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Nazaire Sénou Idrissou Houssou "Debt Position of Developing Countries and New Initiatives for Debt Reduction: A Panel Data Fixed Effects Estimation of the Impacts of the HIPC Initiatives"

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Summary

l. The HIPC Debt Problem

Since the debt crisis of the 1980s, the international financial community has been providing help to debtor countries in reducing their external debt burdens in order to foster growth, reduce poverty, hunger and achieve sustainable food security. This assistance has taken the form of the Provision of concessional financing from international financial institutions, debt relief from official creditors mainly in the context of Paris Club rescheduling, and in some cases, through bilateral action by the creditors. These measures have resulted in considerable success in alleviating the external debt burden of many middle-income countries. Many poor countries, however, continue to suffer from unacceptable levels of poverty and heavy external debt burdens. This group of countries has been classified as Heavily Indebted Poor Countries (HIPCs).

Over the past few decades, weak policies, adverse environmental and other external factors and sometimes misguided borrowing and lending decisions have increasingly impeded progress toward sustainable economic and social development. This, in turn, made the debt burdens of the poorest countries ever more unmanageable. As it had become clearer that much more needed to be done to help countries break the poverty-debt cycle, a global consensus emerged on the need to confront high poverty and crushing debt levels head-on (IMF and World Bank. 2001).

In response, in September 1996, the World Bank and the IMF launched the initiative for Heavily Indebted Poor Countries (HIPC). This initiative was endorsed by 180 governments around the world as an effective and welcome approach to help poor, severely indebted countries reduce debt as a part of the overall poverty reduction strategy. In addition, the HIPC Initiative called for faster and broader debt release for poor countries that pursue economic and social policy reforms. In September 1999, the initiative was significantly enhanced to provide more debt relief to more countries faster (World Bank, 2002).

About eight years after these initiatives were launched, little effort appears to have been directed towards assessing empirical evidence whether they have had positive or negative

effects on debt stock, debt Service and poverty expenditures. Likewise, whether HIPCs have responded in a similar manner to HIPC measures remains unanswered. To fill this knowledge gap in research and development, I have carried out my master's thesis on the theme:
Debt position of developing countries and new initiatives for debt reduction.

2. Research Objectives and Hypotheses

The main objective of this study is to provide an answer to the question; What have been the beneficial effects of the new debt reduction initiatives and their contribution to development. Specifically, I seek to answer the following questions:

1. What have been the effects of the new debt reduction initiatives in terms of debt stock, debt service and poverty-reducing expenditures in HIPCs?
2. How much of the impacts on debt stock, debt service and social expenditures is due to ' HIPC debt relief?
3. Is good governance a source of variability in response to HIPC measures?
4. Under what conditions could the HIPC Initiatives be more effective and what are the prospects for economic growth and poverty alleviation in the future?

3. Data and Methodology

Data on debt service, debt stock and poverty-reducing expenditures were taken from World Development Indicators and Global Development Finance (2004) and HIPC documents. Estimates of governance indicators were taken from Kaufmann et al. (2002).

The approach used in this analysis integrates the comparison "Before and After" and panel data fixed effect regressions with econometrical models in order to quantify the changes that have occurred in terms of debt stock, debt service and poverty-reducing expenditures within the framework of the HIPC Initiatives and isolate their causes as well. Since HIPC effects cannot be captured in one single year alone, I used the average values of debt service, debt stock and poverty expenditures over three-year periods before (1997-1999) and after (2000-2002) the implementation of HIPC measures.

Due to the heterogeneity of HIPCs and the relatively short period of HIPC implementation, panel data allowing fixed group effects estimation was formulated to isolate the impacts of HIPC debt relief. Panel data sets are more oriented toward cross-section analyses; they are wide, but typically short. Even though modeling in this setting calls for some complex stochastic specifications (Greene, 2003); a panel analysis (cross sectional-time series) offers a better framework for analyzing the HIPCs. The fixed effects approach appears to be the most appropriate for the questions under research.

Three interaction factors were introduced in the model: HIPC debt relief* -Political Stability, Government Effectiveness and Control of Corruption. The idea is that we may expect high beneficial effects in HIPCs with improved governance records. Therefore, creditors' institutions may be interested in promoting such factors in order to establish an environment conducive to debt relief initiatives in the future.

Correlation analyses using time series for selected Middle Income Countries and HIPCs was performed to test if there is a correlation between debt level and growth and debt service level and growth.

Finally, governance estimates were chart to explore whether they have improved under the HIPC Initiatives. Estimations of the model and statistical analyses were performed using EXCEL and three econometric packages: LIMDEP, SAS and SPSS.
The various models used in this study have their merits and limitations. In bringing them together, I intend to improve the efficiency of the study. Despite methodological limitations, findings show a meaningful pattern that could not be set aside.

4. Empirical Results
Empirical evidence confirms that the improvement of the debt position of HIPCs may spur, in most cases, economic growth and alleviate poverty in the future. Expenditures patterns of HIPCs under the HIPC Initiatives were conclusive. However, findings suggest that HIPCs display worse governance indicators despite the waves of debt relief. This study emphasizes that poor governance, especially high corruption levels, is a binding constraint to achieving both short-term and long-term debt sustainability and higher efficiency gains from debt relief. It is also found that external debt stock and debt Service have pernicious effects on economic growth in HIPCs.

Furthermore, the results of the panel data fixed effect estimation suggest that the HIPC debt relief did significantly reduce the debt stock and debt Service of HIPCs. The flow effect of debt relief however, is small. HIPC relief did not directly affect poverty expenditures of HIPCs, suggesting no significant resource has been freed as part of the initiatives. Nonetheless, the relief has had an indirect, but small effect on poverty expenditures through debt service reduction. Much of the changes reported in poverty expenditures are due to aid and most probably to other factors.

It is therefore concluded that debt relief has contributed to increasing poverty-reducing expenditures, but this impact is small. Surprisingly, the results also indicate that the impacts of HIPC measures in terms of debt stock may have been diluted by fresh loans contracted during the same period.

All in all, findings reported above provide a mixed picture of the effects of the HIPC Initiatives. Moreover, this analysis reveals that not only debt relief is crucial, but also aid and loans are vitally important for the development of HIPCs.

Based on the above results and despite the achievements of the HIPC measures, this research argues in favor of a HIPC III Initiative. Much more relief is needed to strengthen the link between debt relief and poverty alleviation if the rhetoric surrounding the initiatives is to become a reality. In addition, aid and loans are vitally important for the development of HIPCs. A good governance environment is a precondition for increasing the effectiveness of external assistance. Therefore, HIPCs must make serious efforts to reverse the patterns of their governance. However, this is a long-term process and success cannot be expected overnight.