

Model United Nations of the Far West
60th Session Issues Book
The Group of 20 (G-20) + 10 Simulation

Microlending in the International Economic Community

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In our contemporary economic environment, the international community has attempted to create practices that not only benefit the countries that support that ideas brought forth, but also, the people they directly influence and affect. One of the most successful and widely used is the economic application of Microlending. Microlending “is the lending of small amounts of money at low interest, especially to a start-up company or entrepreneur.”¹ This definition leaves out one of the finer points about Microlending; that it is heavily relied upon in third world or developing countries. Some families rely upon Microloans as small as \$20 in order to live their lives. Though the idea of Microlending or Microcredit has been in existence for quite some time, some elements of the theories have been traced back as far as the 18th century. The economic theorist Lysander Spooner published a work that presented the idea of administering small loans to the poor would help alleviate poverty as a whole. When the Marshall Plan was created after the conclusion of WWII, hints of Microlending practices were evident throughout the rebuilding plan cited in the document.²

The practice of Microlending was made popular during the famine of Bangladesh in 1976. Muhammad Yunus founded the Grameen Bank, an institution that focused solely on Microlending. The first microloans ever administered were issued to village workers who used the aid to manufacture crafts to be sold. Business flourished for the Grameen, thus, becoming a

¹ Dictionary.com, “Microlending,” Ask Corporation, <http://dictionary.reference.com/browse/microlending>.

² WomensTrust, “History of Microlending,” Women’s Trust Incorporated, <http://www.womenstrust.org/content/history-microlending>.

tool of the economy of Bangladesh and its citizens. Today, the Grameen Bank has issued more than \$5 billion in funds to small business owners, and families in need all over the world. In order to help push the repayment of loans over time, the local members of the bank meet weekly with current loan owners to discuss the advancement of their businesses and lives.³ In 2006, Yunus won the Nobel Peace Prize for his work in Bangladesh, and for establishing a model of economic success that has been emulated globally.⁴ The international community has accepted that the debt and length of time these debts will be repaid is, understandably lengthy, however, many high profile members of the international economic community are major contributors to Microlending organizations. Interestingly enough, around 96% of loans issued are given to women. Studies have shown that women are more likely than men to devote the funds towards the advancement and support of their families, making them far more attractive to lend to as well as reliable clients.⁵

The World Bank estimates that there are currently over 7,000 Microlending institutions serving more than 16 million impoverished people around the world. In another World Bank estimate, Microlending has directly affected more than 500 million people since its introduction to the world economy.⁶ While several skeptics of Microlending cite the outstanding debt and unpaid loans to the banks, it is important to understand that these banks knowingly practice Microlending, as well as accept the time period some loans take to be finally paid off. Economics in developing countries is far different than in developed ones. Not only is the political

³ Grameen Bank, "A Short History of the Grameen Bank," Grameen Bank & Grameen Communications, http://www.grameen-info.org/index.php?option=com_content&task=view&id=19&Itemid=164.

⁴ WomensTrust, <http://www.womenstrust.org/content/history-microlending>.

⁵ Ibid.

⁶ Ibid.

climate more influential or unstable, it is also more difficult on the citizens of these nations to profit from their entrepreneurship. For example, taxes on home produced items may be too large to gain any substantial profit from, therefore it is important to have resources such as Microlending to help supplement the scarce profits one makes from their business.

Another source and institution that supports microlending as well as establishes a connection between the administering bodies of microloans and the global community is the International Monetary Fund (IMF). According to the IMF, it monitors the international community's financial status in three ways.

“Surveillance involves the monitoring of economic and financial developments, and the provision of policy advice, aimed especially at crisis-prevention. The IMF also lends to countries with balance of payments difficulties, to provide temporary financing and to support policies aimed at correcting the underlying problems; loans to low-income countries are also aimed especially at poverty reduction. Third, the IMF provides countries with technical assistance and training in its areas of expertise. Supporting all three of these activities is IMF work in economic research and statistics.”⁷

The IMF directly affects the progress of microlending because it will intervene in situations that require direct aid to a country in financial distress. It is important to note that though the IMF plays a major role in microlending, it does not in fact, control the approval rate or number of loans permitted. The IMF is constantly advising countries that need assistance with

⁷ The International Monetary Fund, “What the IMF Does,” IMF, <http://www.imf.org/external/work.htm>.

their economic forecast and future. Through regional representatives employed by the IMF, a certain country has expertise at its disposal that it hadn't had prior to the creation of the IMF. These representatives also are present at the national and global levels as well.

One regulation that the IMF forces upon itself is the 'One-Year Forward Commitment Capacity' regulation. This financial security rule is in place in order to assure the IMF that it can successfully support all of its loans within the next year only, allowing for the organization to remain constantly financially stable. The financial stability of the IMF is constantly updated by its research department, which also provides specific information on the countries represented within its body of 186 independent, governed nations. This stability allows for microlending to reach the target class it was created to focus on, the communities living in extreme poverty.⁸

According to the United Nations World Food Program, about 25,000 people die everyday from hunger alone.⁹ These deaths are mainly caused by inability to purchase or reach the sources of food needed for survival. A family income of some sort is vital to survival in all cases. Microlending provides a jumpstart for that income to either begin, or grow to standards that are needed for a family's survival. Children are typically the most affected by poverty and suffer most from a lack of family income.¹⁰ Noting that most impoverished countries are members of the IMF or have received aid from the Grameen Bank or IMF, these numbers are estimated even with the aid these organizations provide.

Many opponents to the practice of microlending call for a reform within the system to make it more reasonable (or less-risk) for the nations that provide the funding initially, as well as

⁸ The International Monetary Fund, "Overview & Organization and Finances," IMF, <http://www.imf.org/external/about/overview.htm>.

⁹ Poverty International, "Hunger and World Poverty" Poverty.com, <http://www.poverty.com/>.

¹⁰ Ibid.

holding the recipients of the loans more accountable. Discussion has frequented recent international gatherings, as well as G-20 summits. This practice has been one of the most reliable, successful, and life-changing economic ideas ever created, but in a world of micromanagement and skepticism, will the international community allow for its issues to pass unnoticed? Internationally, the world must take the necessary steps towards making microlending feasible and attractive to each and every country of the world; only then can the framework upon which microlending was created become the economic tool it was intended to be.

Questions to Consider:

1. Address the issues of Microlending directly, how does your country position itself when addressing this topic?
2. Why has the International Community embraced this practice as a meaningful, innovative system?
3. Consider the role that the International Community has played in addressing poverty, is microlending the best possible solution from a financial standpoint to address this global issue?
4. Reform talks have existed for years, how does your country feel about changing a system that has successfully existed for decades?
5. What solutions can you provide as a delegate that innovate microlending? Are there ways to successfully transition to a new system of aid?
6. Should International organizations like the IMF and Grameen Bank be fully supported in the global community? Why is there opposition to these organizations?
7. Risk is the deciding factor in most, if not all, large financial commitments countries make. Consider the risk your country must take when discussing new ideas, financial safety is a priority to any nation.

Useful Resources to Consult:

www.microcreditsummit.org

www.gdrc.org/icm

www.grameen-info.org

www.kiva.org/about/microfinance

www.imf.org

www.worldbank.org

International Free Trade Policies and their effect on the Global Economy

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In 1999, as a response to the global economic meltdown of the 1990's, the first meeting of the Group of 20 (G-20) was held in Berlin. The mandate of the G-20 is simple: it is an informal forum for global leaders and emerging markets to come together to discuss issues that affect the global economy and to share national policies as well as international policies. The goal is simple yet hard to reach: global economic stability.

The G-20 is made up of finance ministers and central bank governors from the 20 member nations, which are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and, the United States of America. The final member of the G-20 is the European Union (EU), which is represented by the current EU council president. As a group, the G-20 represents 80% of all global trade including EU internal, which makes the topic very important to this group. Membership in this elite group is prized. It is gained by reaching a point of economic stability that is hard, yet at the same time, achievable. The 20 members of the group could change at any point now or in the future due to changing markets and currency rates, and also economic changes that effect a countries ability to maintain economic stability.

The idea of International Free Trade is not a new one. In 1776 Adam Smith wrote about the advantages of free trade in his book The Wealth of Nations. Many economists throughout history have agreed that free trade policies are good policy, which nations must practice.

Free trade agreements that are at the forefront globally are NAFTA (North American Free Trade Agreement) and the EU (European Union). NAFTA, which is made up of Canada, Mexico, and the United States, are all members of the G-20. NAFTA first took effect on January

1st, 1994 and since its implementation, NAFTA has within the past year seen its full potential because of carefully placed restrictions that call for tariffs to be phased out gradually. Gary Clyde Hufbauer and Jeffrey J. Schott, two experts at the Peterson Institute for International Economics wrote this about NAFTA thus far,

“NAFTA was designed to promote economic growth by spurring competition in domestic markets and promoting investment from both domestic and foreign sources; it has worked. North American firms are now more efficient and productive. They have restructured to take advantage of economies of scale in production and intra-industry specialization.”

These findings conclude that the objectives of NAFTA, both domestically and internationally, what been successful. However in 2003, the Congressional Budget Office of the United States conducted a full-scale study to examine NAFTA thus far; it came up with these results:

- U.S. trade with Mexico was growing before NAFTA’s implementation, and would likely have continued to grow with or without the deal on a scale that “dwarfs the effects” of NAFTA itself;
- The direct effect of NAFTA on U.S.-Mexico trade is fairly small, and thus the direct impact on the U.S. labor market is also small; and
- Overall, the NAFTA deal has expanded U.S. gross domestic product (GDP) “very slightly,” and has had a similar effect—both positive and small—on the Canadian and Mexican economies.

The European Union, like NAFTA, promotes free trade through its 27 member countries. However, in contrast to NAFTA, the EU is much farther along the road of regional integration than NAFTA. The EU was created in post World War II Europe, via the European Coal and Steel Community, and the goal was free movement of goods such as coal and steel between France and Germany. This group grew and now is a premier area for business and labor. Modern day Europe allows for free movement of labor and capital. In 16 of the 27 members the currency is the same and is quickly becoming the worlds leading currency, which is the Euro. However the union does have its downfalls. Many point to the fall of Ireland from economic dominance as a key failure of the union. The rise of the “Celtic Tiger” is a great example of this. The Irish “rebirth” was a great sign of the power and influence the Union can have. However, many say the fall was due to the Unions policies, such as the many thousands of documents and treaties that make up the union. That said, many have a hard time grasping the policies and more often than not lawyers must be consulted to understand it all. Nevertheless, the EU is a great example of a working free trade area, and is atop the leaders in global economics.

The World Trade Organization (WTO) was founded on January 1st 1995, under the Marrakesh Agreement. The WTO currently has 153 members, and the purpose is to regulate trade among its members. In 2000, the World Trade Organization secretariat released a study that makes a case for free trade agreements. The study conducted by Dan Ben-David of Tel Aviv University and L. Alan Winters of Sussex University, was titled “Trade, Income Disparity, and Poverty.” In this study they concluded that, “Trade liberalization helps poor countries to catch up with rich ones and that this faster economic growth helps to alleviate poverty.” Director of the WTO, General Mike Moore, had this to say about free trade and this study:

“This report confirms that although trade alone may not be enough to eradicate poverty, it is essential if poor people are to have any hope of a brighter future. For example, 30 years ago, South Korea was as poor as Ghana. Today, thanks to trade led growth, it is as rich as Portugal.”

One main point of the study is that the living standards in developing countries are not reaching the levels of those in developed ones, but some developing countries are making strides. However, the difference between those who are and those who are not is simple; the ones with a free trade agreement are the ones making the progress and the more open they are, the faster they are growing economically. Also the study found people who are from a lesser-developed nation benefit from trade liberalization. “...Which is generally a strongly positive contributor to poverty alleviation—it allows people to exploit their productive potential, assists economic growth curtails arbitrary policy interventions and helps to insulate against shocks”.

During this time the study supported a similar study conducted by the World Bank, which, “...[by] using data from 80 countries over four decades, confirms that openness boosts economic growth and that the incomes of the poor rise one-for-one with overall growth.”

In November 2001 members of many leading industrial nations met in Doha, Qatar to discuss a wide range of topics, the most pressing of which was international trade. After the meeting was over the Doha Declaration was released, which addressed the mandate for negotiations on a range of subjects and other work, including issues concerning the implementation of the present trade agreements. One of the major topics within the declaration was the question of agricultural subsidies (however, this issue of agricultural subsidies is why the Doha Round talks broke down):

“The declaration reconfirms the long-term objective already agreed in the present WTO Agreement: to establish a fair and market-oriented trading system through a programme of fundamental reform. The programme encompasses strengthened rules, and specific commitments on government support and protection for agriculture. The purpose is to correct and prevent restrictions and distortions in world agricultural markets.”

Governments also committed to have comprehensive negotiations on the following, without prejudging the outcome:

- Market access: substantial reductions
- Exports subsidies: reductions of, with a view to phasing out, all forms of these
- Domestic support: substantial reductions for supports that distort trade

Those present at the meeting took into consideration special and differential treatment for developing countries integral throughout the negotiations.

So as a delegate at Model United Nations of the Far West, what does this all mean? International Free Trade is a very important topic in the current economic climate we live in today. Consider this hypothetical situation: in your country, should the government choose protectionism (not opening trade to other countries) over open trade (opening trade with other countries); in general, what kind of effect will that have on the people living in your borders? Also, is your country more capitalist or socialist in nature, and how does this effect your domestic policies toward free trade? Take into consideration the global climate and how free trade will affect the current international economic and political climate and its future

generations. It is important to have an open mind with regards to change; International Free Trade is a great place to start the discussion on international economic change.

As the members of this committee, the Group of 20 (+10), delegates have the power to make a difference in the world seeing that it is a majority of the economically developed world. As a member of this committee, it is your responsibility to be a global leader and help guide the world out of the current economic problems it faces.

Questions to Consider:

- 1.) What benefits could your country have from extending a Free Trade agreement to a developing nation? What could be an obstruction for your country?
- 2.) Does your Country belong to an agreement similar to NAFTA or the EU? If so since when and how has the economy changed since the agreement?
- 3.) On a global scale is free trade a benefit or interference for your countries stance on the issue?
- 4.) Would your country be willing to extend a free trade agreement to a historically hostile nation for the improvement of the global economy?
- 5.) Do existing trade agreements your country has need to be amended into free trade agreements, for the betterment of the region, or global economies?
- 6.) How would your country's GDP be affected by opening trade? How would it be affected by free trade?
- 7.) How has, free trade agreements such as NAFTA effect the global climate? Will this trend continue?
- 8.) What kinds of issues are pressing from NGO's in concern to free trade?
- 9.) What is the difference between free trade and fair trade?
- 10.) How has Copenhagen effect free trade?
- 11.) How have agricultural subsidies effected trade in your country?

Suggested Web resources:

<http://www.wto.org/>

<http://www.worldbank.org/>

http://www.cfr.org/publication/15790/naftas_economic_impact.html

<http://www.cbo.gov/doc.cfm?index=4247&type=0&sequence=1>

<http://www.g20.org/index.aspx>

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McCormick, John. *The European Union: Politics and Policies*. II. 2003. Print.

"The Effects of NAFTA on U.S.-Mexican Trade and GDP." *Congressional Budget Office*.

May 2003. 28 Jun 2009

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Council on Foreign Relations. 28 Jun 2009 <<http://www.cfr.org/publication/15790/>>.

Group of 20, "what is the g-20." *The Group of 20*. 2009. g-20. 28 Jun 2009

<http://www.g20.org/about_what_is_g20.aspx

International Debt Forgiveness

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The idea and the usage of International Debt Forgiveness is a vital tool used in global economics. Many nations around the world do not experience the luxury of having a developed national economy. There could be several occasions where a lack of experience or knowledge in an official governmental leader, leading his or her nation astray and destroying the economical fundamentals on which the nation was held upon. The 1995 Mexico crisis is an example of such a situation. The President did not destroy his nation or its economy but his chosen actions hurt his nation more than it helped. For many years, International Debt Forgiveness has been a tool promoted throughout the United Nations, urging countries to provide relief to those in need of it. The idea of lending has proven to be beneficial to international economics, while assuring safe and stable interactions between nations. There are various forms that forgiveness can come in, which will be examined below. New forms of implementation may prove to be more efficient, while the international community is also looking at former cases to truly understand the idea of International Debt Forgiveness. This idea is a cornerstone in global economics helping provide a little stability in the world. While, wanting others to grow as developed nations in turn grow and develop our own societies.

The idea of Debt Forgiveness is a simply based off of a childhood lesson taught onto us from our parents: “Treat others as you would want to be treated.” When examining this rule, it is self-explanatory; if one wants to be treated well, treat others well. When one thinks about it, this lesson can be transferred into an economic sense. If one nation is struggling and asking for aid, why not provide it for them? A struggle for the lender may occur; however, one day the tables

could “be turned” and it could be the, once striving nation who may be asking the international community for aid. What would the incentive be for the nation one is asking for aid from, if the striving nation did not provide aid for them when previously asked? Some mistakes are made due to lack of experience and knowledge by governmental leaders, and others because of disasters or unexpected occurrences’ that can destroy a country’s morale and national economy. The idea is very similar to the idea of “There Ain’t No Such Thing As A Free Lunch” (TANSTAFL) a book written by Edwin G. Dolan¹¹. Similar to treating others as one wants to be treated, this philosophy presents the idea that when you help out a nation that is ailing, you would hope/ expect the same action to be taken when you are in a crisis situation. The idea of TANSTAFL presents the idea that everything has a cost, but many things are taking away costs from ones or nations “direct” money or it could also be depleting the only stable source of income¹². Incidents happen whether they are unplanned or are a direct result of prior actions or decisions, but the idea is to aid those in need, nations must realize that everything has its price, and the price paid runs a risk of either being a good or bad investment, intention and motivation aside.

A common tool that is used in the practice of debt forgiveness is rescue packages. A rescue package is a group of loan commitments made by others that will assist an ailing nation, in an effort to get through the crisis at hand. The rescue packages serve several different purposes to its users. During any financial crisis a nation’s private lending may decrease due to the lack of available funds, including crucial international investments, issued in the Crisis of

¹¹ Dolan, Edwin G. *TANSTAFL*. Thomson Learning, 1971.

¹² Dolan, Edwin G. *TANSTAFL*. Thomson Learning, 1971.

Asia in 1997¹³. These packages will help reestablish the private lending in the nation, which will help jumpstart the cash flow of the ailing nation, helping their economy to slowly increase, giving them the ability to lend money, retaining money, and to spend money to continue to boost their own economy. The money that is lent out will also help the nation meet the needs for foreign exchange, investments, and trading, while providing the necessary financial backing for domestic investments, that will provide financial security in case of any decline that may occur in national aggregate demand. Aggregate demand is defined as the total goods and services that is demanded by an economy at a given overall price at a given time period.

A vital part of the lending is to provide economic security for the country in question for the country whose economy is crashing. It allows the country to not hit “rock-bottom,” in which the crisis becomes immensely difficult to emerge from. It is difficult because in their economic crisis while also allowing the government to spend money and to have a cushion to attempt to turn around their economy. The money that is loaned to a nation goes directly into the national economy, to help rejuvenate the cash flows within that nation. It allows the nation to take the necessary risks when trying to turn around their economy when trying to stabilize and improve their economic health, helping them learn from their mistakes and turning red into green.

A recent economic event in occurred in Malawi, in which the government received \$80 million which was issued by the Group of 20 (G-20) summit in London in April of 2009 as a cushion to help combat off the world’s economic crisis. The nation’s rates of foreign currency, reached an alarming low due to the foreign currency shortages the nation had recently experienced. For months Malawi’s exchange rates were steadily decreasing, until the point where

¹³ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg. 494-495.

it became an issue that needed to be immensely addressed. The rescue program was officially implemented in the nation of Malawi at the beginning of August in hopes it could be put to use by the end of the same month¹⁴.

In the idea of foreign exchange, the general theory is to help the ailing nation slowly become active in Global Economic Market so they can continue to find trading partners in hope of raising their national exports to create more national revenue. Increasing their exports allows the ailing nation to invest in their own domestic companies in hopes that they grow and establish themselves as a vital corporation to the national economy. In the theory of “Protectionism vs. Globalization” it is often argued that trade policy is an insufficient form of redistributing income, while the opposing theory is that free trade widens the available options of goods, benefiting the trading nations by increasing the economy’s total output. It is vital that foreign exchange does not spend any reserves too quickly, and also makes sure it has international reserves. In most scenarios, such as China’s foreign exchange reserves, they require a detailed structure of the reserves assets and the commodities of the international and national reserves¹⁵. International and National, or Domestic, Reserves are vital to nations because they are domestic and foreign currency held in banks. The two most common domestic assets available are bonds and loans that the central banks can make. While the two most widely available international reserves, are foreign currency and foreign debt securities¹⁶. These forms of relief are vital to interacting nations as it creates a similar transaction course. China views the Law of Diminishing Return as

¹⁴ Gondwe, Gregory. "Malawi to receive US\$80m IMF funds as economic cushion." July 31, 2009. <http://www.bizcommunity.com/Article/196/87/38495.html> (accessed August 10, 2009).

¹⁵ Daxian, Carles. "Globalization and the Egalitarian Backlash: Protectionism Versus Compensatory Free Trade." (2002): 1-2.

¹⁶ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg. 547.

a theory to strongly watch over, in which it states “At a certain point each additional unit of input yields less and less output”¹⁷.

Another purpose in these packages is the International Monetary Fund (IMF) along with other official lenders, such as governmental, hoping that these effects of the packages will limit the growth of the financial crisis into other national economies. A main purpose of the IMF is to organize an “international safety net” that compares to that of deposit insurance and discount lending, which is used to prevent the spreading of economic instability of one bank to other banks. The idea of deposit insurance was established in the United States in 1933 by the Federal Deposit Insurance Corporation (FDIC). The idea was to encourage the public to deposit money while also providing and maintaining the public confidence in the bank. The FDIC set a standard of insuring up to \$250,000 per institution only if the bank is a member of the FDIC firm¹⁸. Discount lending, or rate, is an interest rate that a depository, that is eligible, would be charged to borrow a short-term funds loan directly from a Federal Reserve Bank. When issuing the interest rate the bank calculates the potential borrower’s present cash flows. The interest rate is typically one of two interest rates set by the Federal Reserve, either the Federal Fund Rate or the Overnight Lending Rate¹⁹. Deposit insurance and discount lending is used by the IMF to help the ailing nations slowly rise out of debt, while not creating a large amount of debt in loan funds. It is presenting safety and security when it comes to the funds, by offering insurance for the funds in the banks and quality, premium rates from the loans.

¹⁷ Daxian, Carles. "Globalization and the Egalitarian Backlash: Protectionism Versus Compensatory Free Trade." (2002): 2.

¹⁸ Kaufmann, George G.. "Deposit Insurance" *Library of Economics and Liberty* 1. (2002), <http://www.econlib.org/library/Enc1/DepositInsurance.html>. (accessed September 2, 2009).

¹⁹ "The Discount Rate." August 11, 2009. <http://www.federalreserve.gov/monetarypolicy/discountrate.htm> (accessed September 2, 2009).

Rescue packages give the IMF the power to impose conditions as a part of a nations new lending, where it would require the government to make crucial policy changes, increasing the recovery rate of the ailing nation. This idea allows the lending government to dictate the new policies and procedures that must be implemented into the ailing nation before any form of relief is given. The idea of globalization is presented in this scenario. It's the idea of trying to connect national economies through investments and international trade²⁰.

Major questions arise when the use of rescue packages are at hand. In the case of the Mexico financial crisis of 1995 the rescue package that was issued was viewed to be successful. Soon after, Mexico began to notice an increase in the nation's deficit as it climbed to six percent of the Mexican Gross Domestic Product. In response to this crisis the government decided to increase taxes and reduce the national spending²¹. The main lender in the relief for the Mexican crisis was the United States government. The United States, being one of Mexico's largest trading partner, became nervous of the at time, current state of the Mexican economy. The amount of aid offered from the IMF and the United States to Mexico reached in total of \$50 billion. In total Mexico only borrowed \$23 billion from the United States, showing that more of the relief funding came from the rescue package from the IMF. This scenario is a perfect example of the success that rescue packages can have, showing Mexico's crisis being resolved in a timely manner²².

The crisis of Asia in 1997 was a scenario where the rescue packages were considered at best minimally successful. The fall of Asia originated in Thailand, and spread throughout several

²⁰ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg. 4-5.

²¹ Meza , Felipe. "Financial Crisis, Fiscal Policy, and the 1995 GDP Contraction in Mexico" *Econ Papers* 40. 6 (2008), 1239-1247, http://econpapers.repec.org/article/mcbjmoncb/v_3a40_3ay_3a2008_3ai_3a6_3ap_3a1239-1261.htm. (accessed September 3, 2009).

²² Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg. 493-494.

Eastern Asian countries. The spread was caused due to the exclusive trading that took place between the neighboring nations of the region. The closeness of the nations led to their collapse, followed by forms of relief to try and pull their trading partners out of the crisis simultaneously. However, due to a lack of economic stability within each nation, the effort made to relieve Thailand, caused the supporting nations to enter into their own form of economic crisis. When the crises were examined the economies of the nations affected were examined and no terrible flaws, such as irresponsible spending or over borrowing creating a larger debt to repay, were found. The weak financial systems, inadequate policies, exclusive trading, and panic throughout the nations were the determining factor in the causes of the Asian crises²³. For all of the Eastern Asian nations in need of aid; the IMF organized \$115 billion dollars in relief. Similar to the Mexico crisis the money helped stimulate the economy however, due to the poor policies held by the recipient it shaded limited growth. This factor is the main flaw when it comes to rescue packages. Money can be applied for crises; however it comes down to the policies of the recipient nation to ensure a full stimulation²⁴.

The issue of "Moral Hazard" is a common problem when dealing with the issuing of rescue packages. Moral Hazard is the risk that one party of a transaction has not entered the contract in good faith, has misleading financial information, or has the incentive to take unusual and unnecessary risks. Moral Hazard can be reduced and increased easily in several situations. An easy way to reduce the risk of an issue is to evenly distribute responsibilities of the issue at hand between the two parties, to ensure both are staying responsible of the duties. The issuing of

²³ Moreno, Ramon. "What Caused East Asia's Financial Crisis?." August 17, 1998. <http://www.frbsf.org/econsrch/wklyltr/wklyltr98/e198-24.html> (accessed September 2, 2009).

²⁴ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 494

relief packages is a vital part of the process is deciding whether an ailing nation is deserving and responsible to receive the aid and which form of relief is proper for their debt restructuring²⁵.

The idea of debt restructuring refers to two types of changes in debt, which are debt rescheduling and debt reduction. The idea of debt reduction is the act of lowering the amount of debt, while the idea of debt rescheduling refers to the changes of payments, by pushing payment dates further into the future. Both ideas present a similar scenario, trying to solve the crisis at hand, however the main issue is finding the right resolution to reverse the direction of the economy. Looking more in depth into both options gives more of a clear description of what both options entail²⁶.

Debt reduction is a more difficult form of restructuring debt. It is a difficult task to decide upon a new total of debt while also finding a way that both parties are able to agree upon the new set rate. The Debt Crisis of 1982 is an example of when debt reduction was used. The crisis began in August of 1982, when Mexico announced it was no longer able to repay their large foreign debt. Shortly after Mexico's declaration dozens of other developing nations announced, the inability to repay their previous loans²⁷.

Several factors went into the cause of the crisis, yet the interest rates of the United States played a large role. During this time the interest rates of the United States sharply increased, due to the shifting the US Federal Reserve; a decision made to make a tighter monetary policy in hopes to reduce inflation. In response to the debt crisis that sent several industrialized nations,

²⁵ "Moral Hazard." 2009. <http://www.investopedia.com/terms/m/morallhazard.asp?viewed=1> (accessed August 5, 2009).

²⁶ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 507-508.

²⁷ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 491.

including the United States into a severe recession. The crisis lasted throughout most of the 1980's due to the lack of a set framework to recover their nations. In 1989, The Brady Plan was instituted, to give a proper framework for the rebuilding. In a typical "Brady deal" the creditor has a choice between the debt reduction and the continuance of its loans agreements. The debt reduction took place when the bank chose to exchange its loans for a smaller amount of new bonds. The Mexican Government received United States Treasury Bonds at a below market rate of 6.25% issued by Federal Reserve Banks. For aiding Mexico in its debt, the US government issued Treasury Bonds that were securitized and were in turn financed by international financial organizations, to the aiding banks²⁸. The Brady Plan relieved 18 nations with crisis totaling \$65 billion, which was one-third of the total debt²⁹.

This idea of rescheduling does not affect the total amount of debt; it just expands that debt over a longer period of time. Stretching out payments, allows the ailing country to have more of a manageable time table to recover their economy from the debt crisis. It helps the nation to not become overwhelmed with the allotted amount of money to repay from the aid relief. The idea of rescheduling tends to be the usual tool of restructuring that is implemented. It usually favors both the indebted and the lending nation and is more easily agreeable on terms than debt reduction. In this process the key issue is to find creditors and borrowers that can agree to terms. A creditor has the right to hold out until the contract that is most satisfying to them is presented. Here lies the problem, finding a suitable lender that can agree on a reasonable, loan and a repayment plan that is achievable for the borrower. It is the similar idea of that of a "free

²⁸ Vasquez, Ian. "THE BRADY PLAN AND MARKET-BASED SOLUTIONS TO DEBT CRISES" *The Cato Journal* 16. 2 (1996), <http://www.cato.org/pubs/journal/cj16n2-4.html>. (accessed September 5, 2009).

²⁹ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 491-493

rider". A free rider can be repaid in full faster than other lending nations which leads to frustration and the future inability to restructure deals³⁰

When it comes to theories of improving the "international financial architecture" there are certainly no shortages. Many proposals raised are very controversial, while others suggest development in the opposite direction for the struggling nation. One major controversial theory is to abolish the IMF, or at the minimum its rescue activities should be limited, because their lending creates moral hazard. However, there are four proposed reforms that receive a widespread amount of support and are not as controversial³¹.

The first proposal is that the developing nation needs to pursue quality and sound macroeconomic policies to avoid possible over borrowing or create a loss of confidence in the government to send the nation into a crisis. Many macroeconomic policies are judged by efficiency by meeting goals like steady growth, stable prices, and full employment. The debatable issue people link microeconomics to is the openness of international cash flows. As new developing nations are integrated into the foreign market volatility becomes an increasing fact of life. In 1970, only 30% (34 countries) of the IMF membership had assumed the Article VIII of the IMF's Articles of Agreement, in which it states to declare their currency convertible on all current account transactions. By the year of 1997 the percentage of nations had increased to 77%³².

³⁰ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 507-508

³¹ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 508-510.

³² Dailami, Mansoor, and Nadeem Ul Haque. "What Macroeconomic Policies Are Sound? ," *Social Science Research Network* (1998): http://papers.ssrn.com/sol3/papers.cfm?abstract_id=597197 (accessed September 2, 2009).

The second proposal is the idea that nations need to improve the financial data that they report to the public to provide detailed information on their total debt and all its components, as well as holding on international reserves. The idea is that it is vital for the government to release this data promptly for the public to become aware. It is believed that this data will become informational to lenders and in turn will make wiser and more informed decisions which will result in overspending less likely to occur. This proposal while not controversial does have some limits. Any developing nation's government has incentive to release misleading data at crucial time periods when lenders need the most accurate information available³³.

The third proposal is that a developing country's governments should avoid short-term borrowing. It is crucial that governments avoid borrowing in foreign currencies to avoid crises that start by the foreign lenders suddenly demanding repayments. The current foreign debt structure of Romania is a good example of this scenario. In April of 2009, Romania's short-term debt fell over 400 million Euros, while the private medium and long-term debt rose over 476 million Euros, according to the National Bank of Romania (NBR). Beginning at the end of May, the National Banks will no longer allow minimum reserves to be held with over a two year maturity. This movement encourages turning short-term credit lines into medium or long-term loans³⁴.

The final proposal enjoys the most widespread support of the four, which is the promotion of better regulations and supervision of banks in the developing nations. Banks are

³³ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 510.

³⁴ Voican, Razvan. "Roman Economics." June 23, 2009. <http://rom-econ.blogspot.com/2009/06/romania-economics-change-in-foreign.html> (accessed September 3, 2009).

known to have a special role in economies. They are the central unit of payment and facilitate economic transactions. In developing nations stock markets are underdeveloped; government regulations and supervision of banks is weak. Weaker regulations allow banks to engage in risky activities. Banks also assume large exposures to exchange rate risk by borrowing foreign currency in terms of funding loan in local-currency³⁵. Bank regulations have often included the safety and stability of a bank and the operations that take place in that bank for a broader financial system as well as consumer protection. It is vital to understand that banks and their customers take on a large part of the costs of regulation. So it is important to minimize any regulatory burden on banks. A key step in creating quality regulatory policies requires that we take a broad view of the way the rules effect the economy, while also maintaining a bit of humility, about our ability to relate the benefits and costs to the society as well³⁶.

International Debt Forgiveness is a vital part of International Economics. Financial crisis often happen when not expected and can be crippling to a nation's economy and moral. Unfortunately financial crisis events have occurred, and have depleted several nations' economies. However several efforts have been created to help out nations that enter rough times. Various forms of relief from debt rescheduling to prime rate loans, have been established in an effort to provide nations confidence to regain their nation's economical status. Between willing nations and organizations such as the G-20 and the IMF Debt Forgiveness has helped the global economy stabilize and continue to grow in many respects.

³⁵ Pugel, Thomas A.. *International Economics*. 13 ed. New York: McGraw-Hill/ Irwin, 2007 pg 509-510.

³⁶ Burnanke, Ben S.. "Bank Regulation and Supervision: Balancing Benefits and Costs." October 16, 2006. <http://www.federalreserve.gov/newsevents/speech/bernanke20061016a.htm> (accessed September 4, 2009).

Questions to Consider:

- Should there be set repayment plans for rescue packages? Obviously every situation is different, but should there be particular lengths of time that an ailing nation has to repay its lenders?
- What would be possible options, when deciding to choose Debt Restructuring? What tools would be useful to create the possibility?
- Should there be banks established and dedicated solely for the purpose of International Debt Lending, instead of using for instance, the United States Federal Reserve Banks?
- How does one decide if another nation is worthy of receiving any sort of relief? It is understandable that many nations trade with each other and need both to succeed. The issue is what if there is a nation that provides no vital exports to other nations and their governing body creates a crisis on their own? Do they deserve the relief? If so, which nations provide it?