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Forget Bretton Woods II: the Role for U.S.–China–Japan Trilateralism

In this age of globalization, nations rise and fall in the world markets day and night. Europe, Germany in particular, may at first have indulged in a certain amount of *schadenfreude* to observe the abrupt fall from grace of the U.S. financial system. But not for long. As of November 2008, the euro zone is officially in a recession that continues to deepen.[1] Germany's government was compelled to enact a 50 billion euro fiscal stimulus package.[2] The Japanese economy, though perhaps among the least susceptible to the vagaries of the European and U.S. economies, followed soon after, with analysts fearing that the downturn could prove deeper and longer than originally anticipated.[3] The U.S.–Europe–Japan triad, representing the world's three largest economies, is in simultaneous recession for the first time in the post-World War II era. China, meanwhile, is suddenly seeing its 30-year economic dynamism lose steam, with its mighty export machine not just stalling but actually slipping into reverse.[4]

This tangle only promises to tighten. In monetary policy terms, major countries will find their interest rates quickly approach zero, leaving little room for maneuvering. On the fiscal policy side, we will continue to see restraints on further discretionary measures as markets across the world turn their attention to measures aimed at ensuring fiscal health. The risk here is that undue pressure will be placed on long-term yield in the process, leading to higher interest rates and creating an additional damper on the economy with inflationary impacts and the ongoing freefall of the U.S. dollar. On top of these gaping policy pitfalls, we are almost

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A second incarnation of Bretton Woods is increasingly implausible.

certain to see antiglobalization sentiments gain further momentum, which will inevitably spill over into the political realm. The world thus faces the combined dangers of overregulation of the market and stifling of innovation, rampant protectionism, and ultimately, the erosion of the liberal international order.

Keeping in mind this dismal prediction, is the world capitalist system headed for a period where major national economic models will diversify? If so, will these diversifying systems be able to coordinate macroeconomic policy and strategy? The circumstances demand a change of strategy, and in very short order. Forget a "new Bretton Woods." The time is neither ripe nor sufficiently abundant now. Instead, recognizing the weight that has shifted to the financial poles of China and Japan, the United States must adjust its global financial strategy to feature the Asia-Pacific element prominently. The current crisis demands not a brand new structure but rather a reenvisioned process, with the careful cultivation of U.S.–China–Japan trilateralism a critical vehicle to this end.

Impediments to a New Bretton Woods

Global challenges demand global responses. In the context of the current financial crisis, there have been increasing calls, particularly from the European quarter, for a fundamental rethinking of the international monetary system, with President Cristina Fernandez de Kirchner of Argentina, President Nicolas Sarkozy of France, and Prime Minister Gordon Brown of the United Kingdom all calling for something akin to a "new Bretton Woods."[5] For their part, large emerging countries like Brazil, China, and India have pushed for seats and say in financial global governance, and found the Group of 20 (G-20) summit to be a convenient vehicle toward enhancing their own interests and status. During the November 2008 G-20 summit in Washington D.C., President Hu Jintao of China's prominent position next to President George W. Bush, in the seating chart and for the photo op, spoke volumes of the changing political landscape. More importantly, it evoked the emergence of a new U.S.–China bipolar world order.[6]

The reality is that circumstances have changed dramatically since the original Bretton Woods formulation, rendering the emergence of a second incarnation an increasingly implausible proposition. The first version was essentially forged between just two countries, with Winston Churchill of the United Kingdom and Franklin D. Roosevelt of the United States drafting its most notable precursor, the Atlantic Charter, in 1941, but the players have now expanded to 20. Actors like Brazil, China, the European Union (EU), India, and Russia have entered the scene, with complications in tow. Too many cooks spoil the broth, and the G-20 major economies are simply too many and too diverse to concoct anything approaching a new Bretton Woods. Beyond this, whereas states were once the predominant economic players on the international stage, private flows have now assumed a paramount role that cannot be overlooked.[7]

What is more, in both Europe and the United States, the bailout focus has been largely domestic and the response of international institutions has been meek. Today's United States is not willing, nor necessarily able, to play the role of global stabilizer, while the EU is mired in its own struggles to construct a viable monetary union.[8] The Group of 7 (G-7) is now only one part of the whole. And many G-7 countries are fiercely protective of their vested interests in the face of a new cast of emerging powers, regardless of what conciliatory messages they might convey in their public rhetoric. In the Washington G-20 meeting, no reference was made to the idea of a new Bretton Woods, or second Bretton Woods, by any head of state. And suspicions remain about the U.S. "cowboy capitalist" streak among some emerging countries. Referring to the Bush administration's sudden appreciation of multilateralism in hosting the G-20, a Chinese diplomat said half-jokingly: "The U.S. is not really serious about G-20 or even G-7/G-8. It is actually only interested in GM [General Motors]."[9]

Eastward Shift

A new global governance cannot be effectively established without taking into account the tectonic change in the world's political economy, namely the ongoing power shift from West to East. In particular, many signs are pointing to an increasingly central role for China and Japan in the management of macroeconomic policy coordination to help revive the global economy. In more general terms, we are likely to witness an overall shift of the global economic center of balance toward the Asia region in the coming years. Of course, this is not new. It is a trend that has been taking place on the world stage since the rise of China over the course of the last decade. What the financial turmoil has done is accelerate its pace and pitch.

A central focus point of this gravitational shift is China. As events continue to unfold, Beijing's role, as well as the development of the U.S.–China bilateral relationship in the wake of the crisis, will be critical fronts to watch. China has shown clear interest in playing a major role in the G-20 to seek solutions to the current crisis. Its position has been that keeping its own growth strong and stable is its primary responsibility to the world economy, what Premier Wen Jiabao

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refers to as the country's "most important contribution." At the beginning of 2009, Wen declared China's determination "to be the first to recover from the financial crisis."[10]

From a macroeconomic perspective, China's position remains very strong. The country possesses nearly $2 trillion in foreign currency reserves, up to 70 percent of which analysts believe to be in U.S. dollar-denominated assets including U.S. treasury securities.[11] The United States is critically dependent on foreign countries for the continued financing of its current account deficit, and China is foremost among them. As of October 2008, China owned roughly 21 percent of all foreign purchases of U.S. treasury securities, surpassing Japan's 19 percent.[12] As some market strategists have colorfully phrased it, China is now "America's financial sugar daddy."[13] Indeed, China has assumed a role which is practically indispensible as far as the United States and the global economy at large are concerned. Under such circumstances, U.S. Secretary of State Henry Paulson's motivation in launching the Strategic Economic Dialogue (SED) in September 2006 is not difficult to discern. Though the meeting was convened among cabinet members from both sides with an agenda covering all manner of economic issues, one need look no further for the core impetus than a U.S. deficit in desperate need of China's continued financing.

This implicit U.S.–China deal is not dissimilar to that in place between Japan and the United States, particularly vis-à-vis the May 1984 Yen–Dollar Accord by which Washington sought to ensure that Japan's surplus would be channeled into financing the Reaganomics-driven current account deficit.[14] By faithfully purchasing U.S. treasury debt, Japan freed the United States of the need to maintain high interest rates in order to present an attractive picture to potential buyers of treasury securities and eliminated any necessity to raise taxes toward reducing the deficit.[15] John Judis describes this arrangement between Japan and the United States as an "informal bargain" that became "the cornerstone of a new international economic arrangement."[16]

China is keenly aware of the U.S. vulnerability and has sought to maximize its strategic gains. For one, Beijing has continued to purchase U.S. treasury bonds. A U.S. diplomat expressed his appreciation for this consistent support, saying that "China has continued to buy the U.S. government bonds, and it quite helps us." The official made this comment while expressing certain misgivings about China demonstrating "too much eagerness to project a U.S.–China bipolarity image onto the world" in its enthusiasm for the Paulson-initiated SED.[17] Certainly, China has not purchased the treasury bonds for altruistic reasons. Rather, Chinese leaders have acted out of a necessity to avert the renminbi's (RMB) appreciation in the currency market. Moreover, with the global downturn intensifying, speculations now arise that China's appetite for treasuries may be on the wane.[18] China also does not hide its ambition to establish Shanghai as a global financial hub in the coming years. At the end of 2008, during Wall Street's meltdown, China took advantage of "the rare lesson and opportunity" when it began to aggressively recruit from leading financial institutions based in London and New York.[19]

And then there is Japan. "After Almost Two Frozen Decades, Japan is Back," a *Financial Times* headline declared last September when the Mitsubishi UFJ Group (MUFJ) struck a deal worth close to $9 billion to acquire a stake in the ailing U.S. financial giant Morgan Stanley. Meanwhile, Nomura Holdings' acquisition of the Lehman Brothers' Asia-Pacific franchise that same month further cemented Japan's stabilizer role on the world financial stage. Japan remains a formidable manufacturing engine, the world's second-largest holder of foreign reserves after China with over $1 trillion worth.[20] By nominal GDP measures, Japan is also the world's second-largest economy.[21]

Compared to the dire economic straits in Europe and the United States, Japan is in relatively good shape and has certainly proven itself better insulated against the blows of the financial crisis, owing largely to the simple fact that Japanese financial institutions have not been as extensively exposed to the "toxic" elements now poisoning the world financial markets. Financial sector reforms undertaken under Prime Minister Junichiro Koizumi left Japanese banks with better liquidity than their European or U.S. counterparts, while the trauma of the Asian economic crisis alerted Japan's financial institutions to the potential dangers of Wall Street's complex debt securities.[22]

For its part, Japan appears to be poised to play a constructive role in efforts to treat the global malaise. In October 2008, the Bank of Japan reduced its key interest rate for the first time in seven years, from 0.5 percent to 0.3 percent.[23] Before attending the G-20 summit in Washington last November, Prime Minister Taro Aso pledged a bridge loan of up to $100 billion to the International Monetary Fund (IMF) to aid economies hit by the financial crisis.[24] He then followed up in December with the announcement of his second economic stimulus package since taking office, worth a massive ¥23 trillion ($255 billion), including measures designed to spur employment and encourage lending. On this occasion, Aso asserted Japan's commitment to "minimize the impact" of the financial "tsunami" in order to see Japan emerge as "the first to get out of the recession, at least among industrialized nations." These new stimulus measures are on top of roughly ¥6.8 trillion ($73.4 billion) in spending announced this year already.[25]

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Is Asia Able and Willing?

Taking an optimistic stance, Asia has shown signs that it is capable of taking the reins in the development of a new global governance, and seems to have an interest in doing so. Ahead of the G-20 summit in Washington in November 2008, Aso dispatched two special envoys to India, Indonesia, and South Korea, partly to gauge their sentiments and partly to elucidate Japan's own position and policies with regard to the crisis. By and large, Japan has been consistent in framing its policy approach as a foundational framework of regional cooperation. This was explicit in Aso's opinion piece for the *Wall Street Journal*, in which he touted "regional cooperation in East Asia, for example, in the area of trade and finance" as "the foundation for a more stable international financial system in the future."[26] This Asian regional cooperation angle has factored prominently into the policy considerations of the Japanese leadership, as in many other East Asian capitals.

Meeting in December 2008 in Fukuoka, Japan, for their first ever full-fledged trilateral summit,[27] the leaders of China, Japan, and South Korea made arrangements for increased bilateral currency swap deals among their economies, calling also in their joint statement for a capital increase for the Asia Development Bank (ADB). In their joint communiqué, the three countries also called for "the setting up of the Tripartite Governors' Meeting of the Three Central Banks to be held on a regular basis," the first initiative of its kind.[28] Such a policy conduit stands in sharp contrast to ten years ago, when no such meeting existed as East Asia was hard hit by the financial crisis. Since then, these three pillars of the northeast Asian financial structure have started working together.

Unwittingly, one of the most dramatic outcomes of the 1997–98 Asian economic crisis was the birth of East Asian regionalism. This was an unexpected development for many in Asia, because the only other Asian regional initiative up until that point had been aborted by a United States plainly hostile to any hint of exclusive East Asian regionalism. Eventually, out of the rubble of the Asian economic crisis arose the ASEAN Plus Three (China, Japan, Republic of Korea) in an informal summit on the margins of the second ASEAN informal summit in Malaysia in December 1997. It was followed by the East Asia Summit (EAS) in Kuala Lumpur in December 2005. These pillars of a new formation in East Asia arose, notably, without the United States. The relationship between China and Japan is now in much better shape. Both feel greater interest and stake in the health and growth of the world economy, particularly the U.S.

economy. In this sense, Asia's earlier crisis served as a sort of tempering fire for the region, setting the stage for further bilateral cooperation and enhanced regionalism. Still, can Asia truly be expected to contribute meaningfully to the development of a new global governance? More importantly, is it actually in a position to assume a leading role in doing so?

Charles Kindleberger proposed many decades ago, in his analysis of the Great Depression, that the smooth operation of a liberal international economic order requires the existence of a hegemon or at the very least a multilateral institution capable of functioning in such a capacity. By Kindleberger's so-called Hegemonic Stability Theory, a sustainable international economy requires an international leader both *able* and *willing* to enforce the rules of the game and to act as a lender-of-last-resort.[29] The Great Depression, therefore, sprung from an ability-motivation gap in which the United States was able but not willing to provide the necessary common goods to maintain the economic order, while the United Kingdom was willing but not able to fill this role. Applied to today's dynamics, while Asia may be able to build a new global governance, it is perhaps not fully willing to assume the full weight of the mantle of responsibility at this stage. The United States, on the other hand, is certainly willing to mount the white horse and come galloping to the rescue, but the truth is that, given the current crisis, it is no longer able, nor will it be in a position to do so in the foreseeable future.

It can be argued that the phenomenon of Asian savings being poured into funding huge U.S. deficits since the 1990s has contributed to the global imbalance of savings and spending. According to Nancy Birsdall, founding president of the Center for Global Development, this state of affairs has perhaps played an indirect part in "U.S. regulatory failures [which] were induced by low interest rates that were in turn made possible by China's savings glut."[30] This is a charge to which China has shown particular sensitivity. At the 2008 Washington G-20 Summit, the Chinese delegation adamantly opposed the inclusion of the term "global imbalance" in the text of the communiqué on the grounds that this might create the impression that the reference was specifically aimed at China's accumulation of hard currency reserves.[31] They argued persistently that China is a victim of the U.S.-induced financial crisis.[32]

The ultimate tension revolves around the relationship between the U.S. dollar and the RMB. China is now the target of criticism for its policy of deliberately allowing for RMB depreciation. For the three days preceding the SED at the beginning of December 2008, Beijing maintained the yuan central parity rate at its lowest level since August, in what one economist with JP Morgan interpreted as being "mostly driven by the motivation to make a strong political statement" on the eve of U.S. Treasury Secretary Henry Paulson's visit.[33] Such behavior seems to diverge from the gradual RMB appreciation to

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which China has de facto oriented its policy since 2005. It also stands in strong contrast to China's stable RMB strategy during the Asian financial crisis ten years ago, when Beijing was widely praised for resisting the temptation to depreciate the RMB in the interests of the region as a whole, demonstrating responsible leadership at a critical moment.

These days, China and the United States appear almost to be locked in an interdependent dynamic, with neither daring to assume a threatening posture toward the other. Lawrence Summers, former treasury secretary and now director of the White House National Economic Council, recognized this phenomenon in the summer of 2004, writing in *Foreign Affairs* magazine of the troubling emergence of "a new version of mutually assured destruction."[34]

This is especially true in China's case. As an ominous manifestation of China's consciousness of its own power, the Chinese government threatened to upset the balance in response to U.S. demands for a revaluation of the RMB in August 2007. He Fan, an official at the Chinese Academy of Social Sciences, presented a clear ultimatum, making pointed reference to what has been described in the state media as China's "nuclear option" by stating that China would "be forced to sell dollars once the yuan appreciated dramatically."[35] If Beijing even implied that it might cash in its dollar holdings as a means of blackmailing for U.S. concessions, be they on currency, trade liberalization, protectionist, or strategic issues, this could initiate a chain reaction of massive worldwide unloading of dollars, triggering a dollar freefall effect that would devastate China's own financial standing just as much as it would the United States'.

Aside from this, several further hurdles bar the smooth path to a new global governance with Asia at the helm. It cannot be neglected that Asia is far from being one unified entity. In particular, China and Japan hold significantly divergent views on matters of global governance. Japan remains highly suspicious of China and its game plan, wary perhaps of a "Beijing Consensus" being imposed in the process, and seems to suspect China's new commitment to global governance may well be fuelled by a hidden agenda to promote the ascendancy of a G-2 (U.S.–China) alignment designed to downgrade and eventually disband the G-7 and G-8 that constitute Japan's major platform in this arena. On the other hand, China perhaps feels that Japan just reflects and represents the order of the G-7 vested interests of the Cold War era. It may even harbor a sense that Japan stands in the way of its growth into a truly global player in the financial and economic fields. One need not look further than the 2005 clash over UN Security Council reform to imagine how conflict could erupt.

There is a clear danger that the strains of the crisis are unleashing protectionist forces, particularly among China, Japan, and the United States. Already, China has reportedly started to dump its oversupplied steel products onto a number of markets—Japan's included—and on December 1, 2008, initiated a series of measures to raise export tariff rebates on over 3,700 items and adjust the export tariffs levied on other goods.[36] Similarly, India levied a new 20 percent duty on imports of some soybean oils just three days after the November 2008 G-20 summit, and Russia is raising tariffs on imported cars, poultry, and pork.[37]

For that matter, fears of a protectionist surge in U.S. policy have emerged across the globe with the election of Barack Obama to the presidency. While campaigning, Obama's platform warned he would use "all diplomatic means at his disposal to achieve change in China's manipulation of the value of its currency, a practice that contributes to massive global imbalances and provides Chinese companies with an unfair competitive advantage."[38] As C. Fred Bergsten, director of the Peterson Institute for International Economics, underlines, "Ironically, it was China and India, the largest and most successful developing countries, that triggered Doha's demise because they were unwilling to open their own markets sufficiently to permit an agreement."[39]

Ultimately, the prospect of Asia's contribution to establishing a new global governance depends on its ability to grow and develop, and to do so soon. In particular, it depends on the resiliency and vitality of the economies of China and Japan. There have, however, already emerged some signs of precariousness here. The RAND Corporation recently released a report forecasting that China's GDP growth will be around 7.5 percent in 2009, down from 9.4 percent in 2008, a figure which IMF Managing Director Dominique Strauss-Kahn has since revised even lower to "5 or 6 percent."[40] This falls far short of the 8 percent growth deemed necessary to absorb the millions flooding the workforce each year.[41] Combined with the country's widening income gap, it also threatens to intensify strains in the social fabric.[42] Japan, likewise, is by no means immune to the contagion. Fundamentally, Japan's economy has yet to recover fully from the aftershocks of the "Lost Decade" of the 1990s. Plunged, as of November 2008, into recession for the first time since 2001, Japan's economic outlook for 2009–10 is bleak, exacerbated by an acute demographic crisis and a prevailing sense of pessimism.[43] Japan is back for now, but still only as a ghost of its former potential.

Battle of the Models

Ten years on, the international community is seeing a similar resurgence of interest in pursuing regional architecture in Asia, though for quite different reasons. This time, the impetus has been forged from a deep disenchantment and distrust among East Asian countries in the U.S. market and in the economic model that it represents. An invigorated search for a new Asian model may have emerged in its wake. Though the U.S. economic model may have held validity for Asian governments after the Asian financial crisis, a decade later it is Asia's voice, and China's in particular, that seems to speak most validly to the present circumstances.

One should not underestimate the impact of the Wall Street meltdown and the subsequent collapse of the U.S. model on Asian economic development strategy in the coming years. The U.S. model has inspired the reform and open door development strategies in nearly every Asian country since World War II. Moreover, it has been inexorably intertwined with the U.S. role as a stabilizer in the Asia Pacific. The combination of economic and ideological soft power with strategic and military hard power has laid the foundation of the U.S. model. Now, the first wheel is off, which will inevitably continue to affect the way Asian countries perceive the U.S. way of life, its political system, and its democracy. This development is likely to be manifested in a weakening of reformist agendas and reformist politics across Asia.

Already in Japan, symptoms of "reform fatigue" have been growing. Perhaps the most marked example in recent memory is the dramatic flouncing of Koizumi's handpicked protégé, Yuriko Koike, in the September 2008 ruling Liberal Democratic Party (LDP) leadership election. The Wall Street meltdown has certainly dealt a great blow to the prospects of Koike and the other "Koizumi children" (perhaps now more accurately described as "Koizumi orphans" with the September 2008 announcement of Junichiro Koizumi's retirement from politics) for the simple reason that the Koizumi reform agenda has been closely associated with the Washington consensus model. At this time, there are no strong reformist groups emerging from either of Japan's major political parties, the LDP or the Democratic Party of Japan (DPJ).

A similar deceleration of economic reform is emerging in China as well, where Goldman Sachs' China chairman Fred Hu notes that the government is "extracting the wrong lesson from recent events" and some Chinese pundits "have gleefully declared the beginning of the decline of U.S.-led free market capitalism."[44] Though the global financial crisis certainly has not helped the cause, without a firm ideological basis, perhaps it is only natural that "the pendulum is swinging back toward ideological competition and big government" in China, particularly as growth slows and inequality continues to mount, fueling resentment and increasing internal unrest.[45]

Macroeconomic policy to *prevent* the collapse of financial markets is urgent on the agenda.

The U.S.-originated financial crisis has also created setbacks in India's reform agenda, where economic reform has already been halting, hesitant, and little helped by a public attitude that economist Pranab Bardhan has called "anti-reform populism."[46] Wharton professor Richard Herring observed this trend and explained that India can now "point to the U.S. in particular and say, 'Look, what a terrible mess they have made with their innovations and liberalized standards. Our direct controls have kept us out of this whirlwind of financial chaos.'"[47]

On the topic of models, a former U.S. official has quipped that the best solution may be achieved through a "yin-yang hybrid," combining the cautious Japanese banking model and the bold U.S. banking model.[48] In truth, it is alas not nearly so easy, and the international community must expect at least some clashing of the Asian and U.S. financial models as events unfold. Several crucial concepts can be explored and articulated as Asia searches for its own models. Among the critical issues confronting the global economy, including fighting poverty, strengthening human capacity building, and narrowing the widening income gap, perhaps one of the most urgent agendas will be the development of macroeconomic policy to *prevent* the collapse of financial markets, particularly when it comes to monetary policy and payment system management.

The debate over the "preventive" role of the central bank is actually a return to the debates within the IMF community during the 1997–98 Asian monetary crisis, when Japan argued for a "proactive and preventive" approach to government-supported financing.[49] Reflecting on the role of the IMF with respect to Vietnam's major 1998 downturn, outgoing IMF managing director Michel Camdessus conceded in June 1999 that a shift "from curative medicine to preventative medicine" was needed.[50] This lesson now demands concrete actions. As a matter of fact, the G-20 leaders agreed in their November 2008 joint statement that "we must lay the foundation for reform to help to ensure that a global crisis, such as this one, does not happen again."[51] The magnitude of destruction has become unbearably high for societies and individuals the world around, with the financial markets globally integrated and poised to ignite massive ripple effects. Without action, we risk unleashing a financial tsunami that would strike at a global level with lightning speed. The cost is simply too high.

Asia-Pacific Agenda Setting

What sort of agendas should be set for Asia-Pacific countries in the coming months? And, through what approaches and type of global governance framework might the deepening economic challenges best be tackled?

First, Asia aspires to have more of its own voices heard, heeded, and incorporated into global governance. With the rise of Asian economic might over the last decade, countries in Asia are becoming increasingly dissatisfied with their representation in such existing governance structures as Bretton Woods, the IMF, and the World Bank, a situation which they feel is neither fair nor reflective of the shifting global power balances. At the same time, perhaps most important at this time is the need for an emphasis on better processes rather than newly envisioned structures. It is best not to be too ambitious in striving for an entirely novel formulation of global governance at the outset, but rather to proceed in novel ways within existing frameworks.

There is no need to build a new Bretton Woods from scratch. Rather, the existing one must be rebooted. In this context, strengthening the foundation of the IMF, particularly the Financial Sector Assessment Program (FSAP), jointly introduced by the IMF and the World Bank in May 1999, is an urgent task. Though the United States has resisted it strongly, agreeing only on the condition that the investigation be completed after a new president is at the helm, it is time for the United States to do its part to participate fully and invigorate the efforts.[52] The G-20 platform can be gradually developed, while at the same time maintaining and strengthening the G-7 as a sort of caucus to the G-20 at the financial minister level for the purpose of macroeconomic policy coordination.

Second, there is the matter of the saving-investment balance. China now charges that the root cause of the current crisis stems from U.S. overconsumption and saving. But perhaps more important at this moment is for Asian countries to augment their own consumption and investments. In other words, Asia, particularly China and Japan, may be best advised to boost slumping domestic demand.[53] China and Japan, along with the United States, should likewise make best efforts to stem the rising tide of protectionist pressures within each country as far as possible.

The Chinese government should consider income tax cuts to further stimulate demand.[54] A shift from industry to the services sector, along with a greater focus on consumption rather than investment and exports, is also in order.[55] China would be well advised, moreover, to develop its own version of the Maekawa Report. The original Japanese version, submitted to the prime minister in 1986 following the Plaza Accord when currency realignment caused the yen to appreciate against the U.S. dollar by 70 percent in seven years,[56] significantly reducing the U.S.–Japan current account balance, stressed the necessity of implementing deregulation measures and of structural reforms aimed at a "transformation from export-led economic growth to domestic, demand-driven growth by expansion of domestic demand."[57]

For Japan, meanwhile, boosting its growth potential should depend on accelerating labor productivity growth, for which foreign competition is among the key elements, as the 2008 Organization for Economic Cooperation and Development (OECD) survey has emphasized: "It is thus important to remove barriers to inward foreign direct investment, as well as product market regulations that discourage foreign investors, in order to strengthen competition."[58] Japan's economic growth strategy should seek to rejuvenate its flagging investment and exports potential through pursuing its own brand of "open door" policy. Additionally, in light of the other major global crisis at this time, climate change, Japan should actively seek to exploit its aptitude in the field of environmental and green energy technology.

China, Japan, and the United States should take incremental steps toward the ultimate object of a form of trilateral consultation on macroeconomic policy, with a U.S.–China macro policy conduit as a particularly crucial element. Though some, in both Tokyo and Washington, are inclined to question the genuineness of China's intentions in entertaining this idea, the opening is now there and warrants earnest exploration, and not merely as a mechanism to exert pressure. In the medium term, the United States must aim to decrease excessive consumption and housing investment, and to increase net export, capital formation, and government spending, particularly on healthcare. For its part, China must decrease net export and capital formation, while increasing consumption, as well as government spending on healthcare and education. The idea of new U.S.–China and Japan–China initiatives to overcome structural impediments for generating growth and decreasing imbalances should be explored.

Third, as the three countries may now arguably have reached a stage ripe for direct trilateral cooperation on the political and security fronts, China may be in an equally more favorable position to attempt something similar in macroeconomic matters. One high-ranking Chinese officially indeed recently remarked to a Japanese counterpart that it was high time for their two countries to cooperate fully on macroeconomic policy to ward off depression. Still, some skepticism has been voiced in Washington and Tokyo alike. A high-ranking official from the Japanese Ministry of Finance observed, "China simply cannot take any peer pressure from other countries on their fiscal and monetary policy."[59] To succumb to such pressure would conflict with China's concept of sovereignty issues, with the principal of non-interference which it still retains, and with its traditional presentation as a representative of the less developed

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countries (LDC). Yet, exerting "peer pressure" for the common good is the essence of policy coordination.

The best strategy will thus be to ease into coordination through discrete bilateral platforms to be merged once conditions have seasoned sufficiently. Ultimately, trilateral cooperation will be most desirable, as Japan can ease and soften the U.S.–China MAD brand of a "balance of terror" in financial geopolitics. Even beyond the coordination of capital flow management, Japan has an important role to play in the environmental realm. Given the high wasteful energy habits prevailing in the Chinese and U.S. economies and infrastructures, Japan's prowess in the development of low-carbon and energy-saving technologies will make a strengthened trilateral approach most effective in the ongoing battle to curb the global climate change crisis as well.[60]

Fourth, there is a pressing need for currency realignment. The RMB must appreciate vis-à-vis the dollar significantly in order to correct the global imbalance in the coming years. As Fred Bergsten argued back in 2006 in testimony before the U.S. Senate Committee on Finance, "In the short run, an increase of 20 to 40 percent in the value of the renminbi (and parallel appreciations of other key Asian currencies) is an essential component of an orderly correction of the global imbalances."[61] This still holds true today.

In the lead-up to the current financial crisis, there have been calls for a new Plaza Accord, or Plaza II, along the lines of the September 1985 agreement by which the major powers agreed to joint action to lower the value of the U.S. dollar against the Japanese yen and the German deutsche mark. Within two years of the accord, the dollar had dropped by 30 percent, and by 1991 the U.S. current account was roughly in balance, although the situation today is "far more complex."[62] Certainly, a comparable arrangement between China and the United States is a possibility, but only if preceded by deepening policy discussions and stronger political will from both sides. Though discreet negotiations may still be fruitfully coordinated between the two countries to realign the dollar against the RMB in an orderly manner, U.S.–China policy consultations should be confined for the time being to behind-the-scenes maneuverings, or risk instigating a dollar freefall which would not be in anyone's best interest.

Fifth, in broad terms, clashes of models should be avoided in favor of fruitful coalescence. The coming years will likely witness an emerging diversification of global capitalist systems among the major global players, and China and the United States should be open to new ideas for growth and innovation from all corners. At the same time, challenging as this may prove, it will be imperative to define principles of common rule to govern world financial markets. Perhaps the greatest and most important trial will be to prevent the eruption of a similar crisis down the line. In the spirit of a shift from "curative to preventive medicine," the preventive role of the central bank should be further expanded and harnessed. Given their own pertinent experiences, "intellectual leadership" from Asian countries, as elsewhere, should be welcomed as the U.S. central bank continues to ponder the best course of action going forward. There is no reason for the United States to fall into the same traps that ensnared Asia in the 1990s.

Finally, as Asian regionalism continues to deepen and a distinct architecture is erected, it is crucial that the United States remain part and pillar of the process. To this end, the Asia-Pacific Economic Cooperation (APEC) should once again be urgently reinvigorated and restored to its original format: a forum designed simply to promote trade and investment, while facilitating development and cooperation. In addition to these two primary objectives, structural reform and sustainability should perhaps now also be incorporated into the APEC agenda. The fight against terrorism and matters of security can be left to other designated bodies such as the East Asia Summit (EAS). Thinking further, the EAS might prove the best conduit for U.S. involvement in East Asian regional integration, and U.S. membership should be actively sought by the incoming U.S. administration and encouraged by the current members.[63] After all, its relative decline notwithstanding, the United States is, and will continue to be for the foreseeable future, the world's dominant superpower and a critical economic and security player in the region.

Trilateral Cooperation: A Crucial Development

No longer can the international community point to one clear-cut model or single *modus vivendi* to guide the world markets, and the task of establishing a set of common rules becomes all the more challenging and crucial. The current crisis demands greater procedural vision rather than an entirely new structural vision. Both the G-7 and the G-20 must be simultaneously strengthened, making certain to fully integrate the emerging markets and provide for the expression of these voices. Finally, as the eastward shift of power is accentuated and accelerated, a robust Asia-Pacific strategy, with a new U.S.–China–Japan trilateral cooperation as its primary foundation, will be critical.

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