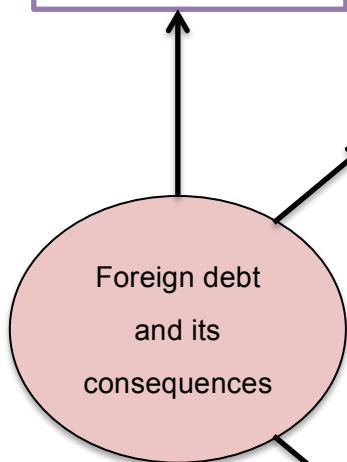


IB Question

- Outline the meaning of foreign debt and explain why countries borrow from foreign creditors.

Main idea 1

- A country's [foreign debt](#) refers to its level of external debt, meaning the total amount of debt incurred by borrowing from foreign creditors.
Foreign government debt arises from three sources:
 1. Government borrowing from multilateral organizations
 2. Government borrowing from foreign commercial banks
 3. Government sales of bonds to foreigners
- Many developing countries had borrowed believing their economies would grow allowing debts to be easily pay-off debts.
- Borrowing from foreign sources enters the balance of payments as a credit in the financial account and helps countries pay for deficits in the current account
- Therefore, countries borrow from abroad because they want to acquire foreign exchange allowing them to pay for an excess of imports over exports

**Definition:**

- [Foreign debt](#): An outstanding loan that one country owes to another country or institutions within that country. Foreign debt also includes due payments to international organizations such as the International Monetary Fund (IMF).

IB Question

- Explain that in some cases countries have become heavily indebted, requiring rescheduling of the debt payments and/or conditional assistance from international organizations, including the IMF and the World Bank.

Main idea 1

- Although the borrowing developing countries grew at an alarming rate, they managed to keep up payments during the 1970s. However, in 1979 OPEC instigated another large increase in oil prices, which contributed to the start of a worldwide recession. For a variety of reasons, developing countries found it hard to make their loan repayments and in 1982 Mexico defaulted on its loans. Over the next few years, several countries followed Mexico and the IMF became instrumental in trying to solve what became known as the "Third World Debt Crisis".
- The IMF lent funds to the developing countries that needed them, but would only do so if the countries in question adopted certain policies. These were known as Structural Adjustment Policies
- However, The SAPs were heavily criticized by many developing economists and by developing country governments due to heavy costs involved which were:
 - A reduction in government-provided services, such as education and health care
 - Increasing unemployment
 - A fall in real wage levels
 - Increased prices of essential products, as government subsidies were taken away

As a result above, a significant number of developing countries experienced "**de-development**".

Definition:

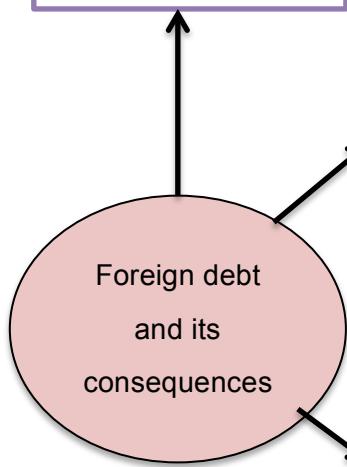
- Indebtedness: the degree to which a person, organization or a country owes money

IB Question

- Explain why the servicing of international debt causes balance of payments problems and has an opportunity cost in terms of foregone spending on development objectives.

Main idea 1

- The country faces severe longer-term balance of payments problems as the prices of primary commodities fall, causing the terms of trade to worsen.
- The need to service debt means that governments are unable to spend money on other areas of the economy. This is a case of opportunity cost that has a detrimental effect on two fronts
 1. Slows down economic growth. Ex) governments do not have funds to invest in improving infrastructure
 2. Slows down development



Definition:

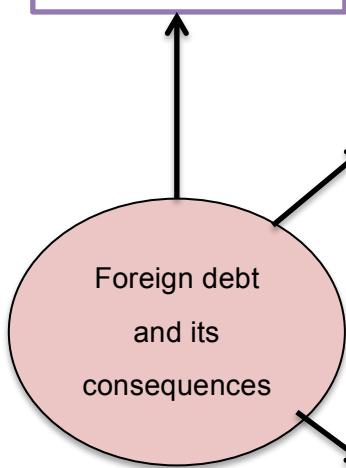
- [Balance of payments](#): It shows the countries' transactions with the rest of the world. It notes inflows and outflows of money and categorizes them into different sections.

IB Question

- Explain that the burden of debt has led to pressure to cancel the debt of heavily indebted countries.

Main idea 1

- The difficulties caused by high levels of debt has led to pressure on creditors to cancel debts of highly indebted countries. In 1996, the World Bank and IMF began the Heavily Indebted Poor Countries (HIPC) Initiative, intended to provide debt relief to some highly indebted poor countries by cancelling a portion of their debts. In 2005, this was supplemented by the Multilateral debt Relief Initiative (MDRI) which provides 100 percent debt relief for debts by 3 multilateral organizations
- The HIPC initiatives is considered to be a welcome step in the direction of solving the debt problem, but has been criticized for several reasons



Definition:

- [Debt servicing](#): It involves payment of the principal (the amount of the loan) plus interest.