Ensuring Global Economic Health

By Hideaki Kumano

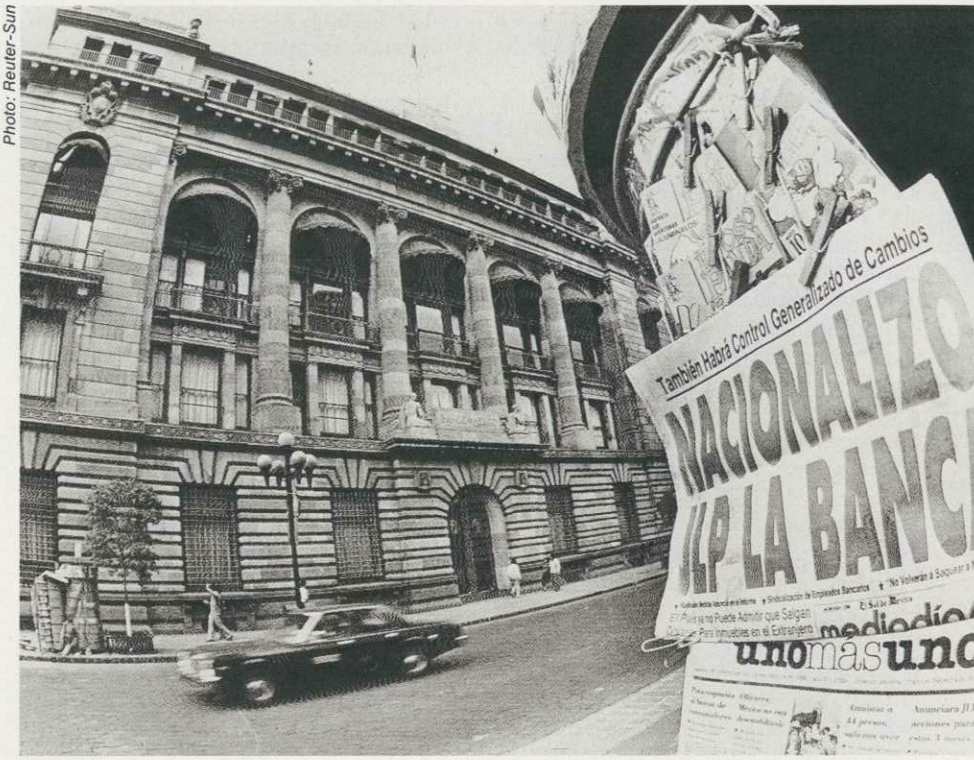


Photo: Reuter-Sun

A Mexico City newspaper at a kiosk near the shuttered Central Bank headlines the nationalization of private banks.

At first blush, international trade insurance (which covers exports, imports and direct foreign investment) may not appear to have much of a connection with developing countries' debt problems. Rather, there is a widespread perception that most of the developing countries' debts represent borrowing from private banks. Trade insurance has a major place in the debt issue, however, and the developing countries hope that it will be increasingly used to help relieve their indebtedness. Trade insurance has become important in light of the rising expectations that Japan will do more to contribute to the international community's economic vitality.

Debt burden eased

The long-festering debt problem was rocketed to international crisis proportions by the Mexican debt crisis of 1982. In the 1970s, Mexico and many other Latin American countries had borrowed heavily from the industrial countries in an ambitious attempt at development, building on the enhanced creditworthiness arising from higher commodity prices. This borrowing took many forms, one of which was credits for deferred payment in the case of importing manufacturing plants and other productive facilities. Trade insurance was extended to cover the risk accompanying these export credits.

As interest rates rose and commodity prices fell in the 1980s, many of the same developing countries found themselves unable to repay their debts and asked the industrial (creditor) countries to reschedule their repayments. This rescheduling has been done in two main forums: the Paris Club for official credits (including commercial credits covered by trade insurance) and the London Club for borrowing from private banks.

When a developing country requests rescheduling of its debt, the creditor countries meet with the debtor country in the Paris Club to decide whether or not the debts should be rescheduled and, if so, what the new terms should be.

Rescheduling means that payment will not be made to the exporter on the date specified in the original contract. Accordingly, the insurer makes payment to the exporter in lieu of the developing country and becomes the de facto creditor. Thus debts that are covered by trade insurance, even though originally private-sector commercial debts, are subject to consultation among the governments concerned at the Paris Club in the same way as direct loans from creditor governments.

In Japan, when the Ministry of International Trade and Industry (MITI)—the Japanese government ministry responsible for administering trade insurance—effects an insurance disbursement in accordance with the insurance contract, MITI, as the de facto creditor, then becomes entitled to receive payment under the terms of the rescheduling (Fig. 1).

Given this fact, it is clear that trade insurance has taken much of the burden off the debtor countries. Applauding the central role played by the Paris Club in alleviating the debt problem, the Economic Declaration adopted by last June's Toronto economic summit noted that $73 billion of principal and interest have been consolidated since 1983. During this same period, Japanese trade insurance has made payments on about ¥680 billion in rescheduled debts—or about 7% of the total for all industrial countries. In addition to these insured commercial debts, Japanese official credits also include those held by the Export-Import Bank of Japan and the Overseas Economic Cooperation Fund (OECF), yet trade insurance accounts for about 70% of the total consolidation by Japan (Fig. 2).

Austerity and aggression

Two different approaches have been taken to resolving the debt problem so far. The first approach has been to see the debt crisis as a temporary liquidity crunch and to treat it with a combination of belt-tightening economic policies designed to reduce the debtor country's fiscal deficit and new lending and rescheduling to supply additional capital to the country.


Photo: Kyodo News Service

The Toronto economic summit held in June of last year applauded the role played by the Paris Club in alleviating the Third World debt problem.

This first approach provoked considerable unrest in the debtor countries without improving their economic positions, however, with the result that a number of countries abandoned austerity and opted for aggressive development policies. At the same time, while austerity has been somewhat effective in shrinking the debtor countries' current account deficits, the improvement was made in tandem with a reduction in exports, such that it was highly deflationary and the debt problem once more came to the forefront in the 1980s in the context of global economic stagnation.

Thus it was that the second approach was devised. This approach, first proposed at the October 1985 IMF-World Bank Annual Meetings by then-U.S. Treasury Secretary James Baker, sees the debt problem as a structural shortcoming resulting in the debtor countries' inability to repay and hence seeks to solve the problem by having the debtor countries enhance their repayment ability through implementing comprehensive economic adjustment policies. Under this second approach, efforts were made to create secondary markets for the developing countries' existing debts and to adopt a menu approach embodying incentives promoting the flow of new capital.

While these efforts are still ongoing, so is the debt crisis, including the Mexican debt repayment difficulties of 1986 and Brazil's 1987 statement that it was temporarily suspending repayments to Paris Club members. By the end of 1987, the developing countries had a total indebtedness of $1.28 trillion.

As a result, while maintaining the second approach's market-oriented and growth-oriented policies, there is a rapidly spreading realization that the policies embodied in the Baker Plan are not sufficient to solve the debt problem and that something must be done to reduce debts per se. The March 1989 proposal by U.S. Treasury Secretary Nicholas Brady was in this vein, and it is expected that this will be a major subject of discussion at the Paris economic summit this July.

Even if there is a debt reduction, however, the second approach's emphasis on economic development should be retained as an indispensable prerequisite for resolving the debt problem. And if

Fig. 1 **Rescheduling Procedures**

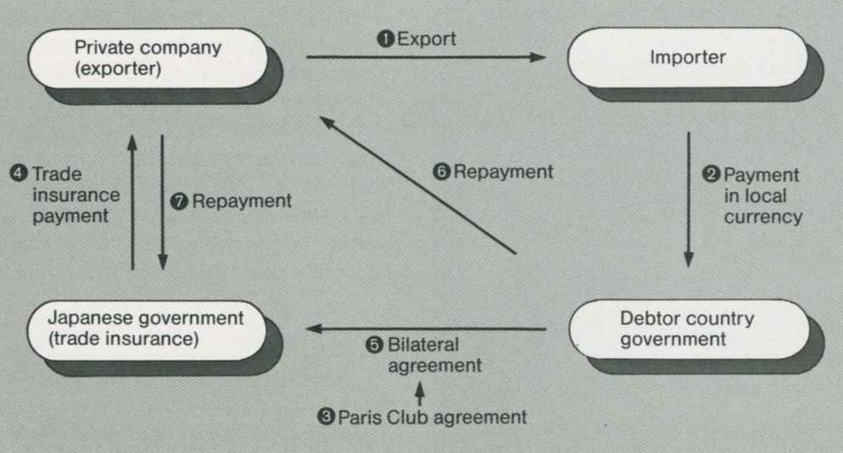
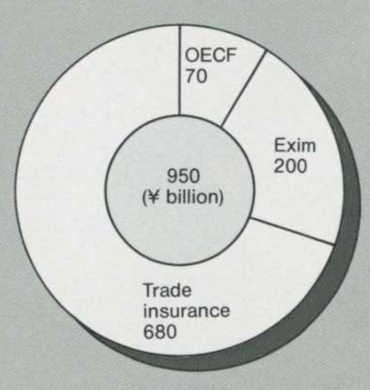
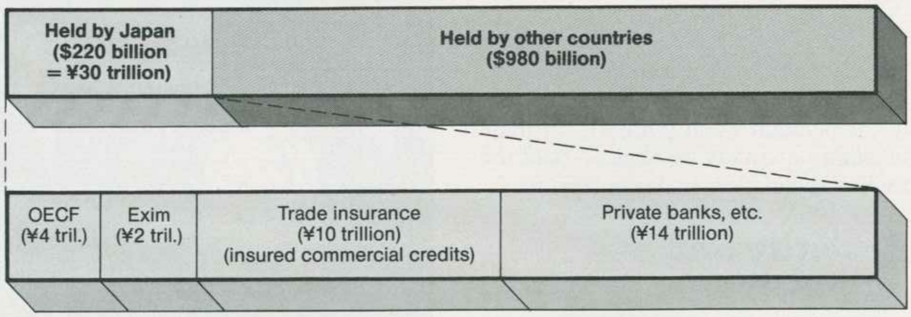


Fig. 2 **Japanese Rescheduling in the Paris Club**



the developing countries are to achieve economic development, it is imperative that they be assured of an inflow of growth-supportive capital. Only when the developing countries benefit from both debt reduction and development-supportive new capital flows will they be able to achieve independent and sustained development.

Fig. 3 **Trade Insurance Claims on the Developing Countries**



Notes: 1. Total indebtedness by the developing countries estimated at about $1.2 trillion, of which about $850 billion is bilateral.
2. Total Japanese-held claims on the developing countries estimated at ¥30 trillion ($220 billion).
3. Japanese claims on the developing countries estimated at about 30% of the bilateral world total.

The industrial countries' increased reluctance to commit new capital in the wake of the debt crisis means that the actual flow of capital to the developing countries is down. In turn, this reduction in the capital flow to the developing countries has forced these countries to rein in their current account deficits by cutting back on their imports, and there is a real danger that this might hobble the effort to attain enhanced repayment capacity through sustained economic growth.

It is thus incumbent on Japan, now that it has become the world's largest capital supplier, to make a determined effort to contribute to expanding the flow of capital to the developing countries. While a continuing effort must be made to enhance official development assistance (ODA), an equally important imperative is that of stimulating a recovery and expansion in the flow of private capital. Providing better risk-offsetting is one effective means to this end, and this is the second way in which trade insurance can help to resolve the debt problem.

Facing risk

One of the main reasons why the flow of private-sector capital to the developing countries is drying up is, as noted above, that the private sector has been reluctant to commit new funds in the face of enhanced risk. Trade insurance can do much to alleviate that risk.

At the same time, new trade credits and direct investments covered by trade insurance are more often than not accompanied by the transfer of technology, management know-how, capital equipment and other resources for economic development. This is another reason why it is so important to expand the private capital flow.

The importance of trade insurance in this area is clear from the extent to which trade insurance covers the risk involved in lending to developing countries. Worldwide, this is 7%. For Japan, it is 30% (Fig. 3).

With the flurry of rescheduling activity, however, Japan has moved to curtail or suspend the underwriting of insurance on trade with an increasing number of countries. At present, underwriting has been curtailed with regard to about 50 countries and has stopped altogether for another 50. As a result, Japanese practice is much more restrictive than in the other industrial countries.

This must be changed. The government of Japan should shake off its underwriting caution and provide the same kind of risk-alleviation insurance as is available in the other industrial countries.

Moving in this direction, work is now under way on revising the selection procedure for countries and projects, and in principle this will adhere to the case-by-case approach rather than a one-size-fits-all formula. This review of Japanese trade insurance policies must thus be carried out in conjunction with the international agencies and other countries concerned.

A steel plant in Brazil built with the help of loans from Japan

Hideaki Kumano is director general of the International Trade Administration Bureau of the Ministry of International Trade and Industry.