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# World Trade Organization

## Sustainable Finance of Development

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### INTRODUCTION

**GDP per capita—**  
*average income per person*

The expanding trade networks and modernized technology of the late 20<sup>th</sup> and early 21<sup>st</sup> centuries have increasingly connected the disparate societies of the world. The one key player in this ‘globalization’ is the economy, mirroring the role that military prowess once played in influencing the international affairs. Countries that have flourishing economies not only tend to have higher living standards, increased political influence in the international scene. Many countries aim to further develop their economies and improve the social and political well being of their citizens. Economic development indicates that a country is industrializing and promoting capitalism. Factors like the change in gross domestic product (GDP), growth rate, and GDP per capita, are commonly accepted ways to measure the economic development of a country. In order to achieve a positive annual growth rate, a country aims to increase productivity by investing in modern machinery, human capital like education and worker training, and public infrastructure, like roads and bridges.

These means of development require funding, or government revenue, to support them. For example, governments need to build schools with better facilities in order to improve education, and better transportation systems such as roads and railways require workers to build them. The issue of sustainable development relates to a sovereign state’s ability to consistently generate funding to invest in factors that improve production without becoming overburdened by national debt. A government can either use its own funds, such as tax or tariff revenue, to spend on development projects, or it can incur a budget deficit by borrowing funds to do so. In addition, a government can opt out of investing in its economy, limiting a budget deficit. But since many people perceive that a government is responsible for the well being of its citizens, a government usually prioritizes development.

There are many reasons why governments may choose to run budget deficits in order to pursue a higher growth rate. One is that they may lack the revenue to do so on their own because they are a newly formed state without strong industries. Also, in wartime, the government often decides that it is necessary to borrow funds to purchase military equipment while maintaining its other development projects. The general reasoning is that a defensively weakened country would be economically worse off than a strong one with a deficit. Some believe that running a budget deficit is not a problem as long as the government eventually gains enough of a budget surplus to repay its debts. As members of the WTO and representatives of various countries, it is your responsibility to understand what strategy your government uses to regulate the budget, and furthermore to think about whether the current model is well suited for your country.

Government debt, also known as public debt or national debt, is money or credit owed by any level of government due to ongoing deficits. It consists of internal debt, owed to lenders within the country, and external debt, owed to foreign lenders, both private and public. Countries with good credit, usually the developed nations with stable governments and economies, generally borrow by issuing bonds, financial instruments that enable investors to ‘buy’ the government’s debt, with the prospect of earning payments on the interest of that debt that will outweigh the price of buying the bond. Less estab-



lished countries, such as those deemed the Heavily Indebted Poor Countries (HIPC) by the International Monetary Fund (IMF), sometimes directly borrow funds for development from international institutions such as the IMF and World Bank. Yet a government cannot borrow funds without planning a method of repayment. Loans are generally subject to interest payments that are calculated as a percentage of money owed. If a borrower continues to take out loans without paying them back, interest payments will pile up. If a government continues to incur budget deficits, a larger fraction of GDP (Gross Domestic Product) will be used to pay off interest, instead of used as direct investment in an economy.

Fiscal sustainability, therefore, requires that public debt, or the amount the government borrows, cannot continuously grow relative to national income because this would force governments to reduce spending on services and projects. In addition, a government could further increase taxes in order to meet interest payments. In extreme situations, excessive borrowing of capital could cause hyperinflation, which is when the government prints too much of its own currency to pay back debts, causing price levels to rapidly increase and decreasing efficiency in the economy. Excessive government debt has been linked with financial crises throughout history; the devaluing of the euro in the past year, for instance, has been attributed to the ballooning deficits of countries like Greece, Spain, and Italy. A question that you, as a delegate of the G-20, should consider is how much should your country borrow to invest in its own economy before it incurs too much debt?

**World Bank**—*An international financial institution that aims to promote sustainable development*

## EXPLANATION OF THE PROBLEM

### *History of the Problem*

According to Keynesian economics, countries can sustain fairly high levels of public debt to pay for development, because this investment will promote economic growth in the future, providing a means to pay back these debts. As this theory grew popular in the 1930s during the Great Depression, many nations began to borrow heavily to finance large infrastructural capital projects, driven by hopes that such spending would stimulate their economies and push them out of recession. In the U.S., this strategy was a significant contributor to the end of the Great Depression, in conjunction with the government financing of military production during World War II. However, a government must still consider how it will lower its public debt to a low, supportable level or face crises in the future. Mounting public debt has been a nearly universal precursor of postwar crises in the twentieth century, as seen in Spain (1977), United States (1984), Norway (1987), Finland (1991), Sweden (1991), and Japan (1992).\*

Good fiscal policy is crucial to any government. In the past, countries (like Spain during the 16<sup>th</sup> and 17<sup>th</sup> centuries) have defaulted on their debts. No longer able to meet interest payments on their debt, countries must break their loan agreements. A default on national debt significantly reduces a country's 'credit-worthiness', deterring future potential lenders from giving loans. In today's market, highly developed global credit markets would thus either refuse to lend funds in the future, or charge exorbitant interest rates on new loans due to the greater risk they incur by lending to a country with a history of credit default. Many countries now finance their debts by issuing bonds or printing their own currency. During the 1970s, many Latin American countries such as Argentina, Bolivia, Brazil, Chile, Peru, and Uruguay incurred large debts and agreed to repay them in dollars, but as interest rates rose on their debts, these

countries resorted to printing their own currency in excessive quantities in order to repay their loans. This resulted in hyperinflation, such as in Bolivia, where prices increased by 12,000 percent in 1985. The most extreme case of hyperinflation may be in Zimbabwe, where, by May 2010, the annual inflation rate reached 516-quintillion percent. By comparison, the US annual inflation rate in 2009 was considerably low at around 3 per cent, which is why the US dollar is often used as a reference to gauge the change in value of other nations' currencies. Hyperinflation greatly decreases a country's economic efficiency, especially in cases as serious as Zimbabwe's, where the price level rises every hour. Workers must rush to spend their earnings before its value drops further; while saving and investment in future developmental measures becomes discouraged. Furthermore, citizens will often exchange their money holdings into US dollars or other more stable currencies, further reducing domestic investments. Hyperinflation usually terminates when the government ceases to manipulate the money supply, often issuing a new currency to replace the devalued pre-existing currency. Delegates of the G-20 should consider the best way to pay back loans while preserving or working towards the stability and efficiency of the economy, considering both short-term and long-term effects of their actions.

**Exchange rate**—*the rate or ratio at which one currency can be exchanged for another, i.e. dollars to pounds*

### *Bretton Woods System*

After the Great Depression of 1929, many countries wished to alter the international economic scene. The United Nations Monetary and Financial Conference at Bretton Woods in 1944, gave birth to the IMF and the World Bank, which were created as parts of an international monetary system that was intended to govern currency affairs among independent countries. Many countries wished to get rid of the gold standard, in order easily alter national economic policy to react to financial crises. Under a gold standard, a government's central bank would be unable to increase the money supply to fight deflation, or limit the money supply to counter inflation. Thus, in the 1930s, a large proportion of countries, including the US and many European sovereign states moved to a floating exchange rate, which does not depend on the amount of gold a country holds. The IMF was created to facilitate foreign trade and ensure the stability of the new international economic scene based on floating exchange rates. The IMF providing a forum for countries to discuss fiscal policy like exchange rates and loans to struggling countries. The World Bank, originally named the International Bank for Reconstruction and Development, was created to expand international investment and economic collaboration. To aid the development of poorer countries, the World Bank sought to make capital available to them through loans with reasonable interest rates or grants.

### *HIPC Initiative*

In 1996, the IMF and World Bank created the Heavily Indebted Poor Countries (HIPC) Initiative with the goal of alleviating the debt burdens of poor countries. Since then, multilateral organizations and governments have committed to this goal to reduce the external debt of HIPCs to fiscally sustainable levels. The Initiative was reviewed thoroughly in 1999 to increase the speed and scope of debt relief and strengthen the relations between debt relief, poverty reduction, and social policies. The Multilateral Debt Relief Initiative (MDRI) was created in 2005 to supplement the HIPC Initiative in streamlining progress towards achieving the United Nations Millennium Development Goals (MDGs). Under the MDRI, countries completing the HIPC Initiative process can have 100 percent relief on eligible debt by the IMF, the World

Bank, and the African Development Fund (AfDF), meaning that all eligible debt is ‘forgiven’, or paid for, in order to free up the government revenue the country was originally using to make debt payments for more productive purposes, such as investments that increase productivity. Furthermore, in 2007 the Inter-American Development Bank (IaDB) sought to grant additional debt relief beyond that given by the HIPC Initiative to the five HIPC countries in the Western Hemisphere.

The HIPC has three minimum requirements for participation in the initiative. First, a country must have unsustainable debt, which is marked by debt that is greater than 150% of government exports and debt that is greater than 250% of government-revenue. Second, the country must be poor enough to qualify for loans from the World Bank’s International Development Association or the IMF’s Poverty Reduction and Growth Facility (PRGF), which gives long-term, interest-free loans to the world’s most impoverished nations. The PRGF aims to ensure that countries that qualify for interest-free loans direct government funds freed from debt repayment into poverty-reduction programs. In addition, they must use these interest-free funds to pay for social benefits like a better health care or education system or government housing, for example, rather than using funds ‘irresponsibly’. In reaction to criticism that IMF conditionality is too stringent towards poor developing countries by regulating how they use their interest-free loans, the PRGF has cut down on the number and detail of IMF conditions and encourages more input from the local community into the terms of the lending program. Finally, to qualify for HIPC debt relief, the country must commit to making reforms aimed at preventing future debt crises.

As of December 2006, the IMF and World Bank have given over \$51 billion of HIPC debt relief to approved countries. Twenty-eight of the forty countries eligible or possibly eligible for HIPC Initiative assistance countries have implemented major reforms supported by the HIPC and are receiving full debt reduction. Seven countries are eligible for full debt relief but have yet to demonstrate a commitment towards fiscal responsibility. Comoros, Eritrea, Kyrgyz Republic, Somalia, and Sudan are potentially eligible for relief and are currently being evaluated by the HIPC. Twenty-nine of the forty HIPC countries are in sub-Saharan Africa.

**EUR**—*abbreviation for euro, the currency of the European Union*

## Recent Developments

Fear that Greece will default on its large government debt has been mounting since late 2009 when the debt reached EUR300 billion (US\$440 billion), which is 125% of its GDP; in other words, Greece’s debt was 25% larger than the amount its entire country was producing in one year. While the IMF has approved its EUR30 billion share of a EUR110 billion bailout package with the European Union (EU) to prevent this default from occurring because it would further deteriorate the EU economy, investors continue to trade Euros for dollars, depreciating the value of Euros. Although experts at the IMF say that fears of Greece defaulting are an overreaction because the package requires Greece to implement structural reforms that allow Greece to fully pay its debts, the eurozone has good reasons for such worry. Many Greek bondholders are in Europe, especially Germany and France, and if Greece defaults, the economic climates in other EU countries like Spain, Ireland, and Portugal could be worsened.

### *Criticism of Bretton Woods Institutions*

The IMF, World Bank, and other institutions, collectively known as the Bretton Woods Institutions (BWIs), have been criticized for not being multilateral enough

in their lending policies. Instead of considering the interests of all countries, the BWIs have favored developed nations and those with large emerging markets over those with weak economies. Although the BWIs are international economic regulatory institutions, the United States holds a significant portion of jurisdictional power. Both the World Bank and IMF headquarters are, notably, located in Washington. Consequently, the IMF has been accused of working for the interest of American businesses in its lending contracts to the HIPCs. IMF conditionality, guidelines that a country must comply with to receive loans, has been criticized as too harsh. These terms have been criticized as favoring the economic interests of more developed countries that seek to profit in these HIPC countries, which have weak economies and global market influence. Critics believe that the IMF should work with the priority of attaining sustainable debt and promoting development in these countries without seeking to gain economic influence.

**streamlining**—*making more efficient, eliminating redundancies*

## FOCUS OF DEBATE

### *Developed Countries View*

The financial crisis in Greece is a case-and-point of the dangers of incurring too much borrowed debt. However, some debt in developed countries is sustainable through the sale of government bonds, which have many buyers in the market. As long as a country's economic growth rate is positive, debt should be maintainable. In addition, good financial regulation is crucial in the success of an economy. The recent global financial crisis of 2007 was due in part to poorly regulated financial institutions in developed countries, which led to irresponsible borrowing. Thus, stricter regulation in the future may circumvent similar crises. Large stimulus packages from the BWIs are crucial in times of economic crisis because a failed economy of a developed country would have catastrophic effects in the world economy, leading to more monetary loss than the stimulus entails.

Because developed countries produce more products and services annually, their economies have more market power. Thus, developed countries should carry more weight in international lending institutions because those decisions may affect them more. The funds the BWIs use to provide debt relief and international investment mostly come from these countries as well, so it is fair for them to make conditions for the loans made out to poor countries to decrease the risk of loans defaulting. Furthermore, conditionality requires the countries backing the loans to implement structural reforms for broader economic stability. The IMF has already responded to criticism by streamlining its conditions in March 2009 in order to avoid excessively burdening HIPCs.

### *Developing Countries View*

Many poor countries need funds to develop and do not have the credit for issuing their own securities for sale on the global market. They rely on international credit institutions like the BWIs to sustain their economies. Since the BWIs represent the international interest, countries in emerging markets and HIPCs should hold an equal voice in the loan policies, rather than be restricted by conditions that seek to control the way they conduct their domestic affairs. Members of developing countries on the G-20, such as China and Indonesia, are advocating reforms that distribute power more evenly between developed and developing countries. They argue that developed countries should be bound by strict conditions for loan contracts from the BWIs just as

developing countries are. Currently, large stimulus packages are offered more freely to developed countries, like EUR30 billion approved to prevent Greece from defaulting on its loans.

Debt relief under the HIPC Initiative allows struggling countries to spend more money on social welfare like health services and education, rather than trying to pay the interest on existing debt. Thus, more relief should be provided to poor countries and the evaluation of the five countries possibly qualifying for HIPC relief needs to be hastened.

**contractionary**—*fiscal policy aiming to decrease the amount of money in circulation*

## POSSIBLE SOLUTIONS

### *Reform the IMF and World Bank*

Some argue that debt relief doesn't help poor countries. Between 1989 to 1997, total debt forgiveness by the BWIs was US\$33 billion while new loans totaled US\$41 billion. Ironically, countries that had the most debt forgiven took out the most new loans, suggesting that this form of debt relief may not be the most effective way for a country to overcome its overwhelming debt. Debt relief has also been shown to be ineffective at increasing economic growth in countries that have been given aid, suggesting that those countries require more fiscal structural reforms. International lending institutions could increase the conditions for poor countries to qualify for loans and monitor their progress towards policies that responsibly utilizes funds towards development rather than corruption. However, stricter lending policies may be politically unpopular. Alternative strategies for helping poorer countries with unsustainable debt pursue better economic policies can be considered.

### *Increase Regulation of Financial Institutions and Increase Savings*

In order to curtail excessive borrowing, developed countries with large national budget deficits such as the US, Greece, and Portugal can improve financial regulation. This may require creating government agencies to assess the functionality of financial institutions to prevent them from making risky investments, like making loans to individuals with bad credit. The government can also increase taxes to raise revenue to decrease its deficit, which would require citizens to decrease spending on commodities and increase saving. By decreasing national debt, a government will have more money to spend on education, roads, and other social improvements. While encouraging saving does not automatically decrease the debt to government revenue ratio, it does increase a country's productivity, which contributes to higher government revenue. This, in turn, decreases the debt burden.

### *Monetary Policy*

Monetary policy can affect debt sustainability mainly through interest rates and exchanges rates. When a country engages in contractionary monetary policy, which is when they decrease the amount of money circulating in the market, the real interest rate on domestic public debt increases because there is less money available to borrow. In general, when an item is scarce, its price rises, so in this case because there is less money available, it costs more to borrow it. This rise in the real interest rate on domestic public debt could lower the real rate on external debt if these higher domestic

interest rates attract foreign capital, or investors who seek to earn higher interest on their savings. The real rate on external debt decreases because of the appreciation of the currency, due both to the contraction in the money supply and the increase in foreign investors in the domestic economy, who must first convert their currency into the domestic currency. This increases the demand for domestic currency and increases its exchange rate value. An appreciation of the domestic currency lowers the real value of external debt payments because the higher exchange rate allows a smaller amount of domestic currency to be exchanged into the currency of the foreign lender to make the interest payment. Thus, in cases when the external to domestic debt ratio is high, when the value of national debt held by foreign investors significantly exceeds the value of national debt held by domestic investors, a tightening of monetary policy could lower the real amount of interest paid on total debt. When considering this solution of contractionary monetary policy to decrease the real interest rate on total public debt, it may be essential to assess individual countries' ratio external to domestic debt ratio as well as the effects of an appreciated currency on trade and other aspects of the economy.

**domestic**—*within a particular country, not international*

Conversely, an increase in the proportion of domestic debt decreases the vulnerability of a country's total public debt to adverse exchange rate fluctuations, such as a depreciation of the country's currency. This increases the real interest rate on external debt. When a larger proportion of the loans the government takes comes from domestic lenders, the real interest rate on public debt is less affected by the appreciation or depreciation of the domestic currency, as described in the previous paragraph. Just as appreciation of the domestic currency may decrease the real interest rate if foreign investors hold the majority of the debt, depreciation in the same scenario would cause an increase in the real interest rate. Furthermore, the exchange rate of any currency is affected by many factors that its issuing country cannot control, such as the policies of other countries that change the value of their own currency. For these reasons, when domestic investors hold a larger portion of total public debt, the payment of the debt is less subject to international factors. However, such an increase in domestic debt also heightens the risk of sharp hikes in the interest during times of currency and balance-of-payment crises. Thus, both having a larger external-to-domestic debt ratio and a larger domestic-to-external debt ratio have risks, so policymakers must weigh the different outcomes in each country and determine the optimal choice, depending on how stable its currency is and how much its domestic lending market fluctuates.

## QUESTIONS A RESOLUTION SHOULD ADDRESS

When writing your resolution, remember to address how the WTO should measure sustainability. Should there be one standard debt-to-government revenue ratio below which debt is sustainable for all countries, or should sustainability be measured on a case-by-case basis? How will the progress of countries receiving loans be evaluated? Will agencies be created to assess them, and if so, how often? How is development going to be financed in countries of the world? Should poor countries look to international lending institutions, or is there a better alternative? Does the resolution address the validity of printing money to pay for debt? Remember that as a member of WTO, you must balance the economic interests of your country with the international body as a whole.

## CONCLUSION

Sustainable development is key to the well-being and improved standards of living for people. In order to improve the lives of its citizens, a country must pursue responsible fiscal policies that allocate funds to bettering of social welfare without endangering future progress. A country should manage its debt so that it can enhance productivity instead of paying interest on its loans. The policies a country pursues, its ability to find borrowers, the interest rate on its debt, and the functionality of its financial institutions are all determinants of the sustainability of debt. Each country has different conditions, such as its level of industrialization and the stability of its government, that determine its ability to support its debt. As you go about your research before the conference, you should keep these factors in mind in determining your country's perspective on sustainable debt. International lending institutions have been created to facilitate fair trade and aid countries struggling under debt burdens, although their policies have generated controversy in the past. The current world economy is far from problem-free, as seen in the debt crisis in European Union countries and in the hyperinflation crisis of Zimbabwe, to name the most recent few. As knowledgeable and influential financial ministers working collaboratively as the G-20, it is your job during this summit to find solutions to achieve sustainable development for the improvement of lives across the world.

**industrialization**—*the process of transitioning from an agrarian or rural society to an industrial economy*

## GLOSSARY

*Appreciation/depreciation*- increase/decrease in value, i.e. in assets or currency

*BRI* – Bretton Woods Institutions- created in 1944, the International Monetary Fund (IMF) and World Bank are the world's first monetary institutions formed to govern decision-making on economy-related issues

*budget deficit* – occurs when a federal government spends more money than it takes in. The opposite is a budget surplus

*contractionary/expansionary macroeconomic policy* – policies aimed at decreasing or increasing a country's growth rate, respectively

*debt default* – failure to pay back a loan; violation of a loan contract

*government bonds* – long term debt securities with generally low interest rates and low risk; bond buyers are lending money to government, or buying its debt

*government debt* – accumulated governmental deficit over several years or more

*gross domestic product (GDP)* – the total market value of the goods and services produced within a country during a given fiscal period (3 months) or a year

*growth rate* – rate of change in GDP, can be positive or negative (associated with economic recession), usually given in "real" or inflation adjusted terms

*HIPC* – Heavily Indebted Poor Countries; group of 40 least developed countries with high poverty and debt burdens which are eligible for extra assistance from the BWIs

*human capital* – the skills, knowledge, and other attributes embodied in the ability to

work to produce goods or services of economic value

*Keynesian economics* – macroeconomic theory that argues that private sector decisions sometimes cause inefficient market outcomes, so the government should act periodically stabilize the market, or maintain its efficiency; based on ideas of 20<sup>th</sup> century British economist John Maynard Keynes.

*Millennium Development Goals* – MDGs; 8 international development goals United Nations member aim to realize by 2015; include achieving universal primary education and enhancing a global partnership for development

*Ponzi financing* – a process wherein interest on outstanding debt is paid with new debt

*productivity* – measure of output from a production process per unit of input, e.g. labor productivity is generally understood to be the ratio of output per labor-hour, an input

*real exchange rate* – value of a foreign country's currency in terms of the home country's currency

*real interest rate* – rate of interest an investor expects to earn after subtracting inflation; can be thought of as price of a loan

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