

“Treasury Secretary Effect” in Yen/Yuan-Dollar Exchange Rate Policy?

A Comparative Case Study in the Relations between U.S. Monetary Power and Japan’s/China’s Currency Exchange Rate Policy

Minqi Chai

Department of International Politics

Fudan University

minqichai@gmail.com

ABSTRACT

In the theory of monetary power, the U.S., as the hegemon, exerts its monetary power in times of its deficit, to divert adjustment costs by intervention in the currency exchange rate policy of the largest creditor. Active lobbying through the U.S. Treasury Secretary’s visits is a noteworthy method of diplomatic coercion to force the revaluation of other state’s currency. Based on the case of yen-dollar (1983-1990) and yuan-dollar (2005-2008) exchange rate policy, this paper examines the application and effect of monetary power from the perspective of Treasury-Secretary-level visits. Building up a three-level model of power asymmetry, state objectives, and the agenda priority, this paper explains why Japan and China acted disparately to pressures from U.S. Treasury meetings and further suggests how China embraces international institutions in a broad manner.

Key Words: Monetary power, “Treasury Secretary effect”, Exchange rate policy

Paper prepared for presentation at the the 56th annual American Association for Chinese Studies conference, Washington DC, USA, October 11, 2014.

I. INTRODUCTION

Japan in the 1980s and contemporary China are generally regarded as a rising economic power threatening the role of the hegemon, which basically follow similar patterns of behaviors. According to the neorealist hegemony theory, as a result, the United States should employ all its resources to contain the expansion of China in all realms. This is especially true in the global financial system, where the United States employs its monetary power to manipulate international institutions and rules to force beneficial adjustments. In reality, the U.S. has urged RMB's free float for years with the complex of diplomatic methods, just as it intervened in Japan's currency exchange rate regime in the 1980s.

Admittedly, Japan's rise and fall in the last decades mirror the opportunities and challenges China is facing today. However, this paper addresses certain differences between China and Japan to understand their different reactions towards different tools of the U.S. monetary power in the currency exchange rate policy issue from a diplomatic perspective. Much has been discussed about joint and independent intervention in global exchange rate system with a complex of coordination and coercion. However, diplomacy in the currency exchange rate field and the function of Treasury Secretary bilateral and multilateral talks in the bargaining are more or less underplayed.

This paper closely examines the period when the United States exerted its monetary power in times of its deficit, by the form of high-level economic talks, to push the appreciation of RMB soon after the Asian financial crisis. Similar case is in the 1980s when Japan, as the largest creditor, was forced to attune its exchange rate policy to the U.S. expectation, with the legacy of the Plaza Accord and the Louvre Accord. A close look at these two cases may enable us to figure out how political means can be transferred to monetary power and under which conditions these means of intervention would function. Analyzing the mechanism of U.S. intervention in China's and Japan's exchange rate policy adjustment can enable us to explore the interaction between the declining hegemon and rising states in the financial realm.

In particular, this paper tries to examine "Treasury Secretary effect," for Treasury-Secretary-level bargaining is one of the main weapons targeting the exchange

rate issue. Using daily exchange rate data from the FRED and meeting data from Factiva, this paper applies a linear time-series approach to examine how bilateral and multilateral Treasury-Secretary-level talks were correlated with China's currency exchange rate policy (2005-2008) and that in Japan's case (1983-1990). It turns out that China and Japan reacted entirely different to Treasury Secretary visits. In Japan's case, yen-dollar exchange rate was adjusted positively towards pressures from multilateral financial talks, which indeed reflects the overwhelming U.S. monetary power in terms of the power to deflect its adjustment costs. However, China acted negatively to bilateral Treasury talks according to the indicator of its currency exchange rate, which indicates a disparate pattern of China and Japan in reaction. To explain the divergent effect of U.S. intervention in specific cases, this paper also involves analysis of certain diplomatic patterns of China and Japan on the dimensions of power asymmetry, state objectives, and agenda priority.

The structure of the paper is: overview, data analysis and explanations. The first part introduces the explanatory theory to measure "Treasury Secretary effect" from both international and domestic level, including the theory of monetary power and a three-level model to predict the efficacy of Treasury visits under different circumstances. Then it gives an overview of the intervention in Japan's and China's currency exchange rate regime. The second part applies a linear regression model based on daily data to measure the influence of Treasury visits in China (2005-2008) and Japan (1983-1990). The third part further delves into the application and efficacy of monetary power in terms of "Treasury effect," and offers some insights of China's embracement of international institutions.

II. OVERVIEW

2.1 The theory of monetary power

The theory of monetary power¹ is the core theory of this paper, which is the source of the U.S. diplomatic influence in Japan's and China's exchange rate policy. Monetary

¹ In the field of international political economy, the concept of monetary/financial power was first elaborated by Charles Kindleberger and Susan Strange, illustrating the period between the First World War and the Cold War. Later

power is generally regarded as a relational property; it is manifest when one state's behavior changes because of its monetary relationship with another state. Note that though the monetary power is not the sole force to coerce another state to shift its monetary policy, it still counts as the state would act differently without the external monetary power over it (Andrews, 2006).

One of the common indirect means of monetary power to alter the third state's policy is issue linkage. As Jonathan Kirshner puts, "as long as there are states and money, states will attempt to manipulate monetary relations to advance their political objectives" (Kirshner, 2005). At the macro level, monetary power indicates the capacity to avoid payments adjustment costs, either by delaying adjustment or by deflecting the burden of adjustment¹ onto others. Here, adjustment means the elimination of unsustainable² current account imbalance. To delay is to attract foreign capitals, and to deflect is to convince surplus states to revalue their currency. In reality, the United States, relative standing in the Currency Pyramid with dollar as the "Top Currency" (Strange, 1971), depends on the relative capacity to avoid the burden of payments adjustment, making others pay instead (Cohen, 2005).

2.2 Three-level model: patterns of states' reaction to pressures from the hegemon on a certain issue

Despite a well-organized theoretical framework, research on monetary power has not yet paid attention to specific diplomatic means in employing monetary power in currency exchange rate. On the other hand, the theory of monetary power is hardly applied in particular currency exchange rate research. Therefore, this paper explores the role of Treasury Secretary lobbying in Japan's and China's currency exchange rate policy, and suggests how differently monetary power functions in Japan and China.

on, David Andrews and Benjamin Cohen delved into the source and characteristic of the monetary power from a social power approach in the contemporary world.

¹ David Andrews, Randall Henning, Jonathan Kirshner, Michael Webb and Susan Strange all mentioned the adjustment cost/ the burden of adjustment in their work.

² "Not all imbalances need to be eliminated, of course. Standard economic theory teaches that many current-account imbalances are simply the result of what may be regarded as a kind of rational intertemporal trade - deficit countries borrowing resources from the rest of the world for productive investment at home; surplus countries investing savings abroad today to support greater domestic consumption tomorrow. Such imbalances, in principle, are sustainable indefinitely and require no adjustment at all." (Cohen, 2005)

In determining the hegemon's influence on other states' decision-making in a certain policy, say, the currency exchange rate regime, we build up a model from three levels to compare such cases from a domestic level.

The first level is power asymmetry, measuring the power relations between the hegemon and another state. The symmetry of their political, military and economic power should be addressed, and moreover, their alliance relations and interdependence shall also be taken into account. The second level is state objectives, which denote the goal of the state in a certain time period. To put simply, what state's image the administration is striving to shape before the audience at home and abroad. The third level is the agenda priority based on the certain issue of the bargaining, accompanying the top agenda during the period.

Generally, relatively power asymmetry with the hegemon, state objective to take international responsibility, and low priority of the agenda, lead to susceptibility to foreign pressures, whereas a deterring power with more independent foreign policy and more focus on domestic concerns would more likely to be intractable. Together with the theory of monetary power, we can use this model to further discuss the intervention in currency exchange rate in Japan's and China's cases.

2.3 Intervention in the yen-dollar/yuan-dollar exchange rate policy

Since 1980s, massive interventions were launched in Japan's currency exchange rate, and behind the joint interventions were the U.S. Treasury, MOF (Japanese Ministry of Finance) and G5. The signature of the Plaza Accord (1985) and the Louvre Accord (1987) is an inescapable sensation in this period. Historic facts and empirical studies indicate that coordination and coercion were both on the international and domestic level in the process of negotiations (Frankel, 1984; Funabashi, 1989).

Besides, many scholars focus on the joint intervention of the Federal Reserve and Japanese Central Bank/Ministry of Finance (Dominguez, 1998; Ito, 2002; Kim & Le, 2010; Reitz & Taylor, 2012), based on a daily data of Bank of Japan intervention from 1991 to 2004. These researches demonstrate that joint intervention operation, especially secret interventions (not reported by the media), generally increased exchange rate volatility.

As an emerging economic power in the new millennium, China seems in the same milieu just as Japan. Starting from 2005, China launched a new exchange regime floated with a basket of currencies. A series of U.S. mainstream studies have highlighted the undervalued yuan and pointed out its threat to Chinese, American and even global financial systems (Goldstein, 2003; Goldstein & Lardy, 2006; Goldstein & Lardy, 2008). Conversely, warnings turn up that RMB's free float as a result of U.S. pressures could only lead China to follow Japan's tragedy, and thus a more moderate exchange rate policy reform is favorable (McKinnon, 2006; R. I. McKinnon, 2005).

Literature on intervention in the yen-dollar and yuan-dollar rate mainly focuses on three categories: a) pros and cons for China or Japan to float its currency; b) first-hand facts and empirical analysis; c) central-bank intervention.

The role of U.S. lobbying is vague in these studies, though Frankel & Wei has taken note of the negative effect of U.S. public complaints on China's decision-making in the currency exchange rate. According to their study, there is no evidence of an association between the complaints from US officials and appreciation of the RMB relative to the currency basket, and cumulative complaints from other U.S. officials are associated with a reduction in the RMB basket's weight on the US dollar (Frankel & Wei, 2007).

Instead, this paper delves into the effect of Treasury visits in the currency exchange rate regime of Japan/China, which tests how the rising economic powers react to the hegemon's means of political coercion and analyzes the pattern of China's decision-making from a diplomatic perspective in comparison to Japan.

2.4 From "Paulson effect" to "Treasury Secretary effect"

To analyze "Treasury Secretary effect", one should step forward and get the knowledge of "Paulson effect" first. This term was coined by Chinese mainstream media during the former Treasury Secretary Henry Paulson's term (2006-2009)¹, referring to a

¹ For key word "Paulson effect (保尔森效应)," there are 72 results of news pieces ranging from 2007 to 2010 from Chinese largest searching engine Baidu. Xinhua News Agency, People.com.cn, and Sina Finance all have coverage of the "Paulson effect."

phenomenon that the U.S. dollar-RMB exchange rate dropped down dramatically every time¹ Henry Paulson paid visits to China during his term as Treasury Secretary.

Although this is only a seemingly transient phenomenon, it raises a worthy question whether the influence of Treasury officials hold significance in the U.S. bargaining with other states in terms of exchange rate policy. This paper tries to extend the “Paulson effect” into the “Treasury Secretary effect” as a main weapon targeting the exchange rate issue. Since the breakdown of the Bretton Woods pegged-rate system in 1971, the evaluation of dollar has become a central concern of the Treasury. The last forty years have witnessed a U.S. boom and bust cycle that in times of large deficit, the U.S. would exert its monetary power to force the creditor state to bear the adjustment cost by ways of currency revaluation. Periodically, the U.S. pressured large surplus states, including Germany, Japan, and China, to bear the costs of adjustment by accepting revalued currencies and a more expansive macroeconomic policy mix (Oatley, 2013). The two cases of China (2005-2008) and Japan (1983-1990) are empirical proofs, illustrating the U.S. monetary power to divert the burden by forcing the revaluation of Yen and RMB.

To closely examine this phenomenon, we should first pinpoint the time period of U.S. bust and its coercion on Japan and China. By annual data (1974-2010) of the U.S. current account balance², bilateral trade balance³ (U.S.-China and U.S.-Japan) and the number of congressional bills related to Chinese/Japanese economic issues⁴, it could be found that data follows the same trend.

Figure 1 about here

In Figure 1, annual data starts from 1974, the year after the termination of the Bretton Woods system. Since the U.S. current account balance and the U.S.-Japan trade balance have been negative since then, figure 1 uses absolute value of the balance data.

¹ Actually, as reported, “Paulson effect” only held true for the first three visits: 09/2006, 12/2006 and 03/2007. Since Paulson’s fourth visit to China, “Paulson effect” did not seem to occur in spite of market expectations.

² Source: Organization for Economic Cooperation and Development. Key word: Current Account Balance: Total Trade of Goods for the United States. Series ID: BPBLTD01USA637S.

³ Source: IMF-Direction of Trade Statistics (DOTS). Key word: Country: United States. Concept: Goods, Value of Exports Partner. Country: Japan/China, P.R.: Mainland.

⁴ Source: THOMAS (Library of Congress). Key word: China/Japan and filter the results of bills independent of economic friction.

The U.S.-Japan trade imbalance grows significantly in the 1980s, coexisted with the large U.S. current account deficit and the concentration of the U.S. congressional legislation relating to Japanese trade and financial issues. At the same time, James Baker, Treasury Secretary in the Reagan Administration, led the campaign to reduce the U.S. trade imbalance through Japanese exchange rate adjustment.

Figure 2 about here

Since the U.S.-China trade balance has been negative since 1983, Figure 2 examines data since then. Notably, Congress pressures on China since 2003 with a rising growth rate of the bilateral trade imbalance and U.S. deficit. Meanwhile, Treasury Secretary John Snow has hammered that China should reform on its pegged exchange regime since 2003, and the Congress urged the Treasury to list China as a currency manipulator in Treasury's biannual report.

From these two tables, one could roughly choose 1980s as the time period of Japan's case and 2000s as the time period of China's case. Generally, it fits into the economic cycle of the gloomy 1980s, the roaring 1990s and the stagnant 2000s. Since the U.S. economy burgeoned in the 1990s together with considerable decrease in U.S. – Japan trade deficit. Besides, this time period is chosen also because much has been discussed about the intervention in the yen-dollar exchange rates in the post-1990 period whose intervention data was published by the Bank of Japan. As for China, since RMB was pegged until 2005 and the global financial shock broke out in 2008, a time period from 2005 to 2008 is reasonable.

John W. Snow's (2003-2006) and Henry Paulson's (2006-2009) terms cover the whole time period for China, while Donald T. Regan (1981-1985), James A. Baker (1985-1988) and Nicholas F. Brady (1988-1993) are included in Japan's case. To note, Under Secretary of the Treasury for International Affairs is a specific position taking charge of the coercion of yen/yuan currency exchange rate adjustment. This is especially true in Japan's case, since David Mulford (1984-1992) frequently visited Japan and led the negotiations in the Plaza Accord and the Louvre Accord. In this way, their bilateral negotiations with Japan/China should also be taken into account in later analysis.

III. EXAMINE THE “TREASURY SECRETARY EFFECT”

3.1 Data & Variables

Generally, this paper explores the correlation between the fluctuation of currency exchange rate and Treasury-Secretary-level visits. As mentioned before, range of data should be confined within 1983 to 1990 for Japan, and 2005 to 2008 for China.

Data of Yen-dollar and yuan-dollar exchange rate¹ is available on a daily basis. To compare the two cases of Yen and RMB, daily rate of change is calculated as the dependent variable. For independent variables, this paper differentiates bilateral Treasury meetings (Bitreasury) and multilateral Treasury-Secretary-level meetings (Multitreasury). Using names of U.S. Treasury Secretaries and Under Secretary of the Treasury for International Affairs as keywords in Factiva news database, a chronology of Treasury meetings is made. U.S. federal funds², a reliable indicator of the dollar price, are introduced as a controlling variable in case that the fluctuation of the exchange rate was due to dollars.

To clarify, bilateral meetings here refer to meetings between U.S. Treasury Secretary/Under Secretary of the Treasury for International Affairs and Japanese/Chinese officials in the time period of 1983-1990 for Japan and 2005-2008 for China. Multilateral here denotes the meetings whose attendees involve U.S. Treasury Secretary/ Under Secretary of the Treasury for International Affairs as well as Japanese/Chinese finance minister, such as International Monetary Fund/World Bank annual meetings and G5/G7 meetings of Financial Ministers.

Those dates with related meetings are coded as “1”, while the rest are marked as “0”. Considering expectations (Somanath, 1984) of the domestic market and the hysteretic nature of governmental policy, a further processing of data is to code as “1” the dates which are five days before or after the meetings. Table 1 indicates the number of days marked as “1” of two independent variables (Bitreasury and Multitreasury) and the overall sample size.

¹ Source: FRED Reserve Economic Data. Keywords: Japan / U.S. Foreign Exchange Rate (Daily); China / U.S. Foreign Exchange Rate (Daily).

² Source: FRED Reserve Economic Data. Keywords: Effective Federal Funds Rate (Daily).

Table 1 about here

3.2 Result and analysis

Adopting a time-series regression to evaluate the influence of Treasury Secretary's visits on yen/yuan-dollar exchange rate, we will first examine independent variables of Bitreasury and Multitreasury respectively with the controlling variable Federal funds, and then examine them together.

Table 2 and 3 about here

As is shown in Table 2, it is evident from a large coefficient that Japan was susceptible facing coercion from multilateral talks, while the correlation between bilateral talks and change of rate is not remarkable. To the contrary, Table 3 illustrates that the variable of bilateral Treasury meetings is negatively correlated with changing rate of the yuan-dollar exchange rate, while the association between multilateral coercion and yuan-dollar rate is not noticeable.

To further analyze the counterproductive effect of bilateral Treasury-Secretary-level meetings in China's case, we classify bilateral meetings into three categories: Secretary (Treasury Secretary's visits to China), Under Secretary (visits of Under Secretary of the Treasury for International Affairs to China), and U.S. meetings (Treasure Secretary's/Under Secretary's meetings with Chinese officials in the U.S.).

Table 4 about here

In particular, bilateral meetings of U.S. Treasury Secretary and Under Secretary with Chinese officials had a conspicuously negative effect, whereas bilateral meetings in the U.S. are negligibly positive to the revaluation of yuan.

Overall, Table 2, Table 3 and Table 4 indicate that "Treasury Secretary effect" worked in Japan on multilateral occasions, but China was surprisingly loath to appreciate yuan when U.S. Treasury Secretary and Under Secretary paid visits. To explain the discrepancy between Japan's concession and China's resistance, to explain why Treasury lobbying as a method of exerting U.S. monetary power succeeded in Japan but failed in China, we shall turn to a domestic level and explore the pattern of Japanese/Chinese decision-making.

IV DIFFERENCE IN U.S. MONETARY POWER EFFICACY

4.1 The U.S. monetary power: insufficient explanation

U.S., as a deficit hegemon, tends to shift the burden of adjustment cost to other states, usually the biggest creditor at that time. The measurement of power to deflect is the degree of openness, the degree of adaptability of each individual economy as well as the policy-contingent motivation of the deficit country (Cohen, 2005). The central position in the global financial system guarantees the U.S. dominance and absolute influence on other currencies. Indeed, the monetary power derives from the interaction between country-level attributes and the network structure of the international financial system (Oatley, 2013). Although the dollar's effective equilibrium exchange rate seems only weakly affected by the renminbi's misalignment, which suggests that a revaluation of the renminbi would have only a small effect on the US trade deficit (Coudert & Couharde, 2007; R. McKinnon, 2005), the U.S. demonstrated strong policy-contingency to invoke a hard-line policy to China and Japan in the trade realm.

The theory of U.S. monetary power has a strong explanatory power on the existence of the "Treasury Secretary effect" in Japan's case. However, it may not be sufficient enough to explain why Japan tended to bow over multilateral pressures rather than bilateral Treasury lobbying. Besides, this theory fails to solve the puzzle of why China's reaction to bilateral Treasury talks in the U.S. belies the notion of "Paulson effect".

4.2 Three dimensions to understand the difference

The core of why "Treasury Secretary effect" differs in Japan and China resides in the different patterns of China's and Japan's diplomacy. With the three-level model: power asymmetry, state objectives, and agenda priority, we might have a clear picture of why Japan and China would behave so disparately.

Table 5 about here

Primarily, the asymmetry in U.S. – Japan relations left Japan between the cracks because a super power overwhelmingly guided the foreign policy of its allies in the cold war time. Although Japan experienced unprecedented economic booms in 1970s and early 1980s, it was still a political and military dwarf in the international arena, not to

mention that the Yoshida Doctrine was still the preponderant ideology in Japanese politics (Iokibe, 2013). To the contrary, this is almost impossible in China's case, since U.S. - China relationship is relatively independent and China has long adopted the nonalignment policy to maintain flexibility in its decision-making process.

It is evident that the U.S. directly or indirectly pressured Japan to swallow the Plaza Accord and the Louvre Accord. U.S. monetary power is embodied in its network structure of the international financial system, and therefore, the state with asymmetric interdependent relation with the U.S. could hardly revolt the whole system. This holds true especially in G5 meetings when Japanese officials felt that the other four members reached agreement first and their job was only to sign the agreement (Frankel, 1984; Funabashi, 1989).

The intriguing part is that despite the marginalization of financial disputes in the alliance, Japan indeed regarded the Plaza Accord and the Louvre Accord as a golden opportunity to demonstrate its status of a responsible political giant by contributions to the stabilization of dollar and world financial system. The Nakasone administration (1982-1987), guiding the fate of Japan in the glory 1980s, announced to build Japan into an international state and great political power. This further suggests why the yen-dollar exchange rate was inclined to revaluation facing G5 coercion rather than bilateral pressures.

As a hawk, Nakasone coordinated with Kohl in Germany and Margaret Thatcher in the United Kingdom to defend against the Soviet military threats. In the cold war days, security was the first priority, and U.S.-Japan conflicts over yen-dollar exchange rates were therefore outweighed. In 1983, Nakasone claimed Japan as the "unsinkable aircraft carrier in the Pacific", assisting the US in defending against the threat of Soviet bombers. Japan yielded in G5 meetings not merely because of the fear of G5 coercion led by the U.S., but because this issue had to give way to security strategy in the big picture of the cold war.

In comparison, China's state objective mainly focused on economic development and aimed to establish itself as an economic power in the 2000s. In the Third Plenary Session of the 11th Central Committee of the Communist Party of China (CPC) in 1978,

China raised the slogan of “central task of economic construction,” shifting its efforts from the cold war confrontation, border security and international recognition of New China to all-round development of economy. Whether from state objective, or from the agenda priority, decision-making in the exchange rate issue should be of prudent consideration in China.

China has long adopted the independent foreign policy of peace, with “independent” and “peace” as the two keywords. China generally resists U.S. or any other foreign state to poke its nose in Chinese domestic affairs. Because of its national identity of “never forget national humiliation” (Z. Wang, 2012), China’s diplomacy has more or less been like “Face Diplomacy” (Moore, 2014) and may overreact to negative comments and pressures, for the government avoids the image of being humiliated just like 100 years before by refusing to yield in the spotlight. Therefore, internationalization of yuan-dollar exchange rate issue is unfavorable for the Chinese government, and it is understandable why bilateral Treasury talks would trigger such a negative effect in practice.

4.3 Remaning puzzle: When does China concede?

Still, there remains a paradox why “Paulson effect” magically worked for three times in a row, but “Treasury Secretary effect” did not exist in the long run, and even backfired.

The Chinese authorities recognize the necessity to regain monetary independence (T. Wang, 2004). However, a correct sequencing of reforms is essential to allow greater exchange rate flexibility, so a gradual liberalization of capital account movements is required (Cappiello & Ferrucci, 2008; Prasad & Wei, 2007). The U.S. official complaints to China initiated from 2003 in the term of former Treasury Secretary John W. Snow, featuring criticism and accusations. When his successor Paulson took office, Paulson turned up as a China hand and strengthened mutual gains in promoting a gradual transformation of the RMB exchange rate regime, which won the favor of the Chinese government and contributed to the revaluation of yuan by tacit agreement. However, when he became increasingly harsh on Chinese reforms, without doubt, PBOC would strike back.

In embracing the international rules and institutions, China has long preserved the tradition of utilizing international pressures as leverage in coordination of domestic factions. In the SOE budget reform in the 2000s, Chinese central government established its resolution and determination in eliminating the soft budget constraint by entering the WTO and readily accepting WTO rules (Ye, 2011). Another case in point is China's Health system reform (2005- Present) soon after the breakout of the SARS (Severe Acute Respiratory Syndromes) in 2003. In fact, WTO tried to sell this idea to China from the 1990s, but its policy promotion was downplayed until the outbreak of SARS (Tang, 2010). In general, only when international incidents or pressures prepare for the priority, focus and endorsements of a certain agenda will China take advantage of the opportunity to conduct reforms.

V. CONCLUSION

Treasury-Secretary-level meetings serve as a specific embodiment of U.S. monetary power to divert the adjustment cost to a large creditor state in times of large deficit. The case of "Treasury Secretary effect" not only reflects the significance of diplomatic and political concerns in the global financial system, but demonstrates that the same way of diplomatic coercion may not work well universally. To better exert its monetary power, the hegemon should study the pattern of other states' political decision-making respectively.

Japan (1983-1990) and China (2005-2008) are two cases in point to examine the correlation between Treasury-Secretary-level visits and currency exchange rate, with the theory of monetary power as the fundamental theoretical framework. However, it turns out that Japan was more likely to bend over pressures from multilateral meetings of Treasury Secretaries (such as G5 meetings), while "Treasury Secretary effect" was surprisingly negative in China's case, belying the magic "Paulson effect" in former Treasury Secretary Paulson's first three visits to China.

To solve this puzzle, we establish a three-level model to compare Japan and China from: power asymmetry in bilateral relations with the U.S; current state objective; and agenda priority of the currency exchange rate issue/trade concerns.

Obviously, Japan could hardly be independent from the U.S. power in the political and military realm. Moreover, deepening of its asymmetric interdependence with the U.S. in the global financial and economic system disabled Japan to disregard international pressures. This is especially true on multilateral occasions, where Japan felt so isolated since European big powers stood closely with the U.S. On the other hand, this financial dispute could also be viewed from the perspective of agenda priority and state position of Japan. Japan downplayed its potential economic loss to avoid uncontrollable frictions with the U.S. for the very priority of security concerns in the cold war background. In some sense, Japan even partly viewed the Plaza Accord as an opportunity to pursue the status of big economic power in accordance with its strategy of the international state.

Compared to Japan, China sat in a relatively equal position with the U.S. in terms of political and military power. Marginalized in the global financial system, China could remain independent in its decision-making and distance itself from foreign intervention in its monetary policy. With economic construction as the first priority, it is reasonable China acted prudently in floating yuan. Furthermore, the independent foreign policy of peace, together with a pattern of “Face Diplomacy”, contributed to China’s intractable reaction, (or even retaliation) when confronted with coercion.

In absorbing international institutions, what China will embrace is win-win negotiations, not one-sided censure, which could only exasperate Chinese and exacerbate the situation. Indeed, Chinese government artfully balances between promotions from international society and resistance from domestic factions, and eventually implements reforms when the prerequisite of priority, attention, and endorsement of the agenda is met.

ACKNOWLEDGEMENTS:

I would like to thank Professor Thomas Oatley from University of North Carolina at Chapel Hill for his enlightening guidance and Tang Junchao from Fudan University for his great help and advice.

REFERENCE

- Andrews, D. M. (2006). *International monetary power*: Cornell University Press.
- Cappiello, L., & Ferrucci, G. (2008). The sustainability of China's exchange rate policy and capital account liberalisation. *ECB Occasional paper*(82).
- Cohen, B. J. (2005). The macrofoundation of monetary power. *Orfalea Center for Global & International Studies*.
- Coudert, V., & Couharde, C. (2007). Real equilibrium exchange rate in China is the renminbi undervalued? *Journal of Asian Economics*, 18(4), 568-594.
- Dominguez, K. M. (1998). Central bank intervention and exchange rate volatility. *Journal of International Money and Finance*, 17(1), 161-190.
- Frankel, J. A. (1984). *The yen/dollar agreement: Liberalizing Japanese capital markets*: Institute for International Economics Washington, DC.
- Frankel, J. A., & Wei, S. J. (2007). Assessing China's exchange rate regime. *Economic Policy*, 22(51), 575-627.
- Funabashi, Y. (1989). *Managing the Dollar: from the Plaza to the Louvre*: Institute for international economics Washington, DC.
- Goldstein, M. (2003). China's exchange rate regime. *Testimony before the subcommittee on Domestic and International Monetary Policy, Trade, and Technology Committee on financial services. US House of Representatives*.
- Goldstein, M., & Lardy, N. (2006). China's exchange rate policy dilemma. *The American economic review*, 422-426.
- Goldstein, M., & Lardy, N. R. (2008). *Debating China's exchange rate policy*: Peterson Institute.
- Iokibe, M. (2013). *The diplomatic history of postwar Japan*: Routledge.
- Ito, T. (2002). Is foreign exchange intervention effective?: the Japanese experiences in the 1990s: National Bureau of Economic Research.
- Kim, S.-J., & Le, A. T. (2010). Secrecy of Bank of Japan's yen intervention: Evidence of efficacy from intra-daily data. *Journal of the Japanese and International Economies*, 24(3), 369-394.
- Kirshner, J. (2005). Currency and coercion in the twenty-first century.
- McKinnon, R. (2005). Exchange rate or wage changes in international adjustment? *International Economics and Economic Policy*, 2(2), 261-274.

- McKinnon, R. (2006). China's exchange rate trap: Japan redux? *The American economic review*, 427-431.
- McKinnon, R. I. (2005). China's New Exchange Rate Policy: Will China Follow Japan into a Liquidity Trap? *The Singapore economic review*, 50(spec01), 463-474.
- Moore, G. J. (2014). "In Your Face": Domestic Politics, Nationalism, and "Face" in the Sino-Japanese Islands Dispute. *Asian Perspective*, 38(2), 219-240.
- Oatley, T. (2013). The Macro-dynamics of American financial power.
- Prasad, E., & Wei, S.-J. (2007). The Chinese approach to capital inflows: patterns and possible explanations *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices and Consequences* (pp. 421-480): University of Chicago Press.
- Reitz, S., & Taylor, M. P. (2012). FX intervention in the Yen-US dollar market: a coordination channel perspective. *International Economics and Economic Policy*, 9(2), 111-128.
- Somanath, V. (1984). Exchange Rate Expectations and the Current Exchange Rate: A Test of the Monetarist Approach. *Journal of International Business Studies*, 131-140.
- Strange, S. (1971). The politics of international currencies.
- Wang, T. (2004). *China: Sources of real exchange rate fluctuations* (Vol. 4): International Monetary Fund.
- Wang, Z. (2012). *Never forget national humiliation: Historical memory in Chinese politics and foreign relations*: Columbia University Press.
- Ye, T. (2011). International Institutions, Soft Budget Constraint and Credible Commitments—China's Accession to WTO and the Political Logic of the Reform of State-owned Enterprises. *Teaching and Research*, 11, 003.

APPENDIX

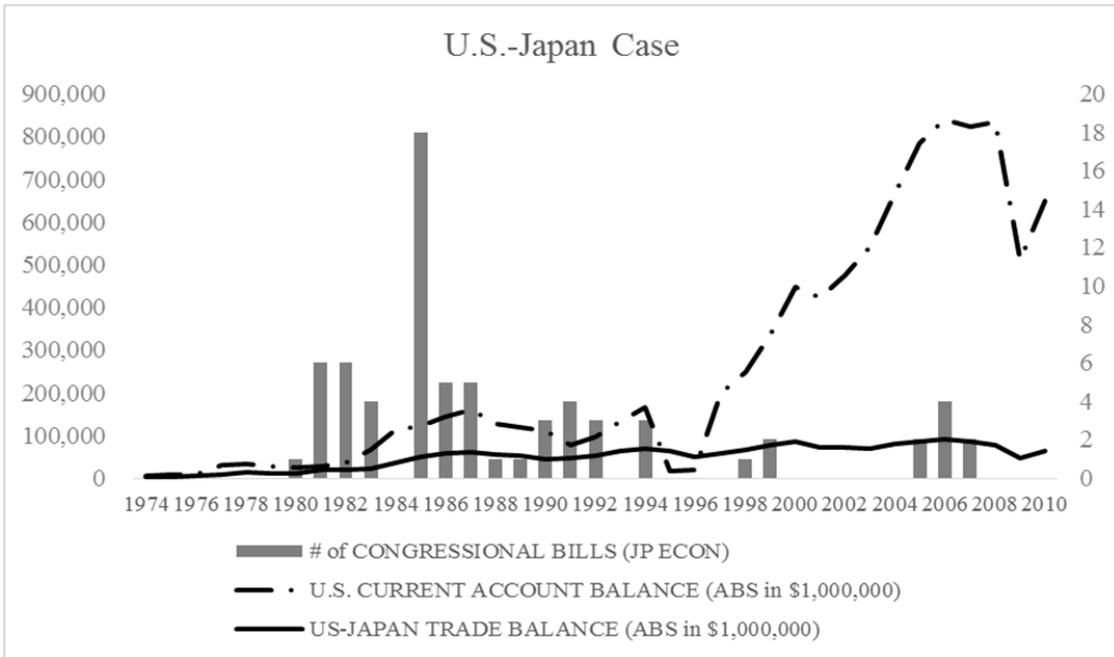


Figure 1

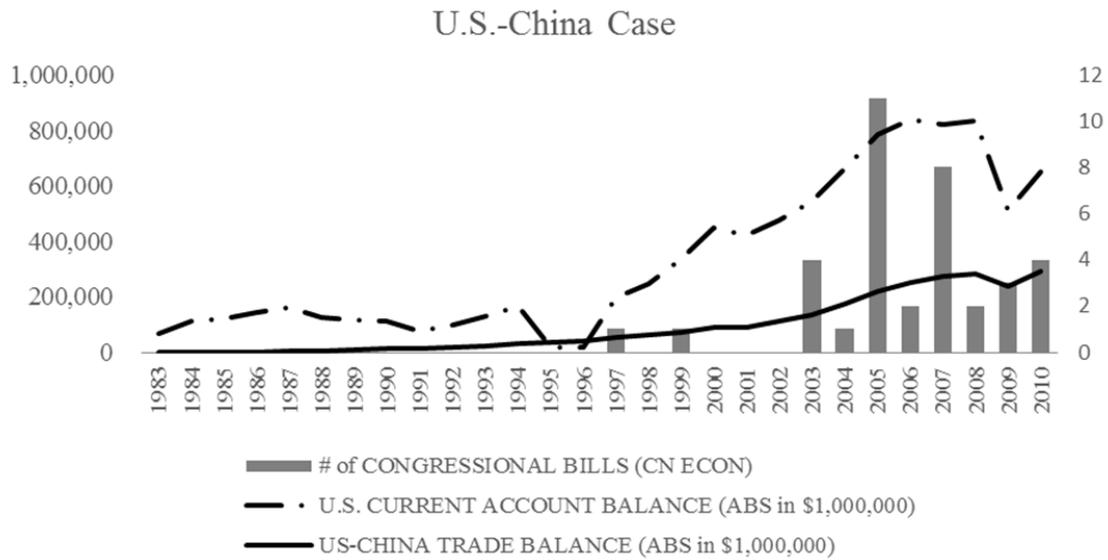


Figure 2

Table 1

Sample size of independent variables

	Japan			China		
	Number of visits	Days of visits	Days coded as "1"	Number of visits	Days of visits	Days coded as "1"
Bitreasury	22	34	152	20	56	199
Multitreasury	18	32	115	6	20	50
Sample Size	2006			1008		

Table 2

Variables	Yen-Dollar	Yen-Dollar	Yen-Dollar
L.Changingrate	8.606*** (2.310)	8.984*** (2.290)	8.996*** (2.291)
Federalfunds	7.966*** (2.308)	8.251*** (2.288)	8.282*** (2.289)
Bitreasury	2.449 (3.543)		3.148 (3.513)
Multitreasury		24.539*** (4.043)	24.658*** (4.045)
_cons	42.931*** (5.876)	36.245*** (5.907)	35.651*** (5.945)
<i>N</i>	2,006	2,006	2,006
F Value	186.24	201.74	151.49
Adjusted R2	0.22	0.23	0.23

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Table 3

Variables	Yuan-Dollar	Yuan-Dollar	Yuan-Dollar
L.Changingrate	0.223* (0.098)	0.221* (0.099)	0.219* (0.098)
Federalfunds	0.167*** (0.009)	0.170*** (0.009)	0.168*** (0.009)
Bitreasury	-0.103** (0.033)		-0.100** (0.033)
Multitreasury		0.130* (0.061)	0.122* (0.061)
_cons	7.070*** (0.038)	7.033*** (0.037)	7.059*** (0.038)
N	1,008	1,008	1,008
F Value	118.63	116.32	90.25
Adjusted R2	0.26	0.26	0.26

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Table 4

Variables	Yuan-Dollar	Yuan-Dollar	Yuan-Dollar	Yuan-Dollar	Yuan-Dollar
L.Changing rate	0.245* -0.098	0.235* -0.098	0.240* -0.099	0.257** -0.097	0.274** -0.097
Secretary	-0.238*** -0.048			-0.249*** -0.048	-0.253*** -0.048
Under Secretary		-0.247*** -0.074		-0.270*** -0.074	-0.263*** -0.073
US meetings			0.129* -0.055		0.132* -0.055
Federal funds	0.167*** -0.009	0.165*** -0.009	0.168*** -0.009	0.163*** -0.009	0.162*** -0.009

_cons	7.071***	7.065***	7.040***	7.095***	7.091***
	-0.037	-0.038	-0.037	-0.038	-0.037
N	1008	1008	1008	1008	1008
F Value	125.11	119.19	116.69	98.37	80.26
Adjusted R2	0.27	0.26	0.26	0.28	0.28

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Table 5

	Power asymmetry	State objectives	Agenda priority & top agenda
Japan (1983-1990)	Asymmetric alliance	Political power & International state	Low Security & Politics
China (2005-2008)	Relatively symmetric	Economic power & Independence from foreign intervention	High Economic development