Benefits of debt cancellation… assignment

Business

Benefits of Debt Cancellation and Agriculture Pricing Policies Benefits of Debt Cancellation and Agriculture Pricing Policies The authorities recognize that debt relief under the initiative would provide a unique opportunity to free up resources for additional poverty reducing spending. They also recognize that debt relief under the initiative would provide a unique opportunity to free up resources for additional poverty reducing spending.

They also recognize that, to enable the country to benefit from the resources made available for the overarching objectives of poverty reduction and economic growth, structural reforms initiated in critical areas , including governance and anti-corruption, need to be accelerated. Against this backdrop, the authorities formally communicated to the Fund and the World Bank (in a letter dated March 23, 2006) that they wished to initiate discussions on the possibility of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and, subsequently, under the Multilateral Debt Relief Initiative (MDRI).

In 2006 the World Bank, International Monetary Fund and African Development Bank agreed to completely cancel the debt of 18 qualifying countries. The total debt cancelled amounted to approximately $40 billion dollars with expected annual debt payment savings of one billion dollars. These countries were so indebted that they were spending upwards of 30% of total income purely on servicing the debt. Many were forced to take out new loans to repay the old loans. The condition described in these countries reflects similar conditions as in the theory of the vicious cycle of poverty.

These countries spent a large portion of money on servicing debt and the rest was dedicated to immediate needs of the people, such as food and water. The focus was on repaying debt and providing means to get by as opposed to saving and making important social overhead investments. The projected benefit to the debt cancellation was that the countries would be able to take the savings from the debt payments and start building important infrastructure, as well as invest money in education and healthcare.

Freeing up this money allowed the government to focus on improvements that would not be supported by private investment in the free market. Projects that require large economies of scale such as building roads and providing public transportation are key drivers to facilitating economic growth that would not be profitable for a private institution. Easing the ability to travel between communities promotes growth and efficiency. For instance, if a farmer has the ability to produce more wheat than is needed by his family or his village, he has two options.

He can produce the excess and let it go to waste, or he can opt to not produce more than is needed and utilize only part of his farmland while the other part sits unused. Meanwhile, a farmer in another village has land that is extremely fertile and great for producing corn. This farmer is faced with the same prospect as farmer one, either produce excess corn and let it go to waste, or utilize only part of the land to produce only the amount of corn that is needed. By creating a road, or mode of travel between these two villages, trade can be initiated.

Farmer one can utilize his land to its full potential to grow wheat and sell or trade the excess to the other village. Farmer two can now utilize his land to its full potential as well, growing corn to provide for his village as well as trade with the other village in return for wheat. In this case, easing the ability to travel between the two villages has made both villages more productive, more efficient and wealthier in terms of corn and wheat. Additional funding towards education and public literacy is another investment these countries are now able to money towards.

Literacy and education is extremely important in creating entrepreneurs in developing countries. By providing education within developing countries, it can alleviate some of the brain drain experienced when a student chooses to pursue education in a developed nation, then decides to stay there as opposed to returning to his home country. By providing good education opportunities within the developing country, the students will tend to stay to continue their education, then use their skills and abilities to contribute further to the development of the country’s economy.

Healthcare is another important investment that these countries will be able to contribute more money to now that their debt obligations have been cancelled. The government will have the ability to put in place programs to ensure sanitary and potable water. By spending money on infrastructure to get potable water to all areas of the country where people reside, it will create efficiency by allowing the people of the village to focus on other things. Instead of spending many hours a day going to fetch water, then boiling the water to make it potable, the villagers will have more time to farm, or go to school or create a business of their own.

Debt cancellation has the potential to free up valuable cash in these countries to put towards important investments that will spur economic growth. The only caveat is that it is absolutely necessary that the creditors of this debt ensure proper controls have been put in place to avoid government corruption. If government corruption persists, the money will not be invested in the proper avenues, or will be invested in inefficient ways, such as, providing potable water or roads only to villages where government members have family.

Without proper controls, government corruption will be a deterrent to future investment from outside sources and will stifle any further economic growth. The statement that famine is an unavoidable act of God and can only be helped by sending food relief is only true in terms of an inefficient society. Famine in developed countries is absolutely unheard of. The free market will not allow famine to occur because if a country is producing efficiently, it will be actively involved in trade with other countries or other regions.

Take the example of the two farmers above. These villages are able to trade freely and would develop businesses that provide good and services to each other, as well as save and reinvest in their villages. If such an act occurred in which village one was unable to produce wheat, the price of wheat would increase to support the reduction in supply. The market would reach an equilibrium in which the demand would meet supply at a certain price. This equilibrium will prevent a shortage of wheat on the market. Wheat will become more valuable and the demand will go down.

Depending on what kind of demand exists outside of the wheat producing village, the village may be able to get more corn or other services in exchange for its more valuable wheat. However, if the government of the nation above has implemented a price ceiling policy on the price of wheat in an effort to make wheat affordable to everyone, famine could strike. In this instance, some occurrence would prevent village one from producing wheat. By keeping the price of the wheat artificially low even when the value of the wheat is increasing, the market has no ability to increase the price of wheat, thus the supply diminishes quickly.

Soon there is a shortage of wheat in the nation. A similar predicament can occur if, for instance, village two decides to attempt to produce its own wheat and focus on import substitution. In this case, because the land of this village is best suited for producing corn, there is a large opportunity cost associated with decreasing production of corn in place of inefficiently producing wheat. The wheat produced by village two and sold to the inhabitants of village two is not grown as efficiently and is therefore more expensive.

In addition to this, the supply of corn has been decreased and is more expensive for village one to buy. Both villages are now worse off than before. If village two continues its focus on import substitution and some act of God occurs in which the production of both corn and wheat are halted, famine can occur because of the severance of its trade relations. Agricultural subsidies and artificial pricing have long caused issues even in developed nations and are often the root of international political turmoil.

The pricing policies of one country can have a huge impact on others as we have seen in the example above, where due to village two's focus on import substitution village one is no longer able to afford corn. Perhaps the political environment created by village two's decision will cause village one not to assist them when some act of God strikes and prevents them from producing anything. Or, village one will put tariffs on imports from village two thus preventing it from exporting as much of their profitable corn crop.

In any instance, agricultural subsidies and artificial pricing lead to inefficient markets. Reference: Case, K. E. , Fair, R C. , Oster, S. M. , Principles of Macroeconomics, 9th Edition, 2009 Prentice Hall, Upper Saddle River, NJ P409 As part of its strategy for achieving economic development, a nation must decide how its economy will be directed. Its basic choices lie between a market-oriented economic system and a centrally planned one. In the 1950s and into the 1960s, development strategies that called for national planning commanded wide support.

The rapid economic growth of the Soviet Union, a centrally planned economy, provided an example of how fast a less developed agrarian nation could be transformed into a modern industrial power. (The often appalling costs of this strategy??? severe discipline gross violation of human rights, and environmental damage??? were less widely known.) In addition, the underdevelopment of many commodity and asset markets in the developing world led many experts to believe that market forces could not direct an economy reliably and that major government intervention was therefore necessary.

Even the United States, with its commitment to free enterprise in the marketplace, supported early central planning efforts in many developing nations. Today, planning takes many forms in the developing nations. In some countries, central planning has replaced market-based outcomes with direct, administratively determined controls over economic variables such as prices, output, and employment. In other countries, national planning amounts to little more than the formulation of general 5- or 10-year goals as rough blueprints for a nation’s economic future.

The economic appeal of planning lies theoretically in its ability to channel savings into productive investment and to coordinate economic activities that private actors in the economy might not otherwise undertake. The reality of central planning, however, is that it is a technically difficult, highly politicized nightmare to administer. Given the scarcity of human resources and the unstable political environment in many developing nations, planning itself??? let alone the execution of the plan??? becomes a formidable task. P409

The failure of many central planning efforts has brought increasing calls for less government intervention and more market orientation in developing economies. The elimination of price controls, privatization of state-run enterprises, and reductions in import restraints are examples of market-oriented reforms recommended by such international agencies as the International Monetary Fund (IMF), whose primary goals are to stabilize international exchange rates and to lend money to countries that have problems financing their international transactions, and the World Bank, which lends money to a country for projects that promote economic evelopment. Members’ contributions to both organizations are determined by the size of their economies. Only 20 percent of the World Bank’s funding comes from contributions; 80 percent comes from retained earnings and investments in capital markets. Increasingly, the developing world is recognizing the value of market forces in determining the allocation of scarce resources. Nonetheless, government still has a major role to play. In the decades ahead, the governments of developing nations will need to determine those situations where planning is superior to the market and those where the market is superior to planning.

Muhammad Yunus, a young Bangladeshi economist created the Grameen Bank in Bangladesh. P409 In 2006, Yunus received a Nobel Peace Prize for his work. Microfinance is the practice of lending very small amounts of money, with no collateral, and accepting very small savings deposits. 2 It is aimed at introducing entrepreneurs in the poorest parts of the developing world to the capital market. By 2002, more than 2, 500 institutions were making these small loans, serving over 60 million people. Two-thirds of borrowers were living below the poverty line in their own countries, the poorest of the poor.

P409 2An excellent discussion of microfinance is contained in Beatriz Armendariz de Aghion and Jonathan Morduch, The Economics of Microfinance, (MIT Press, 2005.) (Case. Principles of Macroeconomics, 9th Edition. Pearson Custom Publishing 25. 3. 2. 4). In the past, most development strategies were aimed at increasing the growth rate of income per capita. Many still are, based on the theory that benefits of economic growth will “ trickle down” to all members of society. If this theory is correct, growth should promote development.

By the early 1970s, the relationship between growth and development was being questioned more and more. A study by the World Bank in 1974 concluded the following: It is now clear that more than a decade of rapid growth in underdeveloped countries has been of little or no benefit to perhaps a third of their population…. Paradoxically, while growth policies have succeeded beyond the expectations of the first development decade, the very idea of aggregate growth as a social objective has increasingly been called into question. P410

The World Bank study indicated that increases in GDP per capita did not guarantee significant improvements in development indicators such as nutrition, health, and education. Although GDP per capita did rise, its benefits trickled down to a small minority of the population. This very limited success prompted new development strategies that would directly address the problems of poverty. Such new strategies favored agriculture over industry, called for domestic redistribution of income and wealth (especially land), and encouraged programs to satisfy such basic needs as food and shelter.

P410 during the 1980s and 1990s, the policy focus turned 180 degrees. The World Bank and the United States began demanding “ structural adjustment” in the developing countries as a prerequisite for sending aid to them. Structural adjustment programs entail reducing the size of the public sector through privatization and/or expenditure reductions, substantially cutting budget deficits, reining in inflation, and encouraging private saving and investment with tax reforms.

These pro-market demands were an attempt to stimulate growth; distributional consequences took a back seat. P410 Structural adjustment A series of programs in developing nations designed to: (1) reduce the size of their public sectors through privatization and/or expenditure reductions, (2) decrease their budget deficits, (3) control inflation, and (4) encourage private saving and investment through tax reform. P410 Six Basic Requirements for Successful Transition

Economists generally agree on six basic requirements for a successful transition to a market-based system: (1) macroeconomic stabilization, (2) deregulation of prices and liberalization of trade, (3) privatization of state-owned enterprises and development of new private industry, (4) establishment of market-supporting institutions such as property and contract laws and accounting systems, (5) a social safety net to deal with unemployment and poverty, and (6) external assistance.

P415 Summary: Developing countries are often burdened by inadequate social overhead capital, ranging from poor public health and sanitation facilities to inadequate roads, telephones, and court systems. Such social overhead capital is often expensive to provide, and many governments are not in a position to undertake many useful projects because they are too costly.

Inefficient and corrupt bureaucracies also play a role in retarding economic development in places. In many cases, developing countries have pursued industry at the expense of agriculture, with mixed results. Recent evidence suggests that some balance between industry and agriculture leads to the best outcome. www. imf. org/external/pubs/ft/scr/2006/cr06417. pdf