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A Japanese Perspective

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A Sketch of the Past Five Years

During the past 5 years, the export credit volume financed by the Japan Bank for International Cooperation (JBIC) has been relatively small, corresponding to the weakened export competitiveness of Japan. During the 1990s, the economies of Latin American countries were in bad shape due to the Mexican "tequila crisis" and its aftereffects. Russia and the Newly Independent States of the former Soviet Union and Eastern Europe suffered economic disorder in the wake of difficult conditions, and major capital projects in these areas fell off. Conversely, with phrases such as "the age of Asia" or "the Seven Dragons," Asia attracted a great deal of attention from major industrial countries.

Asia is said to be the backyard of Japan, but it is not. Export players from many countries were thrown into cutthroat competition in technology and price. Japanese companies had to fight against heavy odds because of the strong yen. This background explains the modest presence of JBIC export credit activity in the Chinese market. In addition, export credit figures after 1998 portray US and European firms eager and able to exploit new deals in Latin America, Eastern Europe, and the Middle East, while Japan was quite exhausted from an unsuccessful struggle to defend its share in the Asian market.

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Despite these adverse circumstances, JBIC has never resorted to special operations to reinforce the competitiveness of Japanese companies in the Asian market. As for untied loans, some people may contend that a huge share of the untied loans provided by JBIC are used by the Chinese government to support imports from Japan. This is not the case, because procurement from Japan under JBIC untied loans accounts for only 25 percent of total untied loans extended to China. I am not sure whether this is good or bad.

The Circumstances of Export Credit Agencies

Will the volume of export credit provided by export credit agencies (ECAs) change significantly in the twenty-first century? Some factors indicate expansion, whereas others imply shrinkage. On balance, the forces for expansion seem stronger. Here are the elements of my forecast:

- No matter what pattern developing countries may follow in their economic development, they will need more capital equipment. In addition to the traditional type of national economic infrastructure, and heavy and chemical industry plants, there will be a growing need for support in such high-technology areas as information industries. Furthermore, with the progress of privatization, private companies will play a more important role in developing countries, which will add to export demand from the industrial areas. The participation of foreign companies and the introduction of state-of-the-art technologies will further accelerate development. Yet developing countries are not able to produce all their industrial needs domestically.

- Risk considerations may depress private bank loans to developing countries. In the second half of the twentieth century, developing countries made rapid progress by borrowing money from private banks as well as from multilateral development banks, bilateral donors, and official export credit agencies. However, the lingering effects of the Asian crisis, and the tightening of Bank for International Settlements (BIS) capital adequacy standards for private banks, will make operations by private banks in developing countries more difficult. Private bank loans were a major promoter of economic development in the twentieth century. An alternative would be inflows via capital markets. Recently, the high-yield bond market has been watched with keen interest by both issuers and investors. However, a shrinking role for private bank lending may lead to greater demands on ECAs.

- The raison d'être for development agencies such as the World Bank is being reconsidered. The report of the Council on Foreign Relations, the report of the International Financial Institution Advisory Commission (the so-called Meltzer Commission Report), and the proposal by US Treasury Secretary Lawrence Summers all point out that the fundamental role of the international financial institutions (IFIs) needs to be reviewed. Meanwhile, the World Bank has announced that it will put more emphasis on poverty reduction, social infrastructure support, and related technical cooperation, rather than on traditional economic infrastructure support. This means that the World Bank will mainly finance so-called commercially nonviable projects. There are several signs that other multilateral development banks will follow the World Bank's approach. These changes imply that ECAs are likely to play a more important role.

- With the change in private bank lending to developing countries, the practice of overborrowing by developing countries (and overlending by banks) is likely to disappear. Economic crises have not been caused by overlending from official institutions. In the future as well, we can keep abreast of the situation in developing-country borrowing through the detailed information exchange between the Organization for Economic Cooperation and Development and IFIs.

Changes Needed in ECA Practices

Considering these circumstances, ECAs will continue to be a major source of competitive finance in the twenty-first century. But can ECAs be allowed to function as they used to? The answer is no. In the twentieth century, members of the OECD Arrangement struggled to slash subsidy elements from excessively sweetened export credits and insurance, virtually to zero. A "level playing field" is now almost established. Indeed, ECAs were excessively absorbed in the combat against subsidy elements, and somewhat careless about changes occurring in the outside world. Subsidy elements were removed from official export credit, but in turn punitive elements were introduced through excessively stiff regulations. This is where the "market window" operation was born. Here are some examples of punitive elements from JBIC's experience.

JBIC established the current Commercial Interest Reference Rate (CIRR) regime in 1987, when financial techniques such as swap, option, and "swaption" were not yet mature. Now that those magic wands are fully available, the margin of 100 basis points (bps) spelled out in the CIRR regime is regarded by the market as excessively high. Many OECD members continue to argue that the 100 bps margin accounts for both the spread between the borrowing costs incurred by domestic first-class borrowers (i.e., AAA-rated companies) and the government bond yield, plus the warehousing costs for the period from the commitment of the financing to disbursement. When reconsidering the CIRR, however, JBIC should take into account the development of new financial techniques. In addition, very few people forecast such a low interest rate as the current Japanese yen CIRR. In the case of Japan, the spread of 100 bps equals almost half the base rate, which is a very awkward situation.

Discussion of the appropriate CIRR has so far been limited to the fixed-rate regime. The status of floating rates has been left open. I think no subsidy element is contained in a floating rate when the rate covers the fund-raising cost of the government or the institution. A key point is that warehousing costs would be almost negligible in a floating-rate loan, because the funds can always be tapped as needed from the market at an interest rate under the London Interbank Offered Rate.

The risk premium system was introduced in April 1999 after prolonged negotiations. The system is not perfect. Administrative mechanisms, such as the premium-feedback tool and country reclassification procedures, are not yet fully established. In my personal view, the overall level of the risk premiums is too high in various ways. The level of the Minimum Premium Benchmark is based on the arithmetic average of the level of premiums imposed by all ECAs at the time the system was developed. This regime is somewhat inflexible and arbitrary. Under the current procedure, once a country is downgraded, it takes too long to restore its previous rating. Therefore, the required ECA risk premium tends to be higher than the market level. Some say that our ECA risk premiums should be adjusted according to the evaluations by rating agencies such as Moody's and Standard & Poor's (S&P). But market premiums sometimes move in an irregular pattern, not closely connected to Moody's and S&P evaluations.

In addition, now that the subsidy element is almost extinct in the interest rates charged on official export credits, it is time to reconsider the strict regulations on the repayment period and the repayment schemes. Furthermore, a wider array of options should be allowed in locking in the CIRR rates quoted to borrowers.

Market windows are now operating in virtually the same manner as traditional official windows. In fact, market windows might supersede official windows in the twenty-first century. Policymakers should make a constructive attempt to incorporate market windows into the OECD Arrangement regime rather than prohibit them. The presumption of the twenty-first century should be that government support will be removed from the official window. The twentieth century was one of deregulation for most sectors of the world economy. Only in the operation of ECAs did regulations pile up. Now ECAs have to tackle two big issues at the same time: the first one is to continue to keep subsidy elements out of the official system, and the second is to reconstitute the official system through deregulation while maintaining a level playing field.

What Should Ex-Im Do in the New Century?

On the basis of the experience of JBIC (and its predecessor, the Japan Export-Import Bank, or JEXIM), several observations can be made on the US Export-Import Bank's operations. The first point concerns domestic content. In the past, JEXIM accepted less domestic content, permitting more foreign content. The reason was that trading firms and engineering companies claimed that the price competitiveness of domestic products was seriously weakened by the strong yen. In that period, Japanese manufacturers were in agony. The trading firms (which occupy a unique role in the Japanese industrial system) coordinate the whole contractual scheme of large projects, including financial arrangements, and take the risks that manufacturers cannot take.

Because they do not manufacture goods themselves, trading firms are prepared to buy from any supplier that can provide low-priced products, regardless of its nationality. If Japanese manufacturers had opposed the flexible national-content requirement, they might have killed an entire contract and missed the chance to make some profit. Therefore, Japanese manufacturers had no choice but to combine their goods with foreign products and to earn a small profit out of the awarded contract. This may have been the best choice, because it helped ensure that a Japanese company held the status of the prime contractor. At the same time, the outcome had a narcotic effect. Domestic manufacturers were too easily satisfied with a thin profit, rather than struggling for more competitiveness through cost reduction and research and development. Now Japanese companies are paying the price for their neglect.

Nonetheless, a flexible national-content requirement may be necessary in this era of globalization—with its decentralization of manufacturing hubs. It would be worthwhile for Ex-Im to consider easing the national-content restriction from 85 percent to, say, 50 percent. If the content requirement is reduced, Ex-Im should consider cofinancing arrangements with other ECAs. Cofinancing by ECAs in two exporting countries will work when both ECAs can provide roughly the same service. For the exporter's convenience, it would be better if only one ECA handled the whole deal. General Electric's subsidiary in Japan sometimes uses JBIC, due to the geographical convenience. It might instead use Ex-Im Bank if Ex-Im's system were flexible enough and if the United States saw merit in utilizing products from the overseas subsidiaries of US firms.

A feature of recent US foreign policy is the frequent resort to bilateral economic sanctions, led by Congress. In the course of imposing these sanctions, financing from Ex-Im and the Overseas Private Investment Corporation is often suspended. National interests are important, and policymakers should not hesitate to sacrifice projects in appropriate circumstances. However, the suspension of official finance as a tool for economic sanctions is not likely to work without a consensus among major countries. To be sure, Japan has often suspended economic cooperation at its sole discretion, especially when the issue is related to nuclear weapons, even without a consensus of the major powers—and without any consideration of the adverse consequences for current and future business deals. These unilateral actions rarely stop ongoing projects, but they may interrupt new ones.

In the years ahead, there may be a great change in the circumstances of ECAs. Multilateral development banks and private banks will reshape their activities, and a wider variety of financial techniques will be developed. ECAs will not be able to take in all the new business growing out of these changes, partly because of budgetary limits. But at least ECAs should do their core business by themselves. For instance, JBIC has handled project finance operations all by itself. It experienced considerable troubles with its first few project finance deals, but soon acquired the necessary skills. It could have hired advisers from private firms, but it would still have had to train its staff to understand and evaluate the advisers. Otherwise, JBIC would have naively taken excessive risks, or would have been too risk-averse.

The only exception to this independent core operation of ECAs would be lawyers, particularly in foreign countries. Like JBIC, most ECAs have no choice but to rely on outside lawyers from first-rate law firms on a deal-by-deal basis. It is almost impossible to secure enough budget for their continuous employment, and it is also impossible for ECAs to quickly acquire legal knowledge and experience. But, as banks, ECAs should do their banking business in-house. The same is true for their funding operations. For example, if ECAs could not understand and evaluate proposals from private investment banks or securities firms, they would need to buy commonplace financial services for an unreasonably high price.

JEXIM, the predecessor to JBIC, was not always a customer-friendly institution. Exporters hated JEXIM because it required them to provide tons of documents and answer endless questions. Exporters unwillingly came to JEXIM because no other financial institution would extend loans with similarly low interest rates and long maturity terms. In the mid-1980s, when the Japanese yen CIRR was above interest rates charged by private banks, the context changed completely, and JEXIM had to alter course to become more customer-friendly. It is probable that JBIC will go further in this direction.[1] When talking about customer-friendliness, JBIC puts a higher priority on Japanese exporters than on overseas importers. It does this because it will be forced to disappear when Japanese exporters decide it is no longer needed. Ex-Im may draw some lessons from the experiences of JEXIM and JBIC.

1. For example, in the twenty-first century, called "the era of information technology," ECAs may be required to accept documentation online. I know that Ex-Im already processes a considerable portion of its documentation online.

Can ECAs, including Ex-Im, be "lenders of last resort"? I think they must be. They are accustomed to the classification of global financial flows into three categories: official development assistance (ODA), "other official finance," and private finance. These three types of flows have played their respective roles; that is, ODA is oriented toward lower-income developing countries, other official finance is largely directed toward more industrialized developing countries, and private finance goes to graduating developing countries. But in my view, this classification became meaningless in the past two decades of the twentieth century, and each flow spilled over into the other fields. The good side of this was that vast capital flows to developing countries created more infrastructure than expected, thus expanding their economies. The bad side was intensified export competition, which led to irregular use of ODA for export promotion, and the overflow of unstable short-term private finance in response to the huge demand from developing countries.

In the future, flows may not be so abundant. The availability of ODA is limited. Private banks and multilateral development banks will decrease their loans to developing countries for different reasons: private banks because of the BIS capital adequacy requirements, multilateral banks because of their concerns for the level of indebtedness of developing countries. In this context, ECAs including Ex-Im should become the lenders of last resort.

ECAs have provided medium- to long-term trade finance to developing countries, have watched the macroeconomies of those countries carefully, and have exchanged information with IFIs. Many people will argue that the public sector, including ECAs, should turn over its functions to private markets. But the financial crises of the 1980s and 1990s suggest that private markets alone cannot ensure steady flows to emerging markets.

The Export Credit Group of the OECD will reach an agreement on common environmental guidelines by 2001 at the latest. JBIC held an environmental symposium in April 2000 in order to contribute to this process. Representatives from major ECAs, governments, IFIs, OECD, and nongovernmental organizations (NGOs) attended. Some say that it is too early to talk about the next step before any agreement is reached, but it needs to be emphasized that the twenty-first century can become the era of disciplined deregulation. Let us look at a power plant as an example.

Suppose a country wants to close an out-of-date, polluting power plant and replace it with a new plant that almost, but not fully, conforms to environmental guidelines. What happens if the government gives up the renewal due to budget constraints and continues to use the old plant? We should ask ourselves: Are industrial countries, which cry for environmental protection, entitled to say "No" to developing countries that want to install a fraction of the power-generating equipment already in place in those industrial countries? It is the duty of the governments of industrial countries, of ECAs, and of NGOs to give a rational answer to this question, both to underprivileged countries and to their own nations.

Whether Ex-Im can continue to be competitive depends on how its beneficiaries—primarily exporters—act. But the term "exporter" includes a wide spectrum of industries. In a more general sense, the whole nation is the beneficiary. Even excellent exporters cannot win a contract without ECA support. If Ex-Im is to remain competitive, Americans need to support it.