Forum: General Assembly 1

Issue: **A**ddressing the efficiency of country loans

Student Officer: Albert Peng

Position: Deputy Chair

Introduction

In an increasingly interconnected world, country loans, also known as foreign loans, have become an important tool for fostering economic development. However, the efficiency of country loans vary based on different factors, including the economic strength of the country. Less developed countries usually borrow heavily to increase their own infrastructure, including education, healthcare, and industries. However, the high interest rates of these loans can cause a negative feedback loop, as low-income countries scramble to pay back creditors by taking even more loans, making foreign loans incredibly inefficient. Conversely, more developed countries, who borrow to cover a budget deficit, do not need to worry about their loans as they are far smaller in terms of debt-to-GDP percentage. For example, a wealthy man borrowing $100,000 is much less worried about repaying the debt than a poor man borrowing $1,000. This creates a positive feedback loop, where money is borrowed to develop infrastructure, which increases GDP drastically, leading to a lower debt-to-GDP percentage.

The current inefficiency of country loans, especially for low-income countries, is a major problem that stymies economic development in many parts of the world. According to some estimates, the amount of money developing nations are paying towards foreign debt as a percentage of government revenue has doubled over the past 10 years. Due to the low interest rates caused by the 2008 economic recession, governments are now more easily able to take on massive amounts of debt. However, this will change, especially with major crises around the world, including the novel coronavirus.

Furthermore, country loans are not simply inefficient; they can lead to human rights issues in developing nations. Due to high foreign debt, governments are unable to spend enough on social policies and human rights enforcement. As such, a solution must be found to the growing foreign debt in many nations around the world.

Definition of Key Terms

Efficiency

Efficiency of country loans refers to how effectively a country can use borrowed funds to develop their economy and achieve economic growth. For example, the United States has high country loan efficiency, as it can very easily develop its economy and increase its GDP with loans, while countries such as Venezuela have low efficiency due to their difficulty in repaying loan interest.

Country Loans

Country loans, also known as foreign loans, are loans made to another country; the loaners may be banks such as the International Monetary Fund (IMF), people, or other countries.

LEDCs

LEDCs, or less economically developed countries, are countries which are still developing industries and economics. For example, Kenya, India, and Mexico are considered LEDCs, as their industries are still growing. These countries usually are unable to pay back country loans, causing economic hardship, inflation, and poverty.

MEDCs

MEDCs, or more economically developed countries, are countries which have fully developed their industries and economies. For example, the United States, the United Kingdom, and Singapore are MEDCs. These countries usually do not worry about paying back loans due to their relatively low debt-to-GDP ratios.

GDP

GDP, or gross domestic product, is the total monetary value of all products produced and exported in a country over a given period of time, usually a year. The GDP is one of the main economic indicators; countries with higher GDPs are considered more developed than countries with lower GDPs.

History & Developments

The first foreign “loans” were offers of military assistance, such as Prussia subsidizing its allies in war. Many countries, tribes, and factions offered to support each other in times of military crisis. For example, the Persian War saw different Greek nations, notably Athens and Sparta, uniting against the Persians.

However, one of the first true foreign loans was the French to the American colonies during the American Revolution. The American Continental Congress accepted loans from the French monarchy, which was crucial to the American victory. They also secured loans from Dutch banks and the Spanish government. This loan was a factor in the French Revolution, as the French monarchy found itself out of money due to the financial support contributed to the new United States of America.

In the 19th century, as European powers expanded to Africa, foreign aid became a widespread strategy. Countries such as England, France, and Germany provided regular financial loans to their colonies, leading to rapid rises in infrastructure in Africa.

Following World War I, most European countries suffered massive economic strain from the war. The United States emerged as a major creditor due to its relative isolation from the war. The US ensured reconstruction of Western Europe by providing loans to European nations.

After World War II, the United States emerged as the Western world's premier superpower. Through the Marshall Plan, a program to rehabilitate the economies of 17 European countries, the US lent over $13 billion overseas. Similarly, the Soviet Union lent aid to its Eastern European allies. During the Cold War, both superpowers used foreign aid as political tools to cement alliances, setting the stage for today's global lending market. Meanwhile, both the World Bank and International Monetary Fund were established.

As the 20th century drew to a close, rapid globalization created a global economic market, allowing countries to take foreign loans easily. Many countries racked up billions of dollars of debt to increase their infrastructure, gambling on the ability to pay it back due to economic development. However, increasing debt-to-GDP ratios have led to some of the worst economic crises of the modern age.

Asian Economic Crisis

The Asian economic crisis was a major economic crisis striking East and Southeast Asia in the late 1990s. A main cause of this crisis was high rates of foreign debt in Thailand. In 1997, due to excessive foreign loans in Thailand, the country's currency, the Thai baht, collapsed; its value, which was tied to the American dollar, fell drastically due to a lack of foreign currency to support it (caused by excessive country loans). This caused a wave of economic crises in the surrounding region, with many seeing their debt-to-GDP ratio rise from 100% to over 180% in the worst periods of the crisis.

In 1998, despite the IMF allowing a $40 billion stabilization program, Asian countries continued to see decline. In particular, Indonesia's president was forced to step down after 30 years of power due to mass riots, and even Wall Street saw stocks fall as the aftermath spread around the world.

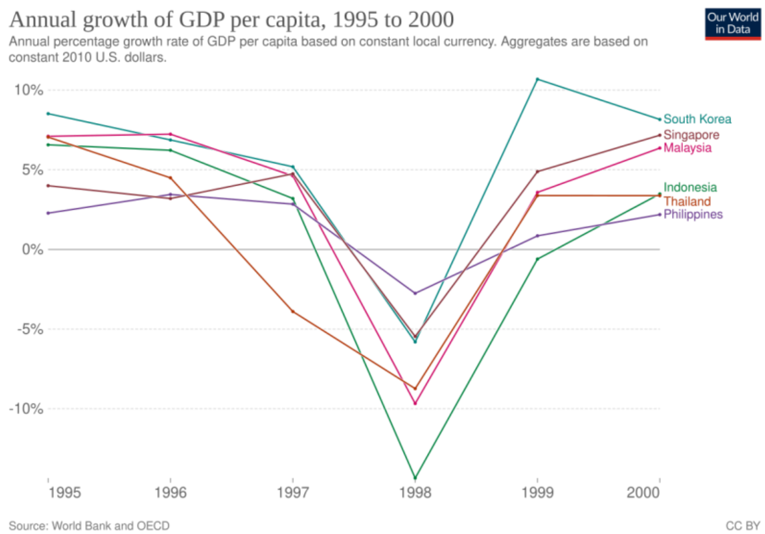

Figure #1: Annual growth of GDP per capita for six Asian countries

European Debt Crisis

The European debt crisis was a major crisis in the European Union, taking place from 2009 to the late 2010s. Multiple member states, including Greece, Portugal, and Ireland, were unable to repay their government debts or bail out their banks without assistance from the IMF and the European Central Bank.

The main cause of this economic crisis was the sudden stop of foreign capital and money into these countries, which had built such a high debt that they were unable to function economically without foreign loans. Even worse, while countries in the Asian economic crisis were able to partially mitigate their meltdown's effects by devaluing their currency, these EU member states were unable to due to having the Euro as a shared currency. Thus, foreign rating agencies such as Fitch downgraded countries' credit ratings, which caused countries like Greece to see their stock markets tumble. In the case of Greece, their debt-to-GDP percentage shot up to 113%, twice the 60% limit mandated by the European Union.

Due to the riots and disasters striking major EU countries, the eurozone nations and the IMF were forced to approve a $143 billion bailout package. However, this turned out to be ineffective; the IMF and the EU eventually created a $1 trillion emergency fund to shore up flagging euro-zone countries (Britannica, n.d.).

This crisis was one of the most violent economic meltdowns of the 21st century. Greece, Italy, and Spain all saw major political crises resulting in the complete overhaul of their governmental leadership, with Greece especially still recovering from the aftermath.

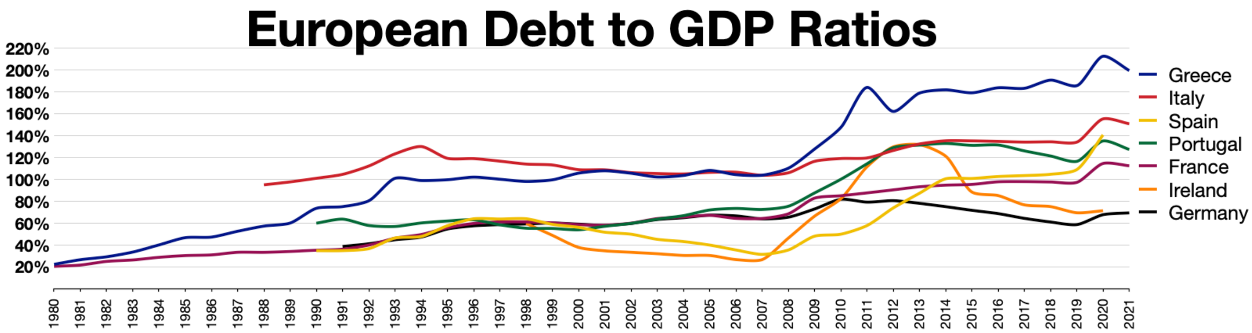

Figure 2: Debt to GDP ratios of European nations hardest hit by the economic crisis

Major Parties Involved

United States

The United States has the largest foreign debt in the world, currently approximately $35 trillion, over twice that of the second largest foreign debt country. Its debt-to-GDP ratio is also extremely high, currently 180%. Historically, it has been a major moneylender to foreign countries, especially during the mid-1900s. It currently provides loans through international aid programs and institutions, including the IMF and World Bank.

Greece

Greece has the highest foreign debt ratio in the European Union; the 2009 European Debt Crisis hit it the hardest. The country has seen turbulent times due to the crisis, with many government leaders being ousted from power and riots breaking out in the streets.

China

China has emerged as one of the main creditor nations of the 21st century through its global moneylending initiatives. The Belt and Road initiative provides monetary loans to many countries in Africa, Europe, and Asia, resulting in high amounts of debt owed to it. Countries such as Kenya, Pakistan, Zambia, and Sri Lanka have all struggled to pay back loans taken for economic development; Kenya and Sri Lanka both already defaulted on their debts to China.

Timeline of Events

Date	**Event Name**	**Description**
July 2, 1997	Asian economic crisis	After Thailand's currency, the baht, collapses, Asian economies see major market failures, especially Indonesia.
January 2009	Eurozone crisis	Eurozone Crisis begins after Iceland's government collapsed due to the failure of Icesave, a major Icelandic bank. The crisis sweeps through most of the EU, with many countries, including Greece, Italy, and Spain, suffering riots and government upheavals.

Previous Attempts to Solve the Issue

Conditional lending: Organizations such as the IMF or World Bank implement conditional lending to countries in need. These conditions, known as structural adjustment programs, require the borrowing country to implement certain economic policies or reforms aimed at improving economic stability and growth. After the 2009 European debt crisis, the European Union announced the creation of the European Stability Mechanism (ESM), which provided a permanent $673 billion fund as a lender of last resort to eurozone countries.

Austerity measures: Austerity measures are economic policies implemented by governments to reduce public sector debt and budget deficits. These measures typically involve a combination of spending cuts and tax increases. Key aspects include spending cuts on public services such as infrastructure, healthcare, and education, tax increases, and structural reforms, including raising the pension age. Despite reducing economic growth in the short-term, austerity measures can help mitigate financial crises. Greece, Italy, and other EU members implemented severe austerity measures after the 2009 debt crisis.

Possible Solutions

Transparency and Accountability: By transparently disclosing all loan agreements and terms are publicly disclosed, **banks can help prevent corruption and misuse of funds by governments**, especially developing countries Furthermore, regular audits by independent bodies can monitor the use of loan funds and ensure they are being used as intended.

Strengthening Institutional Capacity: Providing technical assistance to borrowing countries can help improve their ability to manage and implement loan-funded projects. Furthermore, training government officials and improving financial management systems can also enhance the efficiency of foreign loans.

Effective Project Planning and Implementation: Before approving loans, conducting thorough feasibility studies can ensure that projects are viable and likely to succeed; infeasible projects can then be changed and improved on. Establishing robust monitoring and evaluation frameworks can track project progress and outcomes, allowing for timely adjustments if needed.

Debt Swaps: Implementing debt swaps can reduce debt burdens while promoting sustainable development. Debt swaps happen when a debt is cancelled for an equity position. For example, debt-for-nature swaps, where a government buys up another government's debt to fund nature conservation efforts, could provide up to $100 billion to restore nature and help countries adapt to climate change (World Economic Forum, n.d.). Debt-for-development swaps, meanwhile, result when a government's foreign debt is replaced with liabilities, such as a spending commitment towards a particular goal (International Monetary Fund, 2020).

Community Involvement and Stakeholder Engagement: Involving local communities and stakeholders in the planning and implementation of loan-funded projects can ensure that projects meet local needs and gain public support. Inclusive planning can add support and efficiency to public projects. Establishing channels for feedback from beneficiaries can help identify and address issues early on.

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