

Japan's Attitude Towards External Debts of Developing Countries

Masahiko Agata

Introduction

Japan, having grown to be a major figure in the world economic scene and having persistent current account surpluses, and now determined to realign its economy toward one in better international harmony and to assume a relevant role in the multilateral efforts to re-establish the world's stability and growth, takes the contemporary debt issue as an important area where it should address its care and resources most positively, not for the benefit of only a few (nationality-, industry-, and entity-wise) but in the broadest possible global context. This paper intends mainly to discuss how its official efforts are being done and how an agency which plays a major part in such efforts acts. It does not represent the official view either of the Export-Import Bank or of the Government of Japan but purely that of the author, where opinions are offered.

The Contemporary Debt Issue

Is It Just a Question of How the Existing Debts be Dealt With?

In retrospect, the debt problem of developing countries had the most crucial stage in the 1970s — more specifically after the 1973 'oil crisis'. The abrupt increase in oil prices brought to the non-oil producing developing countries a drastic increase of their current account deficits, and the developed countries, also plunging into adverse balance of payments, were able to allow only a reduced flow of their official funds, more of which would otherwise have gone to compensate for the developing countries' widened deficits. The 'oil money' deposited with private money centre banks enabled a dramatic increase of commercial loans, notably syndicated loans on a floating interest rate basis to occur, and that in turn enabled the developing countries' undwindling appetite for investment to be met. The amount of private source funds borrowed by developing countries shot up from US\$ 3.0 bn a year (average) during 1971-73 to US\$ 13.8 bn a year during 1974-76. The subsequent rise in dollar interest rates, together with the shift of major commercial lenders' attitude toward more conservative balance sheets, pushed the developing country debtors toward the shorter-term finance that was available or to negotiated resche-

dulings with their creditors. Once news of a country's rescheduling became known, investors in that country were swift to precipitate in the flight of their own capital too.

This sequence prompted the realisation that developed nations need to maintain uninterrupted flow of financing toward the developing countries. In the autumn of 1985 the then US Secretary of the Treasury announced the so-called 'Baker Initiative' in which he stressed the importance for debtor countries to be seriously engaged in their economic restructuring measures while he called for creditors to be flexible in providing *new money* to an extent that would permit debtors to sustain growth. The Japanese government accepted the initiative positively as one that addressed the issue rightly; i.e. making a *dynamic approach* placing an emphasis on enabling the debtors' economies to be active and helping them return to the reproductive spiral. To date, this *dynamic approach* has not changed as the mainstay in Japan's debt strategy, in the belief that developing economies have a fair chance to attain a path of self-sustaining growth if they follow the lessons particularly of the Newly Industrialising Economies (NIEs) which proved their potentials by achieving and maintaining healthy and, indeed, remarkable growth through raising export-oriented industries.

If there was a weakness in Mr. Baker's concept, it was perhaps in the degree of expectation and the selection of method for the commercial banks' tolerance in providing new money while putting up bad-debts provisions for the same debtors. The 'New Baker Initiative' of late 1987 encouraged the use of new techniques; e.g. debt-equity swap and debt-debt conversion, etc. It was an attempt to broaden the choice of applicable means and to tap resources in addition to the conventional form of new money. The proposal made in 1988 by Mr. K. Miyazawa, then Minister of Finance of Japan, was based on a similar approach. He drew up a three-point plan calling for (1) agreement between the indebted country and the IMF on a medium-term structural adjustment programme, for which an Expanded Financing Facility (of the IMF) would be made available providing the base for two accompanying actions; i.e.

(2) increased financial flows from both multilateral- and bilateral-institutions, and

(3) splitting the existing obligations to private creditors into two; one being converted into bonds and the other rescheduled, both supported by the IMF-controlled special reserve account set up by the debtor as collateral (or 'credit enhancement'). The 'Brady Initiative', announced in March 1989, turned out to have much in common with this Miyazawa Proposal.

In parallel to such evolution, there were on-going efforts by the government of Japan to accelerate the increase of its Official Development Assistance — a medium-term plan to increase it to an equivalent of 1 per cent of GNP, or to US\$50 bn, within a five year-period, shortened from the original seven years, and in May 1987 there came 'Emergency Measures', an announcement comprising principally the 6,000 bn yen-worth of measures to stimulate domestic demand on the one hand and a programme to have US\$20 bn¹ of the accumulated current account surpluses rechannelled (recycled) to the developing areas in the world on the other. The latter, named the 'Recycling Programme', has become one major and yet unique source of *new money* in the context of international efforts to tackle the world debt problem.

Japan's Fund Recycling Programme

The First Round

As already said, the programme had a size of US\$30 bn to be implemented from the three years ending with Japanese fiscal year 1989. It was decided that: (a) the recycled money should take the form of loans, except for the part made by way of the government's direct contribution to the multilateral development banks (MDBs), (b) the entire funds provided should be fully untied — their uses not tied to purchases of goods and services from Japan, (c) in providing public funds under this programme, private funds should be encouraged to come with them so that the whole recycling effect could be enhanced, and (d) its implementation be aimed at giving its effect as pin-pointedly and as soon as possible.

The \$30 bn is classified into the following four basic categories by mode of implementation (Reclassified by the author. Each allocated amount shown is a minimum target).

Category-A \$8 bn: direct support to MDBs, e.g. capital contributions and subscriptions to the IBRD, ADB and IADB, supplemental assistance ensuring MDBs' smooth issuance of bonds in the Tokyo capital market, etc.

Category-B \$9 bn: loans made by way of co-

¹ It has later become known as \$30 bn programme, counting-in also a \$10 bn programme that had been effected immediately prior to the comprehensive 'Emergency Economic Measures'. This \$30 bn roughly coincides with the size of the negative net flow of capital from developing countries to the developed in 1986.

financing with MDBs. This is further split into two; i.e.

B1: \$6 bn handled by the Export-Import Bank of Japan, and

B-2: \$3 bn handled by the Overseas Economic Cooperation Fund (Japan's aid-loan window).

Category-C \$3 bn: loans provided by the Export-Import Bank of Japan, not in co-financing with the MDBs. It includes also the bank's partial purchase of bonds issued by foreign public entities.

Category-D (Non-Classified)

\$10 bn: establishing 'Japan Special Fund' with the World Bank (approx. \$20 bn), subscriptions to MDBs' capital replenishment (IADB, Asian Development Fund; approx. \$3.9 bn), loan to the IMF (approx. \$3.6 bn), etc.

As seen above, except for the part handled directly by the government itself, the programme's implementation has been commissioned to two governmental institutions, the Export-Import Bank of Japan (JEXIM) and the Overseas Economic Cooperation Fund (OECF). While the OECF's responsibility is easily identifiable as Category B-2 (more than \$3 bn), the JEXIM was originally designated to handle a minimum aggregate of \$9 bn (Categories B-1 and C) and later took charge of providing a SDR 2.2 bn loan (US\$3.0 bn-equivalent) to the IMF for its Enhanced Structural Adjustment Facility (ESAF), which falls under Category D.

Where, then, are these funds actually to be applied? A part of the programme, Categories A and D, goes to the MDBs for their repletion of operational resources, be it to their ordinary capital resources or certain funds set aside for special operations. Categories B and C are applied to the selected priority projects and/or the most imminent structural adjustment policy packages of developing countries and areas. In the programme's operation, particularly in the latter (the so-called policy based lending = PBL), it is recognised that the application of funds to the most objectively needed areas often requires special efforts to do it correctly, for example inducing recipients to choose a difficult and occasionally unpopular project/policy option, ensuring the consistent and exact execution of the agreed project/policy, and, by no means less importantly, ensuring the use of funds to be in a truly *untied* manner.² For these reasons and because Japan's bilateral agencies wish to avoid any appearance of domestic intervention, co-financing and co-working with MDBs is found to be realistic and, indeed, considerably helpful.

Sometimes questions are raised regarding the use of

² For this reason the JEXIM entered a cooperation agreement with Crown Agents of the UK in August 1989.

the JEXIM as a major player in implementing the programme. Many such questions are based on an understandable yet incorrect comprehension of the character of the bank; i.e. it would be reasonable to expect JEXIM to be similar to the many export import banks in the world which are preoccupied with the task of promoting the respective nation's exports. If this view were correct, there would be no conceivable reason for the JEXIM to be involved in this Recycling Programme other than the concealed expectation that the programme would be effectively helpful to Japan's further exports. However, JEXIM is substantially different from many similarly named institutions in other countries for it has long been operating not only export credit but also other actual functions; i.e. import credit (traditionally financing natural resource development overseas and, lately, offering a promotional facility for manufactured imports: use of credit therefore is not linked to Japanese goods and services), overseas investment credit (financing Japanese direct investment overseas, particularly toward developing countries; untied to Japanese exports) and it has indeed a legal provision³ under which it has been making loans to overseas borrowers for their necessities to import supplies freely from anywhere in the world provided that such import were for specifically agreed projects — '*untied loans*'. The bank has thus been acting as a multi-function long-term lender, not only for the cause of Japanese export. It had a good reason therefore to be chosen to play the main role in the Recycling Programme, dealing with developing countries' development financing. At the same time, however, there are areas under the programme that the bank is not so familiar with; e.g. dealing with the lower-income developing countries (those often called the 'Pure IDA Countries') and, especially, the basic infrastructural projects in these countries; and therefore those countries and types of projects are set aside to be handled by the OECF.

The Extended Round

In July 1989, just prior to the 'Arch Summit' and when the Recycling Programme was more than 90 per cent accomplished in terms of concrete commitments with eight months left in the programme period, the Government of Japan announced the expansion of the ongoing programme and an extension of the period. The extended programme was given an aggregate of 'more than \$65 bn' in size and a programme period of five years toward end-FY1991 (inclusive of the original \$30 bn for the three years). The incremental \$35 bn is classified into the following three categories (Category names correspond to those of the original Programme, and this classification was redone by the author for readers' ease).

Category A \$14.5 bn (government)

Category B, C \$16.0 bn (JEXIM/OECF loans)

Category D \$4.5 bn: JEXIM's loans specially made in parallel to the medium-term facility of the IMF.

Notable in this new, stepped-up programme is its inclusion of a pledge of \$4.5 bn 'parallel lending' to accompany the IMF's medium-term facility, which would be provided when a medium-term structural adjustment programme is agreed upon with the debtor as part of the 'Brady Initiative' (or the 'New Debt Strategy') announced just a few months before. Under the New Debt Strategy-based packages to help Mexico and the Philippines, the JEXIM has committed \$1,000 mn- and \$300 mn-equivalent respectively as loans in parallel with the IMF credits (the former, in addition to the JEXIM's \$1.05 bn loan in co-financing with the World Bank). It should be remembered, however, that even in such New Debt Strategy operations the JEXIM's untied loans cannot be made as a resource with which the recipient can 'buy-back' or otherwise dispose of its existing debts but can be provided only to finance the debtor countries' ordinary imports (excluding arms and a few other specifically negative-listed items) in accordance with the bank's statutory restriction.

Conclusion — Still a Long Way to Go

Aside from the above outline of Japan's official initiative in injecting net additional financial resources, there is a positive recognition of the constructive role that foreign direct investment can play in the broad context of the debt strategy. It becomes more evident when we take this foreign direct investment into account that the success of these debt strategies relies upon how the debtor countries endeavour to create an environment of confidence which will be required to attract new loans and foreign investment. The debt reduction scheme, although it has finally been admitted into the latest debt strategy, is the last concession that commercial bankers can offer, and can give only a marginal solution to the whole magnitude of the debt problems of developing economies in the world. It is a persistent fear that such a concession might cause a moral hazard discouraging those countries which are seriously and therefore painfully struggling to restructure their economies. Should such countries as Indonesia, Turkey, Colombia, etc., among others, who are exerting all their powers to resist the external debt burden and to meet existing obligations, fail to keep doing so, it will mean not only that all past efforts concerning those countries will go down the drain but also that the international financing system will end up carrying more insolvent assets than it can bear. Thus, one should always remember the needs of these better performing countries, keeping financial flows going to them and providing them with as favourable an environment as

³ Article 18-8 of the bank's statute.

possible — particularly in keeping the interest rates of key international currencies low.

As for the countries whose external debt problems have been revealed, both the debtor countries and their creditors should avoid taking a short-sighted view simply to evade present debt burdens. They need a longer perspective in order to build up a structure that will enable the economy to expand after the restrained, equilibrium-aimed measures. These can be coped with only by a *dynamic approach* by the creditors and with the presence of willing donors.

There has been and still will be the so-called '*Vicious Circle of Poverty*' in many developing economies; i.e. a low level of standard of living causing a low rate of domestic savings, then a low rate of domestic investment that allows only low productivity, thus bringing about yet lower living standards — a

mechanism which obliges the economy to resort to external financing when an investment becomes necessary, and thus is likely to cause the external debt servicing burden to grow. Altogether, the new debt strategies have a long way to go, in pain and with patience for at least some of those involved, on case by case bases — a way which cannot and should not be avoided under present circumstances. Japan is determined to bear its share, and is calling for others to do so, while the JEXIM is meeting the challenge of dealing with a great number of requests from interested governments and institutions concerning its untied loans under the Recycling Programme. Such a volume of work occasionally requires even the bank to make organisational and institutional adjustments in addition to maintaining its inevitable closer vigilance as a bank over its own asset profile.