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Debt Position of Developing Countries and New Initiatives for Debt Reduction — Panel Data Fixed Effects Estimation of the HIPC Initiatives

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Abstract

In September 1996, the World Bank and the International Monetary Fund (IMF) launched the Heavily Indebted Poor Countries Initiative (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. Three years later, the initiative was enhanced to provide more debt relief.

This study assesses the achievements of the first and second HIPC initiatives and explores further areas of intervention that might help the HIPCs graduate from debt rescheduling and achieve sustainable growth and poverty alleviation.

Using a panel data fixed effect estimation, we find evidence which suggests 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. It is therefore concluded that debt relief has contributed to increasing poverty-reducing expenditures, but this impact is small. Likewise, the stock effect of debt relief has been diluted by the flows of new loans in HIPCs.

Furthermore, findings suggest that HIPCs have displayed worse governance indicators despite the waves of debt relief. This study emphasises 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.

Based on the above results and despite moderate achievements of the HIPC measures so far, this paper argues in favour of a HIPC III initiative. Much more relief is needed to link debt relief to poverty alleviation if the expectations raised by the initiatives are to become 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 with international assistance must make steady efforts to reverse the patterns of their governance at all levels.

Keywords: Debt relief, governance, HIPC initiatives, panel data, poverty