ARE FOREIGN LOANS GOOD OR BAD CHOLESTEROL IN THE ECONOMIC GROWTH OF HIGHLY INDEBTED POOR COUNTRIES? CORROBORATIVE EVIDENCE

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ABSTRACT

This study investigated the impact of foreign debt on the economic growth of 43 heavily indebted poor countries over ten-year period (1991-2001). The findings of this study revealed that foreign debt has a negative and insignificant impact on the economic growth of the surveyed countries. Although debt cancellation may be less effective in the long term, we still concur with the African proposals for debt cancellations suggested by Greenhill and Blackmore (2002) in the report of Jubilee research at the new economics foundation.

INTRODUCTION

Khor (1999) revealed that about 80 of underdeveloped countries (the majority of them are African and Latin American) fell into a debt trap and under the sway of the World Bank (WB) and the International Monetary Fund (IMF). According to WB (2002), the number of severely indebted countries is 88. Out of these 88 highly indebted countries, the WB and key governments considered 42 countries as Heavily Indebted Poor Countries

(HIPCs). Before we assert that all types of foreign debt are good or bad cholesterol in the economy of the HIPCs, as described by Loungani and Razin (2001), it is appropriate to investigate the impact of foreign loans on the economic growth of these countries. Utilizing data set of 43 HIPCs over a ten-year period (1990-2000), this study has examined the effect of foreign loans on the economic development of these countries. We have added Pakistan to the 42 HIPCs because its external debt is $31.7 billion (more than 53% of its GDP) makes it eligible to be HIPC. In addition, its domestic debt at current exchange rates in a further $30 billion (50% of its GDP) makes its total domestic and external debt exceeds its GDP (Greenhill and Blackmore, 2002).

HISTORICAL BACKGROUND OF HIPCS' DEBT CRISIS

Polliewatch No. 37 (1999) outlined the history of the debt crisis including some recent positive developments, reforms providing quicker and deeper debt relief linking debt relief to poverty reduction, and a clear commitment from rich countries to provide new resources for debt relief.

ORIGINS OF HIPCS' DEBT CRISIS

The seeds of the debt crisis in poor countries were sown in the 1960's when many governments of underdeveloped countries pursued industrialization policies that were heavily dependent on imports. At the same time many countries developed policies that undermined their capacity to pay for these imports (e.g., over taxing farmers) so that production of export crops fell, creating a gap between imports and exports. To fill this gap, they borrowed money from abroad and by the 1970's they were verging on crisis (Khor, 1999).

The crisis deepened during the 1970's with dramatic oil price hikes and associated high interest rates causing a global recession. Heavily indebted poor countries were faced with high oil import bills and falling prices for exports of commodities such as tea, cocoa and copper, with many countries losing half their national income. The problem was compounded

in some countries by creditors lending for political reasons, with cold war western loans provided to friendly dictators such as Mobutu in Zaire and Mengistu in Ethiopia-loans used to buy weapons produced in the west or for unproductive projects with no benefit to the poor (IMF, 2002).

Consequently, poor countries found that they are paying back increased debt whilst earning less, being, for all practical purposes, bankrupt. The growth of the debt crisis meant that most governments had to turn for help to the lenders of last resort (the IMF and the WB) for new loans to meet the finance payments on their original loans and to cover budget and trade deficits. Thus, these two institutions now wield considerable power in many poor countries (Joyner, 1998).

By the late 1980's debt stocks were still rising in poor countries. Unpaid interest and the unpaid portion of loans were simply added to the remainder of loans as arrears. The result was that arrears grew at a massive rate. For instance, between 1990 and 1993 Mozambique could only afford to pay 10% of what it was supposed to pay and the balance, almost $US600 million, was added to its growing debt stock. Eventually, creditors began to take steps to tackle the problem of unpayable debt and developed a series of ad hoc measures, which were supposed to provide a solution. Failure of these schemes to reduce the debts of the poorest countries - such as schemes implemented by the Paris Club, a key group of rich OECD country creditors-made repeated rescheduling of debt repayments necessary (European Network on Debt and Development, 2000).

The problems facing HIPCs indebted to the WB and the IMF were particularly acute. Countries had to repay debts in full or face suspension of assistance programs and a cut- off in aid from other donors. WB would not allow its debt to be rescheduled or written off and the IMF saw debt reduction as a threat to international financial security. Although both institutions denied that their debt represented a real problem, the facts spoke for themselves; debt to the WB and the IMF increased from 20% of the total debt stock of heavily indebted poor countries in 1980 to 50% of total debt stock in 1994 (George, 2001).

STRUCTURAL ADJUSTMENT PROGRAMS

Loans from the IMF and the WB have in many cases worsened poverty and widened inequalities (Joyner ,1998). These loans come with conditions set out under the terms of Structural Adjustment Programmes (SAPs), which most countries have been obliged to adopt. Under the Programmes, governments must agree to reform the management of their economies and to increase their debt servicing, with loan conditions often including reducing the size of government and government spending, currency devaluation and increased openness to foreign investment (IMF, 2001; 2002).

In making the often drastic cuts to public spending required by SAP's, social services are usually the first to suffer through cuts to national education and health budgets, reducing access to these basic services by poor households and exacerbating poverty. The impact of debt often also extends beyond the household. Pressured to earn foreign exchange to service debts, some governments are encouraging large scale extractive projects such as mining and logging, often at the expense of the environment and the rights of local people to control the use of their lands. The problems can also become mutually reinforcing at a global level. For example, with many HIPCs relying on the production of cash crops such as coffee and cocoa for export, too much can be grown, resulting in crops flooding the world market and pushing prices down (Oxfam International, 2002).

THE HIPCs' INITIATIVE

The failure of the ad hoc debt relief measures and the growing problem of debt to the WB and the IMF were eventually recognized, and in 1995 the WB and key governments started to develop what became known as HIPCs' initiative. The HIPCs' initiative marked a decisive break with past approaches to debt when it was adopted in 1996. The initiative had considerable potential by bringing all creditors together within one framework and trying to link debt relief to the actual ability of poor countries

to pay. A total of 41 countries were identified under the initiative, 80% of them are in sub Saharan Africa (IMF Press Release, 2002).

Community Aid Abroad and many other organizations welcomed the HIPCs' initiative in 1996. For the first time, debt relief was to be provided in a systematic manner by all creditors, bringing to an end the process of negotiation through different creditor clubs, the growing problem of multilateral debt to the IMF and World Bank was addressed and HIPCs established the principle that debt relief should be linked to ability to pay, rather than creditor demands (Oxfam International, 2002).

Under the initiative, a range of criteria were developed to define the amount of debt that would need to be cancelled in order to reduce the debts of these countries to sustainable levels. For the majority of HIPCs, the amount of debt relief depends upon their level of exports and is conditional upon each HIPC successfully complying with two SAPs of the IMF over a minimum of six years before being eligible for debt relief (IMF Press Release, 2002; Cohen, 2000).

THE FAILURE OF HIPCs' INITIATIVE

Since its inception in 1996, HIPC's progress had been abysmal. The HIPCs' initiative failed to resolve the debt crisis in the world's poorest countries. The debt relief provided was too limited, and implementation too slow: only two out of the 41 countries (Uganda and Bolivia) started to receive debt relief through HIPCs' initiative, and only other three countries (Guyana, Mozambique and Mali) would receive debt relief in 1999. Even after HIPCs' initiative was established, many countries will still remain with unsustainable debt, underlining the inadequacy of the debt relief provided (WB Report, 2002; Ambrose, 2002).

For example, following HIPCs' relief, Uganda's debt servicing in 1998/99 fell from $US165 million to $US128 million ($37 million relief), but still accounts for 18% of government revenue, absorbing finance that could be used for implementation of its national poverty eradication plan. Meanwhile more than 50% of the population lives below the poverty line. Recent decline in coffee prices have meant that even these small HIPCs'

benefits have been lost, and Uganda's debt remains unsustainable. Bolivia's debt servicing in 1999 would also be reduced from $295 million to $228 million ($67 million relief), but the government is still struggling to maintain education spending, and will probably be forced to undertake further lending from the Inter-America Development Bank (IDB) to assist in this effort. This is in a country where UNICEF estimates 700,000 children are absent from school in order to support family income (Joyner, 1998; Cohen, 2000; Ambrose, 2002).

It is now widely recognized that the HIPC initiative failed for three reasons: (1) It provides too little debt relief. The debt relief provided is not deep enough and does not address the burden of debt servicing on national budgets in HIPCs. Under HIPCs' initiative, sustainable debt servicing absorbs up to 40% of national revenue while millions of their people are denied an education or health care. (2) The initiative came too late. Countries entering HIPC must complete two successive SAPs of IMF for six years before qualifying for debt relief. This eligibility requirement leads to serious delays in providing debt relief through HIPC. (3) The initiative has little if any impact on poverty reduction. There is no link to poverty reduction and the HIPCs' initiative; it has been designed to serve the needs of creditors, rather than the needs of these poor countries. The initiative of HIPCs failed to provide sufficient resources, to address the poverty reduction and human development needs of poor countries, and to provide progress on achieving internationally development targets were agreed upon (Cohen, 2000; Dagdeviren, 2001).

CURRENT STATUS OF THE HIPCs' INITIATIVE

Mobilized by the highly successful Jubilee 2001 campaign, tens of thousands of ordinary citizens protesting third world debt greeted the national leaders of the world's largest economies -the G7-when they met in Cologne city, Germany, to discuss the debt crisis. The issue was how to reform the failed HIPCs' initiative. Presented with a Jubilee 2000 debt relief petition signed by more than 17 million people world wide, G7 leaders were under

significant political pressure to take decisive action (Greenhill and Blackmore, 2002).

At the summit, leaders of the G7 agreed to call for reform of the HIPCs' initiative to provide faster and effective debt relief to more countries, with a stronger link between debt relief and poverty reduction. The G7 leaders announced that they want to ensure that HIPCs pursuing sound policies, and demonstrating a commitment to reform and poverty alleviation should be not crippled by the burden of debt. The agreement also called for an increase in the number of countries eligible for debt relief after three years rather instead of the existing six year time frame. The agreement also called for increasing the amount of debt relief from $12 billion under the current HIPCs' program to up to $50 billion in net present value terms (U.S. State Department, 2002).

The G7 Communique also calls on the IMF to reform its structural adjustment programs, on which HIPC eligibility is based, in order to ensure that HIPC is built on "an enhanced framework for poverty reduction." This breakthrough creates the potential for future debt relief to be linked to poverty reduction for the first time. The G7 agreement calls on the World Bank and the IMF to develop, by October of 2000, specific plans for an enhanced framework for poverty reduction. Community Aid Abroad and Oxfam partners welcome the Cologne agreement as an important step forward - but we are only half way toward achieving a full resolution of the debt crisis. While the G7 agreement would generate $50 billion of debt relief to eligible countries, with significant reductions in debt service payments, it will still leave countries spending more on debt service than on basic health and education. Mozambique, for example, will still be paying $US73 million a year in debt servicing under the proposed G7 reforms, down from current repayments of $US98 million a year under HIPC, but still more than it spends on basic health and education combined (IMF Press Release, 2002; Oxfam International, 2002).

Community Aid Abroad welcomes the G7 commitment to provide deeper relief to countries committed to poverty reduction, particularly the emphasis on channeling resources freed by debt relief into basic social services and the call for the WB to help HIPs' draft and implement poverty

reduction plans. Recently, the WB and IMF approved the disbursal of US$ 20 billion in debt relief for 22 countries (4 in Latin America and 18 Africa) in an initiative for HIPCs (IMF, 2002).

CRITICISM OF THE G7 AGREEMENT

Critics argue that the HIPCs' initiative doesn't go far enough. Much of the debt being forgiven is unrecoverable anyway. The HIPCs' initiative simply lower debt service to the level HIPCs were already paying. The financial pressure felt by HIPCs remains the same, and they are compelled to implement SAPs for three. Another criticism is that debt forgiveness may give rise to many problems, including the problem of moral hazard. If countries that ran up excessive debt levels in the past are able to get the debt forgiven, it will distort incentive to repay the loans in the future. In other words, debt forgiveness would be an unfair solution, especially for those countries repay their debts and those countries that refrained from requesting excessive loan (Ambrose, 2002).

Furthermore, debt relief and debt rescheduling may also impose costs on the HIPCs by constraining their access to international capital markets. Exporters and importers have to finance their transactions with cash rather than commercial credit from international financial institutions. The higher transaction costs incurred in the absence of commercial credit will reduce the total volume of trade. Business in HIPCs will have limited or no access to foreign direct investment. These countries will find that they have limited or no access to external source of finance, either through bilateral lending from governments in the developed countries or through multilateral lending agencies (George, 2001).

THE DEVELOPMENT OF AN AD HOC ECONOMIC MODEL

The neoclassical growth model (Solow, 1956; Denison, 1961) proposed that capital accumulation and technological progress is the engine of economic growth. However, this neoclassical exogenous growth model rejected the impact of another alternative approach for studying economic

growth is to view it as an endogenous growth model (Lucas, 1988; Romer, 1986) of several internal factors

Levine and Renelt (1992) and Harms and Ursprung (2002) asserted that there is no universal model of economic growth accepted by all researchers. We have developed an ad hoc model including basic determinants of economic growth as follows: GDP (gross)= foreign loans + foreign aid + foreign direct investment + human capital + growth rate of labor force + growth rate of population + government spending + openness to international trade + Trade openness indicator + economic freedom + business climate + inflation + political regime + political risk + initial GDP in U.S. $1988.

The initial level of per capita GDP was used to test the neoclassical assumption that the starting level of per capita output has no effect on the steady state economic growth. In the transition to steady state, countries with a lower output per capita are expected to grow faster.

These variables drawn from the literature are by no means exhaustive. We examined the relationship between the independent variables and the dependent variable after controlling for cyclical fluctuations and unusual changes in the GDP of each country. We controlled this factor by creating a sample covering the 10-year period. The average of ten years would eliminate any cyclical fluctuations in the GDPs. Therefore, we have included certain factors that influence economic growth and investigated the impact of foreign loans on economic growth in HIPCs.

RESEARCH METHODS

Research methods include sample, data collection, and measurements of variables. Each component was implemented according to the following procedure.

Sample and Data Collection

Data collection consisted of annual data pertaining to a cross-section of 43 HIPCs from 1991 to 2001 period. The purpose of selecting this period

of time is to include a consistent set of recent data. Required data were collected from various resources including Greenhill and Blackmore , 2002, WB (1991-2001); UN reports from 1991 to 2001; International Monetary Fund (IMF) from1990-2001; UN Development Programmes, 2001 and previous reports; Political Risk Services, 1997and previous issues and Harms, 2000; Freedom House, 2001 and previous issues; Gwatney et al., 2002; Pen World Table 5.6 developed by Summers and Heston (1995), and World Bank's (2002) Global Development Finance report and previous reports.

Measurement of Variables

The dependent variable is the average of the economic growth for the years 1990-2001. To control for country size, we divided the total volume of foreign Loans, foreign direct investment, and foreign aid by the population size of each country. To be sure that the results are not just due to the omission of other determinants of GDP, we introduced a number of control variables that are believed to have a significant effect on GDP.

Control variables included in this study are: foreign aid, foreign direct investment, human capital, growth rate of population, growth rate of labor force, government spending, openness to international trade, economic freedom, inflation, business climate, political regime (political rights and civil liberties), and political risk.

(1) Dependent variable

Economic growth was measured by the average of the natural logs of GDPs of each included country from 1991 to 2001. (WB, 2002; UN, 2002; Gwartney et al, 2002).

(2) Independent variables

Foreign loans were measured by the total foreign loans for ten years (1991-2001) of each 43 HIPCs including Pakistan (WB,

2002; UN, 2002; IMF, 2002; Greenhill and Blackmore, 2002).

(3) Control variables

Foreign aid was measured by the natural log of the average of foreign aid received by each recipient country from 1991 to 2001 (World Bank, 2002; UN, 2002).

Foreign direct investment was measured by the natural log of the average of FDI received by each recipient country from 1991 to 2001 (World Bank, 2002; IMF, 2002).

Human capital was measured by the average of adult literacy rates in each country for 1991, 1995, and 2001 (UN, 2002; UNESCO, 2002).

Growth rate of labor force was measured by the average of the growth rates of the labor force of each country from 1991 to 2001 (UN Development Programme, 2002).

Growth rate of population was measured by the average of growth rates of population in each included country from 1991 to 2001 (UN, 2002; World Development Report, 2002).

Government spending was measured by the average of net spending of defense and education as a percentage of GDP for each government of every country from 1991 to 2001 (UN, 2002).

Openness to international trade (reflects the existence of administrative and barriers to trade) was measured by the average of the ratios of exports plus imports to GDP

population in each country from 1991 to 2001 (World Bank, 2002).

Trade openness indicator (reflects the existence of to tariff protection, restrictions to capital movements, and other distortions) was measured by the average of values of trade openness indicator for 1991-1993 and 1994 -2001 (Gwartney et al, 2002; scale 0-10, where number 10 is the maximal openness).

Economic freedom was measured by index of economic freedom assembled on by Gwartney et al. (2002). The average of values of economic freedom for 1991 and 1995, and 2001 was used because it is not available on annual basis (Scale 0-10, where 10 is the maximum economic freedom).

Business climate (quality of business environment) was measured by the average of corruption of government, the quality of the bureaucracy, and a country's law-and-order tradition each country from 1991 to 2001 (Political Risk Services, 2002 and previous issues; scale 0-18, where 18 is the optimal business climate).

Inflation in LDCs was measured by the average inflation rates in each included country from 1991 and 2001 (IMF, 2002).

Political regime:

a. *Political rights* (people's ability to participate freely in the political process) were measured by the average of Gastil index from 1991 to 2001 (Freedom House, 2002 and previous issues; scale 1-7; represents the maximum political repression).

b. *Civil liberties* (freedom to develop views, institutions, and personal autonomy apart from the state) were measured by the average of Gastil index from 1991 to 2001 (Freedom House, 2002 and previous issues; scale 1-7; represents the maximum civil repression).

No political risk was measured by the average of expropriations, exchange controls, and default on government contracts in each country from 1991 to 2001 (Political Risk Services, 1997 and previous issues and Harms, 2001, Scale 0-30, where 30 minimal risk).

The initial GDP per capita was measured in U.S.1988 dollars for each country from 1991 to 2001 (UN, 2002).

DATA ANALYSES

Regression analysis is an appropriate statistical tool and is widely used by researchers investigating relationships of a behavioral and/or economic nature. Regression estimates the relationship concerning independent variables by explaining the variations in the dependent variables (Pindyck and Rubinfeld, 1998). We utilized the multiple regression technique in order to estimate the relationship between the independent variables and the dependent variable.

Thus the regression model is:

$$y = a + b1x1 + b2x2 + b3x3 \ldots\ldots + b15x15 + e$$

Where:

Y= GDP per capita
X1= Foreign loans (debt)
X2= Foreign aids
X3= Foreign direct investments

X4= Human capital
X5= Gowth rate of labor force
X6= Growth rate of population
X7= Government spending
X8= Openness to international trade
X9= Trade openness indicator
X10= Economic freedom
X11= Business climate
X12= Inflation
X13= Political regime:
a. political rights
b. civil rights
X14= political risk (reverse)
X15= Initial GDP in U.S. 1988 dollars
b1, b2,....,b15= estimated regression coefficients
a = constant
e = error term

However, potential problems such as multicollinearity, hetroscedasticity, autocorrelation, outliers, non-linear relationship, and the goodness-of-fit of the overall regression model are potential issues that may confront the regression model. In addition, the data may lack the assumption of normal distribution. The existence of such problems leads to inaccurate results and misleading conclusions and implications (Pindyck and Rubinfeld, 1998).

FINDING OF THE STUDY

To ensure that the multiple regression model has not been undermined by any potential problem, certain statistical tests have been used to check the existence of any problem. Multicollinearity is not a problem because all variance inflation factors (VIFs) are low. Autocorrelation does not exist because the Durbin-Watson statistic is significant (D.W.= 2.4). The plot of the residuals shows that there is no evidence of heterosedasticity.

Neither the Studentized Deleted Residuals Test identified influential outliers for the dependent variable, nor Diffits and the Cook's Test detected influential outliers for the independent variables. The plotted histogram of data depicted normal distribution of the data. The plot of the dependent variable against each of the independent variables showed a linear relationship between these perspective variables. The results of the multiple regression are presented in Table 1. The significant F (F-value= 8.14; P= .001) confirms a complete goodness-of-fit for the overall regression model.

Data analysis in Table 1 reveals that foreign loans (debts) do not have a direct influence on economic growth. Although this factor has a negative effect, it is not significantly different from zero. This finding supports Mishra, Mody, and Murshid's (2001) the notion casting doubts on the ability of foreign capital inflows (including foreign loans) to stimulate long-run growth in underdeveloped economies.

Even when many underdeveloped countries are in favor of capital inflows, Hausmann and Fernández-Arias (2000) asserted that they view international debt flows (especially of the short-term variety) as bad cholesterol. Schaefer and Schavey (2002) also revealed that the International Financial Institution Advisory Commission (known as the Meltzer Commission) urged underdeveloped countries to stop making loans that later crush their recipients under impossible debt. The commission urged rich countries to give them grants conditional on adopting economic policies likely to bring fiscal success.

This finding also supports those of Bosworth and Collins (1999) who provided evidence on the effect of capital inflows on the economic growth of 58 underdeveloped countries between 1978 and 1995. The sample covered nearly all of Latin America and Asia, as well as many countries in Africa. The authors distinguished among three types of inflows (foreign direct investment, portfolio investment, and international banks loans). The authors found that the impact of loans on the economic growth fell below the other two. Dadush, Dasgupta, and Ratha (2000), Lipsey (2001), and Loungani and Razin (2001) found similar results.

With respect to traditional control variables, foreign aid does not have a direct influence on the economic growth of HIPCs. Although this factor has

a negative effect, it is not significantly different from zero. This finding supports those of previous studies (e.g., Griffin and Enos, 1970; Clad and Stone, 1993; Islam, 1992; Johnson and Schaefe, 1997; Villamil and Asiedu, 2001; and Boone, 2002). This finding supports Johnson and Schaefe (1997) who found that the majority of the long-term recipients of foreign aid over 29 years (1965-1994) had achieved very low levels (1%) of economic growth.

Table 1: Multiple Regression Results Concerning the Impact of Foreign Loans on the Economic Growth of Highly Indebted Poor Countries

Independent Variables	Dependent Variable: Economic Growth		
Variables	Coefficient	T-value	Sig. level
Foreign loans	-.0583	1.02	.57
Foreign aid	-.0648	1.08	.49
Foreign direct investments	.8769	2.64	**.05**
Human capital	.1684	1.72	.10
Growth rate of population	.1264	1.36	.23
Growth rate of labor force	.6825	2.14	**.05**
Government spending	-.0597	-1.24	.29
Openness to international trade	.0224	1.28	.48
Trade openness indicator	.0546	1.22	.42
Economic freedom	.0578	1.08	.54
Business Climate	.0611	1.14	.42
Inflation	-.0648	-2.16	**.05**
Political regime:			
a. political rights	.1074	1.33	.27
b. civil rights	.1062	1.17	.32
No political risk	.1038	1.18	.29
Initial GDP in U.S. $1988	-1.0173	-1.48	.10
R-square= .51; Adjusted R-square= .46; F= 5.27; Significant F= .001			

According to Schaefer and Schavey (2002), foreign aid and all efforts of existing institutions and structures have failed to solve the problem of underdevelopment. For example, the United States has spent more than $500 billion over the last 50 years on foreign assistance, yet standards of living have fallen in many underdeveloped countries during that time. Zambia, for instance, has received more than $1 billion in foreign aid since 1964, yet its per capita income has dropped from $664 then to $338 in 1999 (Schaefer and Schavey, 2002).

Even the United States' Agency for International Development itself admits that only a handful of countries that started receiving assistance in the 1950s and 1960s never graduated from dependent status. Despite massive amounts of international aid, the average annual increase in per capita GNP has declined steadily in underdeveloped countries since the 1960s, with many of the underdeveloped countries heaviest foreign aid recipients actually suffering negative economic growth.

In contrast, FDI has a positive and a significant effect on the economic growth of HIPCs. This finding supports those of recent studies (e.g., Dadush, Dasgupta, and Ratha, 2000; Feldstein, 2000; Lipsey, 2001; and Loungani and Razin, 2001). This finding also supports the assertion of Aitken and Harrison (1999) who demonstrated that FDI increases productivity, which in turn promotes growth. But these authors confirm conditions (e.g., skilled labor force, well-developed structures, etc.) under which productivity benefits accrue. For example, some studies claim that FDI boosted productivity in Malaysia, Taiwan, and the southern provinces of China. In contrast, similar benefits were not found in Morocco, Tunisia, and Uruguay. Moreover, firms with greater research and development in LDCs were able to absorb the FDI benefits.

With respect to traditional control variables for economic growth, human capital (represented by the proxy adult literacy) has a positive and significant effect on economic growth, which suggests a strong positive link between investment in education and economic growth. Education enhances productivity and promotes higher economic growth. This finding supports Borensztein, Gregorio, and Lee (1998) who asserted that FDI is more productive in countries with a better-educated labor force.

There is a negative and significant relationship between the initial level of per capita GDP and the economic growth in HIPCs. This finding contradicts the prediction of the neoclassical theory and supports the results of Barro's (1991) study. The two findings suggest that an increase in the starting per capita real GDP that is accompanied by higher investment in human capital may offset each other and thus the initial GDP becomes unable to stimulate growth in the economy.

Growth rate of labor force has a positive and significant effect on economic growth. According to the neoclassical growth theory, labor force growth should have a positive effect on economic growth rate. Economic growth can be sustained through macroeconomic growth policies that curb inflation, high exchange rate of currency and improper government spending. Thus, the government should initiate economic reforms and must fulfill its commitment to improve the quality of the of the labor force by focusing on the people's education and training programs (Kormendi and Meguire, 1985).

Growth rate of population has a positive and insignificant impact contradicting recent findings on the relationship between fertility and economic growth. It is important to note that bigger families with many children are part of the culture of LDCs. The insignificant coefficient of population growth indicates that either capital accumulation or labor force growth does not keep pace with population growth.

This is why Chaliand (2002) suggests that no study of underdeveloped countries (including HIPCs) could hope to assess its future prospects without taking into account population growth. In 1980, the earth's population was estimated at 4.4 billion, 72 percent of it in underdeveloped countries, and it did reach 6.2 billion at the close of the century, where 80 percent of it in underdeveloped countries. This population explosion in the third world will surely prevent any substantial improvements in their living standards and threaten people in stagnant economies with worsening poverty.

Government spending of HIPCs has negative and insignificant effects on economic growth. When we run the regression without the political freedom variable, government spending variable shows a large negative magnitude on economic growth. One possible reason is that governments lacking freedom feel insecure and spend more resources in order to stabilize

their regimes rather than promoting productivity and hence economic growth.

In terms of openness to international trade and trade openness indicator, each finding reveals that openness to international trade and trade openness indicator has the expected positive effects although they are insignificant. It appears that trade in underdeveloped countries is not integrated with the world economy. Both findings support that of Johnson (1997) who found that most recipients of American foreign aid had the highest barriers to trade in the world. In Johnson's (1997) Index of Economic Freedom survey, 69 of 109 underdeveloped countries receiving capital inflows had high or very high marks for their levels of trade protectionism in the world. Trade restrictions are typically expected to have deleterious effects on economic growth due to the inability to exploit comparative advantages. On the contrary, countries ope to international trade, like Australia, Canada, most of the European Union (EU), Japan, Hong Kong, and New Zealand, had either very low or low levels of protectionism.

The insignificant relationship between economic freedom and GDP suggests that if HIPCs want to achieve growth, they must embrace economic freedom. That is, countries having high economic freedom achieve much higher per capita incomes. Conversely, countries lacking economic freedom do not experience sustained growth no matter how much assistance they receive. According to the economists Roll and Talbott (2002), such countries could not afford to clean their environment or raise labor standards. Lower tariffs, smaller barriers to foreign investment, and limited regulatory burdens account for as much as 80 percent of the difference in per-capita income between rich and poor countries.

Business climate has no significant effect on economic growth. This finding indicates that many HIPCs are not providing a complete and healthy business environment for foreign investors. This means that corruption in some governments, complex bureaucracy, and the lack of law and order are deterring foreign investments. This finding supports that of Harms and Ursprung (2002) who attested that healthy business climate enhances FDI, which in turn boosts economic growth in HIPCs. As we expected, inflation has a negative impact on economic growth. It is safe to conclude that inflation deters FDI from investing in LDCs suffering high inflation. This

finding supports the notion that macroeconomic mismanagement lowers aggregate productivity and deters foreign investors. This finding supports those of Harms and Ursprung (2002).

With respect to the political regime (political rights and civil rights) in HIPCs, free-political HIPCs or partly free HIPCs have a higher growth rate than those who are not free. This result tends to support those of Helliwell (1994) who claimed that mature democracies likely suffer a slow-down in growth because of a slow buildup in the powers of special interest groups whose successful claims for special treatment reduce the growth of the economy as a whole. In contrast, countries without political freedom have very low economic growth. A plausible reason is that when governments (particularly in Africa) are confronted with revolutions and military coups, economic plans are usually disrupted, forcing countries into both vicious circles and backward economic processes.

Finally, political risk is based on the International Country Risk Guide of the likelihood of expropriation, exchange control, and default on host government contracts. The insignificant negative relationship between this variable and growth suggests the existence of this political risk, to certain extent, in a large number of these HIPCs.

CONCLUSIONS

The majority of HIPCs being African or Latin American, fell into a debt trap and under the sway of the IMF and World Bank. Foreign loans could not solve all development problems in HIPCs because much of this debt was contracted by undemocratic governments and used for questionable purposes that did not benefit the majority of citizens. Many poor countries could not keep up with their interest payments, let alone ever hope to pay back the principal on their foreign debts. In light of the glacial pace of the HIPC initiative, and developing economic, political and human crises in HIPC countries, we concur Jubilee Plus is calling for the immediate cancellation of 100% of the debts of 42 countries defined by the World Bank and IMF as having unsustainable debts.

RECOMMENDATIONS

In devising a future policy for foreign loans, a country has to remember the brutal fact that the loans (whether obtained by the public or private sector) have to be repaid, with interest, in the specified time frame, and in the foreign currency denominated. This can be done only if the borrower has invested the foreign loan in a project or activity that yields a net revenue sufficient to service the debt. There should be no open-door policy towards loans in general. It must be allowed in as and when required by national policy.

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