

Data Response Question 11

- (a) (i) With reference to Fig. 1, what happened to the debt position of Severely Indebted Low-Income Countries between 1980 and 1994?**

In the given data total debt stock has strictly increased over the 14 year period nearly four fold from just over \$50bn to just over \$200bn. From 1987 the rate of increase of debt has been reasonably steady, along with steadily increasing arrears, a sign that the debt position has significantly worsened.

- (ii) Show, with an example from the article, how opportunity cost applies to debt repayment.**

Opportunity cost is the value of the next best option foregone. The opportunity cost of debt repayments on debts in Zambia has led to the economy forgoing spending on primary school children.

- (b) (i) What is meant by a 'debt-service-to-export ratio' and why is a figure of over 220 per cent significant?**

Debt servicing is the payment of interest and repayment of debt when due. The ratio explains the value of debt servicing required in a given period, usually a year, as a proportion of the value of income earned in the economy on exports. A figure of 220 per cent means the economy finds itself owing more than twice what it earns from exports, so cannot continue to fund its debt servicing and goes into arrears.

- (ii) Explain two possible reasons for increases in debt ratios of developing economies**

Debt ratios can increase due to the economy borrowing more and the money not being productively invested, such as borrowing to finance repayments on outstanding debt.

Export earnings also often decrease over time for developing economies as the products in which they have a comparative advantage in the production of are primary, often agricultural products, which witness a decline in prices over time due to income and price inelastic demand and improved technology.

- (c) (i) State one way in which debt can be rescheduled.**

Where the period of the loan is extended.

- (ii) Explain the operation of any one of the structural adjustment policies favoured by the I.M.F.**

Structural adjustment is the increased operation of the market system within an economy. Many developing economies have practised a centrally planned economy, inefficient as the price mechanism no longer creates efficient allocation of resources as the government is likely to act with urban bias.

The movement towards the favoured policy will require the abolition of state marketing boards to allow farmers to obtain the market rate for their produce and abolition of preferential rates of interest to government favoured investment,

instead allowing the market system to allocate scarce savings to the investments with the highest projected rates of return.

(d) Discuss how the debt position of Sub-Saharan African countries might affect their prospects of development

Development is a steady rise in GDP leading to an improved standard of living and equitable distribution of income, which economies aim to achieve through industrialisation.

Debt gives the economy funds for development when few alternatives are available due to low savings and a lack of FDI. It is crucial these funds are used for productive investment ensure growth happens, key to the self-fuelling growth of Harrod-Domar's model for development. This borrowing lessens future need to borrow and makes the economy more able to finance existing debt as export earnings are generated.

This optimistic analysis has not always operated. Some economies have been unable to meet their current debt repayment requirements. The cost to those economies of high debt is they do not have export earnings left to pay for necessary imports of capital goods and governments do not have the tax revenues left to fully finance education and health programmes. This will harm industrialisation so cause a less productive workforce, lower standard of living and distribution of income due to poor provision.

To conclude, the level of indebtedness in sub-Saharan Africa acts to deter development. This gives weight to policy calls to remove the debt of the poorest countries so the process can restart, as the UK's chancellor Gordon Brown is currently promoting.

These notes are from a lesson on Friday 25th February 2005 and a homework from Monday 21st February.