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Japanese analyst at Daiwa calls for an LDC debt moratorium

by Laurent Murawiec, European Economics Editor

For the first time, a major institution other than *Executive Intelligence Review* has stated publicly that a general, but orderly, moratorium on the debt payments of developing sector nations is the only alternative to chaotic financial collapse. In a paper circulated from his London base, Tadashi Nakamae, the chief economist of Japan's Daiwa Securities European branch, warns starkly, "The banking system has only one of two choices, either accept a moratorium on interest payments or face some sort of default."

The significance of the circulation of Nakamae's paper cannot be overstated. He is very well-regarded in Japanese financial circles and often cited as an authority on international finance in the European press. Nakamae's proposal for a debt moratorium comes at a time when, according to the *Japan Economic Daily* of Aug. 17, bankers in Japan fear the eruption of "a global money panic or a great depression."

The paper, entitled "High Interest Rates: An Alternative View (The consequences of a disappearing OPEC surplus)," was written in July. It begins with a demonstration that the reasons usually presented by official circles for explaining the high level of interest in the dollar sector, are non-existent at best. To a background of a U.S. current-account surplus of several years, of a decline in U.S. inflation, Nakamae adds the swollen "net savings" of the U.S. corporate sector (retained profits plus depreciation, minus fixed business investment, adjusted for inventory changes) to household savings, in order to calculate U.S. net savings. His conclusion, and that of the figures is: "If we look at individual domestic markets in isolation, economic factors overall would justify an ease in monetary conditions and lower interest rates. The argument that higher interest rates are the result of rising budget deficits no longer applies. . . . The real cause of high interest rates is not domestic, but external."

The Euromarkets

Very large amounts of credit have fled the United States, Nakamae argues—one could say they have flown out of the U.S. *economy:* "The central question is where are these outflows of U.S. capital going? The answer is 'the Euromarkets.' There has been a large demand for credit on the Euromarkets to finance the balance of payments deficits of non-oil LDC's and Eastern European countries. The outstanding debt of the 21 major LDC's has reached $440 billion, of which $140 billion is due this year. In addition, the current account deficit of these countries is estimated at $60 billion, of which roughly $45 billion is for interest payments. In 1982, credit demand to finance their deficits and roll over existing debts will surely exceed $200 billion."

Since OPEC has dried up as a source of Euromarket deposits, "the burden of supplying the necessary credit to the Euromarket has shifted from OPEC to the United States," a notion entirely borne out by the most recent statistics tabulated by the Bank for International Settlements (BIS), "because most deficit financing of Third World countries is denominated in dollars, and, due to high credit demand in the Euromarkets, dollar interest rates have remained high and have attracted capital outflows from Europe to the U.S. market in the form of dollar bond investment, and so forth.

"U.S. private sector liquidity, together with the massive outflow of money from Japan and Europe, has been providing funds to the Euromarket. Large demand for credit on the Euromarket has kept dollar rates at high levels, thereby reinforcing capital outflows from Japan and Europe."

Nakamae then shows that with a $1.6 trillion Euromarket (total international bank lending outstanding) at the end of 1981, compared to a $1.7 trillion U.S. domestic market (total assets/total liabilities and capital of U.S. domestically chartered commercial banks), "it is extraordinary that such as vast dollar market . . . has been completely ignored when examining possible causes of the high level of interest rates.

It is the "North-South debate" which must be solved, Nakamae concludes this part of the discussion. "Arguments concerning international interest rates and exhange rates were, in the past, limited to the industrialized countries. For the

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first time, the North-South question has taken the lead in the debate and may be the heart of the problem."

Oil import bills; deepening recession world-wide; sharp decline in commodity prices and higher U.S. interest rates—"the combination of these factors brought about the deterioration of their balance of payments which further damaged their credit standing." The Japanese analyst then reports a striking series of figures published by the Ministry of Finance in Tokyo, which illustrate the depth of the disaster, which is a table of Japan's export growth by area (in quarterly change from year earlier, in percentile).

	South East Asia	Africa	Latin America	Comecon
1980				
1st quarter	14.6	16.1	10.6	−8.6
2nd quarter	15.6	80.7	34.0	6.5
3rd quarter	16.5	51.5	42.3	33.8
4th quarter	25.7	68.6	49.7	68.1
1981				
1st quarter	23.2	50.6	58.8	50.3
2nd quarter	16.5	23.5	30.3	21.7
3rd quarter	10.0	33.8	6.0	−9.6
4th quarter	−0.8	−12.3	−4.5	−24.7
1982				
1st quarter	−4.7	5.0	−7.3	−20.8
April/May	−7.7	−25.5	−9.6	−23.2

This acceleration in the rate of decline of Japanese exports to developing countries embodies most aptly the collapse of the world economy as a growth- and development-oriented system.

Of course, Nakamae continues, the collapse of imports has meant a sharp contraction of domestic economic activity with "three serious consequences . . . serious political and social unrest [are] on the increase. The Polish permanent political tensions and the Argentinian invasion of the Falklands are typical reflections of economic instability. The second consequence is the sharp contraction of economic activity in LDCs has contributed to deepening the world economic recession. The third problem . . . is that despite the improvement in their trade balance, LDCs' current balance of payments has not improved significantly. This is due to the burden of interest payments which has been increasing monthly."

"Two-thirds of the deficit on current account (of LDCs) are due to interest payments," Nakamae shows in facts and figures for seven major developing countries [so-called NICs (newly industrialized countries): Argentina, Brazil, Mexico, Chile, Korea, Thailand, and The Philippines]. From 1980-81, "the increase in the current account deficit was entirely due to the growth of interest payments.

"Thus, deficit financing has actually become interest-payments financing. It is the need for the financing of these interest payments which has maintained high credit demand, which, in turn, has prevented the lowering of interest rates. This vicious circle of high credit demand maintaining high interest rates, and thereby increasing the debt burden and the credit demand further, has been taking place concurrently with the deepening world recession.

Capitalizing interest payments

"The current level of interest rates is extraordinary. . . . [It] could only be brought down by freezing the interest payments burden, which is at present the major source of credit demand in the Euromarket," Nakamae asserts, also criticizing the practice of rescheduling, which, he correctly points out, is little more than capitalizing interest payments. Large-scale reschedulings in 1982 would but settle the appearance of the problem, and make it more acute next year. Further, "this type of rescheduling ignores the major economic problem; that is, as the weight of interest payments within the current account deficit increases, the net transfer of resources will not take place, although the financing of the deficit is achieved. A current account deficit with a trade surplus for the LDCs implies a net transfer of resources from the South to the North. Consequently, from the point of view of the deficit countries, *it would be more economically prudent to seek financial default* rather than desperately attempting to reschedule the debt [emphasis added]."

"However, if a moratorium on interest payments was applied, most of the credit demand on the Euromarket would disappear immediately and interest rates would fall. "This sharp fall in interest rates would in turn substantially reduce the burden of an interest-payments moratorium for the international banking system.

"It is unlikely, however, that this practical solution would be implemented in order to rescue deficit countries except if a serious crisis developed. For instance, the default of a debtor country could force international bankers to apply a moratorium. Clearly, the international banking system has only one of two choices, *either accept a moratorium on interest payments or face some sort of default.*

"The major problem," the Japanese analyst concludes, "is the North-South problem. As long as the financial aspect of the North-South problem is not solved, the world economy cannot enter a new recovery phase. Actually, the industrialized countries must not only solve the financial problems but also expand domestic demand in individual countries, allow a free flow of exports from the Southern Hemisphere and assist their economic recovery. Through this process, the industrialized world would be helping itself recover."

Western European and North American officials and bankers are in dire need of this type of wisdom. We wish that Tadashi Nakamae's excellent argument sparks an urgent debate on both sides of the Atlantic—before the more explosive part of the alternative occurs in uncontrolled defaults.