in currency markets out of concern over the weakened dollar. After unilateral intervention in 1994, the United States was able to collaborate with other G7 members in 1995 to appreciate the dollar.\textsuperscript{19} This led to a continuous trend of an overly weakened

\textsuperscript{14} Dobson 2004, p. 65. Around that time, Japan was facing severe trade friction with the US, which made Japan adopt export restraints on automobiles (1981–1994) and import targets for semiconductors (1986–1992).
\textsuperscript{15} Saito 2017, p. 50.
\textsuperscript{16} Dobson 2004, pp. 70, 72. For a series of G7/G8 Finance Meetings, see http://www.g7.utoronto.ca/finance/index.htm
\textsuperscript{17} Dobson 2004, p. 66-8.
\textsuperscript{18} Pedersen, Thomas (1998) Germany, France and the Integration of Europe: A Realist Interpretation. London: Pinter, p. 125.
\textsuperscript{19} For this process of currency coordination, see Baker 2006, pp. 157-64, p. 181.
yen until the summer of 1998. Japan attempted to attract other leaders’ attention to its currency problem at the G7 and solicit collaboration but without much success. Even after the G7 reached an agreement to stabilize the rise of dollar in February 1997, the problem of the weak yen was not addressed by the United States until June 1998.  

Moreover, on the fiscal policy side, Japan also faced growing international pressure at summits to adopt stimulus packages to tackle deflation and the financial crisis in the late–1990s. In the lead-up to the Birmingham Summit in May 1998, the G7 financial ministers’ meeting in Washington D.C. focused on Japan’s economic problems and requested that Japan undertake effective fiscal measures and structural reform. Then, at the next financial ministers’ meeting in London, which was held separately from the Birmingham Summit, the Japanese government’s economic stimulus package and Financial Big Bang were addressed. Finally, at the Birmingham Summit, the second Hashimoto government announced the above stimulus plan, which was undertaken and implemented under the next Obuchi government. The stimulus package amounted to 10 trillion yen, including 0.7 trillion yen of tax cuts. As put by Andrew Baker, “collective G7 pressure and sentiment helped to convince the new administration of the importance of fiscal activism.” This intended to address not only Japan’s own financial crisis, which worsened after the fall of 1997, but also the impact of the Asian financial crisis from the summer of 1997. Although an even more active fiscal stimulus could have possibly been justifiable for Japan at that time due to its huge depletion of asset values after the bursting of the bubble and staggering nonperforming loan problems, Japan’s fiscal policies were overly sensitive and rather reactive to occasional international pressures. For example, a question of how to use such a stimulus to address long-term structural problems, such as low productivity due to excess capacity and a shrinking labor population, was not well addressed as part of the expansionary initiative.

As discussed above, G7 meetings provided Japan opportunities to work on structural reforms, and the threat of rising protectionism from the United States played a major role in pushing Japan to implement them. Moreover, G7 meetings and U.S. pressure directly or indirectly accelerated Japan’s stimulus stances beyond what it was prepared to handle from a long-term strategic perspective. The timing and the detail of the stimulus packages may not have been well conceived.

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20 Baker 2006, pp. 162-64.
21 Financial Big Bang was a plan to remove regulatory barriers for financial sectors and invigorate capital markets, which was announced by the first Hashimoto government in the fall of 1996.
before implementation because the intent was to showcase Japan’s preparedness to other summit leaders and avoid international criticism.

The second case that shows how Japan responded to international pressure involves bank capital regulation in the 1980–90s. Around that time, Japan had not yet developed sophisticated prudential regulatory tools, and its proposed standards were quite lower than what the United States and United Kingdom demanded. Thus, Japan could not exercise significant influence over the fundamental framework for Basel I, except for some compromises Japan gained. When Basel I was revised in 1996 and Basel II was adopted in 2004 to accommodate banks’ self-assessment of risk in favor of large financial institutions in developed economies, Japan could have warned about financial stability risks for the global economy based on what it learned from its own experiences with the bursting of speculative bubbles in the early 1990s, or acted as a mediator between developed and emerging markets. However, Japan did not assume such a role, either at the Basel Committee or at the G7. The series of negotiations over bank capital regulations were mainly conducted at the Basel Committee based on ‘technical authority,’ and functioned at a different level from other multilateral bodies like the G7, which drew authority mainly from political representation. Even so, the principles and rules proposed by the Basel Committee were endorsed at the G7 and the Financial Stability Forum to encourage emerging markets to adopt these rules. As the 2008 financial crisis revealed the limitations of the existing Basel Accords, financial stability policies became a critical agenda at another multilateral forum—the G20. One could say that bank capital regulations developed under a shared sense of problems and framing negotiation at the G7 and G20, especially after the late 1990s.

Overall, Japan could not play an innovative role in setting up agreements on bank capital regulation across G7 and G10 partners due to its relative inexperience with rules-based and standardized processes of financial supervision especially until the mid-1990s. The lack of openness and the peculiar nature of administrative processes in bank supervision within the Ministry of Finance, which held the authority of banking supervision until the mid-1990s, inhibited Japan from quickly adjusting to newly emerging prudential standards across the world and taking initiative in that field. This limited Japan’s role in agenda-setting and raising concerns about stability risk in relation to the rapid transformation of bank capital regulations from the mid-1990s to the early 2000s, despite its experience with its own financial crisis since the mid-1990s and the

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1997 Asian financial crisis. However, as mentioned below, Japan’s experience with the Asian financial crisis provided Japan with an opportunity to undertake a more active role at the G7 and G20 in financial stability issues.

**Summits as Opportunities for Enhancing Japan’s Leadership**

Japan was able to lead some discussions related to crisis management in the context of the Asian financial crisis in 1997–98. On that issue, the G7 Summit in Halifax in 1995 provided a basic framework for financial stability in response to the Mexican peso crisis from 1994 to 1995. Based on that framework, G7 finance ministers’ and central bank governors’ meetings led to the development of additional details in the aftermath of the Asian financial crisis, but there was a debate about whether the Halifax framework adequately reflected the risks associated with rapid capital liberalization.27

The Asian financial crisis ignited different responses among G7 countries and even occasional tensions over the role of IMF and the formulation of regional financial architecture. Japan informally proposed the Asian Monetary Fund in September 1997, with $100 billion in capital to provide emergency funds to crisis-ridden countries in Asia, but had to drop the proposal due to strong opposition from the United States. Alternatively, Japan was able to launch a more modest version of the financing scheme in October 1998 called the New Miyazawa Initiative, which made $30 billion accessible to countries in Asia for economic recovery and reform and set up currency swap networks among central banks as an emergency lending facility. This initiative did not elicit opposition from the United States and was intended to support the Manila Framework—a regional surveillance system with funding to supplement the IMF that Asia-Pacific countries agreed to in November 1997.28 Then, in 2000, currency swap arrangements were expanded to include all Association of Southeast Asian Nations (ASEAN) member states under the so-called Chiang Mai Initiative, in which Japan became a leading member of the ASEAN Plus Three, or APT (China, Japan, and South Korea). Moreover, after Japan’s constant call for a response to the imminent financial needs of Asian countries, the G7 finally agreed to a $35 billion rescue package in December 1997. In addition, as post-crisis institutional responses, the Financial Stability Forum was created to improve communication among various regulatory bodies in different sectors; G20 finance ministers’ and central bank governors’ meetings were also set up to “regularize communications between the G7 and significant emerging markets.”29

As Andrew Baker notes, “the G7 provided the principal vehicle for the Japanese to promote their interests and its collegiality and consensual mode of operation gave Japan…opportunities to

27 Baker 2006, p. 185.
29 Baker 2006, p. 216.
display intellectual leadership and influence the debate on the global financial architecture.” This concept was applied not only to financial schemes for crisis-ridden Asian countries, as shown above, but also to discussions over IMF reform (its quota system in relation to emerging markets) and a possible regulatory approach to hedge funds, which were criticized for their contribution to the Asian financial crisis. Japan’s proactive role, however, contrasts with its somewhat reactive role in economic adjustments and bank capital regulations. When policy issues and agendas concerned Asia, Japan was able to capitalize on its connections and network with other Asian countries, enabling its unique contribution to the role of G7 in regional economic governance. In this sense, the G7 is an open-ended forum for Japan, which can be utilized more effectively in combination with other regional or global networks.

The G7’s experience with the 1997 Asian financial crisis contributed to further institutionalization of global financial governance after the 2008 financial crisis, as the new global architecture under the G20 construct expanded to include a wider group of countries and emerging economies while upgrading institutions built after the Asian financial crisis. For financial stability issues, the G20 has an advantage due to its more inclusive multilateral characteristics as well as its close liaison with traditional multilateral organizations and with standard-setting bodies, such as the Basel Committee. Such post-crisis developments enabled emerging countries to participate in forming global rules. Japan’s close involvement in developing economic institutions and financial architecture in Asia may enable Japan to serve as a bridge among different regional and global multilateral institutions.

**Policy Recommendations**

The paper’s analysis on the roles of Japan in the G7 and G20 leads to the following recommendations:

1) Japan and the United States have not always agreed on policy measures to manage the global economy but have assumed critical leadership roles in global economic institutions. The two countries should coordinate a joint strategy for agenda-setting and engaging regional partners in the Asia Pacific. U.S.-Japan relations have influenced institutional features and economic cooperation in Asia and the Asia-Pacific region through discussion and negotiation at the G7 and other bilateral and multilateral forums. Institutional development in the Asia-Pacific region, in turn, also increasingly constrains and defines collaboration between Japan and the United States. It is in

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30 Baker 2006, pp. 208. For discussions over post-crisis IMF reforms and hedge fund regulations, see Baker 2006, p. 208-209.

Japan’s interest to keep the United States in Asia and in multilateral institutions to ensure effective global economic governance based on post-war liberal principles.

2) Japan should share its experience with macroeconomic policy coordination and encourage institutions like the G7 and G20 to consider the long-term ramifications of policy measures, not just the near-term responses to economic problems. In recent decades the Japanese economy, which is characterized by slow growth, low inflation (or deflation), and huge public debt, provides some lessons on how to manage macroeconomic policy coordination. Japan was not proactive enough in preparing for its own societal predicaments, such as low productivity with a shrinking population. Japan could have taken more conservative macroeconomic and prudential policies during the economic boom and speculative bubbles. After the bursting of the asset bubble, undertaking long-awaited structural reforms to reduce excess capacity and direct Japan toward a demand-driven and service-oriented economy was necessary to create sustainable growth, but Japan could have done it in a more proactive manner in accordance with its long-term growth strategy. Multilateral pressures incentivized Japan to undertake tough reform but, at the same time, to bring about ‘easy gifts’ to avoid criticism and shame. The informality and political nature of the G7/G20 should not cloud a country’s long-term priority in terms of sustainable growth.

3) Japan can promote more coordination among multilateral institutions, including regional institutions, to better align fiscal and monetary policies and financial stabilization measures. At the G7 Japan has often taken a mediating role between emerging markets—particularly in Asia—and advanced economies. If Japan leverages its geographic and strategic position, as well as promotes lessons learned from its own economic predicaments, it can play a constructive role in bringing some perspectives from emerging economies to the G7 and putting macroeconomic issues in a stability and sustainability context.

4) In terms of the linkage between the G7 and the G20, Japan should exploit different advantages of these institutions to address global agendas. For issues on which a high level of institutionalization for negotiations and a basic level of consensus exist, the G20 can be a useful forum to effect rules-based governance, in which actual rule-making and implementation can be discussed. For financial regulation and stability, for example, the G20 has developed an institutionalized relationship with standard-setting bodies, such as the Basel Committee, which gives it an advantage in dealing with these issues from a regulatory perspective. However, if consensus-building or rule-making processes are not well institutionalized and a basic consensus on principles does not exist, then the G20 may be limited in making substantive contributions due to the forum’s diverse nature. How to address payment imbalances from a stability perspective is one issue where the G20 has not been able to find common ground. When basic conditions for consensus-building and rule-making processes are lacking, Japan can attempt to introduce flexible strategies at the G20, such as setting medium-term goals and encouraging member countries to
conduct self-assessments. In this case, Japan can utilize the G7 as a group of more like-minded leaders to a fuller extent in order to search for a range of concrete policy options.

**Conclusion**

To conclude, Japan’s relationship with the G7 and G20 has been both reactive and proactive. Due to its rapidly growing market power—Japan had to take a defensive stance to accommodate criticism and suspicion of its economic policies. Although the G7 incentivized Japan to undertake a series of essential structural reforms, Japan’s engagement regarding currency and macroeconomic policy coordination may have yielded unanticipated risks for the long-term sustainability of its economy. Given its experience in addressing tensions with other mature economies over its rapid growth, Japan may be able to play a constructive mediating role between G7 and non-G7 member states, as well as between the G7 and emerging economies in the Asia-Pacific region. Japan’s predicaments with economic adjustments, macroeconomic policies, and growth issues, and its active engagement in developing financial architecture in Asia, suggest Japan’s potential role should be in promoting constructive economic coordination both from sustainability and stability perspectives.

Furthermore, Japan’s role at the G7 and G20 can be enhanced through its relationship with connections and networks in the Asia-Pacific region, as these multilateral institutions do not function in a vacuum but in specific regional and global contexts. By capitalizing on such regional ties, Japan can strengthen its role in promoting a rule-based order as well as engaging great powers, such as the United States and China, in multilateral talks. In this sense, Japan’s close partnership with the United States serves not only to promote the two countries’ narrowly defined interests, but also to bring multilateral and Asia-Pacific institutions together to make global governance structure more effective.