IS THE IMPACT OF FOREIGN LOANS ON THE ECONOMIC GROWTH OF SEVERELY- INDEBTED UNDERDEVELOPED COUNTRIES A MYTH OR REALITY? CORROBORATIVE EVIDENCE

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ABSTRACT

This study investigates the impact of foreign loans on the economic growth of 82 severely- indebted underdeveloped countries over a 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 proposals for debt cancellations suggested by the report of Jubilee research at the new economics foundation by (Greenhill & Blackmore, 2002).

INTRODUCTION

The effect of foreign loans on economic development of underdeveloped countries is still questionable and debatable. It has been proposed that if an underdeveloped country seeks an economic growth and welfare for its people, the principal mechanism to do so is to try to have foreign loans. Although there are other factors that affect economic growth, this simple proposition still claims that foreign loans are a necessary ingredient. While

foreign loans can have both negative as well as positive consequences, the positive benefits outweigh the negative on balance, and hence the policy and strategy should be to maximize the positive effects and minimize the negative ones (Villami & Asiedu, 2001).

On the contrary, Roll and Talbott (2002) attested that foreign loans don't contribute toward financing sustained economic growth over the long term. Similarly, Tandon (2002) and Hausmann and Fernández-Arias (2000) discovered that foreign loans are falsely marketed to the developing countries as a solution to their underdevelopment. They did not find correlation between foreign loans and economic growth, or between foreign loans and development.

Khor (1999) revealed that about 80 of underdeveloped countries (the majority of them are in Africa and Latin America) fell into a debt trap and under the sway of the World Bank (WB) and the International Monetary Fund (IMF). According to (WB, 2001), the number of severely indebted countries is about 88. Of the 88 severely indebted countries, the WB and key governments classified 41 countries as highly indebted poor countries (HIPCs).

Hagen, Keleta, Ghebreyesus and Cadet (2004) found that foreign loans of HIPCs have a negative and insignificant impact on the economic growth of HIPCs. This study extended the above study and investigated the impact of foreign loans on the economic growth of 82 severely indebted countries over a ten-year period (1990-2000).

ORIGINS OF FOREIGN LOANS CRISIS

The seeds of the debt crisis in poor, underdeveloped countries were sown in the 1960's when many governments of those countries pursued industrialization policies that were heavily dependent on imports. At the same time, many underdeveloped countries developed policies that lead production of export crops to fall, 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. Creditors lending for political reasons compounded the problem in some countries. (IMF, 2002).

Consequently, the growth of the debt crisis meant that most underdeveloped countries' governments had to turn to the lenders of last resort for help with 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 unpaid debt and developed a series of ad hoc measures that were supposed to provide a necessary solution (European Network on Debt and Development, 2000).

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 for 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 underdeveloped countries 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). Underdeveloped countries have seen considerable business cycles in recent decades. At the same time they have significantly increased their external-debt-to-GDP ratios. It seems natural to suspect that increased indebtedness and the amplified cycles are linked (Leung, 2003).

The problems facing severely indebted countries 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. 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). In the end, the WB, IMF and the industrialized countries (G7) recognized the severity of the debt problem and started working on proposals and solutions, however, many economists questioned these proposals, and the results of these efforts are yet to be seen.

DEBT RELIEF

According to Easterly (2001), debt relief has become the feel-good economic policy of the new millennium. But despite its overwhelming popularity among policymakers and the public, debt relief is a bad deal for the indebted countries. By transferring scarce resources to corrupt governments with proven track records of misusing aid, debt forgiveness might only aggravate poverty among the world's most vulnerable populations. The lesson of structural adjustment programs is that reforms imposed from the outside do not change behavior. It would be better for the international financial institutions to simply offer advice to governments that ask for it, and wait for individual countries to come forward with homegrown reform programs, financing only the most promising ones and disengaging from the rest. This approach has worked in promoting economic reform in countries such as China, India, and Uganda. Rushing through debt forgiveness and imposing complex reforms from the outside is as doomed to failure as earlier rounds of debt relief and adjustment loans.

As long ago as 1967, the U.N. Conference on Trade and Development argued that debt service payments in many poor nations had reached "critical situations." A decade later, official bilateral creditors wrote off $6 billion in debt to 45 poor countries. In 1984, a World Bank report on Africa suggested that financial support packages for countries in that region should include "multiyear debt relief and longer grace periods." Since 1987, successive G-7 summits have offered increasingly lenient terms, such as postponement of repayment deadlines on debts owed by indebted poor countries.

In the late 1980s and 1990s, the World Bank and IMF began offering special loan programs to African nations, essentially allowing governments to pay back high-interest loans with low-interest loans, just as real a form of debt relief as partial forgiveness of the loans. The World Bank and IMF's more recent and well-publicized highly indebted poor countries (HIPCs) debt relief program therefore represents a deepening of earlier efforts to reduce the debt burdens of the world's poorest nations. Remarkably, the HIPCs nations kept borrowing enough new funds in the 1980s and 1990s to more than offset the past debt relief. From 1989 to 1997,

debt forgiveness for the 41 nations, now designated as HIPCs, reached $33 billion while new borrowing for the same countries totaled $41 billion.

The HIPCs' 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 education or health care. (2) The initiative came too late. Countries entering HIPCs 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 international development targets were agreed upon (Cohen, 2000; Dagdeviren, 2001).

So by the time the Jubilee's 2000 movement began spreading its debt relief gospel in the late 1990s, a wide constituency for alleviating poor nations' debt already existed. However, Jubilee 2000 and other pro-debt relief groups succeeded in raising the visibility and popularity of the issue to unprecedented heights. According to Easterly (2001), debt relief has become the feel-good economic policy of the new millennium. But despite its overwhelming popularity among policymakers and the public, debt relief is a bad deal for the indebted poor countries.

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 of several internal factors (Lucas, 1988; Romer, 1986).

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 growth (gross domestic product)= ¦(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 rights and civil liberties)).

These variables drawn from the literature are by no means exhaustive. We examined the relationship between the independent variable 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 82 severely indebted countries.

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 82 severely indebted countries, from the1991 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; 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 1990-2000, measured by per capita GDP. 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 growth.

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, trade openness indicator, economic freedom, inflation, business climate, political regime (political rights and civil liberties), and political risk.

Dependent variable

Economic growth was measured by the average of the natural log of GDPs of each included country from 1991 to 2001(WB, 2002; UN, 2002; Gwartney et al, 2003).

Independent variable

Foreign loans were measured by the natural log of the average total foreign loans for ten years (1991-2001) of each 82 underdeveloped countries (WB, 2002; UN, 2002; IMF, 2002; Greenhill & Blackmore, 2002).

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 (in U.S. dollars per capita) was measured by the natural log of the average of FDI received by each recipient country from 1990 to 2000. (World Bank, 2001; IMF, 2001).

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 on 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 trade openness and barriers to trade) was measured by the average of the ratios of exports

plus imports to GNP population in each country from 1991 to 2001 (World Bank, 2002; Gwartney et al, 2002; scale 0-10, where number 10 is the maximal openness).

Trade openness indicator (reflects the existence of tariff rates and protection, restrictions to capital movements, black market exchange premium, deviations of the actual size of trade sector from the expected size, 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 by Gwartney et al. (2002). The average of values of economic freedom for 1991 and 1995, 1995-1997, and 2001 was used because it is not available on an 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 in government, the quality of the bureaucracy, and a country's law-and-order tradition for each country from 1991 to 2001. (Political Risk Services, 2002and previous issues; scale 0-18, where 18 is the optimal business climate)

Inflation in underdeveloped countries 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).

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 .....+ b14x14 + e

Where:

Y= GDP per capita
X1= Foreign loans (debt)
X2= Foreign aids
X3= Foreign direct investments
X4= Human capital
X5= Growth 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)
b1, b2,....,b14= 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 & 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 problems. 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.= 4.16). 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 regressions are presented in Table 1. The significant F (F-value= 12.65; P= .001) confirms a complete goodness-of-fit for the overall regression model.

Data analysis in Table 1 reveals that f*oreign 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) 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 heavy debt. The commission urged rich countries to give underdeveloped countries grants conditional on their 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.

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	-.0475	1.18	.48
Control Variables			
Foreign aid	-.0475	1.13	.39
Foreign direct investments	.6825	3.27	.05
Human capital	.1582	1.68	.10
Growth rate of population	.1422	1.59	.10
Growth rate of labor force	.7120	2.75	.05
Government spending	-.1417	-2.14	.05
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	.1022	1.28	.27
b. civil rights	.1014	1.25	.32
No political risk	.1523	1.72	.10
R Square= .57; Adjusted R Square= .51 F= 12.65; Significant F= .001; D.W.= 4.16			

With respect to traditional control variables, f*oreign aid* does not have a direct influence on the economic growth of indebted underdeveloped countries. Although this factor has a negative effect, it is not significantly

different from zero. This finding supports those of previous studies (e.g., Griffin & Enos, 1970; Clad & Stone, 1993; Islam, 1992; Johnson & Schaefe, 1997; Villamil & Asiedu, 2001; and Boone, 2002). This finding also 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.

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 2000 (Schaefer & 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 the selected indebted underdeveloped countries. This finding supports those of recent studies (e.g., Dadush, Dasgupta, & Ratha, 2000; Feldstein, 2000; Lipsey, 2001; and Loungani & 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, Lipsey (2001) claimed 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 underdeveloped countries were able to absorb the FDI benefits.

Human capital (represented by the proxy of 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.

Growth rate of labor force has a positive and marginal 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 labor force by focusing on the people's education and training programs (Kormendi & Meguire, 1985).

Growth rate of population has a positive and marginal significant 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 underdeveloped countries. The marginal significant 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 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 was 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 underdeveloped countries 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 open 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 underdeveloped countries 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 underdeveloped countries 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 Harms and Ursprung (2002), who attested that a healthy business climate enhances FDI, which in turn boosts economic growth in underdeveloped countries.

As we expected, inflation has a negative impact on economic growth. It is safe to conclude that inflation deters FDI from investing in underdeveloped countries 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 underdeveloped countries, free-political underdeveloped countries or partly free underdeveloped countries 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 marginal significant negative relationship between this variable and growth suggests the existence of this political risk, to certain extent, in a large number of these underdeveloped countries.

CONCLUSIONS

By the dawn of the 21st century, after 30 years of development strategies that were designed in Washington, New York, London, Frankfurt, Paris, and Tokyo, and trillions of dollars in foreign loans, aid, and investment, more than half of the world's population still finds daily life a struggle. And despite years of rhetoric about debt relief and dozens of structural adjustment plans, the real value of underdeveloped countries debt has continued to grow, to more than $2.5 trillion.

Irresponsible over-lending, poorly conceived projects and privatizations, phony back-to-back loans, outright looting of central-bank

reserves, and massive capital flight continued right under the noses of Western bankers and government officials who were in a position to do something about the problems, but chose not to.

How did 30 years of greatly expanded international lending, investment, aid, and development efforts end up producing such a fiasco? Where did all that money actually go? The 1980s debt crisis became visible as early as August 1982, when Mexico, Argentina, and 26 other countries suddenly rescheduled their debts at once. Our disappointments with globalization have been a popular subject for economists and development policy-makers at least since the Mexico crunch of January 1995, as amplified by the East Asian and Russian crises in 1997-98, and in Turkey, Ecuador, Bolivia, Argentina, Venezuela, and other countries since then.

The majority of severely indebted countries being African and Latin American fell into a debt trap and under the sway of the IMF and World Bank. Many poor underdeveloped countries could not keep up with their interest payments, let alone ever hope to pay back the principal on their foreign debts.

RECOMMENDATIONS

There are no good or bad foreign loans outside of national policy. In other words, it is only in relation to national policy that foreign loans can be described as good or bad. All foreign loans are inherently problematic. Such loans have not been given as a matter of charity; they were given to make profits. Hence, there should be no "open-door" policy towards foreign loans in general. It must be allowed in as and when required by national consensus between the government, the local private sector, the workers and small farmers, and other organs of civil society. Foreign loans must operate under certain nationally determined conditions and must conform to certain performance requirements.

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 net revenue sufficient to service the debt.

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APPENDIX I
DEFINITION OF TERMS

The Gross Domestic Product (GDP) is total annual value of final goods and services in U.S. dollar at the official exchange rate.

GDP per capita at Purchasing Power Party (PPP): It is based on the World Bank estimate of the buying power of local currency. The GDP at PPP is estimated to be three or more times the normal GDP at exchange rate parity.

The Gross National Product (GNP) is the total annual market value of goods and services produced by all citizens, wherever they happen to be working, and capital as a measure of the economy's performance during the year.

Total Debt: this is the amount of money a country owes. It is the amount of money stated in the contracts, plus all accumulated arrears.

Arrears are unpaid interest and principle repayments not made on schedule, and added to the total debt.

Debt service due is the sum of interest and principal payments due right now.

Debt service percentages are the debt service due and paid as percentage of GDP and exports are used as a measure of credit worthiness.

APPENDIX II
COUNTRIES INCLUDED IN THE STUDY

Algeria, Angola, Argentina, Bangladesh, Belize, Benin, Bolivia, Botswana, Brazil, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Chile, Columbia, Congo, Costa Rica, Dominican Republic, Ecuador, Egypt, El-Salvador, Ethiopia, Fiji, Gabon, Gambia, Ghana, Guatemala, Guinea-Bissau, Haiti, Honduras, India, Indonesia, Iraq, Ivory Coast, Jamaica, Jordan, Kenya, Lesotho, Madagascar, Malawi, Malaysia, Mali, Mauritania, Mauritius, Mexico, Morocco, Mozambique, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, Sierra Leon, Somalia, South Africa, Sri Lanka, Sudan, Syria, Tanzania, Thailand, Togo, Trinidad & Tobago, Tunisia, Turkey, Uganda, Uruguay, Venezuela, Zaire, Zambia, and Zimbabwe.