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Unveiling the Veiled Contracts: An In-Depth Analysis of Development Loans and their Implications on Developing Economies' Macroeconomic Interdependence

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1.1 Introduction

In recent years, the world order of developing nations has embraced the prospect of macroeconomic interdependence through resource-backed financing (i.e, development loans). This isn't, however, a recent conundrum in any capacity. Development loans date back to as long as the start of the Second World War (WWII) where developed nations began to provide financial assistance to their former colonies in an effort to support their macroeconomic development. (Latham, 2023) Following the end of the war, the Bretton Woods Conference established the International Monetary Fund (IMF) and the World Bank in 1944. Both have been an instrumental role in promoting development finances.
The fundamental problem of development loans is attributed to the contractual secrecy promoted by their host institutions. There are inappropriate amounts of information provided about each loan to developing economies, who don't have much ground to negotiate. Development loans have long been criticized by these economies as only aiding the macroeconomic stability of the nations and neglecting the poor and burdened of smaller nations. As a result, regional banks were set up in the 21st century to aid to continental development, including microeconomic provision of infrastructural development.
This paper includes: defining the parameters of 'development loans' and 'developing economies', presenting contrasting perspectives, providing implications of said subject, establishing an assessment criteria, and providing forth a personal reflection.
Keywords: *Veiled Contracts, Development Loans, Developing Economies, Macroeconomic Interdependence*

1.2 Analysis of the question statement

Before we delve into the technicalities of development loans, we must understand their definition and purpose. According to the World Bank Blog, development loans are large government finance borrowing, usually for infrastructure, that are collateralized by future income streams from their natural-resource wealth. (Mihalyi et al., 2022) In simple terms, loans are given to developing economies with the prospect of them returning it once they are able to experience sound economic growth, preferably 1-2%.

Developing economies are nations with an underdeveloped industrial base, and a low Human Development Index (HDI) compared to other nations (Das, 2016, 364). These are nations which are economically volatile, and therefore are more vulnerable in times of recessions or domestic crises which is why they avail the option of development financing.

There are multiple types of development loans, in relation to resolving a specific macroeconomic superstructure. Development loans can be broken down into financial interest loans, credits/grants, or guarantees. (World Bank, 2023) There is also contingent financing available as part of a catastrophic risk management option, whereby a nation faces a health emergency or a natural disaster.

Funds are only made available to the countries if there is adequete adherence to a robust macroeconomic policy framework, based on World Bank and IMF evaluations, effective executive of a comprehensive action plan and a

fulfillment of key policy and institutional obligations jointly established by the Bank and the developing nation. (World Bank, 2023)

1.3 Contrasting Perspectives

Research by the World Bank's Human Development Practice suggests that as countries transition to more costly development loans, there is a significant reduction in the proportion of social sector projects supported by the Bank. This indicates that not only are financial analysts hesitant about the prospect of being burdened with development loans, policymakers may also be hesitant to borrow for social sectors, especially through less concessional means.

It is important to note that development loans might be of extreme benefit, especially to developing economies. There is an argument by critics of loans who believe that many nations are unable to give back the loans, and therefore, are victims of circular debt. Nations like South Sudan and Pakistan are visible examples of macroeconomic instability due to inappropriate liquidity and inflation.

For context, the underlying argument of the nation's repayment capacity is inherently flawed. The notion of linking repayment of loans to the individual sectors/projects is problematic as it ignores the concept of fungibility and debt sustainability. On a simplistic level, societal institutions are like organs of a body and practice interdependence. Therefore, providing development loans to a specific sector like healthcare or education should not be measured alongside the post-financing performance of said sector. Rather, the concept of debt sustainability should be embraced - the prospect that a developing economy should be adjudicated on the basis of whether the market it hones is productive enough to maintain and repay the debt it has, rather than that specific project. (Ahmed, 2019)

Taking this argument forward, development loans are inherently beneficial to the developing economies as developing social sectors such as education via development grants can provide a healthy and performing work-force which could aid said nation in experiencing economic growth, therefore, repaying the debt as well as earning a surplus which may be invested in other sectors.

However, on the other hand, development financing may be an empty promise for developing economies due to the contractual complexity of said loans. They are opaque: very little information is disclosed about the essence of the loan, which means public accountability is difficult to achieve. They require a careful cost-risk and debt sustainability analysis as well as transparency about their contractual terms. Therefore, development loans are far more likely to further the likelihood of debt vulnerabilities for already debt-stricken developing economies rather than to ease them. A sample of 30 resource-backed loans extended to central governments and state-owned enterprises in sub-saharan african (totalling $46.5 billion) were analyzed by a group of economies at the World Bank. Despite the huge amount of financing, a minute amount of information was available in regards to their specific terms. (Estevão et al., 2022)

Arguments supporting this claim include the fact that developing economies are known to have weaker debt-reporting practices. Moreover, such loans are usually contracted by state-owned companies that either do not report audited financial statements or do not provide the data to the national debt office. Furthermore, many developing economies often include stringent confidentiality clauses.

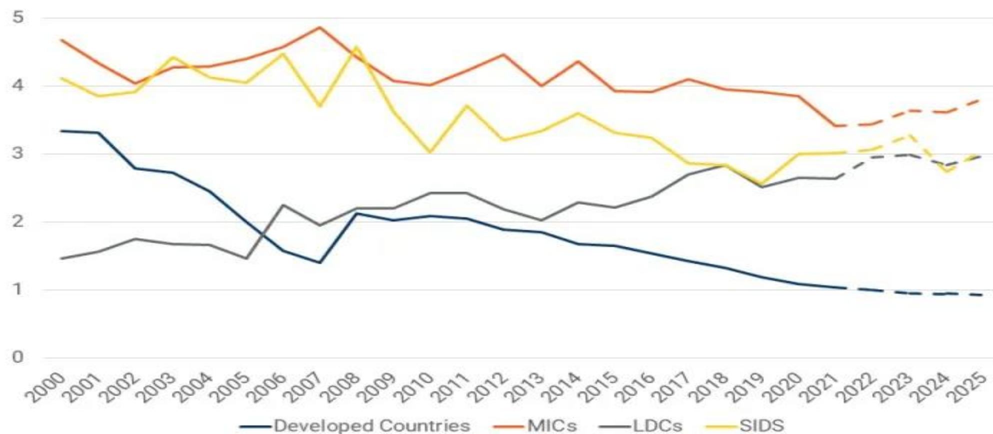
The argument supporting the benefit of development loans provides a sound and conceptually-backed understanding for why they may be able to benefit said nations. While this notion has been cited by leading economists and organizations such as the World Bank and IMF, it is at the end of the day, just a mathematically-calculated prediction; one based on a careful analysis of growth prediction models and indicators. However, it does not acknowledge the uncertainty of the global market and therefore is fundamentally based on hypothesizing.

The argument against the benefit of development loans provides a logically, and statistically backed claim which has been analyzed through the case study of sub-saharan economies. Furthermore, valid externalities such as the possibility of 'debt vulnerabilities' have been brought forth which strengthens the central argument. While the evidential establishment of the argument is positive, it lacks any depth to what the impact of said claim would be. As well as whether it is just an over-dramatized version of discussing state-privacy.

1.4 Implications of development loans

There are considerable implications enacted upon various spheres of society due to the enablement of development loans for developing nations. Let's break it down into Social, Political and Environmental (SPE).

Figure 1. Average interest cost of outstanding government debt, percent



Source: Source: Volz, Ulrich, and Damon Aitken. 2022. "Public Debt in the Time of COVID-19 and the Climate Crisis." Background Paper for the Financing for Sustainable Development Report 2022.

BROOKINGS

Social:

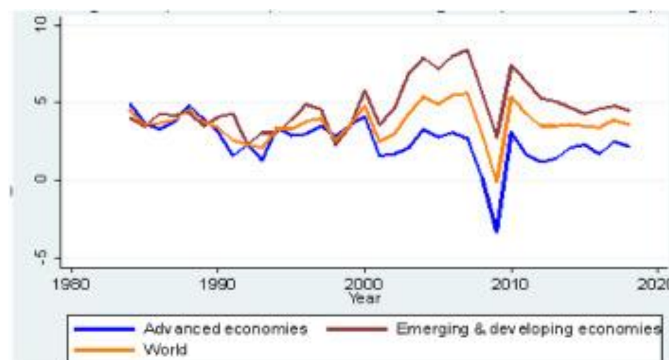
Understanding that the interest loans on developing economies' development loans are thrice that of developed economies (Figure 1, Kharas & Rivard, 2022), it is considerably difficult for the government to facilitate societal development in terms of social institutions.

Therefore, understanding the high interest rates (Kharas & Rivard, 2022) helps us acknowledge that fact that those governments which are investing into social institutions such as, education and media, do not yield productively efficiency performing labor forces since those labor forces are used to fight off the ever-increasing circular debt, hence, burdening them beyond their biological means and creating a tired and unproductive workforce.

Political:

Governments usually assess any risk before engaging in any developmental loans or contractual agreements. However, the possibility of securing those loans to begin with is strongly inter-linked with the stability of the present governing body as well as the political affiliations of said body. Many developing economies are riddled with political discrepancies such as civilian unrest or corruption scandals. More importantly, in democratic structures, long-term macroeconomic-centered developing financing is particularly difficult due to the constant change in bureaucratic regulations pertaining to infrastructure development. Interestingly enough, there are certain case studies outside of the democratic realm which also pose certain implications. (S. & J., 2022)

The case of Taiwan, for one, presents an intriguing puzzle, as the state had direct control over the financial system following decolonization and the Kuomintang regime's relocation from the mainland. Despite this, Taiwan did not utilize preferential credit to shape its industrial structure, a strategy employed by Korea and France. This distinguishes Taiwan from other countries, such as Thailand, the Philippines, and Mexico, where the financial sector is not under government control, and where credit has been used as a principal tool of industrial policy. It appears that Taiwan's leadership had the ability to use credit, but chose not to do so, suggesting a deliberate policy choice. (Tun-Jen, 1993)



Environmental:
According to Fig. 1, emerging and developing markets have experienced greater growth in real gross domestic product (GDP) compared to developed economies and the global average. This trend has been consistent since 2000. Over this period, annual GDP growth in emerging markets outpaced that of developed economies and the world average, with the former recording the highest growth rate of 4.1%, compared to 2.4% for the latter and 3.7% for the world average (IMF, 2018).
The rapid economic expansion of the energy sector has given rise to apprehensions regarding environmental sustainability at the global level, and thus, there is an urgent need to examine strategies that can reduce greenhouse gas emissions and prevent ecological disasters in these nations without hampering their economic growth. In this regard, the financial sector has come under scrutiny by scholars and policymakers, who suggest that financial development could serve the dual purpose of facilitating economic progress while mitigating environmental harm (Ozturk & Acaravci, 2013, 262-26)

1.5 Assessment Criteria

The sources used within the essay include organizations, private economists, private reporting journals and economic magazines. More specifically, the World Bank and the International Monetary Fund were frequently mentioned. Understanding the vast amount of research think-tanks available to both organizations, the sources provided the essay with depth and evidential claims which fundamentally strengthened the structure of the essay. The rubric was professional in terms of selecting aspects of these sources. They were predominantly in the form of journal articles by working macroeconomists. They provided an expert review of certain terminologies and presented economic terms in an appropriate fashion.
However, there may be an underlying bias within the bloggers of these two sources due to working within the company, being paid a wage by them. The authors may be naturally acclaimed to defend the organization in its role of exploiting vulnerable developing economies in their need for infrastructural development.
Therefore, to provide a balanced argument, sources such as the Brookings Institution of Finance and IGI Global have also been used. The Center for Global Development also provides a holistic understanding of the implications of development loans, more so specifically, why they may be beneficial.
They may have a bias in promoting global development and therefore not presenting any information against it. All in all, the sources used for the essay have strengthened the whole-encompassing argument.

1.6 Personal Reflection

The fundamental ethos of my economic understanding has significantly shifted after this research. The primary driver in that is understanding the role of exploitation on the basis of vulnerability which leaves many countries in circular debt.

Moreover, the fact that the concept of fungibility is often overlooked in the discussion of loan repayment. I also learned that majority organizations such as the IMF and the World Bank center their developing financing initiatives towards macroeconomic stability (even in the cases of disaster-risk management) which poses a significant hurdle to the poor within a developing economy.
Many shocking revelations came forth, especially the one surrounding the lack of information availability in the 30 sub-saharan countries as evidence to contractual discrepancies.

1.7 Conclusion

The question stands, are development loans beneficial to developing economies? The answer is significantly more complex than what is assumed within this context. Understanding how there are conceptual hurdles in the way debt sustainability is being carried out; with respect to loan repayment specifically; a difficult conundrum is posed towards development finance initiatives. Notwithstanding the argument of contractual trust issues, and how many countries don’t consent to all contractual terms because they don’t receive an opportunity to read all of them.

The implications draw concern towards the purpose of development loans. Are they core to environmental degradation due to reported enablement of polluting energy generation. And the political causes which drive a country towards hyperinflation and negative economic growth, a point from which recovery is considered difficult. Social circumstances, such as the recognizing the importance of social institutions which require infrastructure development is also important. In order to yield a productive labor force, rather than an unproductive one.

Further research relevant to the chosen question can be done through reading articles from the *Center for Global Development*, *IMF*, and magazines such as *Energy Economics*. Journals such as the *Bosta Istanbul Review* and *J Int. Bus Policy* are also great sources which provide excellent guidance in terms of information about macroeconomic loan stability.

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