In the Wake of the Crisis: should poor countries bail out the rich?

Hi, I’m Emer Byrne and I will be chairing your Economics Committee along with Jamie and Becki. I hope you will all enjoy being on the committee and have a good time at the conference. I hope my briefing paper can give you some ideas about one of the topics we’ll be discussing and for writing your resolution. The deadline for position papers is 18 February. If you don’t know what these are, it’s just a brief summary of what your country’s view on the topic is – 50 words or so is fine!

Background

In recent years, the aftermath of the global credit crisis and the recession has forced EMDCs to rely increasingly upon funds and advice from the International Monetary Fund (IMF). The IMF was founded at the Bretton Woods conference in 1944, with the purpose of acting as a "lender of last resort" for nations with balance of payments problems. Traditionally, the IMF has been involved with bailing out small developing countries. Until recently, it has never been involved in activity which might strain its treasury. However, the recent sovereign debt problems facing developed countries have marked a new and uncertain era for the IMF. The $110 billion euro bailout fund given to Greece in 2009 was by far the largest in the IMF’s history, creating a great deal of annoyance amongst non-EU countries, for which the survival of Greece was not as critical. As sovereign debt problems continue to loom for Ireland, Portugal and Spain, a debate has developed over whether it is right for the IMF to keep handing large bailout funds to the rich.

Arguments against LDCs making payments to the IMF

One main concern amongst the LDCs is that the IMF could run out of money if it engages in another bail out of a rich country with sovereign debt problems. After the IMF’s bailout of Greece, scepticism was raised about whether it would be able to do the same thing again for a country with a GDP the size of Italy. This isn’t necessarily a desperate cause for concern, as according to the IMF Italy has the 7th largest GDP in the world – $2.1 trillion in 2009. However, it does stress that the IMF’s funds are not limitless and that in an era where countries such as Spain, with a GDP of $1.5 trillion, have sovereign debt issues, could run out of liquidity to help emerging markets.

Many LDCs are also bitter because they feel that this is Europe’s problem. There are two main reasons why reason why Greece’s difficulty repaying its sovereign debt created such a crisis in Europe. The first is that it was mainly European countries who had lent the money to Greece in the first place. The IMF’s bailout of Greece means that it can continue to repay its debts to its rich neighbours, whereas if Greece had been allowed to default they would have lost the billions they had lent out. The second is to do with the stability of the Eurozone. If a country the size of Greece defaulted on sovereign debt, it would have shocked global financial markets. No one would have wanted to keep their money in Greece’s financial institutions, causing a panic selling of the euro and a quick depreciation. This destabilization would have had negative implications for the rest of the Eurozone. Inflation could rise and the panic could easily spread to their financial markets. As a result, many LDCs feel that since the Greek problem was such a potential disaster for Europe, Europe should have bailed it out rather than the IMF. For the same reasons, they will be less than enthusiastic to help the next European country which finds itself with sovereign debt problems.

LDCs also hope that paying less money into the IMF and therefore cutting its funds could act as a moral hazard for the rich. The sovereign debt crisis was not forced upon the developed countries, unlike some of the engrained problems facing developing countries. LDCs feel that because the richer countries got into the credit crisis out of carelessness and greed because they had the knowledge that institutions such as the IMF
exist to numb the pain of the consequences. Many developing countries feel that rich countries that have
gotten into sovereign debt should be made an example of, to ensure that the experience is engrained in the
memory of the rich world and an avoidable crisis never occurs again.

There is also an argument that it is incredibly unfair that LDCs have to sacrifice a proportion of their limited
gDP to help get rich countries out of their sovereign debt, when they themselves have so many debt
problems. Many LDCs have had to sideline development programmes because they are struggling to repay
massive debts to the rich. Many of these debt repayments have been acknowledged as fundamentally unfair, as
they are often incurred under oppressive regimes which waste the money, or at completely unreasonable terms.
For example, South Africa is still paying a debt of $22 billion which was lent to help the apartheid regime. As
a result, many LDCs feel it is incredibly unfair that they are expected to help rich countries with their
sovereign debt crisis when they are yet to be granted relief on the unfair debts which they owe the rich.

LDCs also feel it is incredibly unfair that the IMF is dominated by rich countries, and that therefore
developing countries do not earn a large say in whether these bail outs go ahead. The top five countries in the
IMF in terms of voting power are all developed: the USA, Japan, Germany, the UK and France. Combined,
they have 39% of the vote. The 27 member states of the EU have a combined vote of 32%. Consequently,
LDCs feel that they are paying money into an organisation in which their interests are second to the rich.

Reasons why LDCs should continue contributing to the IMF

However, the debate is not one sided. Rich countries would argue that since the voting quote is a direct
reflection of how much of their GDP they contribute to the IMF, they have a right to have a greater say in
where the money goes.

EMDCs also argue that if the IMF helps to relieve their sovereign debt, they can continue to make aid
contributions to help the development of poorer countries. Britain is amongst the rich European countries
struggling with sovereign debt. This has led to the introduction of an ‘emergency budget’ which cut public
expenditure in most areas of the economy. However, the one area of spending which the government raised
was its contributions to international development. This was increased by nearly 40%, whereas the budget for
Britain’s own local government grants was cut by just over 20%. If countries like Britain cannot rely on IMF
funding as a safety net, they will be forced to readdress the way in which they allocate spending and the
developments of LDCs could ultimately suffer.

There is also an argument that it is in everyone’s interest to save the richer EU countries from their sovereign
debt worries. In an age of globalisation and free trade the economies of LDCs are largely dependent upon
their exports to rich countries. If the EU runs into difficulty, it could create another recession, which would
lead to less spending in all areas of their economy, including imports. This would cause the problem to spread
to the LDCs with which the EU trades. As a result, it could ultimately be in the developing countries best
interests to prevent the sovereign debt crisis from causing real problems in Europe.

There may also be a solution to the worry that the IMF is about to run out of funding because it has to
provide large bail outs for indebted rich countries. The BRIC countries (Brazil, Russia, India and China) have
emerged strongly from the recession. They have healthy current accounts, and generally a high saving ration
amongst consumers. This has led some to hope that they will fill the gap in IMF funding left by the increasing
strain on the US and Europe, and ensure that developing countries are not neglected amongst the sovereign
debt bail outs.
Useful Links

- http://www.imf.org/external/about.htm

As well as the previous links there are other useful ones:

For country profiles:

- http://news.bbc.co.uk/2/hi/country_profiles/default.stm

For issues of current debate:

- http://www.newint.org/
- http://www.idebate.org/