RELIEF AGENCY, HEGEMON, OR FAILURE?
AN EVALUATION OF THE IMF AS CRISIS MANAGER

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RELIEF AGENCY, HEGEMON, OR FAILURE?
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Thesis

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CHAPTER I
INTRODUCTION

In November of 1998, in the wake of an economic meltdown in East Asia and an emerging economic crisis in Russia, the International Monetary Fund (IMF) requested an additional eighteen billion dollars from the U.S. Congress. As part of the legislation authorizing these funds, Congress created the International Financial Institution Advisory Commission, also known as, and henceforth referred to, as the Meltzer Commission, named after the commission chair, economist Allan H. Meltzer. He was the Allan H. Meltzer Professor of Political Economy at Carnegie Mellon University and served as a member of President Clinton’s Council of Economic Advisers and Economic Policy Advisory Board. The Meltzer Commission served as a bi-partisan group selected by Congress and given six months in which to conduct an analysis of the future roles of seven international financial institutions. These institutions were: the International Monetary Fund, the World Bank Group, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the World Trade Organization, and the Bank for International Settlements. The commission dealt with each institution, but the bulk of its report focused on the IMF and the World Bank. For the purposes of this paper, only conclusions dealing with the IMF are analyzed.
Using various sources, including the Meltzer Commission Report, Congressional testimony, and the works of historians, economists, and social critics, this paper will investigate and analyze the findings and recommendations of the Meltzer Commission to determine shortcomings in the IMF’s response to various economic crises that have occurred since the abolition of the gold standard. To accomplish this task, the paper will use two different methods of analysis. The first method will be a synchronic analysis of the level of industrial development and economic infrastructure within countries that experienced economic crisis. The second method will be a diachronic analysis of Japan’s economic infrastructure since 1800 to identify the factors that enabled Japan to build a modern economy. The goal is to remove the western economic model as the base from which the IMF plans its response to economic crises and replace with a Japanese model, using Japan’s economic growth as a foundation.

Many critiques of the IMF take a different approach than this thesis. The majority of IMF critics believe that it is a severely flawed institution that should be abolished. These authors include James Petras and Henry Veltmeyer who argue in *Globalization Unmasked* that the IMF is a tool of imperialism that allows the U.S. to control other markets. They believe that the IMF was set up as an institution to protect the interests of the ruling class, namely the U.S. political and economic elites. In *Empire*, Michael Hardt and Antonio Negri argue that imperialism no longer exists; now nation states compete for position within a global empire. They believe there are new forms of authority and instruments of coercion, such as the IMF, that are designed to prevent nation states from
breaking free economically from the global economic empire controlled by the U.S.\textsuperscript{ii}

Some works let the reader know an author’s view of the IMF without having to open the book. Titles such as \textit{Unholy Trinity} and \textit{The Chastening}, are obviously not positive studies of the IMF.\textsuperscript{iii} Other works, such as Clyde Prestowitz’s \textit{Rogue Nation}, place the blame for IMF failures on the United States. This work argues that the IMF is essentially a U.S. institution designed to provide opportunities for U.S. corporations to initiate exploitive practices that would be illegal within the U.S.\textsuperscript{iv} A number of important works offer ideas for reform of the IMF. Joseph Stiglitz’s \textit{Globalization and its Discontents} calls for reform in the creation of an organization with the power to hold the IMF accountable for the consequences of its policies.\textsuperscript{v} Authors such as Jessiah Ben-Aharon, argue a mixture of the two previously mentioned theses. In his book, \textit{America’s Global Responsibility}, Ben-Aharon argues that the IMF has created an environment corporations are able to exploit because there is no institution to hold the IMF accountable.\textsuperscript{vi}

The final part of this paper suggests that the IMF should examine non-western economic systems in order to find solutions other than what has been previously prescribed to nations in economic crisis. An examination of Japan’s pre-war economic development will expose alternative approaches for the IMF to incorporate into their repertoire. The use of Japan as an economic model is nothing new, but this thesis will take a different approach than previous works. This thesis focuses on various stages of Japanese economic development starting
in 1800 and ending in 1950 to show alternative methods of economic recovery intended to promote long-term stability in developing nations. The majority of works that propose using the Japanese economic system as a model focus on the so-called “Japanese Miracle” that occurred in the 1960s with the intention of improving the United States’ declining economic position. Works, such as Ezra F. Vogel’s *Japan as Number 1*, argue that Japan is a superior industrial nation when compared to the U.S. Vogel argues that Japan goes through a process of self-evaluation that allows deficiencies to be recognized before they become problems. He believes that by following the steps of the Japanese in the post-war era, the United States may have been able to prevent the economic turmoil of the 1970s.\(^{vii}\) Other works, such as *Politics and Productivity*, argue that the U.S. should adopt the Japanese variation of capitalism. Japanese capitalism is known as “developmental capitalism.”

The major difference between the different variations of capitalism is how efficiency is viewed. There are three major variations of efficiency within capitalism. These three variations of efficiency are: “Ricardian efficiency (the allocation of resources according to their effects on current economic conditions), growth efficiency (the allocation of resources according to their effects on economic growth), and Schumpeterian efficiency (the allocation of resources according to their effects on the pace and direction of technological change).”\(^{viii}\) Japan follows growth and Schumpeterian efficiency and western capitalism follows Ricardian efficiency.
This study finds that the majority of critiques of the IMF either call for its abolition or offer solutions that are shaped by the western economic model. The conclusions reached in this paper will separate it from the historiography from which it is based in several different ways. This thesis argues that the IMF’s policies towards crisis nations are severely flawed because they do not take into account the internal, cultural, and developmental factors that shape a nation’s response to economic conditions. However, if adequately reformed, these policies could serve a vital role in providing long-term economic recovery for nations in crisis. Also, this thesis argues that IMF reform should center on strategies that reflect the needs of national economies in various stages of development. This argument calls for reform of the IMF through an examination of the various stages of Japanese economic development since 1800.

This thesis is not the first to suggest the adoption of a Japanese economic model. However, those that have suggested the use of a Japanese economic model in the past have been interested only in Japan’s post-war economic development and have suggested the Japanese model as a tool to improve the western economic system; this paper differs by using Japan’s pre-war economic development to identify economic trends that can serve as models for developing countries in the present. Using Japan’s economic history, these reforms will approach economic recovery from each crisis nation’s level of economic development with the goal of producing long-term stability.

The analysis of this paper will occur within seven chapters. Chapter two will provide a brief history of the IMF, its purpose, institutional evolution, and its
current role in the international economy. Chapter three will be an analysis of Mexico’s relationship with the IMF. It will cover the various reforms the IMF tried to initiate in Mexico during a period that lasted over twenty-five years. The fourth chapter will provide an analysis of the East-Asian economic crisis that was the catalyst for the formation of the Meltzer Commission. It will include coverage of the IMF-initiated reforms and will show that these reforms exacerbated one nation’s economic downturn into a crisis that affected numerous nations throughout the world. Chapter five covers the Meltzer Commission Report and any consequences that occurred as a result of the Commission’s findings. Chapter six will examine various trends in Japan’s economic development. Chapter seven will be the conclusion and will argue that during crisis management, the IMF should apply the trends discussed in chapter six. This chapter will consider alternatives to promote economic recovery, all of which can be identified in the history of Japan’s economic development since 1800; it will provide an analysis of the IMF’s practices after the Meltzer Commission report; and offer ideas of reform for the IMF.
Bretton Woods and the Origins of the IMF

For twenty-two days in July of 1944, delegates from forty-four countries and a representative from Denmark met at the Mt. Washington Hotel in Bretton Woods, New Hampshire, and negotiated the “Articles of Agreement of the International Monetary Fund,” creating the IMF and establishing a “new world order” in terms of a global economic system. The purpose of the IMF was to establish a system that would prevent the monetary instability and economic crises that characterized the interwar years from 1918 to 1938.

Prior to World War I (1914–1918), many economists believed the gold standard to be the natural standard for regulating monetary value and world currencies. Domestic currencies and international exchange rates were all based on gold. The gold standard system was a self-regulating economic system; a deficit in one nation would lead to an outflow of gold in the form of payments to another nation. This outflow of gold would reduce the amount of currency in circulation, the reduced amount of currency would lead to deflation of the currency’s value and things would return to normal. The gold standard system began to fall apart when countries started keeping gold reserves. The increase in
gold reserves led to a decrease in the movement of gold, therefore nullifying the self-regulating aspect of the gold standard system.

World War I led to a brief period of currency inconvertibility because nations warring with each other were reluctant to recognize their enemy’s currency. This resulted in a brief collapse of the gold standard system, but following the war, many economists believed a return to the gold standard system was the best solution. However, the large amount of reserves held by each nation again caused the gold standard system to become ineffective. To try and force the movement of gold that had been so vital to the pre-war period, the gold standard system evolved into the “gold exchange standard system.” What this meant was that foreign currencies were no longer accepted as payment; only gold bullion could be used for payment. Because nations were reluctant to give up their gold supply, the “gold exchange standard system” could not function as planned.

The result was the collapse of the gold standard system and an increase in currency speculation in which a nation would sell its own currency for less than its value to undercut other nations in an attempt to increase trade. Undercut nations would sell their currency for even less in retaliation and eventually every currency devalued to the point that international trade started to slow drastically. The Great Depression (1929–1939) made matters worse, and with the outbreak of World War II (1939–1945), many economists believed there would be a repeat of the worldwide economic collapse that followed World War I.

Two such economists were John Maynard Keynes of Great Britain and Harry Dexter White of the United States. These two men began working on very
similar ideas concerning international monetary systems. Their two plans joined with the ideas of other economists from around the world and shaped the “Articles of Agreement of the International Monetary Fund” established at Bretton Woods in July of 1944. On July 22, the President of the Bretton Woods Conference, Henry Morgenthau, announced on national radio that the Bretton Woods Conference “has successfully completed the task before it.” That task was the creation of a permanent international organization that could show that mankind could unite for a peaceful economic mission during an era defined by violence.

On December 27, 1945, twenty-nine of the forty-four countries that met at Bretton Woods signed the “Articles of Agreement of the International Monetary Fund,” thereby creating the IMF. Article I of the “Articles of Agreement of the International Monetary Fund” outlined the purposes of the IMF and reads:

The purposes of the International Monetary Fund are:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article. xvii

The IMF’s Changing Role

In December of 1945, the International Monetary Fund came into existence. From 1945 to 1959, the IMF played a minor role in international finance. There was a transitional period of five years in which member nations were not required to follow IMF guidelines, and the fund was not to be used for reconstruction or financing debt resulting from World War II. In 1948, the IMF decided that any nation participating in the Marshall Plan and helping with recovery in war-torn Europe should not be allowed to borrow money from the IMF. As a result, the IMF did very little except set par values for members’ currencies, meaning that currency values were “expressed in terms of gold as a common denominator or in terms of the U.S. dollar.” xviii In 1956, the IMF’s lending policy was put to its first real test when France and the United Kingdom requested money to cover their financial loss due to the closing of the Suez Canal. The influx of IMF money was able to stop any further devaluation of French and British currencies. xix This first test was one which the IMF passed successfully. By 1959, the number of participating countries in the IMF grew from twenty-nine to sixty-eight. xx
The period from 1959 to 1968 is considered to be the highpoint of the Bretton Woods system in which the world had full currency convertibility, which meant that each currency had a set value and exchanges from one currency to another would not result in a loss or a profit. Full currency convertibility allowed for more efficient global trade, which increased the amount of trade taking place. However, experts began to see signs that the Bretton Woods system would not last forever. Foreign nations began to hold onto large amounts of U.S. currency to back up their own currencies, and with the amount of U.S. gold reserves on the decline due to a speculative run on gold in 1968, there was less and less gold to back up the U.S. currency.\textsuperscript{xxi} It became clear that something had to be done or there could be currency instability and crisis for the IMF and its now 107 member countries.\textsuperscript{xxii}

After the speculative run on gold in 1968, the gold market was split into public and private spheres. The private sphere was essentially a private market for gold. Gold’s value in this market floated and gold could only be traded between official members of the market. These new spheres were unable to prevent further gold speculation.\textsuperscript{xxiii} This caused many nations to devalue their currency to make their goods more attractive to other countries. A few nations allowed their currency to start floating which allowed the market to dictate the price of their goods. However, the damage had been done, and in 1971, in an attempt to prevent the collapse many saw coming, the U.S. suspended the convertibility of the U.S. dollar into gold, therefore ending the Bretton Woods
system. By 1973, the Japanese yen and six European currencies were floating against the dollar.\textsuperscript{xxiv}

The Bretton Woods system had two basic tenets: freedom of trade and regulation of capital. Suspending the convertibility of the U.S. dollar into gold ended the ability to regulate capital. Harry Dexter White and John Maynard Keynes believed the regulation of capital allowed nations to create a fiscal policy that could sustain full employment and implement social programs without the fear of capital flight. They believed the free flow of capital would lead to highly concentrated pockets of capital that would influence a nation’s social policy by punishing uncooperative nations with capital flight.\textsuperscript{xxv} Capital flight occurs when investors become nervous and pull their money. The removal of the investor’s money makes any potential problem much worse. White and Keynes feared capital flight could be used as a tool of coercion. For example, the U.S. could punish a nation they did not agree with by removing all of its money from that nation’s economy. If the U.S. invested heavily in the other nation’s economy, the removal of this money could be disastrous.

One would think that, with the collapse of the Bretton Woods system, the IMF would also collapse because it is “the institution overseeing the maintenance of convertibility of gold into the dollar and fixed exchange rates.”\textsuperscript{xxvi} However, a 1976 amendment to the “Articles of Agreement of the International Monetary Fund” gave the IMF supervisory and surveillance powers over its now 138 members.\textsuperscript{xxvii} These supervisory and surveillance powers include: policy advice, policy coordination and cooperation, information gathering and dissemination,
technical assistance and aid, identification of vulnerabilities, and policy prescriptions. These supervisory and surveillance powers changed the IMF from a relief fund to a tool of domination for the western powers, particularly the U.S., to manipulate the economies of smaller, weaker nations.

Economic Crises in the 1980s

It would be an exaggeration to say that the moment the IMF received supervisory and surveillance powers, there was a seemingly never-ending supply of financial crises, but it would not be a large exaggeration. The list of nations that experienced one or more economic crises during the 1980s includes: Argentina, Mexico, Nigeria, Brazil, Uganda, Mozambique, Nicaragua, and the nations of the Caribbean and Sub-Saharan Africa. In each of these situations the IMF offered assistance on the condition that these nations institute certain internal economic reforms.

The IMF would typically offer assistance in the form of debt rescheduling and credit in exchange for a “wide-ranging but a generally uniform package of economic reforms.” These reforms were intended to relieve short-term balance of payment problems but never looked at the causes of the economic stagnation. These reforms called for a reduction in government spending, and the easiest place to reduce spending was in social programs and infrastructure. The reforms also called for increased taxes, increased interest rates, wage freezes or declines, and the elimination of worker benefits and unions. Another demand of the IMF was state privatization, which called for the selling of state-run
enterprises, and market liberalization, which called for removal of import restrictions. Nations were forced to follow these IMF prescriptions if they wanted to receive debt rescheduling or new loans.

The biggest problem with this approach was that it shifted the control over economic policy from an individual nation to an international body. The result was an intervention in national policy by a foreign power the likes of which had not previously been seen in the post-colonial era. The IMF would insist on reducing barriers to free trade and reducing a nation’s power over its domestic economy. The end result meant the nations that received IMF assistance essentially lost control of policy creation, policy enforcement, and the ability to protect their local markets and industries.

In each instance the IMF instituted similar reforms. The IMF would not protect the local markets, but rather sought to open local markets and integrate them with external markets. Additionally, many of these nations were attempting to industrialize, and the IMF would stop the attempts at industrialization and try to increase agricultural exports. In many cases, such as in Africa and Latin America, the IMF seemed to be recasting these nations into their previous roles as agricultural exporters implemented by foreign powers during the colonial era.

After the IMF instituted its reforms, each country had similar results—and the results were usually not very good. For example, due to the lack of protection for local markets, unemployment rose while wages and standards of living fell. In addition, by undermining the political power of individual nations, the political landscapes in each became chaotic. Finally, with the intrusion of external markets
on local markets, foreign companies made profits while local companies lost money. It appears that the IMF could not figure out why their reforms did not work, but the answer is quite simple. The IMF assumed that the international economy played no role in the domestic economic crises faced by these countries; in each situation, the IMF believed the problem was internal and its recommendations called for changes to national economic policy.

It is striking that the IMF never investigated the role of international economic policy on nations in economic crisis. Yet, it seems only logical to look for international causes, because the majority of these nations’ problems first arose from the collapse of the Bretton Woods system and the rise and fall of crude oil prices in the 1970s.\textsuperscript{xxxiii} The Meltzer Commission Report does not cover any of these economic meltdowns from the 1980s in great detail other than to say this is the time period in which the IMF began exerting more power over nations receiving IMF loans by imposing coercive repayment terms. An analysis of these small-scale economic meltdowns of the 1980s might have enabled the IMF to adjust its approach and avoid subsequent meltdowns in the 1990s.

Economic Crises in the 1990s

The Meltzer Commission Report covers the three major economic crises of the 1990s. These crises include: the 1994–95 Mexican crisis, the 1997–98 East Asian crisis, and the 1998–99 Russian crisis. While these crises may not be as well known as the Great Depression that affected the U.S.:

Liabilities of bank failures in crisis countries often reached 20% of annual income, a far greater financial collapse than occurred in any
developed country, including the United States, during the depression of the 1930s or the banking and U.S. savings-and-loan failures in the 1980s.
CHAPTER III
THE MEXICAN TIME BOMB

The IMF and Mexico have an economic relationship that began in 1982 and during that time, the IMF has had a very strong influence over government policy in Mexico. However, it was Mexico that changed the IMF from a lending agency to a debt-management agency when it announced in 1982 that it could no longer service its foreign debt. That year marked the beginning of IMF-led bailouts, yet it was the 1994–1995 Mexican-peso crisis that began the era of massive bailouts, subsequently investigated by the Meltzer Commission. The IMF’s bailout of Mexico in 1995 has largely been viewed as a success. It resulted in a quick economic recovery that restored confidence in the Mexican peso and prevented the crisis from becoming international. However, those that view the bailout as a success do not mention the affects of the bailout on ordinary Mexicans. In order to see the 1995 bailout in the correct perspective, an examination of the IMFs relationship with Mexico from its inception in 1982 is required. This examination will show that the IMF-led approach to debt-management is flawed, that it delays reform, and influenced Mexican internal politics and government through conditional loans.xxxv
The Origins of the Debt Crisis

From 1940 to 1970, the Mexican economy grew at an annual average rate of six percent. This rate of growth is quite impressive and comparable to other booming economies of the same era such as: Japan, South Korea, Taiwan, and West Germany. During this same thirty-year span, Mexico also experienced very low rates of inflation. However, by the 1970s, Mexico faced several structural problems. The population had been growing annually at an average of three and a half percent, and widespread rural migration to cities transformed Mexico from a rural economy to an urban economy. The booming population and the large number of people moving to urban centers led to chronic unemployment and underemployment as the economy was not able to keep up with the change in population. xxxvi

As a consequence, by the late 1970s Mexico began borrowing money from foreign lenders to put into the economy in hopes of generating growth. This idea was very similar to the concept of “priming the pump” that was advocated by Franklin Roosevelt during the Great Depression. Mexico hoped that the infusion of capital would generate economic growth. Until this growth occurred, Mexico relied on petroleum exports to pay the debt incurred by the foreign loans. However, two events in 1981 severely hurt this economic plan. First, interest rates within the United States soared. At one point, the United States prime rate was twenty-one percent. Many of the foreign loans Mexico received were from banks within the United States or from banks tied to the floating interest rate. The rising interest rate caused Mexico’s interest payments to increase dramatically.
Secondly, a decline in world trade reduced the demand for petroleum on the world market. Along with less demand, non-OPEC nations began increasing their petroleum production. The result was a significant drop in the price of oil. These two events hurt Mexico greatly because oil—the main export they used to pay off the foreign loans—dropped in value at the exact same time that interest rates rose causing Mexico’s payments to their foreign lenders to increase.\textsuperscript{xxxvii}

As the value of petroleum dropped and interest rates increased, investors began losing confidence in the Mexican economy. Over the first few years of the 1980s, thirty-six billion dollars left the Mexican economy in capital flight as investors lost confidence. Mexico found that the only money it could borrow to service its debt came in the form of short-term loans with very high interest rates, which did nothing but increase foreign debt.\textsuperscript{xxxviii}

Mexican debt began growing at extreme rates in the early 1980s. In fact, foreign debt increased by twenty-two billion dollars in 1981 alone. In 1982, Mexico announced that it could no longer service its foreign debts and approached the United States Treasury Department seeking help to prevent Mexico from defaulting on its loans. An agreement was reached, and in exchange for over eight billion dollars in loans, Mexico agreed to follow IMF measures. The goals of the IMF measures were for Mexico to reach five percent annual growth by 1985. However, these measures had the opposite effect and plunged the nation into a depression. The economy went into atrophy, foreign debt continued to grow, and Mexico’s ability to service the growing debt vanished. The amount of money needed by Mexico to service its debt was seventy percent
higher than before the IMF measures were enacted. Average annual gross domestic product (GDP) began growing at less than one percent, average annual per capita income decreased, foreign debt grew by eighteen billion dollars, and US exports to Mexico were down twenty-five percent from when the crisis began.\textsuperscript{xxxix}

The major flaw in the measures taken by the IMF was that they were no longer applicable without the Bretton Woods system. The IMF used prescriptions from the 1950s that called for the assumption of new debt in order to service old debt. However, these prescriptions were successful under the Bretton Woods system when imbalances of national economies could easily be managed. These imbalances could be easily managed because the Bretton Woods system did not allow for extreme fiscal and trade deficits. Following the collapse of the Bretton Woods system, extreme fiscal and trade deficits were commonplace. Therefore, when the IMF used the Bretton Woods solution of debt servicing, without the Bretton Woods controls over deficits, the amount of debt increased. Mexico’s debt increased to the point that repayment was virtually impossible.\textsuperscript{xl}

One troubling point about the debt crisis that occurred in 1982 is that rich Mexicans took their capital out of Mexico and stored it in foreign banks. This was a case of capital flight. This money could have paid off Mexico’s debt; instead the middle class and poor watched their wealth continue to shrink while the elites found their wealth secured by the same foreign banks that were choking the Mexican economy.\textsuperscript{xli} The best way to measure the size of a nation’s debt is to compare it against the strength of its economy. In 1983, Mexico had an annual
per capita income of $2,240 and a public foreign debt of sixty-four billion dollars. Therefore, the average per capita Mexican income bore a debt of twenty-two million dollars. Of every nation in debt during this time period, Mexico’s was the most severe. 1983 also brought the end of Mexico’s other dynamic industry, steel. Mexico’s two major industries had been petroleum and steel production. The price of oil collapsed in 1981 and in 1983 the United States began to implement protectionist measures for its own steel industry, and these measures eliminated the United States as a destination for Mexican steel.xlii

The Baker Plan

In 1985, James Baker, Secretary of the United States Treasury, asked the World Bank, IMF, and regional development banks to provide over nine billion dollars in development funds. These funds were destined for fifteen debtor nations, one of which was Mexico. The plan included measures to support domestic growth within the debtor nations. These measures included the liberalization of trade and investments, the privatization of state-run enterprises, and a call for new loans to pay the interest on Mexico’s existing debt. The logic behind the “Baker Plan” was that “debtor nations could not pay if they did not grow.”xliii There are two troubling aspects to the Baker Plan. The first is that the very existence of the Baker Plan is an acknowledgement that the IMF reforms initiated in 1982 had failed. The second troubling aspect is that the emphasis of the plan was to promote growth so foreign lenders could receive money rather than promoting growth to help the people of the nation in debt.
The results of the Baker Plan were similar to the results of the first recovery plan implemented by the IMF in 1982. The reason for this is quite simple: the Baker Plan followed the same mistaken remedy advocated by the IMF. Mexico received four billion dollars in new loans from the IMF and World Bank, two billion dollars from the United States, and six billion dollars in new commercial loans. The most glaring flaw in the “Baker Plan” was that in just eighteen months, Mexico received over one-third of the funds that the “Baker Plan” intended to distribute to fifteen different nations over a three-year period. The economists that developed the plan knew it was inflationary and would actually increase Mexican debt by twelve billion dollars in two years, yet it was hailed as a breakthrough in debt-crisis management and quickly implemented. If the goal of this plan was truly to help debtor nations, the debt should have been forgiven, and then any new economic growth could benefit the nation rather than being sent out of the nation to foreign economies to repay loans.\textsuperscript{xliv}

The Time Bomb Explodes

From 1988 to 1994, the Mexican economy began to recover. In 1988, President Carlos Salinas implemented economic reforms that were acclaimed worldwide. In order to increase confidence in the Mexican economy, the peso was pegged to the US dollar. This pegged exchange rate was intended to prevent inflation of the Mexican currency. Along with the pegged exchange rate, the government made the peso fully convertible. This globalized the peso and allowed a free-flow of capital into and out of Mexico. Over the next four years, growth of Mexico’s
GDP averaged three and a half percent. However, in 1993, the growth of the GDP dropped to half a percent. Over the same four years, cumulative inflation was over 135 percent in Mexico, while only twenty-seven percent in the United States. xlv

In March of 1994, the United States Federal Reserve raised interest rates. The raised interest rates increased Mexico’s payments to its foreign lenders. It also led to a run on the peso in which Mexico lost fifteen billion dollars in foreign exchange reserves. The Mexican government began issuing domestic credit to prevent any further fall in the money supply. However, all confidence was lost in the peso and the government began issuing short-term dollar-denominated bills known as tesobonos. Fears that the US Congress was going to reject the North American Free Trade Agreement (NAFTA) led to another run on the peso. By December of 1994, the amount of investment capital leaving Mexico reached ten billion dollars. xlvi

In January of 1995, the United States orchestrated an emergency loan package for Mexico. This loan package called for the United States to loan Mexico twenty billion dollars and another thirty billion dollar loan from the IMF. Throughout 1995, interest and inflation rates within Mexico reached 100 percent. The peso continued to fall making payments to foreign creditors nearly impossible and causing Mexico’s financial system to collapse. Therefore, the fifty billion dollar rescue package from the United States and IMF went primarily to Mexico’s financial institutions so they could continue making payments to their
foreign creditors. By the end of 1995, the amount of investments fleeing Mexico reached sixty billion dollars.\textsuperscript{xlvii}

Moral Hazard

By the time of the collapse of the Mexican banking system, IMF policies had already created a moral hazard within Mexico. Moral hazard is when investors make investments they know to be dangerous, but believe will be subject to a government bailout allowing them to recover any loss they would incur. Moral Hazard is essentially a loophole in IMF policies that allows investors to make investments they would not make without the possibility of IMF bailouts. Because the IMF had bailed out Mexico during previous economic hardships over the prior twelve years, investors and members of the Mexican government did not adequately reform their economic practices and expected a bailout if the economy went through another downturn. IMF policies also helped redistribute Mexican wealth from the bottom up. The elite members of society that invested their money were the members of Mexican society that had their losses cut through IMF loans. The middle and lower class Mexicans did not receive any of the money provided to Mexico by the IMF.\textsuperscript{xlviii}

Conclusion

Mexico has been and continues to remain one of the largest recipients of IMF assistance. The country began to receive assistance in 1982 and really never stopped up to the time of the 1994 crisis. Twelve years of IMF assistance could
not stop the collapse of the Mexican peso. Following the collapse of the Mexican banking system in 1994, the IMF offered Mexico the largest financial package ever granted in the amount of $17.8 billion in 1995. The U.S. Treasury also gave Mexico another $20 billion. The IMF views its solution to the Mexican crisis as a success. The large influx of money allowed Mexico to continue making payments on its large debt, allowed the banking system to get back on its feet, and most importantly, prevented any foreign investors from losing money.xlix

What the IMF did not do was fulfill its duties as outlined in the “Articles of Agreement of the International Monetary Fund.” Article I, section II states that one of the six purposes of IMF assistance is:

To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.1

After twelve years of economic assistance by the IMF, Mexico went through a banking crisis bigger than the Great Depression. After the largest IMF assistance package was awarded to Mexico, it had the ability to continue paying debt and reopen its banks, but the people never saw what was promised by article I, section II of the Articles of Agreement of the International Monetary Fund: high levels of employment and real income. To date, Mexico continues to pay out 20 percent of its annual Gross Domestic Product to repay the money given to it during the 1994 banking crisis. Since the collapse of the Bretton Woods system, Mexico’s external debt has increased fivefold, and real income has not increased in twenty
years. Since the IMF began offering Mexico assistance, real wages for those receiving the minimum wage have fallen by fifty percent.\textsuperscript{li}

Oddly, the fall in wages has been viewed as a positive; the Mexican Secretary of Commerce believes the low wages are good because they will entice foreign investment. The IMF also instituted agricultural reforms in Mexico that have had drastic effects. The IMF prescribed a shift in agricultural production towards the production of animal feeds and exports. This has benefited Mexican agribusiness but has resulted in food shortages and large increases in malnutrition for the Mexican population.\textsuperscript{lii} Mexico, once able to support itself with domestic agricultural production, now has to import large amounts of food.

Charles Calomiris, an economic adviser hired by the Mexican government in 1995, argued that there was a “corrupt partnership” between industrialists, bankers, and government officials.\textsuperscript{liii} This is because all receive money in exchange for promises of economic reform. Economic recovery could have been reached in Mexico had the IMF not been involved. Moral Hazard, along with protections from the United States and IMF, creates a situation in which there is no imperative for economic reform. The most troubling aspect about the Mexican recovery plan is that it has been viewed as a success. The United States received its money from Mexico, not from actual recovery, but by arranging for the Mexican government to increase its debt by receiving new loans. It should concern the entire planet that a plan organized to help one nation with economic recovery did nothing more than increase that nation’s debt and make money for the United States. This led to a tidal wave of immigrants from Mexico.
into the United States. Creating a strong Mexican economy should have been the goal of the United States and IMF from the beginning of its relationship in 1982. Instead, the narrow self-interest of insuring continued payments was the ideology. Had real economic reform taken place, the current political issue of illegal immigration from Mexico would be a non-issue.
CHAPTER IV
THE EAST ASIAN MELTDOWN

The East Asian crisis of 1997 was much larger than the Mexican crisis. It affected a larger area and a greater number of people; therefore, the IMF assistance package offered to East Asia dwarfed the previously unprecedented assistance package of $17.8 billion given to Mexico. In this instance, the IMF offered the nations of East Asia over $100 billion in assistance packages. Because the East Asian crisis was so large, more attention was paid to it than any previous crisis, and for the first time, the policies of the IMF and its future were being questioned by economists and political leaders.

The IMF’s recovery plan for the East Asian crisis had similar results to the recovery plan for Mexico, meaning that foreign businesses were protected from financial losses, but the people of the region suffered. It is not hard to make the argument that the IMF is directly responsible for the meltdown. The crisis began in early 1997, when for the first time since the end of the Cold War, Thailand’s exports began to slow. Investors became fearful that Thailand would be unable to maintain the exchange rate between the Thai baht and the U.S. dollar. It can be argued that these worried investors created a self-fulfilling prophecy by pulling investments out of Thailand. As a result, Thailand was forced to fall back on its
foreign exchange reserves. Once these reserves were depleted, Thailand was forced to let the market determine the value of the Thai baht. At this point, Thailand sought assistance from the IMF.

The IMF came in and implemented various economic reforms. The reforms included higher domestic interest rates along with currency devaluation. These reforms placed enormous strains on an economy that was already going through a downturn. The higher interest rates and devalued currency created an atmosphere in which companies could no longer service their loans. This led to a dramatic increase in the number of non-performing loans. This resulted in a lack of money, which caused the domestic banking system to become insolvent. The rapid currency devaluation made it impossible for financial institutions to repay foreign loans because the payments increased as the currency depreciated. As the currency continued to depreciate, the Thai stock market crashed. Further increases in interest rates and the closure of the majority of the domestic banks sent any remaining investors fleeing.

The crisis then spread to other nations through the actions of panicking investors. Investors would target nations with conditions similar to Thailand’s and pull their money. This caused Thailand’s crisis to spread to Indonesia, the Phillippines, Malaysia, and Korea. Each country fell victim to the same cycle as Thailand: currency depreciation, financial system failure, and stock market collapse. The IMF applied the same prescriptions of tightening fiscal policy in Asia as it previously prescribed in Mexico. However, the Asian nations were not running large budgetary deficits or current account deficits like Mexico. As a
result, the fiscal tightening pushed the Asian economies into a deeper recession. In order to halt inflation and capital outflows the IMF increased interest rates. The higher interest rates accelerated the economic down-turn that was already in progress and failed to accomplish its main objective, a stabilization in the exchange rate of the Asian currencies relative to the U.S. dollar.\textsuperscript{lvii}

The East Asian crisis came as a shock. Economic crises in developing economies have to be expected, but only when those economies have weak exports. However, East Asia had experienced unprecedented growth since the end of the Cold War and that growth was fueled by very strong exports.\textsuperscript{lviii} East Asia also had a very strong economy prior to IMF involvement because the nations in East Asia did not follow the “Washington Consensus.” The Washington Consensus is a term that describes the economic policies that the U.S. tries to implement in other nations. This includes many of the same reforms that are advocated by the IMF, such as: trade liberalization, an increase in foreign investment, and state privatization.\textsuperscript{lix}

Only after IMF intervention in Asia in 1997 did major problems begin to occur. In Malaysia, where IMF assistance was refused following the meltdown, the economic downturn was not as severe as in nations that received IMF assistance.\textsuperscript{lx} Malaysia’s success has been labeled as unorthodox and criticized for not following IMF prescriptions even though economic recovery occurred. “There appears to be a fatally flawed belief that success in stabilising an economy under assault means there was never anything wrong with the ‘Malaysian way’ of doing business.”\textsuperscript{lxii} This seems like an attempt to blame the Malaysians for the
economic downturn and in some cases the critics of Malaysia appear to be in
denial. One example of this denial is:

No doubt that there has been some progress made in restoring the
banking system stability… The banking system’s capital levels have
also recovered sharply. Nevertheless, there is little evidence that the
banking sector reforms will significantly enhance economic recovery, let
alone create the financial basis for sustained economic growth and
structural transformation.\textsuperscript{lxii}

While the quote is accurate in that the future cannot be predicted, surely an
economy with a stable banking system and increasing levels of capital has a better
chance of recovery than a nation without, and the nations without a stable banking
system and increasing capital were the nations that received IMF assistance.
Many books by economists attempt to revise history in order to explain the
occurrence of the 1997 crisis; they claim that the Asian countries were seen as
unstable due to their large reliance on foreign loans. However, the opposite is
ture, the loans were an indication that these economies were strong enough to
attract capital, and the Asian economy had been growing rapidly since the end of
the Cold War. This is an attempt to shift the blame to the nations that suffered the
crisis rather than placing it on IMF policies or the nature of the international
economy that allows for rapid capital flows.\textsuperscript{lxiii} The IMF recovery plan did not
work in Asia, and it delayed the eventual recovery. The IMF policy of
liberalization was the most significant cause of the meltdown because it opened
up the East Asian currencies to speculation that drove down their value.

IMF Policy in Asia Prior to the Meltdown

The East Asian crisis was the point when the use of the IMF as a tool of U.S.
hegemony became obvious. Following the end of the Cold War in 1991, East Asia was no longer dependent on the U.S. market. An Asian market began to grow with its greatest strength being that it was a “closed market.” This means that Asian countries protected their markets from foreign interference, as the western nations did to jumpstart their economies in the late nineteenth century. The western nations accomplished this by practicing the complete opposite of what the IMF prescribes; they prevented the liberalization of their market and limited the intrusion of foreign goods. By the 1980s, in order to compete with Asian goods, the U.S. began moving factories outside of the U.S. to lower labor costs and make their goods more appealing to foreign markets.

To try and penetrate the emerging East Asian market, the U.S. initiated the 1985 Plaza Accords with Japan. The Plaza Accords of 1985 increased the value of the yen and decreased the value of the U.S. dollar. This was supposed to make U.S. goods less expensive and more attractive to the Asian market. By 1995 this had not resulted in the growth of U.S. exports, so a “reverse Plaza Accord” was initiated. Following the original Plaza Accords, the developing East Asian markets pegged their currencies to the value of the dollar. The “reverse Plaza Accord” initiated a fall of sixty percent in the value of the yen. This meant that when the “reverse Plaza Accord” took effect, the other East Asian markets found their currency to be much more valuable than the yen; therefore, their goods were much more expensive and export rates collapsed.

Another attempt to try and weaken the growing East Asian market took place in April of 1997 when U.S. Treasury Secretary Robert Rubin met with the
finance ministers of G-7. The G-7 is the Group of Seven which is made up of the seven industrialized nations: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. The G-7 has annual economic summits and sets the agenda for the IMF.\textsuperscript{lxv} This meeting led to the decision to revise the IMF charter to promote “freedom of capital flows,” exactly what Harry Dexter White and John Maynard Keynes had argued against. They had argued in favor of the regulation of capital flows because they believed that the liberalization of finance would hurt the freedom of trade. White and Keynes argued that the free flow of capital would create concentrated pockets of wealth that would enable powerful economic interests to influence the social policy of a nation. If a nation initiated policies that were not in favor of these highly concentrated pockets of wealth, they could be punished by capital flight.\textsuperscript{lxvi}

Another reason for the success of the Asian market was its corporatist approach and closed market. Almost all major Asian corporations were interconnected in one way, each benefiting from the growth of another.\textsuperscript{lxvii} In most instances, an Asian corporation owned all stages of production. Therefore, a manufacturing company that made a part without many uses did not have to worry about making a profit because its parent company did make a profit and the wealth was shared throughout the corporation. In a western economic system, the company that manufactured a part without many uses would have to increase the price of that product in order to prevent financial loss. This increase in price would cause an increase in costs for the larger company that required the part, thereby reducing their profits. The Asian market was very successful because it
depended on a closed market. The liberalization of this market could only have been done to benefit the U.S. and other western nations because the Asian nations were experiencing substantial growth.\textsuperscript{lxviii}

One might wonder how the U.S. could get away with this, especially regarding the manipulation of the value of the yen. The answer is that the U.S. and Japan have developed a special relationship. Since the end of World War II, Japan no longer funded their own defense because the U.S. provided Japan’s entire defense needs. Believing Japan to be a bulwark against communism, the U.S. opened numerous military facilities in Japan and still has over 100,000 U.S. troops stationed in Japan and South Korea.\textsuperscript{lxix} Japan also has a secure U.S. market for its high-tech industries and does not want to disturb this situation. Instead, Japan focuses on its leadership role in the Asian regional economy. However, this leadership role in Asia will not take priority over its relationship with the U.S., and Japan will always defer to U.S. demands in Asia.

Another reason for this close relationship is that the U.S. and Japan want to prevent enforcement of the “scarce currency clause” of the “Articles of Agreement of the International Monetary Fund.” Section three, Article VII of the “Articles of Agreement of the International Monetary Fund” states:

\( (a) \) If it becomes evident to the Fund that the demand for a member's currency seriously threatens the Fund's ability to supply that currency, the Fund, whether or not it has issued a report under Section 2 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action.
(b) A formal declaration under (a) above shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange operations in the scarce currency. Subject to the provisions of Article IV and Schedule C, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question, and they shall be relaxed and removed as rapidly as conditions permit.

(c) The authorization under (b) above shall expire whenever the Fund formally declares the currency in question to be no longer scarce.

The “scarce currency clause” allows for sanctions to be placed against nations that have a scarce currency. These sanctions allow the IMF to limit the exchange of a scarce currency until it is no longer scarce. The “scarce currency clause” has never been implemented because for most of the history of the IMF, the U.S. would be the only nation that could have sanctions placed against it for violating the “scarce currency clause,” and the U.S. controlled thirty percent of the votes within the IMF, more than the twenty percent needed to veto any call for sanctions. The number of votes a member nation has within the IMF is based on the amount of money it contributes to the fund. For example, if a nation’s contribution makes up five percent of the fund then that nation controls five percent of the vote.

However, the U.S. was slowly losing votes throughout the late 1970s and 1980s and eventually fell to nineteen percent; at the same time that the U.S. was losing votes, it was also turning into a debtor nation, while Japan was gaining votes and turning into a surplus economy. With Japan voting with it, the U.S. got the percentage of votes needed for a veto lowered to fifteen percent. What this
did was prevent any IMF intervention under the “scarce currency clause” against the U.S. or Japan. The U.S. dollar and the Japanese yen are two of the most important currencies in the world. The U.S. dollar is widely used to back up western currencies, and the yen plays a similar role in East Asia.\textsuperscript{Ixxii}

By preventing the enforcement of the “scarce currency clause,” the U.S. and Japan are able to keep their currencies relatively scarce and therefore more valuable than many other currencies. This gives these two nations much more control in the global market because many currencies are pegged to the value of the dollar and yen. This added control allows the U.S. and Japan the ability to manipulate the currencies in many other countries.\textsuperscript{Ixxiii} All of this work to control the percentage of votes seems odd, given that the IMF has only held 12 votes out of 2,000 decisions prior to 1998.\textsuperscript{Ixxiv} This collusion between the U.S. and Japan to prevent enforcement of the “scarce currency clause” is also a violation of section five, Article VII of the “Articles of Agreement of the International Monetary Fund” that reads:

\begin{quote}
Members agree not to invoke the obligations of any engagements entered into with other members prior to this Agreement in such manner as will prevent the operation of the provisions of this Article.\textsuperscript{Ixxv}
\end{quote}

The Meltdown Spreads Out of Asia

The East Asian crisis also led to a fall in oil prices, severely hurting Russia. Fearing that foreign capital would be pulled from their banks, the Russians began offering extremely high interest rates to keep foreign capital coming in. The interest rates were so good that international hedge funds and banks began to
borrow money in countries with low interest rates, and invest it in Russia at a higher rate. Everyone knew the Russians would not be able to repay the money, but it was assumed the IMF would bail out the Russians. The IMF, however, was under pressure to bail out the East Asian nations and did not have the money to help Russia. In order to make up for the losses in Russia, hedge funds and banks began to sell off their investments and shift their capital to more solid markets. The hedge funds and banks took their money and bought U.S. T-bonds, thought to be a secure investment. The large purchasing of U.S. T-bonds drove their price down. Other markets had to raise interest rates to secure their money and were soon in trouble similar to that of Russia.

This is an example of “capital flight” as warned of by Harry Dexter White and John Maynard Keynes and demonstrates how the East Asian crisis initially spread to Russia. The IMF attempted to initiate a recovery plan in Russia, but the twenty billion dollar loan was not enough to prevent the Russian stock market from crashing or prevent Russia from defaulting on its debt. IMF assistance had similar results in Russia as it had previously. There was widespread poverty, no credible rule of law, and a decline in the standard of living. Because of the crisis in East Asia, the IMF was under intense international scrutiny, and many were skeptical of pouring money into what was perceived to be a corrupt Russian government. One such critic was the U.S. Congress, and their skepticism led to the convening of the Meltzer Commission this same year.
In November of 1998, the Meltzer Commission assembled to analyze the various international financial institutions, including the IMF, and recommend any reforms they deemed necessary. This was unprecedented for two reasons. First, it was the first serious look at the IMF and its policies by an organization outside of the IMF. Secondly, it was an attempt by the U.S. Congress to gain control of an international body that had been used to circumvent Congressional oversight. The Meltzer Commission completed its task and offered a scathing indictment of the IMF as it currently existed and operated. The commission concluded that the biggest problem was that the conditions in which the IMF had been created no longer existed. The Bretton Woods system ended in 1971 and the IMF saw its role change. “Nothing in the founding mission or the accumulated experience of the IMF prepared it to deal with these evolving changes.”

The IMF currently acts as a long-term lender to developing economies, as an information center to lend advice and council to nations that request it, and as a collector of economic data on its 182 member countries. The IMF attaches conditions to its loans, but it does not enforce the conditions of the loans equally. The IMF has slowly been increasing the scope and frequency of the advice gives, and its role as data collector consumes more man-hours than any of the other IMF
activities. In recent times, with the large number of economic crises, the IMF has also taken on the role of crisis manager. The commission concluded that the IMF’s role as crisis manager is one in which it is not well suited because “its system of short-term crisis management is too costly, its responses too slow, its advice often incorrect, and its efforts to influence policy and practice too intrusive.”

The IMF has also been used to achieve political objectives, such as when it attempted to change the command-and-control economies of the former Soviet Bloc into market economies. The IMF was not designed for state building or for interfering in the political systems of its member nations. Not only was the IMF not designed for these operations, the activities were a violation of U.S. law that forbids the circumvention of the appropriations process of the U.S. Congress. IMF practice had allowed the executive branch to use U.S. money to reach a political objective without Congressional approval.

The commission also found that the IMF generally failed to improve conditions for its member countries. The transformation of the IMF into a long-term lender has “made poorer nations increasingly dependent on the IMF and has given the IMF a degree of influence over member countries’ policymaking that is unprecedented for a multilateral institution.” Nations indebted to the IMF never seem to be able to get out of debt. There are twenty-nine nations that have been in debt to the IMF for less than ten years, twenty-five nations that have been in debt to the IMF for over ten years, forty-six nations that have been in debt to the IMF for over twenty years, twenty nations that have been in debt to the IMF
for over thirty years, and four nations that have been in debt to the IMF for over forty years. The commission found that unemployment rises and living standards fall in nations that receive IMF assistance.\textsuperscript{lxxii}

A startling aspect to the commission’s findings was the amount of influence the IMF has over its member countries. In many cases, nations that are borrowing money from the IMF will use the situation as an excuse to receive concessions from their legislatures. This results in a shift in the balance of power, away from the legislative branch and more to the executive branch. Creditor nations like the U.S. use the IMF as a tool to perform political objectives because it is free from congressional oversight, because it is an international body. Conversely, debtor nations use the IMF to gain power over their legislatures. What this does is create a chaotic political atmosphere in which nations act based on the will of the executive and not through the actions of the legislature.

The commission found that, contrary to proponents of the IMF, there is no evidence to even suggest that it has the beneficial effect of increasing the standard of living or income of its member countries. It has also hurt the U.S. The numerous crises have caused the prices of U.S. import goods to fall, which is good for consumers seeking lower prices and companies that require large amounts of imports, but it has hurt the workers and companies that are in competition with these new lower-priced imports.\textsuperscript{lxxiii}

The Meltzer Commission’s Recommendations

The Meltzer Commission made several recommendations as to how the IMF
should operate in the future. The commission felt that the IMF should be downsized and have only three major responsibilities. First, the IMF should be a lender to emerging economies only as a last resort. Second, the IMF should collect financial and economic data and publish these findings frequently at a set date in order to track this information over time. Third, the IMF should continue to provide economic advice, but it should not impose conditions on nations receiving this advice.

The commission also recommended several other guidelines by which the IMF should operate. The commission stated that the IMF should no longer give out long-term conditional loans that do nothing but create a state of permanent debt. Rather, the IMF should only give out short-term loans. In order to receive these loans, nations must permit foreign financial institutions into their nation, and the loans should not be used to protect foreign investors from economic loss. These loans should also have a maturity of 120 days with only one rollover allowed. The IMF should also be given priority in payment over other creditors. Member nations that default on a loan from the IMF will not be eligible for loans or grants from other agencies or member nations.lxxxiv

Problems with the Meltzer Report

The major problem with the Meltzer Commission report is partisanship. The commission was a bi-partisan group made up of Democratic and Republican appointees. Commission chair Allan H. Meltzer was a Republican appointee, and his appointment as chair of a group assembled to propose reforms for the IMF is
troubling given that he had previously advocated the abolition of the IMF.\textsuperscript{lxxxv}

The problem that arises from having Republican and Democrat appointees is that there is no consensus on the commission’s findings. There is a majority report that was signed by eight members, in which seven members were Republican appointees and only one of which was a Democratic appointee, and there was a dissent signed by four members, all of whom were Democratic appointees.\textsuperscript{lxxxvi}

Furthermore, three members testified before the Senate Foreign Relations Committee, and the testimony showed the same partisanship as the majority report and the dissent. The Democrat attacked the two Republicans that supported the report, and the two Republicans attacked the Democrat that did not support the report.\textsuperscript{lxxxvii}

There are other problems with the report. The report mentions that national sovereignty in member countries suffered because the IMF had too much influence over domestic policy; yet the commission states that in order to receive a loan, foreign financial institutions must be permitted access to the nation. Forcing member nations to allow foreign financial institutions into their country in order to get a loan may make one think that these are “conditional loans,” just what the commission recommended ending.\textsuperscript{lxxxviii} Also, forcing these nations to allow foreign financial institutions into their country is an attempt to make these nations become part of the western free market system. This could be viewed as a violation of national sovereignty, exactly what the commission claims to want to protect.\textsuperscript{lxxxix}
Another problem with the report is the recommendation of the 120-day maturity limit for the short-term loans. According to the commission, nations are only to seek IMF assistance as a last resort. These IMF loans are to be paid back in 120 days minimum, and at the most, 240 days or the nation will default, at which time it will not be eligible for assistance from the IMF or other member nations. So basically, these loans are conditional on the basis that they must be paid back almost immediately or the nation will forfeit its right to further assistance. This may make the poorest nations reluctant to try and receive IMF assistance for fear that they may be cut off from aid permanently if they default on the loan.

The 120-day maturity of the loans also seems very harsh. By the commission’s own admission, the economic crises of the 1990s were far worse than the Great Depression that rocked the U.S. in the 1930s. Yet, if these crises were to occur again, these nations would be required to have an economic recovery and repay their loans in less than a year. This seems harsh considering the United States’ own experience, as it could not have possibly had an economic recovery and been able to pay off its debt in less than a year during the Great Depression. Another problem is how the commission will be viewed in the eyes of the international community. While the commission does state that the IMF should not be a tool of U.S. policy, all of the reforms suggested are the product of a U.S. member only commission.

It is clear that the IMF needs to either be reformed or discontinued. It is a product of the Bretton Woods system that is trying to operate after Bretton Woods
was abolished. The increase over the years in the IMF’s supervisory and surveillance roles has done nothing to help the numerous nations that have been rocked by economic meltdown. In fact, it now seems the meltdowns that occurred in the 1990s were only made worse by IMF “assistance.” The Meltzer Commission was the first serious attempt to reform the IMF and to try and ensure that it has a future. However, it may have done just the opposite. The new guidelines which the commission recommended for the IMF to follow will prevent many nations from receiving assistance and make other nations hesitant to ask for assistance. The result is that the IMF may be put in a position that cripples it to the point that it can no longer operate. This may be good news to some people. People on the far right believe the IMF creates a “moral hazard” that rewards investors for making bad economic decisions in the form of an IMF bailout. People on the far left view the IMF as a tool of U.S. hegemony and want to abolish it.

However, the best solution probably lies somewhere in the middle. Those on the left should be satisfied if the IMF were to come under the supervision of an international body such as the United Nations. To lessen the chances that political motives would regulate IMF policy, the way votes are gathered should be changed. Currently the number of votes a nation receives is based on the percentage it contributes to the fund. This results in the G-7 and other nations in the European Union controlling fifty-six percent of the IMF votes while only making up fourteen percent of IMF member nation’s population. The simple solution is to give every nation one vote and require each nation to contribute the
same percentage to the fund. To satisfy those on the right who worry about the
“moral hazard,” there should be guidelines as to how long loans can be made and
when they should be paid back, but these guidelines should be realistic and
achievable by nations requiring assistance.
CHAPTER VI
A JAPANESE APPROACH TO ECONOMIC RECOVERY

The success of the Japanese economy in the late nineteenth century depended more on government manipulation than free trade or individual enterprise. This manipulation was able to take place because Japan emerged as an industrial nation later than the western nations. Japan was able to use the western nations as models and attempt to manipulate different aspects of the economy to avoid many of the mistakes the western nations made while transitioning to industrialization. Many aspects of industrialization, and the manipulation of that industrialization, occurred after the Tokugawa era (1603–1868). However, the infrastructure and many of the programs were created during the Tokugawa era and helped pave the way for the Meiji restoration (1868–1912).

From 1852–1868, this infrastructure took the form of roads linking major towns and cities, coastal shipping between major port cities, commercial networks, financial institutions, and proto-industrial factories and craft workshops. Western commercial penetration of East Asia, and China’s defeat in the Opium War (1839–1842), prompted the overthrow of the Tokugawa Shogunate in 1868 and its replacement by the Meiji restoration. The restoration centralized the political and fiscal institutions in order to consolidate power and
increase the security of Japan. The Meiji reforms from 1868 to 1875 were inspired by a Japanese phrase that summed up the Japanese state-of-mind during the mid-nineteenth century. The phrase is *naiyū-gaikan*, which translates to, “troubles at home, dangers from abroad.” The troubles at home were the collapse of the feudal system, economic crises, and peasant revolts. The dangers from abroad were reports of the western nations intrusion into China, which were taken very seriously by the Japanese, especially after western warships began entering Japanese ports. The historian W.G. Beasley argues that there was a challenge by the western nations, who wanted access to Japanese goods, and a response by the Japanese, who did not want what happened in China during the Opium War to repeat itself in Japan. The Japanese response took the form of the Meiji restoration and the slogans of the time provide evidence of this. These slogans include; *sonnō-jōi*, which translates to “honor the emperor, expel the barbarian,” and; *fukoku-kyōhei*, which translates to “enrich the country, strengthen the military.” From the restoration to the present, the Japanese state has linked economic security to national security and defense—an approach that reflects its Confucian Tokugawa roots and its unique approach to modern economic development.

The Japanese realized that the must learn to adapt to the western powers or suffer the same fate as China. They realized that their situation was dire and decided to learn from the very nations that threatened their way of life. The defining characteristic of the Meiji era is the integration of foreign policy and domestic economic policy. The Japanese began examining the western nations
looking for ways to strengthen the Japanese homeland—and to protect the homeland from these same western nations. The Japanese looked to Bismarckian Germany for guidance.

Bismarckian Conservatism

The most influential western nation on Japan was Germany. The Japanese were attracted to the Bismarckian conservatism that characterized Germany in the late nineteenth century. Bismarckian conservatism influenced Meiji leaders due to perceived similarities in circumstances between the German and Japanese experiences. The Germans were embracing industrialization while trying to prevent the social revolutions they saw taking place in Britain: such as socialism, the development of unions, and class cleavages. The Japanese wanted to develop an industry, but like Germany, feared the social upheaval they believed to be a characteristic of industrialization.

German economic theory was a challenge to the laissez-faire liberalism of other western nations. The Germans believed that one economic theory could not be universal to every country. They believed that a country’s economic system was inseparable from each nation’s society, culture, and history. German economic theory held that an economic system had an ethical guideline that economic policy should benefit the entire society. Therefore, they believed in a great deal of state intervention to prevent any of the class cleavages they witnessed developing in Britain. This state intervention took the form of “factory inspection laws, social insurance plans, state encouragement of consumers’ and
producers’ cooperatives, state ownership of railroads, and minimum wage laws." The ideas of Bismarckian conservatism influenced the Japanese to push for industrialization and anticipate social revolution and prevent its outbreak by adapting to Japanese circumstances and learning from the lessons of other nations that previously experienced industrialization.

Kanai Naburu (1865-1933) was the first academically trained economist of Bismarckian conservatism in Japan, and he is responsible for its introduction to Japanese industry, bureaucracy, and academia. Noburu promoted “preventive action” that became a staple of Meiji conservatism. Preventive action called for the use of western nations as models, and learning from the western experiences to plan for prevention of the social problems created by industrialization. Kuwata Kumazo, a member of a group called Shakai Seisaku Gakkai that wanted to prevent social clashes between conservatives and liberals that took place in the western nations, wrote:

The fact that the Japanese people established a constitutional system without shedding a drop of blood is a matter or great distinction in modern history. In the coming economic revolution, too, why should it not be impossible to solve this great problem peacefully?

“Growth From Above” Versus “Growth From Below”

There are two prevalent theories as to what fueled Japanese economic growth during the pre-war period. Japan’s economic growth from 1868–1920 has previously been categorized as either “growth from above” or “growth from below.” Those that advocate the growth from above theory believe the Japanese government was able to control and direct economic growth; and those that
advocate the growth from below theory believe Japan’s economy was able to
grow due to a strong economic system at the grassroots level. However, Sidney
Crawcour argues that these two views are not mutually exclusive, and in many
cases growth from below was stimulated by growth from above and vise-versa. Prior to World War I, growth from above and growth from below proceeded
together without conflict. The growing modern sector was too small to compete
with the traditional economy, and the money brought in from the traditional
economy fueled the modern sector. Once the modern sector began taking over, it
was able to develop new methods to increase the productivity of the traditional
economy. Therefore, the growth of Japan during this time period was largely
fueled by the traditional economy in conjunction with the growing modern
sector.

From 1868–1920, there was also marked by a change in the education
system. Japan’s education system was based on the notion that early uncritical
emulations of western culture had failed. Therefore, the education system took a
nationalistic approach with the primary objective of creating loyal subjects. The
farming system also went through a change because agricultural growth during
this time period was not as dramatic as previously expected. There were
substantial increases, but these took place in the form of a developing agri-
busines, such as crating silk for U.S. parachutes, and individual farmers still
faced a life of hardship. There were also changes in the Japanese banking system
in that a centralized national banking system was created in 1882. Japan’s
banking system did not grow from the needs of economic growth; rather it was
created prior to the demand for a national banking system, therefore helping to facilitate economic growth. The bank helped serve the need to balance payments and helps create successful trade. It also served to direct capital into key industries and provide low cost loans to businesses. This is a prime example of the Japanese government planning ahead by copying the western nations and creating an institution before the lack of said institution could slow economic growth.\textsuperscript{cii}

World War I and the Japanese Economy

Following the Russo-Japanese War (1904–1905), Japan’s economy began a slow downward spiral. Japan faced large amounts of public debt, an increase in prices not matched by an increase in wages, a decline in exports, and a trade deficit. From 1914–1919, Japan experienced a short economic boom when Japanese trade grew significantly due to the outbreak of World War I. Japanese industry was needed to supply the allies with munitions, and Japanese textiles filled the vacuum when the British left East Asia to focus on the war effort.\textsuperscript{ciii} Japanese GNP rose by a third, mining and manufacturing output rose by almost 50 percent, and the merchant marine fleet doubled in size. Businesses were experiencing profits so large that new plants were built and new workers were hired at rates never previously imagined. However, everything was not going as well as it seemed. Most of the perceived profits that were being experienced were not real, due to staggering wartime inflation.\textsuperscript{civ} The increased work force led to an increase in union membership, which led to an increase in labor disputes. In 1914
Japan had 50 labor disputes, in 1918 the number rose to 417, and in 1919 the number grew to 2,388.\textsuperscript{cv}

Eventually the economic boom led to a recession by 1918. Britain and the United States were attempting to reclaim their hegemony over the Asian market they had prior to the war. This reduced Japanese exports because of British and U.S. competition; additionally, the economic boom brought about severe inflation at home that drove up the prices of Japanese goods; Japan began falling back into a trade deficit.\textsuperscript{cvi} The large number of new workers found themselves unemployed, homeless, and hungry. The worsening conditions led to the 1918 food riots. Many Japanese began ransacking food stores, and many began attacking other institutions they felt were to blame for their hardships. Coming one year after the Russian Revolution (1917), these developments frightened the Japanese authorities and they responded with an iron fist. The authorities deployed 100,000 troops and 8,000 Japanese were arrested, with 5,000 convicted of a crime for their role in the riots.\textsuperscript{cvii}

While this period was marked with economic boom and recession, the benefits of the boom far outweighed the effects of the recession. Heavy industries, such as iron, steel, shipbuilding, and engineering had developed at an earlier stage in Japan’s modern economic development than in western industrialized nations. This is because they did not grow out of immediate need but, rather, the government knew that there would someday be a need for them in a modern economy through its examination the experience of western nations. Therefore, the motivation for creating many of these industries was a result of
Japanese government initiative from 1880–1910, rather than current economic need. Between 1885 and 1920, Japan’s GDP had risen 2.8 times; agriculture, forestry, and fisheries grew by 67 percent; commerce and services by 180 percent; mining and manufacturing by 580 percent; transport, communications, and public utilities by 1,700 percent; and construction by 170 percent. Japan’s export of goods and services rose 9.4 times and its imports of goods and services rose 12 times. During this period, the Japanese government was responsible for 30 to 40 percent of all capital investment, but focused on heavy industries such as railroads. Japan began to subsidize the shipping industry which had three distinct results: first, the merchant steam fleet expanded from 45,000 tons to 1.577 million tons; second, construction and maintenance of the merchant steam fleet led to an increase of heavy industrial engineering; third, the growth of the merchant steam fleet and the growth of heavy industry allowed Japan to take advantage of the vacuum that was created when the nations involved in World War I abandoned South East Asia to defend Europe.

Japanese Self-Control, 1920–1945

Following World War I, Japan faced two economic obstacles that would become catalysts pushing Japan’s economy towards state intervention. The first obstacle was economic depression. The post-war depression strained the Japanese economy, but the financial panic of 1927, the worldwide depression of 1929, and speculative dollar buying from 1930–1931 dealt severe blows to any hope of economic recovery. The second obstacle that occurred in the early 1930s was
increasing wartime production. As the Japanese went to war in Manchuria in 1931, with China in 1937, and with the U.S. in 1941, Japan needed an economy capable of meeting the wartime production demands. In order to improve the economic situation, Japan made many changes to the economy. These changes were labeled as economic “self-control” by the historian Chalmers Johnson, and were the first steps towards the economic state-control that would characterize the post World War II era. cx

Japan’s distinct economic system of this time period was begun during World War I. The economic boom was brief, and Japan was in a recession throughout most of the 1920s, and eventually fell into a depression with the rest of the world in 1929. The laissez-faire economic policies that were enacted by Takahashi Korekiyo (1854–1936) in the early 1930s allowed Japan to recover—only to find their economy and government hijacked by the military. However, the economic reforms of Takahashi allowed Japan to recover to the point that it could maintain the empire the Militarists wanted to put into place. cxii

The Japanese viewed these changing economic conditions from the early twentieth-century to the 1930s with great concern. In 1913, prior to World War I, Japan was a debtor nation with a debt of 1.1 billion yen. By 1920, Japan was a creditor nation with a surplus of 2 billion yen. The goal of Japanese economic policy was a return to the gold standard that had been abandoned during World War I. However, drastic economic conditions prevented this from occurring until 1929. These economic conditions included a post-war fall in prices of Japan’s
most valuable exports, a devastating earthquake in 1923, and the financial repercussions that resulted from the earthquake.\textsuperscript{cxii}

Japan found its economy under strain as early as 1920 and was not prepared for the worldwide deflationary trend after years of Meiji inflationary economic policy. In order to prevent continual losses, many industries combined into oligopolies and cartels began to emerge. The creation of cartels was a way for the Japanese state to push towards an oligopoly. Oligopoly is “the domination of markets by a limited number of firms.” It is a natural trend in most economies; however, in Japan it was government policy. Because competition in the world market was so fierce, the Japanese felt it was not efficient for Japan’s companies to have to compete with other national companies and then compete with international companies.\textsuperscript{cxiii} These cartels were treaty-like arrangements between the state and certain industries “to control prices, production, and the terms of trade for a whole industry.” Cartels were legalized for a few industries under the Exporter’s Association Law of 1925. Opponents of the cartel system were not very outspoken, because although they did not like the cartel system, they believed it was better than the nationalization of industry. Proponents of the cartel system were mostly the \textit{zaibatsu}. The zaibatsu were very large business conglomerates that saw cartels as a way to control competition, and they believed cartels were also useful ways of creating takeovers and mergers. Industries excluded from forming cartels began pushing for them due to the economic hardship of the Great Depression. The Important Industries Control Law of 1931 legalized cartels for the majority of big industries throughout Japan.\textsuperscript{cxiv} There was
still some substantial growth during the post-war recession due to Japan’s protectionist policies of its industry and the influx of capital into the expansion of harbors, highways, and railroads.

The U.S. panic following the stock collapse of 1929, along with Japan’s lifting of their gold embargo plunged Japan into a severe depression. The new minister of finance, Takahashi, took a laissez-faire position and allowed exchange rates to find their own equilibrium point. Takahashi used low interest rates, low exchange rates, and increased fiscal spending to help drive Japan’s economic recovery. He also recognized that slowing the domestic demand of individuals would eventually spread and slow down demand at the corporate level as well. This was a concept put forward by John Maynard Keynes but largely ignored by the western nations. There was a succession of various control laws such as the Oil Industry Law. These laws gave the Japanese government the power of approval over a firm’s yearly plans, and led to the enactment of a series of laws that imposed standards and controls over manufacturing and distribution making firms legally responsible to react to demand from the military and the public for their products.

In 1936, Takahashi was assassinated by the Japanese military, thereby making his successor, Baba Eiichi (1879–1937), very reluctant to violate the wishes of the military. Japan was now at war with China and the economy became a “control economy” in which industry was responsible for facilitating the demands of the military. As a result, the National General Mobilization Law of 1938 came into effect, giving the government powers, such as the ability to create
firms; to issue directives concerning the manufacture, use, distribution, and consumption of certain materials; and the authority to enact conscription for military and industrial needs.\textsuperscript{cxv}

One characteristic of the self-control era was a dramatic increase in laws that gave the state more control over the Japanese economy. These laws were signs that Japan was pushing towards state control. However, Japan during this time period was authoritarian not totalitarian. This means Japan pushed for state control but was not able to fully accomplish it. This is due to the fact that many of the biggest Japanese industries were not located within Japan; they were located in Japan’s colonies.\textsuperscript{cxiv}

The other important aspect of the Japanese economy was the zaibatsu. The zaibatsu were essentially large business conglomerates. These business conglomerates were a product of the Meiji era. Through Meiji government assistance, savvy business leaders were able to expand their businesses very effectively. By the time of the Russo-Japanese War, these large businesses had become even larger conglomerates. The economic boom of World War I allowed the zaibatsu to accumulate large amounts of money that would dramatically reduce the hardship that other industries went through during the post-war depression. The large size of these conglomerates also promoted stability within the zaibatsu. If a zaibatsu was faced with an economic hardship the effect was not nearly as hard of a hit as it would be on an individual business. As mentioned, the zaibatsu could rely on large amounts of stored capital or it could fall back on the resources of the component businesses that made up the zaibatsu. By 1930 the
various zaibatsu controlled large sectors of Japanese industry. The three major zaibatsu controlled 63 percent of the mining industry, 54 percent of the iron and steel industries, 37 percent of the metallurgy and machinery industries, 63 percent of the transportation and communication industries, and 50 percent of the banking industry.\textsuperscript{cxvii} Because of the large amount of the economy under the control of the zaibatsu, the political and bureaucratic elites were careful to listen to advice from, and to pay attention to what zaibatsu leaders were doing because they had so much control over the economy.\textsuperscript{cxviii}

There are a few other notable laws that show how Japan was pushing towards state-control throughout the era of self-control. One important law was Law 47 of April 6, 1933, that created the Japanese Steel Corporation. The Japanese steel industry was plagued by excessive steel production that started with the World War I economic boom. When Japan began going through economic hardship following the war, the steel industry was plagued with excess production capacity. Throughout the mid-1920s there had been calls for a government bailout or government control of the steel industry. There never seemed like an opportune time for the government to take this action. However, in the early 1930s, when the decision for military expansion had been made, it was believed that government control of the steel industry could help facilitate this expansion.\textsuperscript{cxix}

As Japan was heading closer to a national defense state and the military began pushing for state-control, the National General Mobilization Law of 1938 was passed by the Diet. Co-authored by civilian and military leaders, the
National General Mobilization Law of 1938 “was a comprehensive mobilization statute intended to cover every war production requirement by controlling labor, the establishment of new companies, additions to capital, mergers, [and] changes of product.” The National General Mobilization Law of 1938 is also important because it gave the state the ability to conduct investigations of businesses, demand reports from businesses, and give them administrative guidance. These are rights the Japanese state still has over Japanese industry today.

Within the National General Mobilization Law of 1938 was Article 17. This allowed for further state-control through the development of control associations. Written in 1938, Article 17 was not implemented until 1941 because of disputes within the Diet. The control associations were essentially the cartels formed in 1931, except that they were now official government institutions, under government control, and the leaders of the control associations were now quasi-governmental officials. Article 17 was implemented through the Transfer of Administrative Authority Law of 1942. The control associations controlled different aspects of the Japanese economy, and each business had to deal with several different control associations to operate. One example is Japan Steel, which had to deal with twenty-four different control associations to operate. By the end of World War II, there were almost 2,000 control associations “covering every industry and economic transaction in Japan.”

One final aspect of the Japanese economy was the eidan. The eidan were business units created during World War II. They were “wholly government-owned and government-managed special legal entities charged with functions that
were difficult to perform on a private, profit-making basis.\textsuperscript{cxxii} This included continuing to fund industries that by themselves lost money, but provided a service for a larger, more important industry. At the end of the war, the Japanese government had three forms of control over the Japanese economy: “the General Mobilization Bureau of the Ministry of Munitions, the eidan, and the control associations.” These are the institutions that would lead to economic state-control in the post-war period. The General Mobilization Bureau became the Economic Stabilization Board, the eidan became various government agencies, and the control associations became public corporations. The only difference between these three institutions and their pre-war forms is that they were free from the demands of the military and could now solely focus on the Japanese economy.\textsuperscript{cxxiii}

Japan already had a strong infrastructure in place that allowed it to focus on other ways to strengthen the economy from World War I to 1945. The economy was being drained by depression and its requirement to meet the needs of the military. In order to counter this drain and protect its domestic economy, the Japanese instituted various protectionist measures. The formation of cartels, conglomerates, and control associations were ways to protect Japanese industries from destroying each other in their attempt to get a share of the global market. This process created an atmosphere in which Japanese industries succeeded or failed based on international competition rather than national competition.

Japanese State-Control, 1945–1960

Following World War II, the U.S. occupation of Japan was the catalyst for the
transition from a self-control economy to a state-control economy. The Supreme Commander for the Allied Powers (SCAP) attempted to democratize the Japanese economy. However, in their attempt to reform Japan’s wartime economic structure, SCAP actually allowed Japan to strengthen its economy and put in motion economic plans that had existed since the late 1920s. These economic plans had called for the move to a state-controlled economy but were never accomplished due to the demands of the zaibatsu and the military. During the occupation, the military was no longer a factor, and SCAP broke up the zaibatsu. This allowed the transition from self-control to state-control to occur during the post-war occupation.

In an attempt to democratize Japan, SCAP enacted the National General Mobilization Abrogation Law in December of 1945. This law was intended to reverse the 1936 National General Mobilization Law that provided the legal basis for the control associations. As a result of this new law, the control associations disbanded and then reformed as trade associations. According to SCAP, these newly formed trade associations were “control associations in all but name.” The SCAP then took the dramatic step of abolishing the laws of the wartime economic structure and then demanded that the Japanese government create a new economic “planning, allocation, and rationing agency.” This new agency took the form of the Economic Stabilization Board (ESB). The ESB then delegated the bulk of its powers to the new trade associations, which were the old control associations; therefore, the economic system that the SCAP put into place
functioned just like the wartime economy, but without the obstacles placed on it by the military.

Due to the abolition of the National General Mobilization Law, the ESB did not have a legal basis to operate. Therefore, SCAP had the Diet pass the Temporary Demand and Supply Adjustment Law of 1938, which gave the government complete control over the economy. This Law was eventually abolished, as it was not intended to last forever. However, by the time of its abolition, the Ministry of International Trade and Industry (MITI) had developed new laws allowing the government to maintain complete control over the economy until the 1960s.

The next phase of state-control was the development of public corporations. These public corporations were known as kodan and “were special legal entities, tax exempt, staffed by government employees, with all their fixed capital supplied by the government.” The kodan differed from the wartime cartels in that they were completely financed and controlled by the government, whereas the wartime cartels were private institutions with private funding that operated under government supervision. Therefore, the attempt by SCAP to reform and democratize the wartime economic structure did nothing more than nationalize the economic system that was in place. The biggest change to occur under the occupation was a shifting of the power base within Japan. SCAP took away power from the zaibatsu, also took away power from the military, and put power in the hands of civilian economic bureaucrats.
During this period there were attempts to jumpstart the Japanese economy through various aid programs. While the Japanese economic structure was put back into place quite easily, the economy was still in disarray as was the country itself after being devastated during the war. As soon as the Japanese surrender was official, the U.S. pushed for Japan to become a member of the IMF and the World Bank. Japan also received aid from Government and Relief in Occupied Areas (GARIOA) and from private loans from western banks. Japan received a slight wartime boom during the Korean War (1950–1953), but following that war the economy began to slow once again.\textsuperscript{cxxx}

This is also the time period in which the U.S. and Japan began to develop a special relationship. In 1954, the U.S. enacted Public Law (PL) 480 in an effort to dispose of U.S. agricultural surplus; this resulted in an aid program for Japan.\textsuperscript{cxxxi} Japan would eventually become the leading importer of grain from the U.S., and PL 480 is what started this exchange. Japan also found a market in the U.S. for its many exports. In fact, Japan began exporting so much volume to the U.S. that by 1955 MITI imposed export restrictions on exports to the U.S. to prevent any backlash against Japanese products.\textsuperscript{cxxxi} Japan then began looking towards Western Europe for trading partners but found these nations to be not as willing trade partners as the U.S. Western Europe, itself devastated from the war, was very reluctant to trade with Japan. As early as the late 1950s, Japan found its economy healthy enough to supply far greater demand than it was facing.\textsuperscript{cxxxiii}

Japan did face several obstacles in its transformation to a state-controlled economy. First, the western economic system, or Bretton Wood’s system, was
based on the U.S. dollars convertibility into gold. Many nations began to use U.S.
dollars to backup their own currencies. This was easy for the nations of western
Europe to accomplish because they already faced a surplus of U.S. dollars.
However, Japan found it difficult to accumulate enough surplus U.S. dollars to
properly backup its currency, making it appear as a risky investment on the world
market. Although these obstacles were great, Japan benefited during the
post-war era more than any other nation. Much of this had to do with its special
relationship with the U.S. Japan was considered a valuable Cold War ally that the
U.S. did not want to lose. Therefore, Japan was able to avoid forced liberalization
of its market, received economic concessions from the U.S., and received access
to foreign markets. In return, the U.S. received military bases, supporting votes in
the United Nations and IMF, and support of the Vietnam War.

Japanese Capitalism
What may explain the Japanese economic miracle further is to distinguish the
difference between Japanese capitalism and western capitalism. In Japanese
capitalism, markets are seen as a source of economic growth where in western
capitalism markets are seen as an indicator of short-term efficiency. In western
capitalism the governments provide incentives to foster the growth of domestic
producers. In Japanese capitalism, the government develops a policy that looks
long-term rather than changing a situation to boost short-term efficiency that may
have unanticipated long-term consequences. An example of long-term
government policy is the lowering of interest rates and increasing fiscal spending
to help drive the economy. One of this paper’s main critiques of the IMF is that restoring debt payments is only a short-term resolution and does nothing to further the long-term development of these developing economies.

The major difference between the different variations of capitalism is how efficiency is viewed. There are three major variations of efficiency within capitalism. These three variations of efficiency are: “Ricardian efficiency (the allocation of resources according to their effects on current economic conditions), growth efficiency (the allocation of resources according to their effects on economic growth), and Schumpeterian efficiency (the allocation of resources according to their effects on the pace and direction of technological change).” Japan follows growth and Shumpeterian efficiency and the western capitalism follows Ricardian efficiency. The difference can be seen in post-war production techniques. The U.S., looking for short-term growth, used advancing technology to increase volume production. In Japan, technology was based on flexible production rather than volume. The results of these distinct variations of capitalism were a post-war economic boom by the U.S. that peaked and began to fall just as Japan’s economic boom was occurring. Considering the fact that Japan was peaking as the U.S. was falling, and that the two nations were trading partners at the time, shows that the variations of capitalism have quite distinct results. As economist and historian Chalmers Johnson concisely states:

Asian capitalism, understood as a version of Japan’s combination of a strong state, industrial policy, producer economics, and managerial autonomy, seems destined to lie at the center rather than the periphery of what economists will teach their students in the next century.
Conclusion

The defining characteristic of Japanese economic development was that it occurred later than the development in the western nations. Japan also developed at a much faster rate, this is due to an examination of the development of western nations that allowed the Japanese to avoid mistakes and create predictions as to what economic policies to enact. Though Japan’s economic development was based on that of western nations, it became something quite distinct. The Japanese planned for long-term economic development and national security. They continued the tradition of government supervision and direction of commerce, industry, and banking. The Japanese used vigorous investment in financial, communication, and industrial infrastructure. Along with the creation of organizational frameworks linking state and enterprise to maximize domestic industrial development and international trade while minimizing domestic competition, boom and bust cycles, and class conflict.

Japan also took a greater amount of control over their economy than their western counterparts. This large amount of control allowed Japan to dictate economic policy that would be considered inefficient in the west due to different views of efficiency. The difference in views on efficiency is another area where the Japanese differed greatly from the western nations they studied. The Japanese believed efficiency should be judged in long-term results, whereas western nations judge efficiency on short-term results. From 1868–1960, the combination of government control, and planning for long-term efficiency, allowed Japan to create an economy that is commonly called a “miracle.”
Perhaps the biggest weakness in IMF reforms is that their prescriptions are based on a western economic model derived from western economic experience. The countries that experience economic crisis are countries that are still developing, and IMF reforms attempt to alleviate short-term crisis rather than support long-term development. The western nations that control the IMF have been at the forefront of economic development and do not understand the proper steps a developing nation should take in order to catch up to the developed world. One nation that understands what steps that need to be taken is Japan. Japan was considered to be a backward nation, as recently as the 1890s, but by the 1960s, Japan became an economic powerhouse and model for economic development. By examining the development of Japan, flaws in the IMF approach become apparent.

The major characteristic of Japanese capitalism, which developed from the Tokugawa tradition and Bismarckian conservatism, is the adaptation to individual circumstances and learning lessons from nations that previously experienced similar situations. These ideas should form the backbone of IMF reform. Had the IMF realized that the circumstances in Thailand were different from the circumstances in Mexico, perhaps the methods of reform would have been
different as well. The Japanese looked at the development of western nations so they could plan their development and be prepared for any consequences of that development. On the contrary, the IMF initiated policies run counter to policies the western nations instituted during their development. One example would be protectionist policies; Japan and the western nations protected their goods from foreign competition during their early years of modern economic development while the IMF routinely prescribes free trade policies. The IMF should allow for crisis nations to create protectionist policies in order to help make sure that money being spent by the population does not leave the country.

Infrastructure

The developing economies of East Asia were seen as very strong prior to the 1997 meltdown. This was because of their strong export sector. Japan was able to develop a strong export sector by investing in the infrastructure of the economy. When exports slowed in Thailand in 1997 and IMF policies initiated the meltdown, the vast sums of money the IMF provided in loans went to pay off Thailand’s debt. Perhaps, if IMF relief funds had invested in the infrastructure of the economy, the nation could have recovered and continued paying off its debt. As it stands now, the IMF provides loans that do nothing more than increase a nation’s debt without addressing the weak economic infrastructure within the developing nations. Crisis nations must be allowed to use IMF monies to invest in their infrastructure—or else any improvements made by the IMF will only be
short-term because the crisis nations will still not have the infrastructure needed to promote economic growth.

Thailand and Mexico both feature a traditional economy based on agriculture and a growing industrial economy. The IMF might have advocated “growth from above” and “growth from below” so that the modern sector and the traditional agricultural sector could have reinforced each other. Instead, as previously mentioned, the IMF ignored infrastructure and converted the traditional economies into agri-businesses. If the IMF had followed the Japanese model, they could have contributed to infrastructure and developed an industrial base that could be fueled by the traditional economy. Instead, the IMF increased debt and transformed the traditional economy into agri-business. This led to Mexico’s inability to provide enough food for its population, and western corporations owned many of the agri-businesses so that any profit made from what was left of the traditional economy went to another nation.\textsuperscript{exli}

The previous chapter gave several examples of Japan investing in infrastructure, even before their economy needed many of these investments. The benefit of this investment was that it gave Japan an ability to foster growth faster and more efficiently than it would have been able to do without the infrastructure. Japan recognized the need for infrastructure by thinking about the economy very differently than the IMF. The IMF operates within the western economic system that is too focused on short-term results. Japan’s investment in agriculture was a result of long-term planning. The IMF’s idea of successful crisis management is the ability to get a nation to continue paying off its debt. This short-term result
does not benefit the nation in crisis, only the nation it is indebted to. And more importantly, it does nothing to help with long-term development.

Interest Rates
Japan instituted low interest rates, low exchange rates, and increased fiscal spending to drive economic recovery. The IMF does just the opposite. It institutes high interest rates that, in the case of Thailand for example, slowed the economy to a halt. Japan also increased fiscal spending, something the IMF conditions do not allow nations in crisis to do. The IMF requires that any excess monies be put towards the debt, rather than back into the economy; and in many cases, it calls for decreases in fiscal spending to create more money to be put towards the debt. The very fact that the IMF increases interest rates and slows government spending in the name of improving an economy should cause alarm in anyone with a basic knowledge of the history of modern economic development. That is the exact opposite of what is supposed to be done to promote economic growth. Interest rates are lowered when the economy needs to expand, and the U.S. got through the Great Depression by implementing large scale government spending known as the New Deal, which gave the federal government much more control over the economy. The nations in crisis should be allowed some control over their economies, and the IMF should lower interest rates to promote investment within the nation. These nations need monies to be invested within them, which is what low interest rates would provide.
Protectionist Measures

The formation of cartels, conglomerates, and control associations were ways to protect Japanese industries from destroying each other in their attempt to get a share of the global market. This process created an atmosphere in which Japanese industries succeeded or failed based on international competition rather than national competition. This is a process the IMF would never think of instituting for nations in crisis. The Japanese essentially nationalized the economy as a protectionist measure. The IMF prescribes free trade, when crisis nations could reduce competition through the nationalization of certain industries. This reduces competition within the crisis nation and makes its goods more valuable on the international market. In Thailand, this approach could have had great benefits because the crisis started when Thai exports slowed. The nationalization of industry could have protected Thai exports. The IMF needs to allow for protectionist measures, even if foreign nations will not make money off of the crisis nations. The IMF needs to remember that its goal is to help the nations in crisis, not create an atmosphere in which foreign corporations can profit. Protectionist measures do just that. They help protect the nations in crisis from international competition.

Crisis Management

Japan and the U.S. found goods each other needed and set up a trade relationship.

When a member nation is in need of a certain good, the IMF should take notice
and then set up a relationship with another nation that has that good. Priority should be given to developing nations because this could prevent the slowing of exports, such as happened in Thailand or Mexico. An example of this would be Mexico’s steel industry. When Mexico’s steel industry slowed due to U.S. protectionist measures, the IMF should have located another member nation that needed steel, and set up a trade relationship between the two nations. One main critique of the IMF by the Meltzer Commission was the forced liberalization of developing economies. The IMF should not force liberalization. Instead of economic concessions, it should provide debt forgiveness, and it should facilitate access into foreign markets. These were steps the U.S. took with Japan after World War II and it became one the strongest economies on the planet.

Bretton Woods Revisited

While the IMF may not work well and is far from perfect, the abolition of an international relief fund can only be seen as a step in the wrong direction. Perhaps what would be best is for the Bretton Woods conference to be revisited. A new conference with economists from around the world could come together and create a new international financial system comparable to the work done by economists at Bretton Woods. Ideally, a Bretton Woods-type conference should be held every ten or twenty years so that problems in the international financial system can be identified and fixed so the system evolves rather than collapses. It would not be a giant leap to assume that an international group of economists
could certainly come up with better ideas and concepts of reform for the IMF than the eleven-member Meltzer Commission.

Certain reforms should be made so the IMF is not viewed as a tool of U.S. hegemony. As it stands now, the seven nations that make up the G-7 control over fifty percent of the votes. This should be changed so each nation gets an equal vote and is therefore considered an equal member. The biggest reform should come in a changing of perspective in IMF prescriptions. Rather than looking for short-term fixes to help developing nations resume debt payments, the IMF should look for long-term solutions to promote economic growth. There should also be temporary debt forgiveness so that any IMF loans that come into the country could be put into rebuilding the infrastructure rather than immediately leaving the country in debt payments.

The IMF should also follow basic economic guidelines and cease raising interest rates in crisis nations. All this does is slow down the domestic economy and create an atmosphere where investors use the high interest rates to make money while the people of the nation suffer. The IMF should also encourage nations to put money into social programs and infrastructure rather than demanding that the nations reduce these investments. Another reform would be ceasing the forced liberalization of member nations. The IMF should allow member nations to nationalize parts of their industry and enact protectionist measures. The forced liberalization of markets only makes economic recovery more difficult because companies have to compete with national and international competitors.
Perhaps the most important reform is the one that would be the most difficult to achieve. This would be a return to a system similar to the Bretton Woods system that allows for the regulation of international capital flows. Greater regulation of capital would lead to more efficient global trade and would serve as a protection against capital flight.

The IMF after Meltzer

The Meltzer Commission was the first serious look at the IMF and attempt to reform it. However, the commission was still stuck in a western model and believed adequate reform was in making short-term reforms more efficient rather than creating long-term economic solutions that foster development. In fact, the Meltzer Commission should be viewed as a complete failure. Following the commission’s recommendations, there was yet another economic meltdown caused by the IMF, this time in Argentina. Throughout the late 1990s, Argentina followed IMF prescriptions and sold off 80 percent of its banking industry to foreign institutions, it pegged its currency to the U.S. dollar, and by 2002 was rewarded with the largest amount of public debt ever held by any country; Argentina was in debt $160 billion. In December of 2000, the IMF gave Argentina a $40 billion dollar “conditional” loan. The IMF “conditions” required that Argentina fire large numbers of government workers, reduce wages, and end benefits. The result was that national income shrank by two-thirds, and Argentina went through five governments and six economic ministers in less than a year.
Argentina found that it could not repay the $40 billion, and the country defaulted on the loan.

Following the recommendations of the Meltzer Commission, the IMF then refused to offer Argentina any more aid, and it could not receive aid from any IMF-member nation. The Argentine peso’s value on the open market then fell by 220 percent.\textsuperscript{cxliii} While some members of the U.S. Congress wondered whether the mass firing of government officials in Argentina was a good solution, others were more concerned about U.S. corporations losing money and felt the solution to the problem was giving corporations that invested in Argentina tax breaks to help make up the money they lost.\textsuperscript{cxliv} This is the IMF in action after enacting the Meltzer Commission’s recommendations for reform, and it does not seem as if anything has improved. The IMF needs to be reformed with guidelines that protect the crisis nations. If this is not done, the IMF will continue to be viewed as a tool of western, namely US, hegemony. The reforms that were enacted by the Meltzer Commission make the words of Soviet economist Mailakovievich Volkov seem prophetic when he wrote in 1976:

Although the imperialists have lost their colonies, they are as avid as ever to fleece other people, if they can. To do so in the changed circumstances, they are building a new system of exploitation in place of the shattered colonial system, using new methods towards the same end, which is to keep the now independent peoples under their own economic control.\textsuperscript{cxlv}
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