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Japan's 50 Years with the IMF and the World Bank and Agenda for Reforms*

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Great Achievements and Changing World

The establishments, 50 years ago, of the International Monetary Fund and the World Bank, and of the United Nations, were the most important achievements of international cooperation following the Second World War. The IMF was guardian of the Bretton-Woods regime of fixed exchange rates, and its essential mission immediately after the war was to seek foreign exchange rate stability and a balance-of-payments equilibrium through three instruments: short-term financing, policy surveillance, and capital controls. The World Bank supported reconstruction and development through long-term finance and mobilization of private capital through risk transfers.

Over the past 50 years, however, the world has witnessed tremendous changes in its political and economic regimes, largely altering the environment in which international financial institutions, including the IMF and the World Bank, pursued their activities. After the collapse of the Bretton-Woods regime in 1971, the fixed exchange rate system gave way to a floating exchange rate system. Owing to spreading liberalization of capital controls, the free flow of capital became a fact of life, and was often volatile and massive. These changes of economic and financial environments appeared to have made the missions of the Bretton-Woods institutions irrelevant.

There should have been a fundamental reappraisal and redefinition of the roles and

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responsibilities of the IMF. Indeed, some efforts were made at such forums as the G10 and the IMF's Committee of Twenty,** to review and adjust its missions. Under the pressure of urgency created by series of such events as oil shocks, currency crises, and the end of the Cold War, however, the function of the IMF has only evolved incrementally, without a clear-cut redefinition.

The World Bank initially concentrated on the reconstruction of devastated economies in Europe and Japan, as well as on underdeveloped countries. The initial reconstruction phase soon ended, with industrial countries achieving rapid recovery and graduating from World Bank borrowing, thereby removing their need for medium to long-term financial assistance from it. The development of private capital markets also reduced the role of the World Bank as the main source of long-term capital for development through industrialization. Nowadays, there is more demand for the World Bank financing of such non-profitable projects as education, health care, and environmental protection, as well as for humanitarian aid to countries in Africa.

Reform Needed

The loss of a clear sense of mission and consistency by these institutions has created a rivalry between them. It is a natural impulse of bureaucracy to try to preserve and expand its organization and employment. Unfortunately, however, the turf war between the IMF and the World Bank has often led to ad hoc approaches to financial and currency crises, especially those seen in the 1990s. The malady of overgrown organization is reflected in their lack of transparency and accountability.

The coming era is bound to be eventful, as the stage is set by fundamental disequilibrium in the US economy, lagging reform in Japan and Europe, the intractable misery of Africa, and uncertainty in such large emerging countries as China, India, Indonesia, Brazil, and Russia, just to name a few contributing factors. Against the backdrop of the continued vulnerability in global security, the deteriorating environment, and the backlash against globalization, the need for international cooperation will increase, in which active roles by the IMF and the World Bank will be useful. Although the IMF and the World Bank have lost their original mission, I don't think this is the right moment to try to overhaul them, because there is no sense of which direction such an exercise should go in, although I do think some modifications should be made. I would like to present some proposals to be addressed in each of the two institutions.

First of all, since the lack of exchange-rate stability after the collapse of the Bretton-Woods regime has burdened many countries with the heavy cost of policy adjustments, the IMF should be more active in and responsible for securing the stabilization of the three major currencies, the US dollar, the euro, and the Japanese yen. It is almost obscene that the IMF, which used to be the staunchest guardian of exchange rate stability, has become so

** The Committee on Reform of the International Monetary System, its formal name, was established in July 1972 and concluded its work in June 1974, agreeing on an immediate program to help the monetary system evolve. Discussions on reform were then conducted by the Interim Committee.

apathetic. Second, the IMF should be more concerned about speculative, greed-driven short-term capital flows which pursue maximum profit. Third, surveillance of problem countries should be intensified, and policy consultation stepped up, to exert strong peer pressure to prevent or correct inappropriate policy measures taken by them. Early warning systems should also be strengthened to prevent financial crisis.

Regarding the World Bank, it is essential that it rigorously combine financing policy with the imposition of international rules on recipient countries, such as respect for intellectual property rights, contractual obligations, and other rules of law. Second, the World Bank should not abandon the principle of self-help by recipient countries when disbursing financial assistance to them. No poverty reduction will be achievable without the elimination of the horrendous waste of resources lost through infighting. Third, the World Bank should shift more to IDA-type concessional lending, since there are now more methods of financing emerging market countries through private institutions, and access to them has become much easier for these countries than before. This may require some institutional amendments involving the voting procedures of IDA voting system.

It is most important that the two institutions first stop fighting turf wars with each other. Since no single institution can save the world, each should identify its own mission and focus resources on it. To promote this division of labor, it is important that the main shareholders-including Japan-should show more interest in the activities of these institutions, and actively participate in their decision making processes.

Japan's Benefits and Responsibilities

Japan has experienced many ups and downs in the 50 years since gaining membership in the IMF and the World Bank in 1952. Membership in these institutions signaled a great step forward in Japan's return to the international community. In the 1950s and 1960s, Japan received a great deal of benefits from international organizations, both financially and institutionally. In particular, the World Bank provided financial assistance for the postwar reconstruction of Japan, starting with a loan to the Kansai Electric Power Project in 1953, when a stable supply of electricity was an top priority. During the next 13 years, Japan received financing from the World Bank, equaling US$863 million, for 31 reconstruction projects, including dams, highways, and bullet trains. It should be noted that the World Bank provided not only the financial means, but also the expertise needed for the economic infrastructure, which greatly contributed to Japan's rapid economic recovery and development. Japan was able to graduate from World Bank borrowing in 1966, and finished repayment of all loans by 1990.

Under the international monetary system of the Bretton-Woods regime, Japan benefited from the fixed rate of exchange where the yen was undervalued for a long time, at 360 yen to the dollar. This arrangement provided a foundation for the development of Japan's export industries.

Japan is now the second-largest shareholder in both institutions, and the largest provider of trust fund grants to the World Bank Group. Japan has a considerable responsibility to maintain the framework of the IMF regime, and should bear its fair share toward doing so.

After the rapid growth of the 50s and 60s, however, Japan suffered from its own success, and was not able to reform. Furthermore, Japan was too slow to respond to the end of the Cold War and the trend toward globalization in the late 1980s and early 1990s. False expectations of a return to the successful years prevented reform in Japan.

Unlike those days, the IMF and the World Bank must face such complicated challenges as the recent instability and poverty of developing countries. Japan's economic condition is quite important not only from a domestic viewpoint, but also from an international perspective, and therefore must show to the outside world its will to reform and revitalize the economy.

For that purpose, it is crucial for Japan to regain its competitiveness. It is a race against time, as the society is rapidly aging and facing challenges from China. Transformation must be made from a bureaucratic-led to a private-sector-led economy, and also from export-type manufacturing to domestic-type information and services.

I believe that the Koizumi administration has taken the first step in that direction. It is urgent to push such reforms as the privatization of the postal savings system and the public highway corporation, despite opposition from vested interests. It will be impossible to regain international competitiveness if as much as one-third of the financial sector remains under government control.

Regarding tax reform, a medium-term vision of the Japanese economy should be drawn first. The recent proposal of the government tax council apparently lacks the intent to strengthen the competitiveness of the economy in general, and the private-sector-led service economy in particular. I believe that tax cuts will be effective, assuming the balancing of the budget in the medium run, but not necessarily in the short run. Further deregulation should also be possible, to promote private sector activities in newly developing fields.

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