# Japan at the OECD and the OECD in Japan

## A story of economic policymaking

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**Japan and the OECD have worked hard to get to know each other over the last 50 years.**

A rather sarcastic view of Japan's role in international organisations was expressed in the *Financial Times* of 22 January 1992. The article was entitled "Japan's turn", and it said: "Japan has been better at donating money, rather than its brightest civil servants, to international organisations. So, Kumiharu Shigehara's career as the OECD's next Chief Economist will be watched with more than usual interest".

Not only was I about to become the first ever Japanese Chief Economist at the OECD, but the *Financial Times* writer described me as one of a new breed of "assertive and internationally-minded" economists who "speak their mind". Could I live up to the billing?

To tell the truth, I initially declined a personal invitation from Jean-Claude Paye, then secretary-general of the OECD, who sent his chief of staff to my office in Tokyo in autumn 1991–I was then chief economist of the Bank of Japan–to ask me to consider running for the post of Head of the OECD Economics Department. I had heard rumblings of dissatisfaction from finance and central bank officials from major OECD countries, particularly about how two key bodies–the Economic Policy Committee (EPC) and the enigmatic-sounding Working Party No 3 (WP3)–were being run. Moreover, I had already worked at the OECD on three previous occasions, including as a director in the Economics Department, so I was well aware that the task of reviving these bodies would be daunting. Besides, the personal costs of curtailing my career as chief economist at the Bank of Japan and going back to Paris would be high. But I decided to take up the challenge when some months later the OECD secretary-general himself rang me to persuade me to put my name forward.

The announcement of my return to the OECD generated some interesting reactions. Mervyn King (then executive director, later governor, of the Bank of England) sent me a letter of congratulations and strong encouragement. A more nuanced letter came from Steve Axilrod, who was the most powerful staff director at the US Federal Reserve Board and the right-hand man of Paul Volker, the Fed's chairman. While he thought it good for Japan to have someone of my ability in a key international position, he felt it might be even better for Japan if I remained at home. However I was supposed to take this message, at least I realised that all eyes would be on my performance.

This impression was confirmed several months after my return to the OECD, when the *Financial Times* reported on my reform efforts at the OECD with the headline "Think-tank operator seeks a refill of ideas". Even the main picture was of me.

Refill and reform I did, with positive results. In 1994 Secretary-General Paye passed on very favourable comments on the department's recent work from senior officials of the UK treasury who had been most critical of its past performance. Our Economic Policy Committee's work had been "dramatically transformed" and "very satisfactory", their memos proclaimed. They even went as far as to describe the WP3 as "the best-prepared international meeting".

Now, outsiders may be able to hazard a guess at what the Economic Policy Committee does: as its name suggests, it monitors and reviews the economic and financial situation and policies of OECD and partner countries, in line with the organisation's objectives. But it is much harder to understand the value of work done at the highly confidential WP3. Yet as a body that watches over policy impacts on balance of payments, not only does it have global influence, it also attracts top people. To be effective, those people need to know each other, speak candidly off the record and express their own opinions. Restoring that sense of personal contact at WP3 was a goal I set. The late Sir Andrew Crockett, who was the general manager of the Bank for International Settlements (BIS), wrote in 2011: "(I)n the end, what one remembers of a two-decade hitch with WP3 is not so much the policy issues (after all, these discussions were going on in multiple other fora as well). It is the individuals, and the sense of camaraderie that builds up as economists responsible for policy issues put their trade at the service of public policy".

**Different views**

International economic policy co-operation can lead to unsatisfactory outcomes in the long run, as Japan once found out to its cost and to the cost of some of its trading partners too.

Allan Meltzer noted: "Japanese policymakers in the second half of the 1980s changed from a credible policy of maintaining low inflation to an exchange rate target at a time of deregulation. The new policy financed the so-called 'bubble economy'".

This occurred despite the OECD warning in its November 1986 report on Japan that "further relaxation (of monetary policy) may risk excessive monetary growth". But the Bank of Japan ignored its message and reduced its discount rate further to 2.5% on 1 November 1986. It did this ostensibly to contribute to exchange rate stability and to promote domestic demand-led economic growth, while reducing Japan's current account surplus. In reality, the Japanese central bank was at that time under the control of the Finance Ministry under an archaic law dating from wartime.

> "Good judgement and communication help political leaders implement policies and convince electorates of their benefits

The result was a major bubble in the late 1980s, which burst in 1991, causing a protracted downturn that cost Japan and its trade partners dearly. My argument as OECD chief economist during most of this phase, particularly strongly expressed in the 1994-95 period of the yen's sharp appreciation and later, was that an effective way to jump-start the Japanese economy would be an aggressive easing of domestic monetary conditions to ward off a deflationary spiral; but if nominal short-term interest rates fell towards 0%, causing a liquidity trap (this is known as the "zero lower-bound problem") it would be essential for an open economy facing recession to resort to another effective stimulative mechanism, namely a package of measures including currency depreciation and growth enhancing structural reform with further opening of domestic markets, if at all possible, with the understanding and support of its trade partners. Japan's nominal interest rates did approach zero in the late 1990s, but my policy advice did not find favour in Japan or the US at the time. Yet today it is essentially the first and the third of the three pillars of the so-called "Abenomics" announced in November 2012 by Prime Minister Shinzo Abe, who was then leader of the opposition Liberal Democratic Party.

More recently, the outbreak of the global financial and economic crisis has revealed weaknesses in global as well as regional frameworks. Indeed, neither global surveillance by international institutions such as the International Monetary Fund (IMF) and the OECD, nor regional surveillance by the European Commission, proved to be effective. These disappointing policy experiences demonstrate that delayed policy adaptation to changing conditions is costly, and that what is needed is flexible and smooth immediate adjustment. They also underline the importance of good judgement and communication in helping political leaders and senior officials not only to implement timely policies, but to convince their electorates of the benefits.

Japan can still draw lessons from this. Though its economy appears to be improving, there is still uncertainty ahead, both at home and in neighbouring markets. Let's hope policy can adapt quickly as circumstances change again.

* Kumiharu Shigehara's career at the OECD spanned 30 years, from 1970 when he joined as an economist to 1999 when he was deputy secretary-general. For a brief interlude (1989-92) Mr Shigehara was the Bank of Japan's chief economist and head of the Institute for Monetary and Economic Studies.

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