

The role of borrowed capital in a country's economic growth

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Abstract: In times of states experiencing lack of funds to finance their own economies it becomes rather essential to look for credit sources. Back in times and now also such an example could be a high economy state and/or a specialized organization. They are capable of setting up groundwork of an economic miracle by giving credit to those who need it. The credit in its turn can activate functioning of economic relations.

Keywords: Borrowed Capital, IMF, Japanese Economic Miracle, The Miracle on the Han River, International credit

1. Introduction

The globalization process being taken as a feature of 21st century's world advancement puts activation and stimulation of permanent international collaboration in the first place of its agenda. But that kind of collaboration cannot be reached in no ways but through advancing economic framework of the collaborators [1]. Many countries changed their economic systems into capitalism facing the problem of disability of their banks to give a long-term credit. The reasons of such a failure are investors' lack of vision and/or internally available investment resources shortage. After all it is not said in vain that the fate of a state getting through the age of changes is unenviable.

In this way the relevance of attraction of foreign investment in the form of international credit becomes worth to be mentioned. The credit itself is central to the development of international trade as it induces its volumes growth.

The organizations responsible for giving such loans are International Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, The World Bank and, in some cases, state themselves. The resources of these organizations go, for the most part, to lending for the developing countries. The scheme of operations of the credit institutions can be described in the case of the most famous one: the IMF.

International Monetary Fund is a kind of a cashbox. It receives deposits from the participating countries according to quotas while the parties create management bodies inside the IMF. Then, the collected funds go to those in need and this decision is up to the Board of Governors which operates a "weighted" voting system. That means the parties can influence the decision-making process

according to their share in the organization's capital. The most influential side is the American one with share over 17%. This quantity is not capable to force other members to follow the will of the U.S. but it is enough to block any proposal that comes up during negotiations.

Thus, that kind of organizations gives credits to the less advanced countries by taking money from the more advanced ones. And that is fair. The history of crediting economies has both sets of positive and negative examples.

2. Effectiveness of borrowed capital

The ability to use a borrowed capital efficiently is a path to accomplish stability in economy's growth and prosperity of a state [2]. The fact of receiving credit by government should cause a strong will to put their funds in sectors of economy and make sure there are sufficient conditions for a budget surplus and following debt repayment. The way to do consists of maximum of state, business and people's efforts and minimum of losses (i.e. corruption, expenses etc.). The first positive example of such a symbiosis can be Japan. Its rapid economic dash forward in the middle of the XX century has become known as the Japanese Economic Miracle. Beginning from the 50's and until 1973 (the 1973 oil crisis) an average annual GDP growth of Japanese economy was about 10% while an average growth rate of the U.S. was about 3-5% per year [3].

That result would be impossible to reach unless Douglass McArthur, an American general, decided to rebuild Japanese economy after WWII ended. The U.S. and other states gave support to Japan by supplying of food, petrol and other materials meanwhile giving an international credit to the Japanese government for fur-

ther development. Exactly at that time, when Japanese economy was financially dependent and the debt exceeded GDP by 70~80% their enterprises revolutionized the technological industry. Exactly at that time (50's – 70's) the standard of high quality Japanese products that left behind all the others existing was born. It should be noted, the Japanese case is unique for the fact that Japan's government funded its military only with 1% of GDP. The Japanese government decided it in 1976, in addition to the Constitution enshrined the state's demilitarization. The majority of assets were used in rising up industries and high technology productions. The message was following: export or death. It took Japan only 10 years to square its duty with the U.S. and today's debt of land of the rising sun is ranked 6th in list of countries by public debt and is over 3 trillion USD. That volume of debt is three times the Japan's GDP but this causes no troubles for Japanese products to compete successfully in outside markets, budget to keep growing, and the Bank of Japan to introduce a negative rate for mortgage and traditional loans [4]. Nowadays many countries are looking into the

Japanese experience and implementing similar management schemes in enterprises and in state levels [5].

The Miracle on the Han River may serve as another positive example of rocket-fast economic growth brought by using borrowed funds. "The Miracle on the Han River" is a reference to Korean economic growth in early 1960's – late 1980's. The situation Korea was in resembled the Japanese case a lot: the infrastructure was collapsed after the Korean War and this could be the one way ticket to oblivion unless Koreans performed a miracle. Unless they possessed bee-like diligence, unless their government commanded hard, and finally, unless there was foreign investment attracted Korea could never make its way up to the 10 biggest economies of the world. The difference was, if Japan's strategy of growth assumed unity of a nation by particular idea and that business could trust government and vice versa, the Korean case had a dictator represented by Park Chung Hee. By the way, Koreans took over the Japanese "export or death".

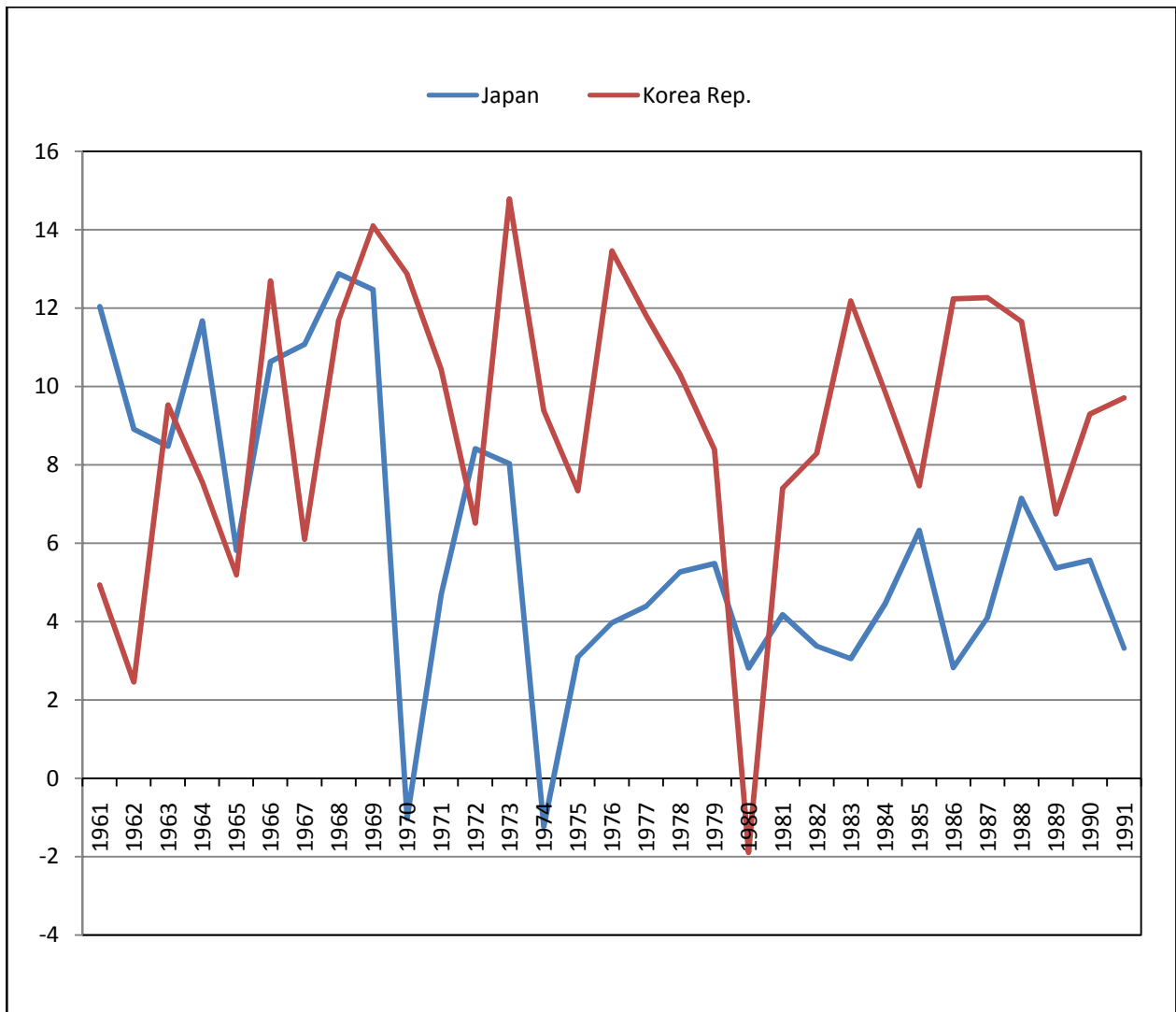


Fig. 1. The review in years 1961-1991 - Japan and Korea Rep. GDP growth (annual %). Source – The World Bank

Korea's first creditor was also Washington which was followed by other 54 UN participating countries. During the period from 1962 to 1989 Korean economy grew annually for 8% on average which is slightly less than Japan's growth rate. Korea, just as much as Japan, put it all on export-oriented industries and succeeded. Nowadays Korean goods compete well outside the Han River land and the targeted markets include electronics, machine building, ship building and others [6].

Speaking of negative examples of usage of borrowed funds the Ukrainian case can be considered the one. By the end of 2014, the total number of IMF loans to Ukraine since it gained sovereignty was equal to 55 billion USD. At the same time, the real GDP of Ukraine has declined by around 35% since 1991 [7]. It clearly points at the fact that the funds were used inefficiently and, in many cases, may have been taken by corrupters. The following year brought GDP drop by 9.9%. In the same year Ukrainian exchange rate fell against USD dramatically and was equal to 30.01 UAH which was a historical low [8]. But this was barely the end. In the following years IMF allocated tranches numerous times having the last one happened in spring 2017, the funds of that tranche were spent on paying off previous borrowings given that the economic indicators of Ukraine continued declining while productions continued stopping. The question is: how the country will get more credits to discharge new debts? The case traces possible opportunistic attitudes of the creditor: having Ukraine obtaining more tranches with the current level of corruption inside the government may lead to default and, possibly, to losing Ukraine its sovereignty. That would be the worst scenario.

3. Conclusions

According to the aforementioned information there is a conclusion to be drawn that borrowing foreign capitals may be a worthy launch pad for further development of a country consisting of establishing innovative productions along with new workplaces that would lead to increase of national well-being. The formula of success is simple: *international credit + diligence and work +*

good policies = economic breakthrough. But, in case when the funds provided are used in a twisted or inefficient way, when they are being wasted or plundered, the borrowed capital may become a road to constantly accumulating debt and, as the final destination point, to loss of sovereignty.

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