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Master's Degree in International Development Policy

Impact of Debt Relief on Economic Growth in

Heavily Indebted Poor Countries:

A case study of Tanzania 1990-2010

February, 2014

Program in International Development Policy

Graduate School of International Studies

Seoul National University

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**Impact of Debt Relief on Economic Growth in
Heavily Indebted Poor Countries:**

A case study of Tanzania 1990-2010

A thesis presented

by

Gomera Said Jumanne

A dissertation submitted in partial fulfillment
of the requirements for the degree of Master
of International Development Policy

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ABSTRACT

Impact of Debt Relief on Economic Growth in Heavily Indebted Poor Countries

A Case Study of Tanzania 1990-2010

The launch of the Heavily Indebted Poor Countries Initiative (HIPC) in 1996, the enhanced HIPC in 1999 (The enhanced HIPC initiative) and the beginning of the Multilateral Debt Relief Initiative in 2005 following the G7 decision to further provide debt relief for eligible poor countries has raised the question whether these programs are effective in helping to boost economic growth of the participating countries and only few studies have assessed the direct effects of debt relief on economic growth of HIPC countries per se.

Based on the Debt Overhang hypothesis this study finds econometric and statistically significant evidence that debt relief has a positive impact on economic growth and growth of GDP per capita income of HIPC countries. For each percentage point increase of debt relief both GDP and per capita income of Heavily Indebted Countries will rise by 0.3 percentage points. We also conducted a case study analysis on the effects of debt relief initiatives in Tanzania, and found that before the HIPC initiatives, Tanzania's growth was relatively low and at times even negative, but upon joining the HIPC Initiatives and receiving debt relief, Tanzania's economy grew, increasing financial allocation to health, education, roads, water and agriculture. These findings are very much consistent with the theoretical baseline on fiscal space gained through debt relief initiatives that releases financial resources which would otherwise have been spent on meeting foreign debt servicing obligations.

In addition, this study demonstrates that debt overhang is negatively correlated to economic growth and GDP per capita growth of HIPC countries. This could be due to

the fact that higher external debt depresses growth by either discouraging investment or creating disincentives for governments to take necessary reforms that are critical for long-term growth. Therefore, debt relief provides an incentive for reforms, increasing investor as well as potential lenders' confidence to invest and thereby contributing to economic growth. Furthermore, through debt relief, HIPC countries were able to increase their social and economic expenditures which have long term impacts on economic growth.

Key words: HIPC, MDRI, Debt Relief, Economic Growth, Debt Overhang, Tanzania, Fiscal Space

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ABBREVIATIONS AND ACRONYMS

HIPCs: Heavily Indebted Poor Countries
MDRI: Multilateral Debt Relief Initiatives
GDP: Gross Domestic Product
IMF: International Monetary Fund
WB: World Bank
WDI: World Development Indicators
IDS: International Debt Statistics
IDA: International Development Association
ESAF: Enhanced Structural Adjustment Facility
PRGF: Poverty Reduction and Growth Facility
PRSP: Poverty Reduction Strategy Paper
OECD: Organization for Economic Cooperation and Development
MDGs: Millennium Development Goals
AfDF: African Development Fund
IaDB: Inter-American Development Bank
GNP: Gross National Product
SLF: Sustainable Livelihood Frame
GNI: Gross National Income
UNCTAD: United Nations Council on Trade and Development
GRPCY: Growth of Per capita Income
ERP: Economic Recovery Program
MTEF: Medium Term Expenditure Framework
NSGRP: National Strategy for Growth and Reduction of Poverty
US: United States of America
PV: Present Value
USD: United States Dollar

TABLE OF CONTENTS

ABSTRACT	i
ABBREVIATIONS AND ACRONYMS	iii
TABLE OF CONTENTS	iv
TABLES AND FIGURES.....	vi
I. INTRODUCTION.....	1
1.1. Statement of the Problem	4
1.2. Purpose of the Research	5
1.3. Significance of the Research	6
1.4. Scope and Limitation of the Research.....	8
1.5. Structure of the paper	9
II. LITERATURE REVIEW	10
2.1. Overview of the Heavily Indebted Poor Country Initiative (HIPC & MDRI).....	10
2.2. Mechanism and Criteria under HIPC	12
2.3. Growth model & External Debt	13
2.4. Theoretical Literature on the relationship between debt and growth.....	16
2.4.1. Debate over debt relief.....	18
2.4.2. Theoretical Literature on Debt Relief and Debt Overhang.....	19
2.4.3. Debt Relief and Fiscal Space.....	20
2.5. Empirical Literature on the Relationship between external debt, debt relief and growth	22
III. RESEARCH METHODOLOGY, DATA & HYPOTHESIS	24
3.1. Research Methodology.....	24
3.2. Data Collection.....	24
3.3. Theoretical Framework	25
3.4. Hypothesis.....	26
3.5. Global Analysis of HIPCs Initiative.....	26
3.6. Country Analysis of HIPC Initiatives.....	30

IV.	IMPACT OF DEBT RELIEF (HIPC) ON GROWTH AND DEVELOPMENT OF RECEIPIENT COUNTRIES	32
4.1.	The Relationship between Debt Relief and GDP Growth	32
4.1.1.	The relationship between debt relief and growth of per capita Income	34
4.2.	The Relationship between Debt Relief and Growth of HIPCS.....	36
4.2.1.	The Relationship between Debt Relief and Growth of GDP per capita of HIPCS	39
V.	IMPACT OF DEBT RELIEF ON GROWTH AND DEVELOPMENT IN TANZANIA.....	47
5.1.	Overview of Tanzania’s Economic Outlook	47
5.1.1.	Tanzania Debt Relief under HIPC.....	50
5.2.	Debt Relief, GDP Growth and Growth of GDP per capita in Tanzania	50
5.3.	Tanzania’s National Debt and Debt Sustainability and Management Mechanism	53
5.4.	Comparison of Growth Trend with other Non-HIPCs Low Income Countries	58
5.4.1.	Djibouti’s Growth Trends	58
5.4.2.	Gabon Growth Trend	59
5.4.3.	Kenya’s Growth Trend.....	60
5.4.4.	Eritrea’s Economic Growth Trend	61
5.4.5.	Guatemala’s Growth Trend.....	62
5.4.6.	Tanzania’s Growth Trend in Comparison with non-HIPCS	63
VI.	CONCLUSION	66
	APPENDIX	68
	LIST OF COUNTRIES INCLUDED IN THE REGRESSION ANALYSIS.....	68
	REFERENCES.....	69

TABLES AND FIGURES

Figure 1: External Debt Service of HIPC.....	2
Figure 2: Average GDP growth rate of HIPC Countries	3
Figure 3: Debt Relief amount received by HIPC.....	5
Figure 4: FDI Inflows in Developing Countries	6
Figure 5: Review of HIPC Process	13
Figure 6: Debt Overhang Laffer curve	18
Figure 7: Theoretical Framework.....	25
Figure 8: Relationship between Debt Relief and Economic Growth of HIPC.....	39
Figure 9: Relationship between GDP per capita growth and Inflation in HIPC (1990-2010)	41
Figure 10: Growth rate of HIPC from 1990-2010	44
Figure 11: Debt Relief and GDP per capita growth of HIPC (1990-2010)	45
Figure 12: Tanzania and HIPC GDP growth.....	45
Figure 13: Tanzania and HIPC GDP per capita growth	46
Figure 14: Average Growth of Domestic Product GDP Annually (%).....	49
Figure 15: Tanzania GDP per capita growth.....	51
Figure 16: Financial allocation for various Social and economic sectors for the year 1970/00 – 2010/11 – (Billion) Shillings.....	52
Figure 17: Tanzania Exchange rate Trends in USD.....	55
Figure 18: National Debt stock projection	56
Figure 19: National Debt Service Projection	57
Figure 20: Djibouti Growth Trends.....	59

Figure 21: Gabon growth trend	60
Figure 22: Kenya Growth Trend	61
Figure 23: Eritrea GDP growth Trend.....	62
Figure 24: Guatemala Growth Trends.....	63
Figure 25: Tanzania Comparison of GDP per capita growth rate with Non-HIPCs	64
Figure 26: Comparison of Population growth rate (%)	65
Table 1: Data source and description	30
Table 2: The results of Regression on Debt Relief and GDP growth	33
Table 3: Regression Results of Debt Relief on GDP Per capita growth	35
Table 4: The Regression Results on Debt Relief on GDP growth of HIPCs	37
Table 5: Regression Results of Debt Relief on growth GDP per capita of HIPCS.....	42
Table 6: Average growth rate of HIPCs.....	44
Table 7: National Debt Current in Tanzania shillings (\$ 1 is approx. 1600 TZS)	55

I. INTRODUCTION

Over the last five decades many parts of the world have experienced dramatic economic growth. However, there are great differences as far as growth of different countries is concerned; Most growth occurred in parts of East and South Asia while the majority of Sub-Saharan African countries and a few Latin American countries grew less or even at a negative rate as is the case for Heavily Indebted Poor Countries (HIPCs). Most of these countries, located in Sub-Saharan Africa, are trapped in high external debt which affects their economic growth and development and in turn deepens poverty in these countries. In some years, the growth rate of Heavily Indebted Poor Countries was on average was -0.73%, -0.9%, -1.2%, in 1990, 1992 and 1994 respectively. (See figure 2 below)

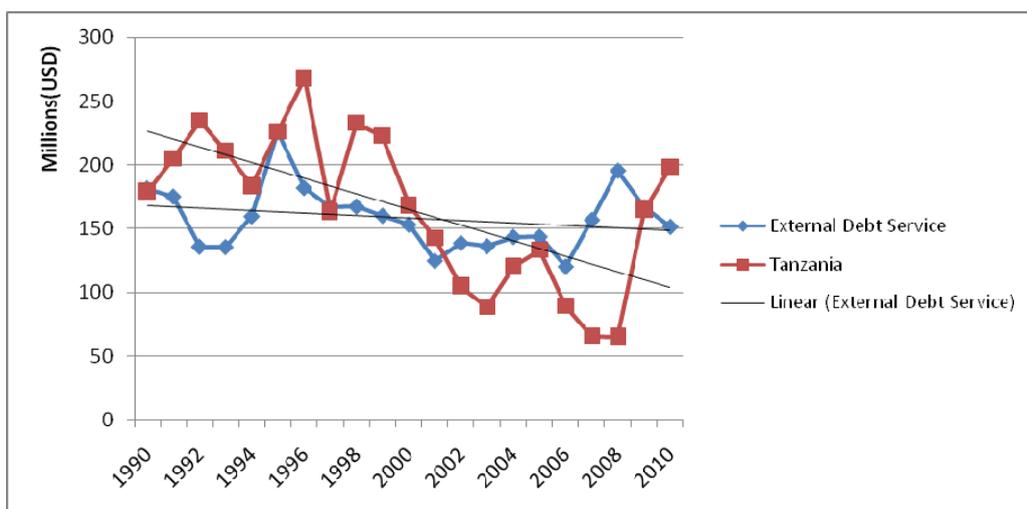
In response to these dire prospects, the international community initiated a scheme to forgive some of the debt owed by these countries as an alternative source of aid modality. As of April 2013, of the 39 eligible HIPC Initiative countries, 35 had reached the “completion point” when debt relief was issued to these countries to stimulate economic growth and to reduce poverty. They received debt relief under both the HIPC Initiative and the MDRI. One country out of thirty five is receiving interim assistance after having reached the “decision point” when it qualifies for HIPC. If all 39 potentially eligible countries reach completion point, total debt relief provided by the World Bank and all participating creditors is estimated at about US\$38.9 billion and \$112.8 billion, respectively, in end-2011 Present Value (PV) terms. ¹

Debt-service payments have declined as a result of the initiatives in the 36 post-decision-point HIPCs. For these countries, the average debt-service payment relative to GDP has dropped from 2.9 percent of GDP in 2001 to 0.9 percent of GDP in 2010 (See

¹ <http://web.worldbank.org>

Figure 1, from 1990 to 2010 the average total decline was from \$181,815,333 to \$151,731,254). The decrease in debt-service payments was accompanied by an increase in poverty-reducing expenditures in various areas including health, rural infrastructure, and education. For the 36 countries that have benefited from debt relief, social expenditures have increased on average from 6.3 percent of GDP in 2001 to 8.8 percent of GDP in 2011 (World Bank, 2013).²

Figure 1: External Debt Service of HIPC



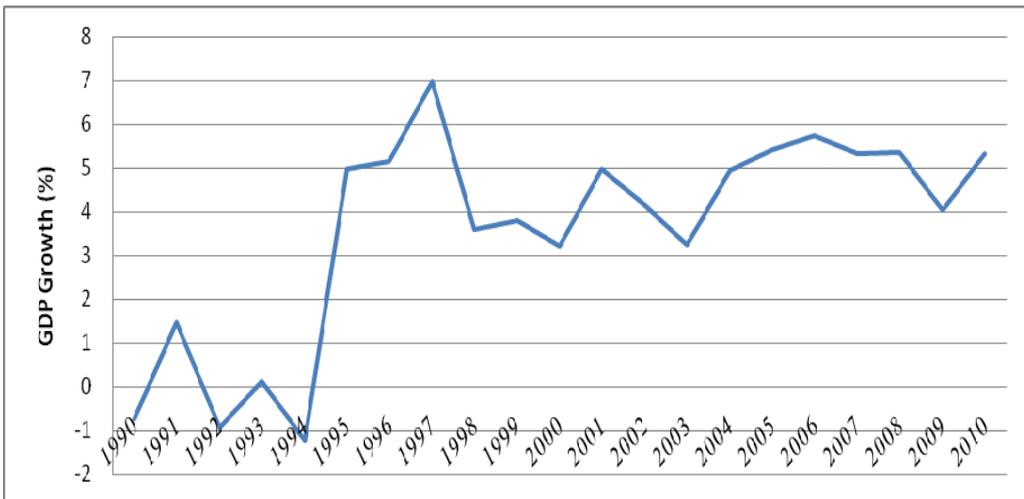
Data Source: World Bank, International Debt Statistics, 2013

The Oil Crisis in the late 1970s, as well as the decline in commodity prices in the 1980s and the rapid accumulation of external debt in the early 1990s all were obstacles to the development of most of these poor countries. Against this backdrop, the 1996 HIPC initiative has put into question the relationship between debt relief and economic growth of the recipient countries. The further acceleration of debt relief by multilateral financial institutions in 2005, granting large-scale debt relief to the countries qualifying for the HIPC's initiative also raises questions as to whether or not these programs have indeed helped the participating countries.

² <http://web.worldbank.org>

The major target of the HIPC and MDRI was to reduce the debt burden of the participating countries hitherto obliged to follow suit on foreign debt obligations that impeded development and fiscal sustainability by compromising economic growth; *“This initiative (HIPC) is a breakthrough . . . It deals with debt in a comprehensive way to give countries the possibility of exiting from unsustainable debt. It is very good news for the poor of the world”* (Then World Bank President, James D. Wolfensohn) Presbitero, A. F. (2008).

Figure 2: Average GDP growth rate of HIPC Countries



Data Source: World Bank, World Development Indicator

This study thus investigates econometrically the impact of debt relief on economic growth of recipient countries using a cross-country regression analysis method for a group of 35 Heavily Indebted Poor Countries which are currently eligible for full debt reduction. We also conducted a case study analysis of Tanzania, being one of the principal beneficiaries of this program, using descriptive qualitative analysis at a micro level. The findings show that Tanzania grew, on average, relatively faster compared to the period before joining the HIPC Initiative.

In a similar vein, we also find that debt overhang depresses both growth and development by discouraging public and private investment and potentially reduces incentives for governments to carry out reforms thus restricting countries' access to new finance which is critical for economic growth and development. Debt relief has a statistically significant and positive impact on GDP growth and growth of GDP per capita in HIPC; freed resources can be subsequently invested in areas, such as education, health and infrastructure.

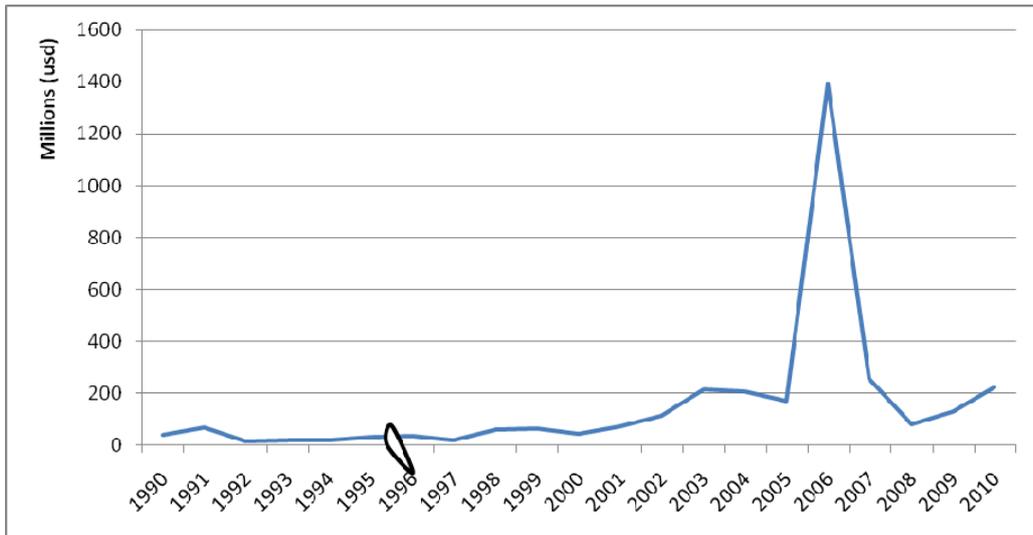
1.1. Statement of the Problem

There has been a growing debate on the relationship between external debt, debt relief, economic growth and economic development. The year 1996 was a wakeup call to a number of researchers trying to determine the relationship between debt relief and growth. Most of the findings concluded that, up to a certain threshold, external borrowing enhances economic growth. Beyond that threshold, higher external borrowings impede economic growth and development.

However, a majority of the findings were mixed; Clements & et al (2005), pointed out that some of these results had found the relationship between economic growth and external debt to be negative (Greene and Villanueva (1991), Serven and Solimano (1993), Elbadawi, Ndulu, and Ndungu (1997), Deshpande (1997) and Chowdhury (2001), and some finds negative relationship up to certain threshold Pattillo et al (2002), Clement et al (2003) and Clements et al (2005) others ends up with statistical insignificant Savvides (1992) and Dijkstra and Hermes (2001) (Clements & et al 2005)).

In addition to that, the majority of researche was conducted between 1990 to 2005, even though it was only after 2005 that internationally agreed development goals and the commencement of the Multilateral Debt Relief Initiative, launched in collaboration with the World Bank, International Monetary Fund and the African Development Bank, resulted in full debt cancellations for countries that were able to reach the completion stage under the HIPC Initiative. (See Figure No. 3).

Figure 3: Debt Relief amount received by HIPCs



Data Source: World Bank, International Debt Statistics, 2013

Therefore, the period covered in this paper will provide a complete picture of the purported effectiveness of both the HIPC and MDRI initiatives with regard to economic growth of HIPC countries. Furthermore, the majority of studies previously conducted use a sample of both HIPCs and non-HIPCs together, whereas this study only covers HIPC countries using a global coverage as a benchmark given the fact that most HIPC countries share similarities in terms of their economic structure. As a result we compare the degree of achievement before and after the initiative was launched, employing a direct relationship between debt relief with GDP growth and growth of GDP per capita which is intended to fill this gap in the existing literature.

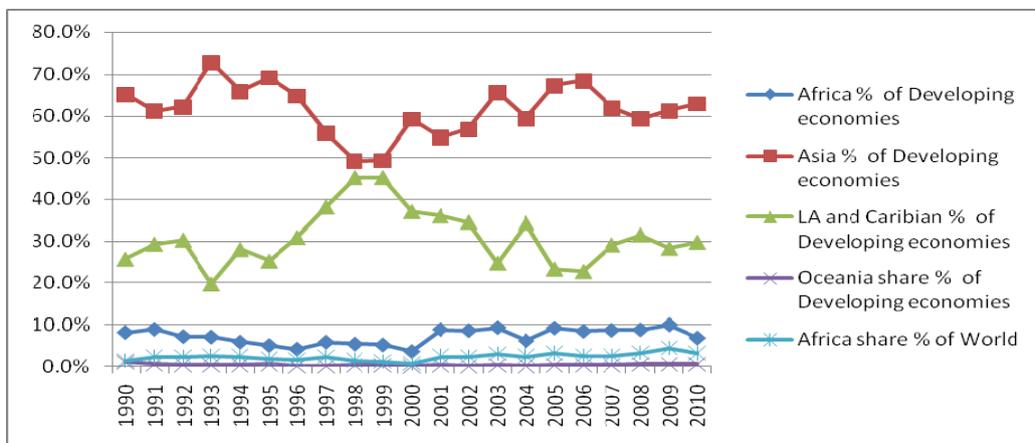
1.2. Purpose of the Research

This study was conducted in order to test econometrically and statistically the impact of debt relief on the growth of both Gross Domestic Product and GDP per capita income of HIPC countries and to assess the effectiveness of the HIPC Initiative in enhancing growth and development by analysing the case of Tanzania as one of the principal beneficiaries of this initiative.

1.3. Significance of the Research

Official development assistance and the use of debt relief have been and will continue to be the most important sources of foreign financial inflows in Low Income Countries, due to the fact that this group of countries has relatively restricted access to the international financial market even when attracting Foreign Direct Investment (see Figure 4 below). Therefore, debt relief is an important source of external finance to free some of the scarce financial resources and to use these funds to invest in other productive areas including education, health and infrastructure that would lead to greater economic growth, the fulfilment of international agreed development goals and eventually to poverty reduction.

Figure 4: FDI Inflows in Developing Countries



Data Source: UNCTAD, World Investment Report, 2013

A number of studies have been conducted on the relationship between debt overhang and growth. Few of them have focused on HIPCs per se and especially on the effects of debt relief on growth in HIPCs. Most of the studies were conducted by mixing this group of countries with either emerging markets or lower upper middle income countries, despite the fact that these groups of countries have different economic

structures; therefore the impact of external debt on growth might differ when looking at these particular countries. (Clements & et al 2005)

Thus, the study will contribute to the existing literature and inform policy makers, development practitioners and the international community on the effects of external debt on growth in HIPC's, with a detailed micro-level study, at a time when these countries not only struggle to meet the Millennium Development Goals but also when most of them have reached the completion point qualifying them for partial or full debt cancellation.

While most of the previous studies have been conducted between 1996 and 2005, from 2008 onward the world has undergone two major economic shocks that have affected the stock of external debt not only for upper and middle income countries but also for low income countries to respond to the adverse effects by resorting to stimulus packages or increasing external borrowings.

Using an extended dataset, this study is timely and relevant in assessing the commitment of the international community in dealing comprehensively with the debt burden of developing countries as reflected in the Millennium Development Goal target 8D through both national and international measures making debt sustainable for long-term economic growth and development.

In theory it would seem obvious that debt relief will lead to more spending on education, health, and infrastructure as enough fiscal space is created for such spending. However in practice this notion is questionable according to Cussimon, D et al (2013) arguing that debt relief allowing for fiscal space effects "is however not straight forward, and not easy to measure".

This is because a decision to grant debt relief does not necessarily implicate national economic growth of recipient countries, in practice, debt relief decisions often take

longer to materialize into cash flow gains of the recipient countries. For instance, the fact that the amount of debt that would have not been paid or paid in part in the absence of debt relief, “*as in practice debt forgiven often would have been serviced only in part, debt relief is more correctly measured as the debt service that would have been serviced in the absence of debt relief*”. Cussimon, D et al (2013).

In addition to that, donors may reduce their financials support when granting debt relief and thereby leading to little or no financial gains to the recipients countries. Furthermore, according to the aid fungibility theory, recipient countries may cut down domestic revenue or spend debt relief funds to solve the inherent problem of fiscal budget deficit and therefore no or little fiscal space is created to provide social public services or poverty reduction expenditures(Cussimon, D et al,2013)

As a result, it is not assured that (HIPC) debt relief has led to more resources availability and that these resources are being spent according to the donors’ objectives, along with increasing investment or recurrent spending to target poverty and boost economic growth. This is therefore an empirical issue which this study has tried to investigate by proving econometrically and statistically the significance of the initiative in translating these efforts in economic growth and development in the world’s poorest nations and shaping the agenda of the post Millennium Development Goals.

1.4. Scope and Limitation of the Research

This paper therefore uses data on Heavily Indebted Poor Countries to measure the relationship between debt relief and GDP growth and GDP per capita growth of 26 out 35 HIPCs. To a large extent, the debt relief data drawn from the World Bank database only covers debt relief granted by multilateral agencies of the Organization of

Economic Cooperation and Development (OECD), World Bank, International Monetary Fund, African Development Bank and Inter-American Development Bank.

Therefore, the data used in this study does not cover bilateral arrangements between HIPCs and other non- OECD countries like Brazil and China who are now rising to the most important player in this field of international development cooperation. However, the case study of Tanzania provides a critical analysis of HIPC initiatives in enhancing growth and development. The analysis was limited due to the fungible nature of public financing which made it difficult to follow the channels through which debt relief funds are allocated in the annual budget as a whole and in the Medium Term Expenditure Framework in particular.

Furthermore, this study only provides statistical evidence on the impact of debt relief on growth and development of recipient countries without considering each country case (only the Tanzanian case will be discussed in this paper), although some examples have been drawn randomly from this group of countries to explain specific issues that are relevant for the purpose of this research.

1.5. Structure of the paper

The paper is organized into six chapters. The first chapter is composed of the introduction, research purpose and scope and limitation, whilst the second chapter will be concerned with an extensive literature review on the subject matter at hand. Chapter three presents an overview of the methodology, hypothesis, theoretical framework and data, whilst chapter four will provide an empirical analysis of the main findings. Chapter five presents an analysis of the case of Tanzania, whilst the last chapter will be dedicated to the conclusions drawn from the analysis of the main chapters.

II. LITERATURE REVIEW

2.1. Overview of the Heavily Indebted Poor Country Initiative (HIPC & MDRI)

The Heavily Indebted Poor Countries initiative, launched in 1996 by the World Bank and IMF, raised a number of questions as to whether debt relief would effectively improve economic growth of recipient countries. Numerous studies have subsequently been conducted on external debt and growth but only a few studies have attempted to explore the relationship between debt relief and growth. The HIPC's initiatives commenced in 1996 with the objective of helping poor countries manage unsustainable debt level by granting debt relief so as to avoid economic stagnation and to boost development and poverty reduction.

In early 1996, HIPC initiatives attracted criticism from various groups and activists questioning whether this initiative would help poor countries to escape poverty or even boost economic growth. This was due to the fact that, a number of criteria were set, which were perceived as a fundamental barrier to poor countries' access to the benefits promised by this initiative. In response to the criticism raised, various international financial institutions in 1999 substantially revised the qualification criteria in order to enable a majority of poor countries to participate and benefit from the program and to align the initiative with the goal of poverty reduction and social policies of the recipient countries. (IMF 2013)

According to the World Bank (2013), at the moment, there are 35 countries that have reached completion point, which makes them eligible for full debt relief. The majority of these countries are from Sub-Saharan Africa. With a view to accelerating the achievements of the Millennium Development Goals (MDGs), in 2005, HIPC initiative was supplemented with the Multilateral Debt Relief Initiative (MDRI) by the

International Financial Institutions. MDRI allows for 100 percent relief for eligible debts to recipient countries. *“In 2007, the Inter-American Development Bank (IaDB) also decided to provide additional (beyond HIPC) debt relief to five HIPCs in the western hemisphere”* (IMF, 2013).

Against this backdrop, however, concerns grew whether the initiative would improve the lives of the poor by raising incomes indirectly through the expansion of social services provisions like health and education as well as economic infrastructure through public investment that would boost economic growth and development. This concern has attracted a number of studies on the relationship between external debts and growth.

2.2. Mechanism and Criteria under HIPC

“Countries must meet certain criteria, such as commit to poverty reduction through policy changes and demonstrate a good track-record over time. The IMF and World Bank provide interim debt relief in the initial stage, and when country meets its commitments, full debt relief is provided”. (World Bank, 2013)

According to the World Bank (2013), in order to be considered for assistance under the HIPC Initiative, a country must fulfil the following four conditions;-

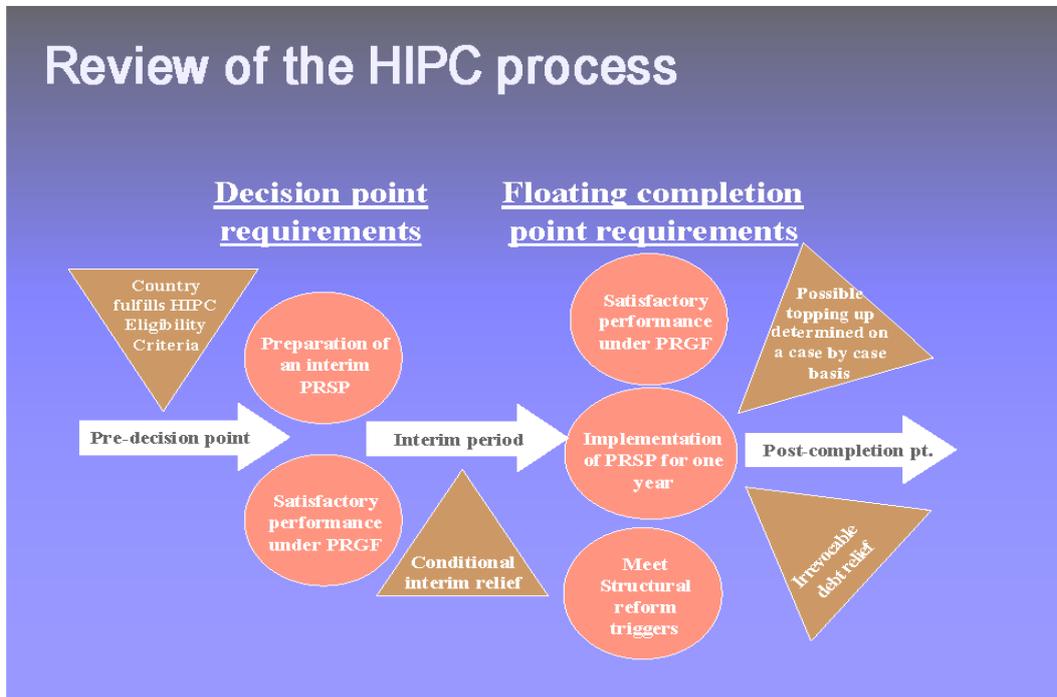
- a) Eligible to borrow from the World Bank’s International Development Agency, which provides interest free loans and grants to the world poorest countries, and from the IMF’s Poverty Reduction and Growth Trust, which provides loans to low income countries at subsidized rates.
- b) Face an unsustainable debt burden that cannot be addressed through traditional debt relief mechanism.
- c) Have established a track-record of reforms and sound policies through IMF and World Bank supported programs.
- d) Have developed a Poverty Reduction Strategy Paper (PRSP) through broad based participatory process in the country.

According to the World Bank (2013), once a country has met or made sufficient progress in meeting these four criteria, the Executive Boards of the IMF and World Bank formally decide on its eligibility for debt relief, and the international community commits to reducing debt to a level that is considered sustainable. This stage under the HIPC Initiative is referred to as decision point. Once a country reaches its decision point, it may immediately begin to receiving interim relief on its debt servicing falling due”.

Furthermore, in order to receive full and irrevocable reduction in debt available under the HIPC initiative a country must establish a track-record of good performance under programs supported by loans from the IMF and the World Bank, implement key

reforms agreed at decision point and adopt and implement its PRSP for at least one year, this stage is referred to as completion stage, which allows a country to receive the full debt relief committed at its decision point (See Figure 5 a summary of two process)

Figure 5: Review of HIPC Process



Data Source: Presbitero (2008)

2.3. Growth model & External Debt

External Debt

According to the IMF's "External Debt Statistics, Guide for Compilers and Users" (2003) gross external debt is defined as the outstanding amount, at any given time, of

those actual current, and non-contingent liabilities that require payment by the debtor at some point in the future and that are owed by non-resident of the economy.

As such, external debt or foreign debt is that part of the debt in a country that is owed to creditors outside the country. The debtors can be a government, corporation or even private households. The debt includes money owed to the private commercial banks, other governments, or international financial institutions such as the International Monetary Fund (IMF) and World Bank usually denominated with foreign currency, in most cases US dollar.

On the other hand economic growth refers to the “quantitative change or expansion in a country’s economy. Economic growth is conventionally measured as the percentage increase in gross domestic product (GDP) or gross national product (GNP) during a year “(Soubbotina, 2004). In the economics literature there are two basic ways in which a country can grow its economy; either through innovation in the process of competition (Ellig, 2001) or by expanding the amount of investment and savings (according to Solow’s neo-classical theory, 1956). However in order to increase investments, a country can either use internal resources or borrow from external sources and thus eventually achieve economic growth.

In theory, therefore, borrowing would help to increase the amount of resources required to carry out investments that, if optimally used, will lead to economic growth and improving living standards, as long as per capita income grows along with economic growth.

Due to the fact that the majority of Least Developed Countries including HIPC’s had faced and continue to face financing gaps to fund different development projects under persistent budget deficits (caused by a low tax base, general revenue and other reasons) , the better option would be foreign borrowing. In explaining this option,

Adegbite, E et al (2008) argued that the dual gap theory offers a better explanation in that the level of domestic savings for developing countries is very short in order to invest in economic development.. Thus, external sources offer an alternative for these countries to borrow and finance investment projects as investment is a function of saving, even though the relationship between domestic savings and foreign funds determines how much a country can borrow abroad. In theory since most of the HIPC countries are still far from steady state growth, any investment could result in accelerated economic growth.

However, borrowing implies an obligation that the borrower is meant to respect with regard to his creditor, to pay the principal amount as well as the interest on a loan and sometimes penalties in case of a delay in meeting the obligation on time. Therefore, borrowing should be associated with higher rates of expected return than with the cost of borrowing to meet the ensuing obligations. In theory external debt does not automatically translate into debt burden as it will provide additional resources for productive investment with higher rates of returns, as was pointed out by Adegbite et al (2008); under optimal conditions, the marginal return on investment is greater than or equal to the cost of borrowing, in which case debt will show a positive impact on growth.

In practise borrowing is associated with risks, like in the case of the Heavily Indebted Poor Countries, where economic problems were caused by a number of factors, such as the decline of commodity prices of primary products, the oil crisis, bad governance, all of which affected their economic performance and returns on investment.

Furthermore, when developing countries incur debt to foreigners, those debts are overwhelmingly denominated in terms of the major foreign currency, the US dollar, the euro, or the yen. This practise, however, is not a matter of choice; in general, lenders from richer countries, fearing the extreme devaluation and inflation that have occurred

so often in the past, insist that poor countries promise to repay them in the lender's own currencies. (Krugman et al, 2012)

Additionally, for poor countries borrowing in a major foreign currency, a fall in export demand may occur because poor countries tend to be net debtors in major foreign currencies. Thus, a depreciation of domestic currency causes a transfer of wealth to the foreign creditor by raising the domestic currency value of the net foreign debt, amounting to negative insurance. (Krugman et al, 2012).

Economists like Barry Eichengreen from the University of California Berkeley and Ricardo Hausmann from Harvard University coined the phrase "original sin" to describe developing countries' inability to borrow in their own currencies. In their view, the inability of poor countries is a structural problem caused primarily by features of the global capital market such as the limited additional diversification potential that a small country's currency provides to creditors from rich countries, which already hold all the major currencies in their portfolios. (Krugman et al, 2012).

2.4. Theoretical Literature on the relationship between debt and growth

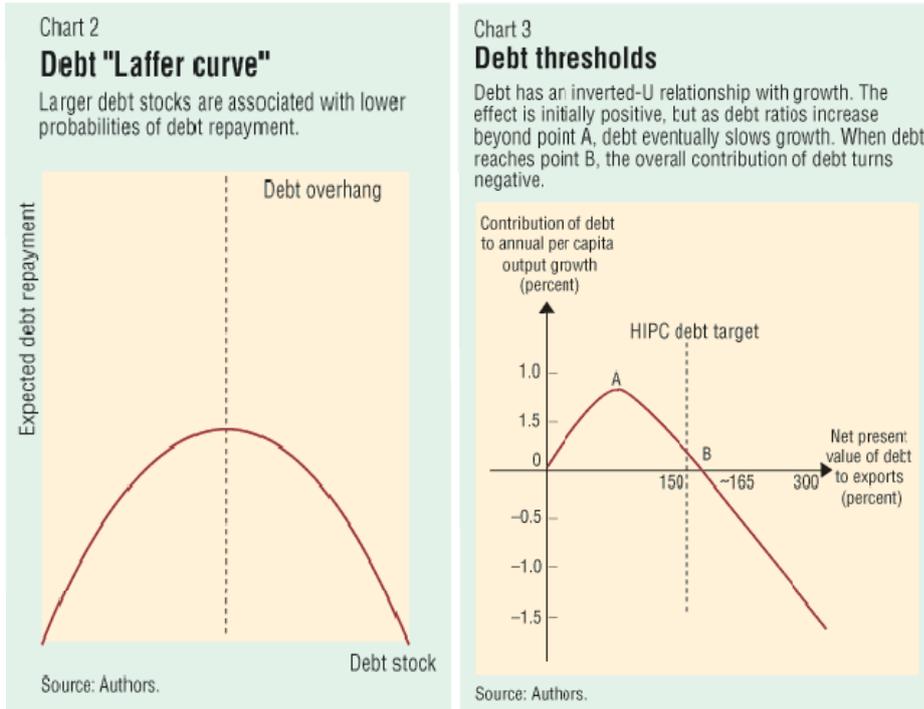
The theoretical literature on the relationship between external debt and growth rests on the debt overhang hypothesis by Myers (1977) and Krugman (1988) defining debt overhang theory as the situation where debt is so large that a country's debt may not be paid off in the future, therefore expecting debt service will discourage both domestic and foreign investors as well as potential lenders. In this situation, the expected rate of return from investing in that particular country falls to low levels due to uncertainties which will further discourage domestic as well as foreign investors, eventually leading to an economic slowdown. (Krugman 1988, Sachs 1989)

Furthermore, Claessens and Diwan (1990) also argued that "debt overhang is a situation in which either illiquidity effect or disincentive effect, or both are strong

enough to negatively affect economic growth in the absence of concessions by creditors". In a similar vein, Were (2001) emphasizes the negative effects of external debt service by looking at the compromising effects of some of the productive investments in education, health and economic infrastructure which affect the economic growth of a given country. As cited by Clement et al (2005) in their paper, Agenore and Montiel (1996), argued that debt overhang increases uncertainties about government policies targeting debt service obligations, some of which might be inflationary (taxation or printing money), resulting in negative effects on investment returns, and thereby discouraging both potential domestic and foreign investors as well as lenders.

Jeffrey Sachs (1989) introduced the concept of the debt laffer curve, borrowing from the tax laffer curve, arguing that debt overhang occurs similarly to the tax laffer curve which shows a non-linear relationship; as such, a further increase in the tax rate, set by the government to a point where people will be discouraged to pay, will lead to tax evasion and eventually to the decline of government revenues. In other words, an increase in a country's debt beyond its repayment ability will eventually discourage investments and lead to economic slowdown (see Figure 6 below on the debt Laffer curve). As a result, in order to restore economic growth, creditors will have to forgive some of their debt to allow for economic recovery, otherwise debtors risk defaulting, as witnessed in the case of some Latin American countries in the 1980s.

Figure 6: Debt Overhang Laffer curve



Data Source: Pattillo et al (2002)

In summary, the theory suggest that debt overhang depresses growth due to its negative effects on investment as it creates uncertainties for both domestic and foreign investors, thus discouraging new lenders. Additionally, debt overhang creates disincentives for governments to take up reforms since any income gain will be subsequently taxed away by foreign creditors.

2.4.1. Debate over debt relief

There are still sceptics who question whether debt relief programs are beneficial for the participating countries as well as for the international economy. Some scholars point to

the “moral hazard effects by referring to the possibility that debt relief might induce debtors to believe that creditors have taken a softer stance and that they may be more willing to forgive any future debt, when the possibility to obtain a repayment decrease substantially”(Presbitero,2008).

According to Presbitero (2008), cited in Bird (2007) debt relief will lead to debtor moral hazard in that countries could pursue expansionary domestic policies thus incurring external debt, in the hope for future debt cancellations by multilateral institutions. Further to that, other economists argue that the expectation of debt reduction “encourage private international capital markets to underestimate the risks associated with lending to individual countries or group of countries and therefore to over lend.”

In a similar fashion Arslanalp and Henry (2008) argued that a large amount of debt reduction increases the capacity for new lending, attracting non-concessional financing, where debt relief could work as a subsidy to lenders offering non-concessional loans, thus creating a free-riding problem among creditors.

2.4.2. Theoretical Literature on Debt Relief and Debt Overhang

Krugman (1988) in his article published in the Journal of Development Economics argues that when a country faces debt overhang, creditors have two options; they can either finance the country in the hope that the country will be able to repay its debts in the future or they can forgive part of the debt, reducing it to a level the country can actually repay. Krugman further argues that, in determining whether to finance or forgive, creditors inevitably face a trade-off.

Choosing to finance their debtors, the creditor has an option value where if the country does relatively well, he will not have written down their claims unnecessarily. However, debt overhang distorts the country’s incentives to undertake necessary adjustments

since the benefits of good performance will directly flow to the creditors and not to the country itself. Nevertheless, Krugman claims that some debt forgiveness and new lending is beneficial to the creditor; he suggest that by providing new lending, it is in the best interest of the creditors to act collectively as non-cooperation (free rider problem) will lead to a liquidity crisis and/or disorderly defaults which would not benefit anyone. Furthermore, this new lending would have to be on concessional terms and if creditors were to charge the higher interest rate payable, it would act as a disincentive to the debtors.

Thus, this study presents, econometrically, the relationship between debt relief on growth of per capita income and gross domestic product of Heavily Indebted Poor Countries based on the aforementioned theory.

2.4.3. Debt Relief and Fiscal Space

It is important to note that fiscal space, although it is a relatively new term, its contents are not. As noted by Heller (2005), “fiscal space is a room in a government budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or stability of the economy.” He further argues that, fiscal space must exist or be created if extra resources are to be made available for worthwhile government spending. Furthermore, the government can create fiscal space “by raising taxes, securing outside grants, cutting lower priority expenditure, borrowing resources (from citizens or foreign lenders), or borrowing from the banking system. It must do so without compromising macroeconomic stability or fiscal sustainability making sure that it has the capacity in the short term and the long term to finance its desired expenditure programs as well as to service its debt”. Furthermore, Heller maintain that, Fiscal Space may also refer to a space for infrastructure projects, health and education spending with the logic that, these projects creates productive assets and higher human capital respectively which is beneficial to a country in a longer term.

And therefore, the challenge of creating fiscal space is one that confronts governments, policy makers and international institutions such as IMF. Therefore, among other alternatives, debt relief may create fiscal space to provide for more social and economic services that has impact on economic growth and development.

Heller (2005) argued that, for developing countries and emerging market economies, fiscal space may seem a more immediate issue than in advanced economies because there are more pressing needs for expenditure today. But, longer term issues are also involved, even for Lower Income Countries, because of the need to ensure that there will be a room to respond to anticipated fiscal challenges.

Therefore, debt relief, among others, provides a means through which a country can create fiscal space to allow more investment on infrastructure projects, education and health which all have impacts on the growth of national income in the long term. Although there are other ways in which the government can create fiscal space to allow for more public spending on education, health and infrastructure which include raising revenues (through tax reforms, broadening of the tax base and improving tax administration for Low Income Countries), reprioritizing expenditure by curbing unproductive spending on various aspects of public spending (subsidies, military outlays, wage restraints or rationalization of civil service elements, including curbing the common problem of ghost workers), boosting efficiency (through combating corruption and improve governance) and by increasing borrowing.

Thus, debt relief provides a means by which a government is able to spend on health, education and infrastructure projects which in the longer term have positive impacts on economic growth and development of the recipient country and which can be measured by the level of of public investment as percentage of Gross Domestic Product (Cassimon et al 2013).

2.5. Empirical Literature on the Relationship between external debt, debt relief and growth

Empirically, researchers have found mixed results to support the debt overhang hypothesis, with the majority of findings supporting the debt overhang hypothesis only beyond a certain threshold. In addition to that, some scholars tried to find a relationship between debt overhang and growth using indirect measures like the public investment variable; few research has been conducted to assess the impact of debt relief using debt reduction variables and in particular with regard to HIPC countries after 2005. As cited by Clement et al (2005), Greene and Villanueva (1991), Serven and Solimano (1993), Elbadawi et al (1997), Deshpande (1997) and Chowndury (2001), evidence exists to support the debt overhang hypothesis and its effects on discouraging investment which leads to slow growth despite its non-linear relationship.

Pattilli et al (2002) and Clement et al (2003) also found that up to a certain threshold, higher external debt negatively affects growth of per capita income, which is due to its effects on both domestic and private investment. Clement et al (2005) found that external debt compromises income growth in low income countries only after its face value reaches 50 percent of GDP or 20 to 25 percent of its Net Present Value.

Fosu (1999), also found evidence of debt overhang in a sample of thirty five Sub-Saharan African countries in the period from 1980 to 1990, the results of which he published in a paper for the Canadian Journal of Development ; he argues that net outstanding debt was deleterious to economic growth for given levels of production inputs, whereas growth in Sub-Saharan African countries would have been 50 percent higher without the external debt burden, which points to a correlation between debt and investment levels.

However, in his sample of 54 developing countries including fourteen Heavily Indebted Poor Countries, Hansen (2001) found no statistically significant evidence to

support the debt overhang hypothesis, with additional explanatory variables such as inflation, openness and budget balance.

Further to that, in his paper on investment slowdown in developing countries during the 1980s (*“Debt Overhang or Foreign Capital?”*) Savvides (1992) finds that the ratio of debt to Gross National Product is statistically insignificant with regard to its effects on growth. The majority of empirical literature suggests that debt overhang depresses growth of per capita income through its effects on either discouraging investments or reforms that governments should take, eventually leading to slow economic growth. Debt overhang scares potential investors or lenders and it might lead to capital flight or even short term investment that does not support sustainable long term economic growth.

This research provides an extended time period to cover both the HIPC initiative, Enhanced HIPC initiative and the Multilateral Debt Relief Initiative using the debt relief variable to measure its impact on growth of HIPC countries. Therefore, we offer an alternative tool to measure the HIPC initiative’s effectiveness in enhancing growth of Heavily Indebted Poor Countries.

III. RESEARCH METHODOLOGY, DATA & HYPOTHESIS

3.1. Research Methodology

This study was conducted using both quantitative and qualitative research methods. Part one of this study was conducted using quantitative regression analysis to measure the relationship between debt relief and growth of both GDP and GDP per capita. We also employed descriptive qualitative analysis in assessing the impact of debt relief in the case of Tanzania at the micro level.

Building upon the broad of body of knowledge, and for the purpose of consistency, we adopted a model used by previous researchers like Clement et al, (2003), (2005) in their study on Low Income Countries. In addition to that, this study examines the relationship between debt relief, GDP growth and growth of GDP per capita of only HIPC countries and finally employs a country case analysis for Tanzania. Further to this, debt forgiveness grants (current US\$) drawn from the World Bank data base on International Debt Statistics was used as a proxy to test the effectiveness of the Heavily Indebted Poor Countries initiative on per capita growth. Therefore this study combines both quantitative analysis as well as descriptive qualitative analysis in order to assess the impact of debt relief in Tanzania since each country is set in specific socio-economic and political contexts. We also compare growth patterns of Tanzania with other non-HIPC Low Income Countries across the region in order to measure the consistency of our findings.

3.2. Data Collection

Data for part one was sourced from officially recognized sources such as the World Bank database-World Development Indicator and International Debt Statistics, the United Nations Council on Trade and Development and the International Monetary

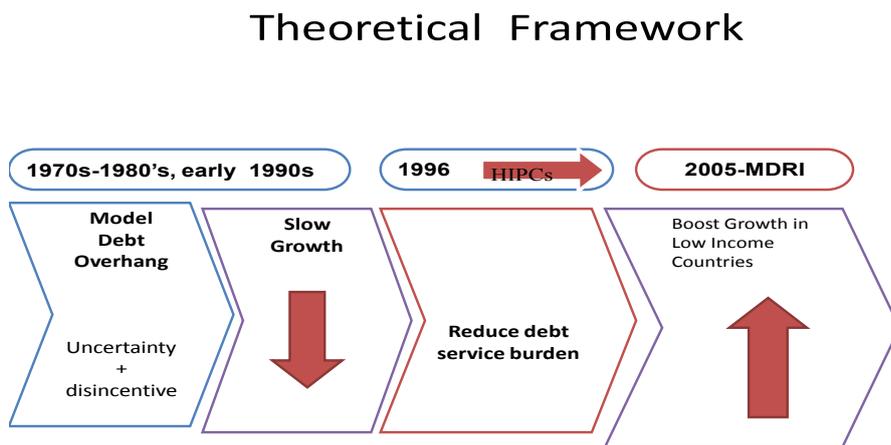
Fund’s World Economic Outlook. In addition to that, data for the case study was obtained from the Ministry of Economics in Tanzania and other countries’ official documents including a comprehensive country report on the fifty years of independence.

3.3. Theoretical Framework

The study was conducted based on the Debt Overhang Theory, which explains the negative effects of external debt on economic growth and development. According to this theory, higher external debt beyond repayment ability discourages economic growth because of the uncertainty it engenders, thus creating disincentives for both domestic and foreign investors.

Krugman (1988) defines debt overhang as a situation in which the expected repayment on external debt falls short of the contractual value of debt. If a country’s debt level is expected to exceed the country repayment ability with some probability in the future, expected debt service is likely to be an increasing function of the country output level.

Figure 7: Theoretical Framework



Source: Author

3.4. Hypothesis

This study was conducted using the Debt Overhang hypothesis which is at the heart of this research. As pointed out by Krugman (1988), the debt overhang theory shows that if there is a possibility that in the future debt will be larger than the country's ability pay, then expected debt services will discourage further domestic and foreign investments because the expected rate of return from investing in projects will too low to support the economy as the significant portion of any subsequent economic progress will accrue to the creditor and thereby create either disincentives or uncertainties.

As a result, both domestic and foreign investments will decline and finally discourage economic growth (Krugman, 1988, Sachs, 1989). Therefore "debt overhang" discourages investment, scares potential lenders and subsequently negatively affects economic growth by increasing uncertainty.

3.5. Global Analysis of HIPC's Initiative

The study investigates the relationship between debt relief and its impact on growth and development of the recipient countries using quantitative analysis by means of a cross country regression –Ordinary Least Square (OLS) regression. The adoption of this method enabled us to evaluate the impact of debt relief in promoting growth and development of the Heavily Indebted Poor Countries Initiatives as a benchmark.

We present the empirical findings of the debt relief initiatives of 35 HIPC's during the period from 1990 to 2010, classified as eligible for the IMF's Poverty Reduction and Growth Facility (PRGF), which provides concessional loans at low interest rates (0.5 percent a year), we estimated equations to identify the key determinants of the growth of per capita income (GDP) and GDP growth as dependent variables.

To report the role of debt relief on growth, we adopted the standard growth model used by Pattilli *et al* (2002), Clements *et al* (2003) with one of the four widely used debt

variables, the face value and the net present value of the stock of external public debt, each as a share of GDP and as a share of exports of goods and services.

In principle, the net present value of debt reflects the degree of concessionality of loans long repayment periods and below-market interest rates—and is therefore a more accurate measure of the expected burden of future debt-service payments than the face value of debt (Clements *et al* (2003)).

In the model, the chief determinants of growth of per capita income (GDP) and growth are lagged real income per capita (a proxy for the level of economic development), population growth, gross investment (public as well as private) in percent of GDP, secondary school enrolment, changes in the terms of trade (to capture external shocks), the central government's fiscal balance in percent of GDP, openness to trade, total debt service (private and public) as a share of export earnings, and the external debt stock as percentage of Gross National Income.

Following the previous studies, population growth and gross investment are proxies for the rate of growth of factor inputs (labour and capital) in the production process; secondary school enrolment rate is widely used as a proxy for the quality of human capital both drawn from World Bank Development Indicators. The change of terms of trade variables is drawn from the United Nations Council of Trade and Development and used to capture external shocks to the economy since the sample of countries under study are very much prone to external shocks due to the fact that these countries are major exporters of primary commodities such as agricultural products.

The central government fiscal balance is drawn from the World Bank and the World Development Indicator is included to control for the effect of fiscal balance on growth. The rate of inflation was also included to control for the effects of exchange rates that might also affect growth and development. Trade openness data drawn from the United Nations Council on Trade and Development was also included following the literature on the effects of trade on growth (Sachs and Warner 1995). To measure the effects of

debt overhang and crowding out effects the stock of external debt as percentage of export value of goods and service was included, and finally debt reduction was added to the model to measure the impact of debt relief on growth and development of the Heavily Indebted Poor Countries both from World Bank International Debt Statistics.

Debt relief indicators used in this study were drawn from the World Bank Data on International Debt Statistics relief indicator “Debt Reduction or Forgiveness” which shows the amount of funds that each heavily indebted Country was forgiven through the Multilateral Debt Reduction Initiative in 2005 which was an extension of the relief program by the International Financial Institution including the World Bank, International Monetary Fund, African Development Bank and Inter-American Development Bank.

The study was conducted using two dependent variables which are the Gross Domestic Product growth and growth Gross Domestic Product of per capita in order to measure levels of economic growth and economic development respectively, using per capita income growth as proxy in measuring the level of economic development as indicated in the two models below together in Table 1 of the data source.

The equation Models:

$$1. \text{GDP_Growth}_{it} = \alpha + \alpha_1 \text{LYRPC}(-1)_{it} + \alpha_2 \text{TOTGR}_{it} + \alpha_3 \text{POPGR}_{it} + \alpha_4 \text{GSEC}_{it} + \alpha_5 \text{GROINV}_{it} + \alpha_6 \text{FISBAL}_{it} + \alpha_7 \text{OPEN}_{it} + \alpha_8 \text{DEBTSTOCK}_{it} + \alpha_9 \text{EXTDEBT}_{it} + \alpha_{11} \text{INFLATION}_{it} + \alpha_{10} \text{DEBT_RELIEF}_{it} + \mu_{it} \quad (1)$$

$$2. \text{GRPCY}_{it} = \alpha_r + \alpha_1 \text{LYRPC}(-1)_{it} + \alpha_2 \text{TOTGR}_{it} + \alpha_3 \text{POPGR}_{it} + \alpha_4 \text{GSEC}_{it} + \alpha_5 \text{GROINV}_{it} + \alpha_6 \text{FISBAL}_{it} + \alpha_7 \text{OPEN}_{it} + \alpha_8 \text{DEBTSTOCK}_{it} + \alpha_9 \text{EXTDEBT}_{it} + \alpha_{11} \text{INFLATION}_{it} + \alpha_{10} \text{DEBT_RELIEF}_{it} + \mu_{it} \quad (2)$$

Whereby GDP_Growth= GDP growth

GRPCY = growth of real per capita income (GDP)

LYRPC (-1) = per capita income Lagged one period, measured in natural logs

TOTGR = percentage change in the terms of trade

POPGR = population growth rate, in percent

GSEC = gross secondary school enrolment rate

GROINV = gross domestic investment in percent of GDP

FISBAL = central government fiscal balance in percent of GDP

OPEN = openness indicator (exports plus imports as a share of GDP)

DEBTSTOCK = total debt stock in percent of exports of goods and services

EXTDEBT = external debt as percentage of GNI measured in natural logs

INFL= Inflation Rate measures in Consumer Price Index (CPI %)

DEBT_RELIEF = External Debt Relief or Reduction

Table 1: Data source and description

Variables	Description	Data Source
GDP Growth	Growth GDP, dependent variable	World Bank database, WDI
GRPCY	GDP per capita growth, dependent variable	World Bank database, WDI
Lagged GDP per capita	GDP per capita lagged (-1)	World Bank, WDI
Population growth	Control variable-Labor Force	World Bank database, WDI
Gross secondary school enrollment	Control variable-HCD	World Bank database, WDI
Openness to trade	Effects on Trade for growth	UNCTAD, UNCTAD stat
Total debt service external	Debt service on external debt, total (TDS, current US\$)	World Bank database, International Debt Statistics (IDS)
Gross government Investment (public +Private) in % GDP	To effects on Investment on fiscal expansion on relief	World Bank database
Changes in the terms of trade	To capture external shocks	UNCTAD, UNCTAD stat
Inflation	Inflation, consumer prices (annual %)	World Bank database, WDI
Fiscal Balance	The central government's fiscal balance in % of GDP	UNCTAD, UNCTAD stat
Debt Relief	External debt forgiveness or Reduction	World Bank database, IDS
External Debt as % of GNI	Shows external debt as % of GNI	World Bank database, IDS
External debt as percentage of Export Earnings	total debt stock as percentage of exports of goods and services	World Bank database, IDS

3.6. Country Analysis of HIPC Initiatives

Tanzania is one of the principal beneficiaries of the HIPC initiative and since each country experiences different levels of growth, development and debt management, a descriptive qualitative analysis method was adopted in order to explain trends and

development in Tanzania and the current situation as far as debt relief is concerned and its impacts on growth and development.

With regard to this part of the analysis, we used both primary as well as secondary data from the Ministry of Finance of the United Republic of Tanzania as it is the responsible ministry for external and internal public finance management via its Policy Analysis Department. We also used data from the World Bank report on external debt management in Tanzania to provide a critical analysis on the relationship between debt relief and economic growth and development.

IV. IMPACT OF DEBT RELIEF (HIPC) ON GROWTH AND DEVELOPMENT OF RECIPIENT COUNTRIES

4.1. The Relationship between Debt Relief and GDP Growth

We applied a cross-country regression analysis to assess the impact of debt relief on growth of the recipient countries. More than seventy countries were observed from the period of 1990 to 2010 as a benchmark. The results of the regression are shown in table two showing that debt relief has a significant relationship with economic growth. Although its relationship is nonlinear for economic development this means that higher external debt relief does not have immediate positive effects on development compared to its effects on economic growth.

The first and second regression results in the minimalist growth model are meant to ensure consistency and compatibility with debt relief on economic growth allowing for interaction with the all Heavily Indebted Poor Countries and four high-relief receiving countries both of which were as dummy variable. The last two regressions results were run to determine a relationship between ‘high’ recipient countries and all Heavily Indebted Poor Countries using interactive terms. These results support the debt overhang hypothesis and are consistent with other studies such as the ones conducted by Benedict Clements et al. (2003 and 2005). External debt shows a negative correlation with economic growth due to the debt overhang hypothesis.

As depicted in Table 2 below, we estimate the impact of debt relief on economic growth through its impact on GDP growth. We use eight independent variables; population growth, gross government investment, and debt relief are positively correlated and significant in boosting economic growth. However, gross secondary school enrolment and changes in terms of trade are positive and insignificant. On the contrary both fiscal balance and trade openness are all insignificant and negative

while external debt as percentage of export earnings is negative and significant which proves the validity of the debt overhang hypothesis.

Table 2: The results of Regression on Debt Relief and GDP growth

Dependent Variable GDP growth				
Independent Variables	Reg 1	Reg 2	Reg 3 HIPC 4	Reg 4 HIPC_ALL
Terms of Trade (Change)	0.000165 (0.026)			-0.0003 (-0.059)
Population growth	1.172 (6.604)***	1.297 (8.151)***	0.011 (0.427)	0.674 (4.123)***
Secondary school enrollment	0.002 (0.359')	0.008 (1.616)	-0.0006 (-0.785)	0.006 (1.316)
Gross government Investment (public +Private) in % GDP	0.052 (2.134)**	0.093 (5.260)***	0.003 (1.129)	0.0582 (2.854)***
Fiscal balance as percent of GDP	-0.022 (-0.917)			-0.007 (-0.323)
Trade Openness	-0.0075 (-1.171)			0.001 (0.124)
External debt as % of Export earning	-0.0016 (-3.489)***			-0.0000687 (-0.118)
Log debt Relief _HIPC all	0.185 (7.324)***	0.185 (9.019)***		0.227 (10.794)***
LN_DEBT_RELIEF*HIPC4			0.236 (41.038)***	
EXBEET_GNI				-0.013 (-3.167)***
Inflation				0.009 (1.280)
No. of Observation	537	710	710	489
No. of Countries	74	82	82	71
R-Square	0.25	0.26	0.70	0.32
Notes: ***P<0.01 **P<0.05 *P<0.1				

We then added other independent variables to the regression up to the fourth regression to see whether debt relief would still have a significance impact on GDP growth; the results show that debt relief is positive and significant for its impact on economic growth, thereby proving the validity of the debt overhang hypothesis and its theoretical grounding underpinning the debt relief initiative.

4.1.1. The relationship between debt relief and growth of per capita Income

Throughout the history of human development, economic growth has proven to be path-dependent, differing widely in its trajectory from region to region. In many cases, growth failed to materialize or was achieved at the cost of greater inequality, higher unemployment, weakened democracy, loss of cultural identity, or the depletion of natural resources. Against this backdrop, this study made an attempt to see beyond economic growth by taking into account the relationship between debt relief and growth of per capita income as proxy for economic development. Although this measure is bound by certain limitations, it nevertheless sheds light on the question whether debt relief has promoted economic development.

Similar to previous studies, we run another regression model using growth of per capita income as proxy to measure economic development as shown in Table 3; the results for this part demonstrate that debt relief is positively correlated and significant with regard to economic development in the sample of 73 countries, although its coefficient is relatively lower compared to the case of GDP growth. However, its significance is relatively high in the case of ‘high’ recipient countries such as Nicaragua, Tanzania, Zambia and Ghana which were granted relatively large amounts of relief.

Table 3: Regression Results of Debt Relief on GDP Per capita growth

Dependent Variable GDP Per capita growth		
Independent Variables	Reg 1	Reg 2
LogGDPPC(-1)	-0.0000599 (-2.009)**	-0.0000977 (-0.585)
Terms of Trade (Change)	0.005 (4.328)***	0.004 (0.571')
Population growth	-0.018 (-0.578)	0.550 (3.109)***
Secondary school enrollment	-0.000438 (-0.430)	0.001 (0.237')
Gross government Investment (public +Private) in % GDP	0.0015 (0.345)	0.047 (1.895)*
Fiscal balance as percentage of GDP	-0.004 (-1.017)	-0.041 (-1.768)*
Trade Openness	-0.0000678 (-0.059)	-0.009 (-1.355)
External debt as percentage of Export earning	-0.000275 (-3.306)***	-0.00147 (-3.158)***
Log debt Relief		8.94E-10 (2.604')***
LN_DEBT_RELIEF*HIPC4	1.06E-09 (9.982)***	
No. of Observation	513	513
No. of Countries	73	73
R-Square	0.22	0.07

Notes: ***P<0.01 **P<0.05 *P<0.1

The conclusions that can be derived from these results show that debt relief has a significant impact on the economic growth of Heavily Indebted Poor Countries, whilst showing a relatively lower impact on the economic development of recipient countries.

However, since these results include both HIPCs and non HIPC countries, it is somewhat difficult to measure the effectiveness of the Heavily Indebted Poor Countries Initiative and the impact of debt relief on economic growth and development. In the following sub-section, we use a sample of Heavily Indebted Poor Countries to determine the compatibility and consistency of these findings.

4.2. The Relationship between Debt Relief and Growth of HIPCS

In an attempt to measure the impact of debt relief on economic growth, we used a sample of 35 Heavily Indebted Poor Countries, classified as eligible for the IMF's Poverty Reduction and Growth Facility and at the stage of completion. We present the results of 26 countries under this scheme with observations from 1990 to 2010. The regression results are shown in Table 4 below. There are three regressions with the results showing that debt relief has a statistically significant and positive relationship with GDP growth in the HIPCs.

Table 4: The Regression Results on Debt Relief on GDP growth of HIPCs

Independent Variables	Dependent Variable GDP Growth(HIPCs)		
	Reg 1	Reg 2	Reg 3
lagged GDP per capita	-0.003 (-2.188)**		-0.002 (-1.346)
Terms of Trade (Change)	0.003 -0.346	-0.004 (-0.472)	-0.000105 (-0.013)
Population growth	1.297 (4.196)***	1.387 (4.689)***	1.163 (3.841)***
Secondary school enrollment	0.013 (1.568)	0.013 (1.646)*	0.006 (0.796')
Gross government Investment (public +Private) in % GDP	0.115 (3.501)***	0.166 (4.293)***	0.148 (3.268)***
Fiscal balance as percent of GDP		0.057 (1.391')	0.059 (1.055')
Trade Openness	0.033 (2.282)**	0.012 (1.014')	0.019 (0.982')
External debt as % of Export earning			-4.82E-05 (-0.054)
debt Relief	0.334 (2.399)**	0.242 (1.703)*	0.299 (2.192)**
EXDEBT_GNI		-0.016 (-3.223)***	-0.015 (-2.302)**
Inflation	-0.003 (-0.138)	0.039 (1.959)**	0.046 (2.084)**
Debt Service		-1.04E-09 (-0.531)	
No. of Observation	298	303	259
No. of Countries (HIPCs)	26	26	26
R-Square	0.17	0.21	0.17

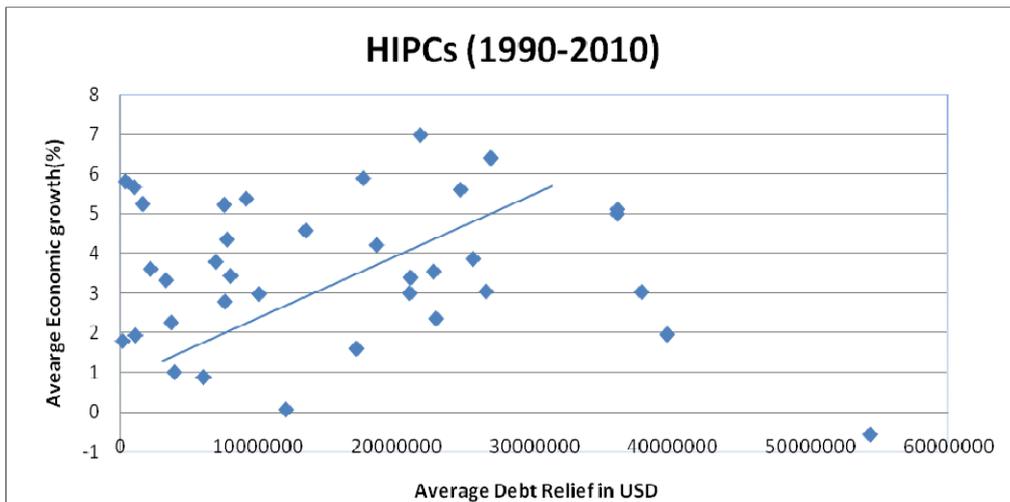
Notes ***P<0.01 **P<0.05 <*P<0.1

Similarly, we estimate the impact of debt relief on GDP growth using eight independent variables; the results show that population growth, gross government investment, and debt relief are positive and significant. An increase in public investments on social and economic infrastructure such as health, education and roads and harbours as percentage of gross domestic product will increase the GDP of HIPCs, seeing as the majority of these countries have relatively low levels of both social and economic infrastructure. Population growth shows a positive correlation and is statistically significant with regard to GDP growth. These results can be supported with recent findings by Dyson (2010) who claims that declining mortality rates boost economic growth and hence lead to an increase in living standards. Similarly, Bloom and Canning (2001) and Kalemli Ozcan (2002) find that declining mortality rates in developing countries raise educational attainment and saving rates thus increasing investments in both physical and human capital which influences economic growth.

On the other hand, gross secondary school enrolment is positive and insignificant, while changes in terms of trade and inflation show mixed results. On the contrary, both fiscal balance and trade openness are insignificant and positive, which is consistent with the literature highlighting the importance of trade on economic growth. Its insignificance could be due to the lower trade shares of the sample under study, while external debt as percentage of export earnings is positive and insignificant and external debt as percentage of Gross National Income is negative and significant.

In Figure 7 below, the relationship between debt relief and economic growth for 35 HIPCs is positive, although with some exceptions as in the case of the Democratic Republic of Congo which received a considerable amount of debt relief despite slow growth; this could be due to the fact that this country has experienced long and drawn-out political instability. On average, however, debt relief shows a positive relationship with GDP growth of HIPCs.

Figure 8: Relationship between Debt Relief and Economic Growth of HIPCs



Data Source: World Bank, World Development Indicator

4.2.1. The Relationship between Debt Relief and Growth of GDP per capita of HIPCS

In order to measure the impact of debt relief on economic development, we adopted the sample of HIPCs similar to the case of economic growth; we used the data from 26 HIPCs with observations ranging from 1990 to 2010. The regression results are shown in table five below. These four regressions show that debt relief has a significant and positive relationship with growth of GDP Per capita although this relationship is nonlinear.

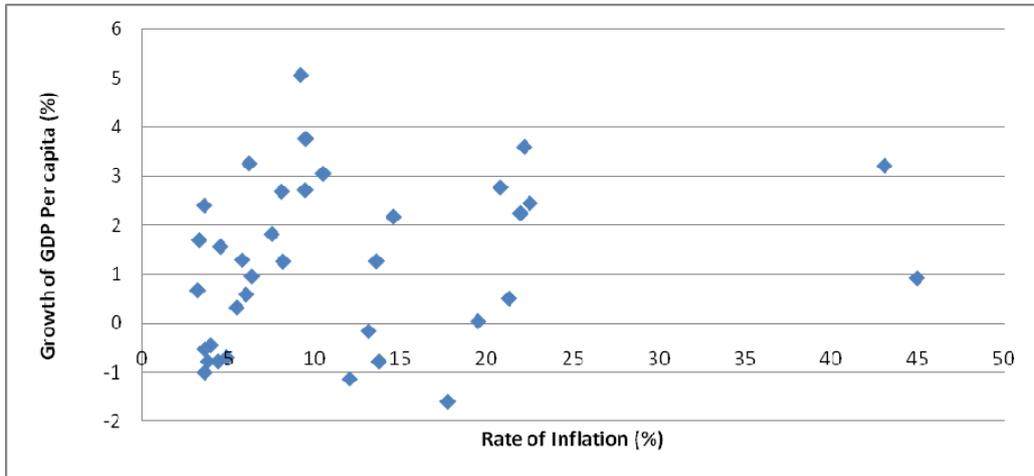
In the first regression, Population Growth, Gross Government Investment, and Trade Openness are significant and positive. Moreover, Fiscal Balance and Secondary School Enrolment are positive and insignificant, whilst GDP per capita, lagged one year, is negative and significant. This result is consistent with the findings of Benedict Clements et al (2003) whose study is based on a sample of 55 Low Income Countries from 1979-1999. We then added another independent variable in the second regression to determine whether debt relief still significantly affects GDP per capita growth in

HIPCs during the stage of this regression. Until the fourth regression, we can see that debt relief significantly affects growth of per capita income of recipient countries. Other control variables such as Gross Government Investment, Fiscal Balance, and Trade Openness are positive and significant in their effect on GDP per capita growth in Heavily Indebted Poor Countries. With an increase in Government Investment, Trade Openness and Fiscal Balance, GDP per capita growth also increases. Other variables such as Population Growth and Secondary School Enrolment are positive and insignificant. These results are consistent with the findings of other scholars like Clements et al 2005. Moreover, Change in the Terms of Trade has a negative impact on GDP per capita growth and is insignificant.

The Inflation variable seems to be insignificant and positively related to growth of per capita income in HIPCs. The literature suggests a negative relationship, however, a number of studies have found either a weak or mixed relationship between inflation and growth of per capita income such as in the case of Gokal, V & Hanif, S (2004), while Ghosh & Phillips in 1998 found a negative relationship between Inflation and economic growth. As shown in Figure 8 below, the relationship between growth of per capita income and inflation is mixed for this group of countries, with the majority of the countries experiencing growth with relatively low inflation and with other countries like Malawi, Mozambique, Sao Tome and Principe, Guinea and Sudan growing despite high inflation rates.

In addition to that, due to the economic recession and stagnation of the 1990s which the majority of these countries were facing, any expansionary macroeconomic policy would boost aggregate demand with moderate rates of inflation during economic recovery. Increasing either monetary supply or government expenditure has positive effects on the general price of goods and services in the economy, although in the long-run a price increase can be expected, though less than what actually appears in the short-run. This is a basic macroeconomic challenge in restoring full employment in the economy.

Figure 9: Relationship between GDP per capita growth and Inflation in HIPCS (1990-2010)



Data Source: World Bank, World Development Indicator

Up to the fourth regression, debt relief still has a significant impact on growth of per capita income, whereby a one dollar increase in debt relief leads to a 0.36 point increase in GDP per capita growth thus proving the validity of the debt overhang hypothesis. These results are consistent with the findings of other scholars like Clement et al (2005) and Sichula (2012).

Table 5: Regression Results of Debt Relief on growth GDP per capita of HIPCS

Independent Variables	Dependent Variable GDP per capita Growth(HIPCs)			
	Reg. 1	Reg. 2	Reg. 3	Reg. 4
lagged GDP per capita	-0.003 (-1.741)*	-0.003 (-2.163)**	-0.002 (-1.314)	-0.004 (-2.829)***
Terms of Trade (Change)		-0.006 (-0.797)		-0.003 (-0.358)
Population growth	0.764 (2.809)***	0.136 (0.468')	0.701 (2.598)**	0.238 (0.796')
Secondary school enrollment	0.007 (0.713')	0.009 (1.290')	0.008 -0.796	0.01 (1.335')
Gross government Investment (public +Private) in % GDP	0.135 (3.014)***	0.171 (4.482)***	0.098 (2.544)**	0.153 (4.043)***
Fiscal balance as percent of GDP	0.074 (1.609')	0.106 (2.598)**		0.107 (2.575)**
Trade Openness	0.039 (2.311)**	0.028 (1.842)*	0.03 (1.882)*	0.043 (2.781)**
debt Relief	0.303 (1.914)*	0.308 (2.365)**	0.307 (1.933)*	0.359 (2.711)**
EXDEBT_GNI		-0.014 (-2.941)**		
Inflation		0.048 (2.274)**		0.007 (0.394')
No. of Observation	332	292	332	298
No. of Countries	26	26	26	26
R-Square	0.11	0.16	0.09	0.12

Notes: ***P<0.01 **P<0.05 *P<0.1

Based on these results, we can draw policy recommendations to the effect that an increase of debt relief for HIPC's could improve economic growth and growth of GDP per capita. As shown in figure six and table seven below, HIPC's grew on average faster from 1996 to 2010.

It is therefore clear that debt relief has helped boost growth of HIPC's, which can be concluded from the considerable growth rates that were achieved by this group of countries from 1996 to 2010 as shown in table six, figure eight and nine below. Debt Relief frees up some of the resources that would otherwise be used to service debt obligations; instead, these resources can be used for investments into economic and social infrastructure, such as education, health and roads which have a positive impact on growth of GDP and GDP per capita of Heavily Indebted Poor Countries, this can clearly be seen by the increased Social and Economic Spending rising from 6.3 percent of GDP in 2001 to 8.8 percent of GDP in 2011(World Bank, 2013)

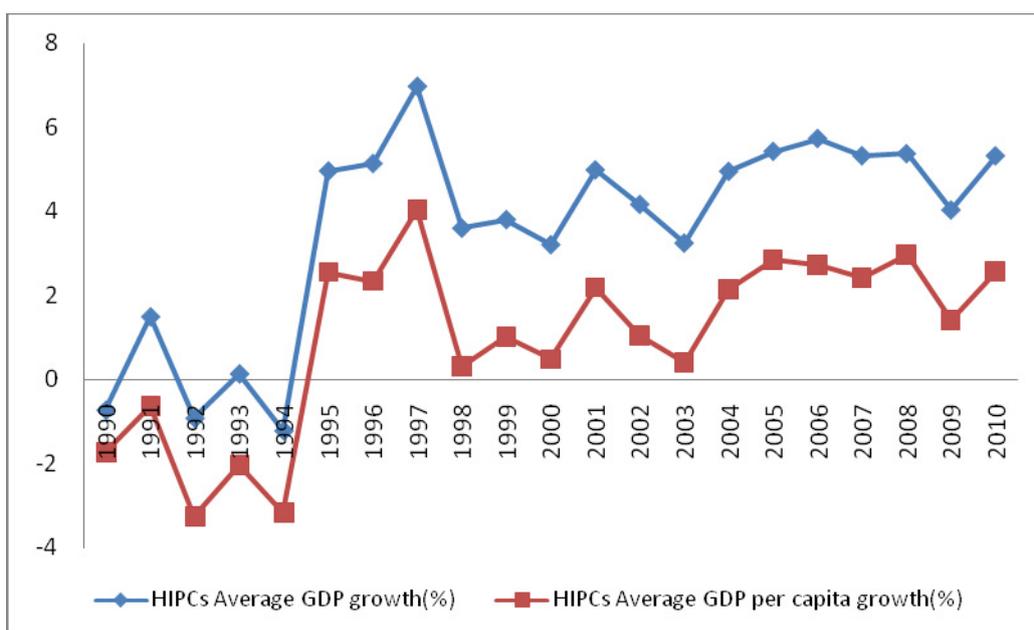
By participating in this initiative, HIPC's were able to undertake major macroeconomic reforms that were part and parcel of this initiative which in turn created a conducive environment for socio-economic improvements and economic growth. Under the Poverty Reduction and Growth Facilitation framework (former Enhanced Structural Adjustment Program of 1987) of the International Monetary Fund and International Development Agency of the World Bank these countries were able to secure loans on concessional rates with longer repayment periods that also helped to fill the financing gap of the Heavily Indebted Poor Countries seeing as these countries were still facing budget deficits. Hence the HIPC initiative helps to fill this gap by means of discounted financial assistance.

Table 6: Average growth rate of HIPC

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP Gr	-0.7	1.5	-0.9	0.1	-1.2	5.0	5.1	7.0	3.6	3.8	3.2	5.0	4.2	3.2	4.9	5.4	5.7	5.3	5.4	4.0	5.3
GDPPC Gr	-1.7	-0.6	-3.3	-2.0	-3.2	2.6	2.3	4.0	0.3	1.0	0.5	2.2	1.1	0.4	2.2	2.9	2.7	2.4	3.0	1.4	2.6

Source: World Bank, World Development Indicator, 2013

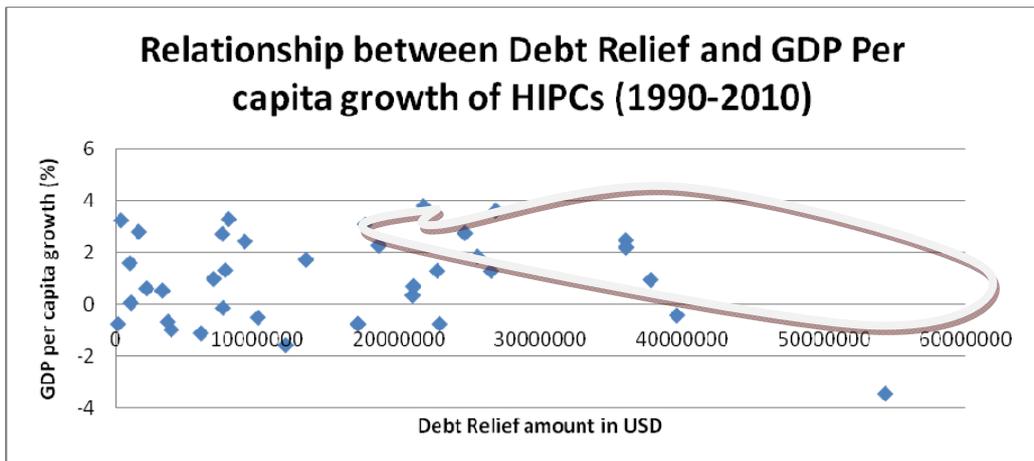
Figure 10: Growth rate of HIPCs from 1990-2010



Data Source: World Bank, World Development Indicators, 2013

Although HIPC countries have many aspects in common, their economic growth rates and development differ depending on their individual socio-economic and political context as depicted in Figure 11 below, with some countries showing a greater performance with regard to debt relief and growth of per capita income, as opposed to other countries, such as the Democratic Republic of Congo, Zambia, Burundi, Cameroon and Central Republic.

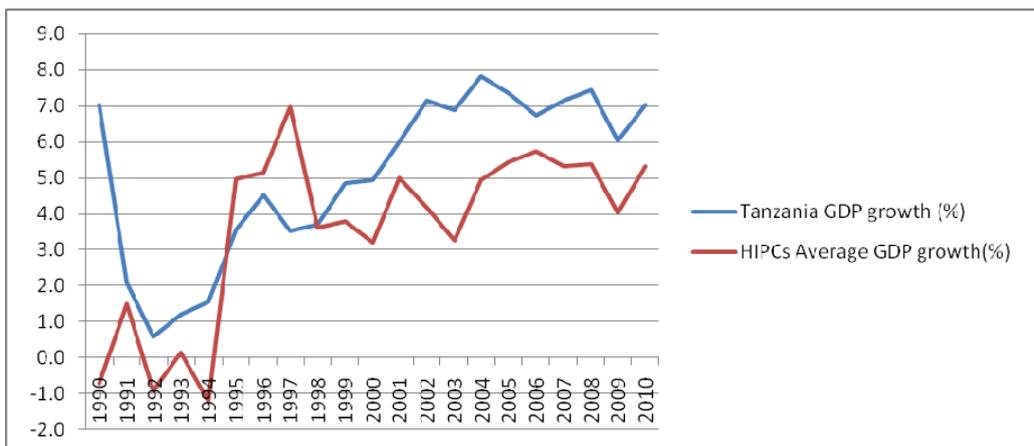
Figure 11: Debt Relief and GDP per capita growth of HIPCs (1990-2010)



Data Source: World Bank, World Development Indicators, 2013

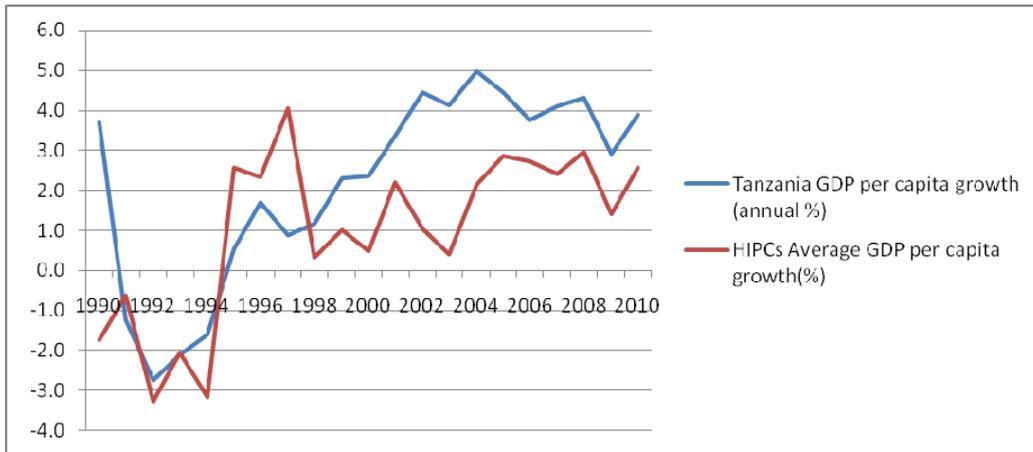
Furthermore, as shown in figure twelve and thirteen below, Tanzania grew faster than the HIPC average during the period from 1990 to 2010, with GDP growth at more than 6 percent per annum and GDP per capita growth rising from 3.3 percent to 4 percent between 2001 and 2010.

Figure 12: Tanzania and HIPC's GDP growth



Data Source: World Bank, World Development Indicators, 2013

Figure 13: Tanzania and HIPC's GDP per capita growth



Data Source: World Bank, World Development Indicators, 2013

The HIPC initiative helps boost growth of these countries as whole; it seems clear from the evidence that there are variations between countries as far as growth patterns are concerned with some countries' growth rates being better than others. Tanzania constitutes a good example in that it grew faster than other HIPCs. With this in mind, a case-by-case study could be useful to analyse individual country situations. In the following chapter of this paper, we conduct a case study analysis on the impact of debt relief on growth in Tanzania, asking why it witnessed relatively more improvements than other HIPCs. .

V. IMPACT OF DEBT RELIEF ON GROWTH AND DEVELOPMENT IN TANZANIA

5.1. Overview of Tanzania's Economic Outlook

In the 1980s and early 1990s most countries, particularly developing countries, including Tanzania, experienced serious economic crises, which resulted in very low productivity in all sectors of the economy. Tanzania's economy was ailing and the living standards of Tanzanians deteriorated to unprecedented levels. It was during this period that most countries, including Tanzania, liberalized their economies on the basis of market economic principles, embracing globalization along with political pluralism. At that time, the world witnessed the fall of communism in Eastern Europe and the disintegration of the Soviet Union as well as the end of single party systems in most countries. Tanzanians also demanded economic and political change, and they started to question the rationale of a single party system in the era of globalization and free market economy. (President Office, State house, Fifty Years of Independence Report, 2011)

The economic recession was caused by a series of factors including the collapse of commodity prices, the oil shock, a serious drought (1973-1974 and 1981-1982), the breakup of the East African Community (1977), and the 1978-1979 Uganda-Tanzania War (Maliyamkono and Bagachwa 1990). By 1985, Tanzania's economy was highly unstable, characterized by high inflation rates, decreasing GDP and exports, a balance of payment crisis and increasing poverty. ((Elena & Kazuhiro, 2009) (See Figure 12 below).

As a result, from 1986 to 1989, the government agreed to implement the IMF's Economic Recovery Program (ERP) in an effort to achieve economic growth by adjusting price levels, reducing state ownership and intervention in the economy and

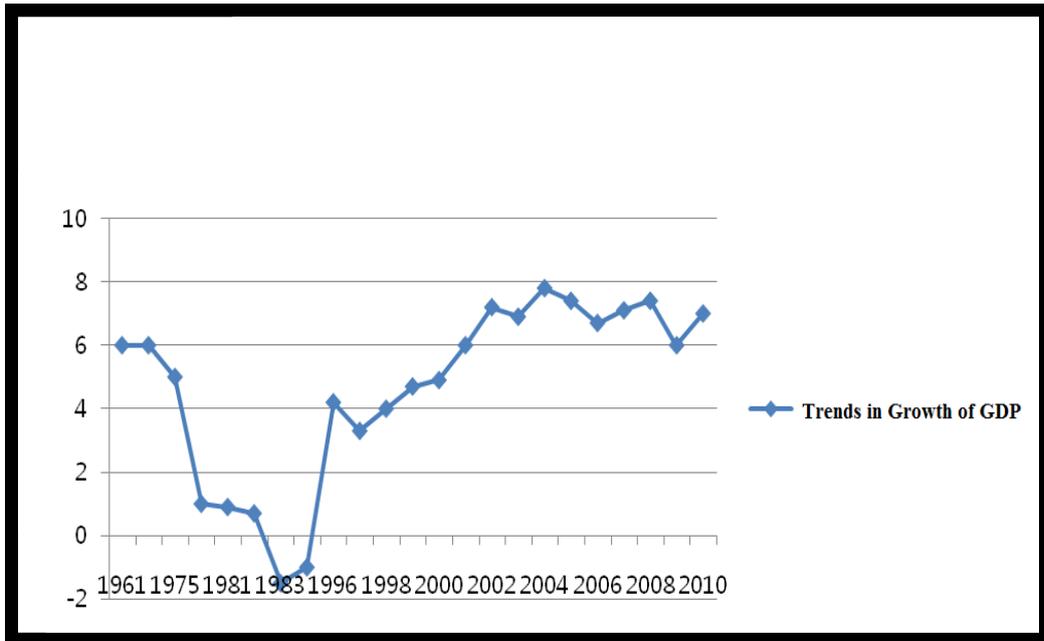
increasing agricultural export that would in turn improve depleted foreign exchange reserve (Norde et al 2009).

In addition to that, the fall of socialism worldwide brought about less financial and political support from ex-communist countries, which led Tanzania in 1991 to sign the IMF's Enhanced Structural Adjustment Facility (ESAF). Under the "banner of the Washington Consensus", the authorities liberalized foreign direct investment and trade, unified and liberalized exchange rate and started privatization of parastatals (implemented by the Parastatal Sector Reform Commission in 1992). However, up until 1995 the economy would remain weak (Elena & Kazuhiro, 2009).

After 1995, however, the first results of the economic reforms started to manifest; the previously enacted liberalization policies continued with the 1996-997 and 1998-1999 ERPs under the ESAF. Liberalization of import allowed the private sector to trade freely, a fact that led to booming export that provided much needed foreign exchange reserves. Financial sector reforms, which allowed the involvement of foreign banks in the domestic market, increased the amount of funding needed by the private sector.

After 1996, Tanzania's growth statistics began to show promising trends as indicated in Figure 11. The HIPC scheme that facilitated macroeconomic reforms as a criterion for engagement was a critical juncture for economic growth, although economic recovery programs enabled the economy of Tanzania to grow at a satisfactory rate of 6 percent from 1986 onwards. With the help of the HIPC program in 2001, the economy grew between 4 and 7 percent per year. Various statistics have placed Tanzania among the 20 fastest growing countries in the world. In spite of the global economic downturn, Tanzania's mainland economic growth rate reached 7 percent in 2008 as shown in figure fourteen.

Figure 14: Average Growth of Domestic Product GDP Annually (%)



Source: The Economic Survey, Ministry of Finance, 2011

It should be noted that upon independence the per capita income was only 34 US dollars per annum. Government efforts to bring about development were directed at increasing per capita income by ensuring that government expenditure was channelled to serve poor people and to create employment opportunities for the majority of Tanzanians. Policies regarding employment conditions, especially concerning minimum wage, price for farmers' crops and increases in production were among the strategies implemented according to the development plans. The achievements made by implementing these policies are evident because per capita income levels increased to 545 US dollars in 2010. (President Office, Fifty Years of Independence Report, 2011)

5.1.1. Tanzania Debt Relief under HIPC

Tanzania, currently benefits from debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative of 1996 and the Multilateral Debt Relief Initiative (MDRI) of 2005. The government committed to allocating resources made available from debt relief to key anti-poverty programs, which are outlined in Tanzania's National Strategy for Growth and Reduction of Poverty (MKUKUTA) (www.who.int/immunization, 2009). Notwithstanding the strides made in changing the economy, most African countries remain poor and heavily indebted, with Tanzania being one of the Highly Indebted Poor Countries (HIPCs) categorized for debt relief in the initiative by 2001. In early 2002 the Paris Club VII was signed to provide for the prospects of relief in excess of the promised upon the complete point.

In addition to that, the Tanzanian government channels funds via the Medium Term Expenditure Framework (MTEF) in its yearly national budget. According to IMF data on debt relief, between 1990 and 2010, Tanzania received a total of sum of USD 7,573,760,000 in the form of debt relief or forgiveness from multilateral and bilateral donors excluding non-OECD members; during this period Tanzania's annual GDP grew on average nearly 6 percent.

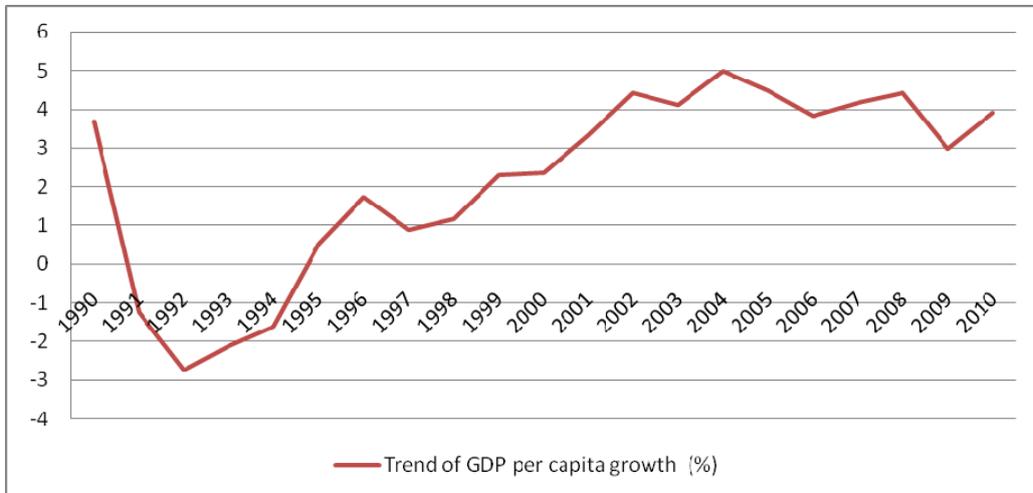
Of course there are other factors that contributed to the impressive growth rate, including sound macroeconomic policies and poverty reduction strategies all of which were part of the HIPC schemes.

5.2. Debt Relief, GDP Growth and Growth of GDP per capita in Tanzania

Since then, considerable efforts have been made by the government of Tanzania to control development programs within macroeconomic management. Starting from the 1990s macroeconomic performance has been improving compared to the late 1980s. In the course of 20 years the GDP grew on average by 5.1 percent along with per capita

income levels growing at a rate of 2.2 percent. This has been possible with the help of HIPC's and other arrangements in debt relief and forgiveness.

Figure 15: Tanzania GDP per capita growth



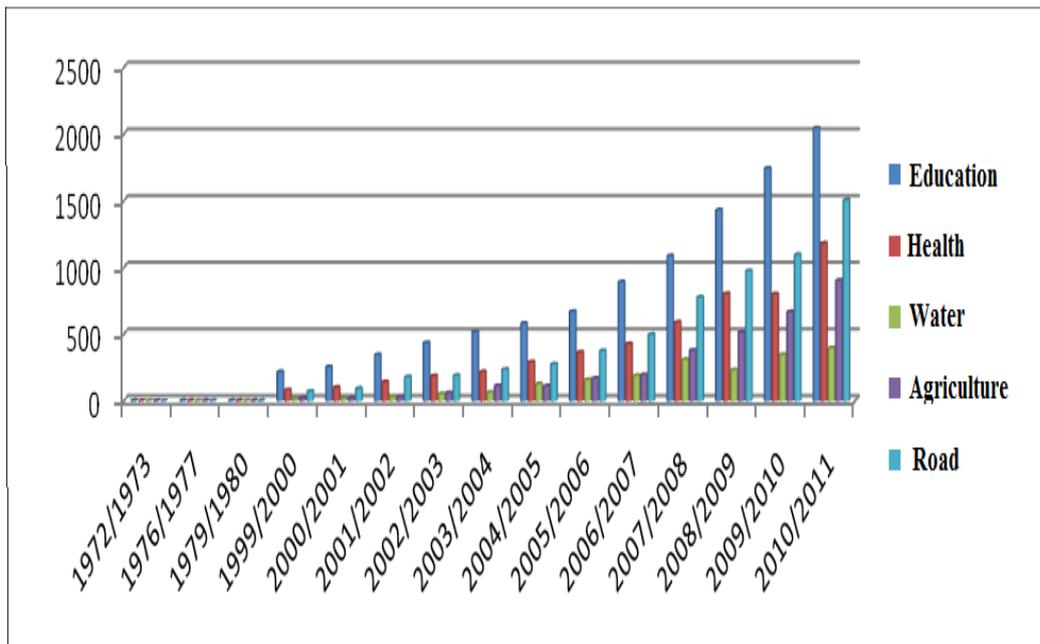
Data Source: World Bank, World Development Indicator, 2013

Figure 13 shows that, in 1991, 1992, 1993 and 1994, Tanzania's GDP per capita income grew at a rate of -1.2%, -2.7%, -2.1% and -1.6% respectively, at a time when external debt was relatively high. From 1996 onwards, growth of per capita income became positive reaching 1.7% and 3.9% in 2010.

However, debt relief only moderately helped increase government expenditure on basic health services; According to World Health Organization, two out of about 11 completion point triggers were directly related to health. Both had been implemented satisfactorily Immunization of at least 75% of children under two years of age against measles and DPT3. Implementation of the national HIV/AIDS campaign, including completion of visits to 75% of all districts. Despite of that, due to the fungible nature of the funds within the budget, tracking of debt relief savings is not possible (www.who.int/immunization, 2009).

On balance, the evidence suggests that through fiscal space created by the HIPC initiative, Tanzania was able to allocate funds to various social and economic sectors including education, health, water, agriculture and roads construction since 2000/2001 which is when the HIPC program started, and continuing this trend until 2010/2011 as shown in Figure 16 below.

Figure 16: Financial allocation for various Social and economic sectors for the year 1970/00 – 2010/11 – (Billion) Shillings



Source: Ministry of Finance Tanzania, 2011

According to the World Bank National Accounts data and the OECD National Accounts data of Tanzania, annual percentage growth of household final consumption expenditure, based on constant local currency, grew from 1.9 percent to 6 percent between 1990 and 2010. Aggregates are based on constant 2005 US dollars. Household final consumption expenditure (formerly private consumption) is the market value of all goods and services, including durable products (such as cars, washing machines, and home computers), purchased by households. It excludes purchases of dwellings but

includes imputed rent for owner-occupied dwellings. It also includes payments and fees to governments to obtain permits and licenses. Here, household consumption expenditure includes the expenditures of non-profits institutions serving households, even when reported separately by the country.

Moreover, the World Health Organization's National Health Account database for Tanzania reveals that government expenditure on health services as percentage of total health expenditure is the sum of public and private health expenditure. It covers the provision of health services (preventive and curative), family planning activities, nutrition activities, and emergency aid designated for health but does not include provisions for water and sanitation which have increased from 3 percent to 7 percent of total GDP between 1990 and 2010. This is a considerable achievement given the fact that the current GDP has grown from USD 7,546,708,700 to USD 19,965,679,449 in 1990 and 2010 respectively. (World Bank, World Development Indicator, 2013).

5.3. Tanzania's National Debt and Debt Sustainability and Management Mechanism

In order to guarantee the sustainability of the benefits reaped from HIPC initiatives, an effective debt sustainability and management mechanism is required to avoid roll back. To this effect, the government of Tanzania set up a debt management mechanism through a national debt strategy, a legal framework and institutional set up for the management of debt relief. The current debt sustainability and management mechanism enjoys the centralized power and authority of the government to enter into contract with foreign bilateral or multilateral donors with the Finance Minister being the central authority to borrow and manage public debt. This new mechanism built upon the lessons learnt from past experiences which saw the accumulation of a huge national debt beyond the ability of the government to repay which in turn led to a debt crisis in the 1980s.

A country is able to determine the sustainability of its debt levels by carrying out a debt sustainability analysis, referred to as Debt Sustainability Analysis (DSA). Under the Highly Indebted Poor Countries (HIPC) initiative there are indicators used to show the

sustainability of a country's debt level. Usually the IMF and World Bank conduct the DSA in collaboration with official of a debtor country (Ministry of Finance, Tanzania, 2013).

Moreover, in order to avoid irregular borrowing by Ministries, Parastatals, Local Governments or any public entity, the government amended the Government Loans, Guarantee and Grants Act no 30 of 1973 and came up with a new Act in 2003. The new Act restricts the government's power to borrow, grant guarantees and to receive guarantee, authorizing only the Minister for Finance to do so. It was observed that irregular borrowing was one of the reasons behind increasing public debt levels. The Act also lays down conditions for borrowing and issuing guarantees. To strengthen the debt policy and strategy, this Act lays down the debt management objectives of the Government; in order to strengthen the institutional framework, the Act legalized the National Debt Management Committee and Technical Debt Management Committee and defined their respective roles. (Ministry of Finance, Tanzania, 2013)

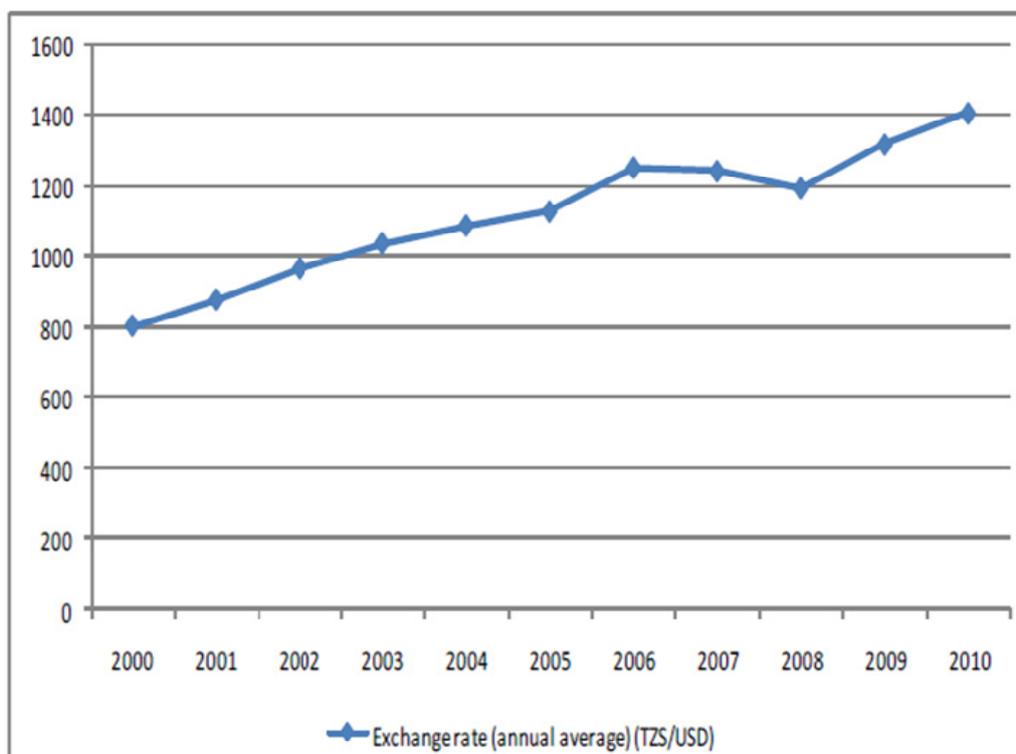
Nevertheless, the government has taken several measures to control the amount of public debt; the current debt trend reveals an increasing trend of both domestic and external debt levels, with current figures projecting these levels to increase by the year 2020. This increase can be attributed to ongoing development projects and financing of national development plans. This is good news for a country which seeks economic development, however if this trend continues, it might affect the benefits accrued so far. Table 7, shows that total debt has increased from TZS 6,545 billion to TZS14, 900 billion between 2000 and 2010. The total debt stock has increased by 2.2. In addition to that, domestic debt accounts for the rapid four-fold increase compared to the two-fold increase in foreign debt. In absolute terms external debt is significantly higher than domestic debt, due to the current trend of persisting depreciation of the Tanzania shillings against the US dollar as shown in Figure 15.

Table 6: National Debt Current in Tanzania shillings (\$ 1 is approx. 1600 TZS)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Domestic Debt Stock	898.46	811.21	869.65	0.93	1.03	1,625.13	1,763.44	1,827.84	1,895.44	2,491.41	3,360.87
External Debt Stock	5,647.27	5,191.71	5,910.85	7,058.04	7,609.16	8,391.39	5,071.19	5,790.62	7,133.29	9,000.59	11,540.09
Total Debt Stock	6,545.73	6,002.92	6,780.50	7,058.97	7,610.19	10,016.52	6,834.63	7,618.46	9,028.73	11,492.00	14,900.95
Debt to GDP Ratio	80%	66%	65%	58%	54%	63%	38%	36%	36%	41%	46%
GDP mp (billion)	8,152.79	9,100.27	10,444.51	12,107.06	13,971.59	15,965.29	17,941.27	20,948.40	24,781.68	28,212.65	32,293.48

Source: Ministry of Finance, Tanzania 2013

Figure 17: Tanzania Exchange rate Trends in USD

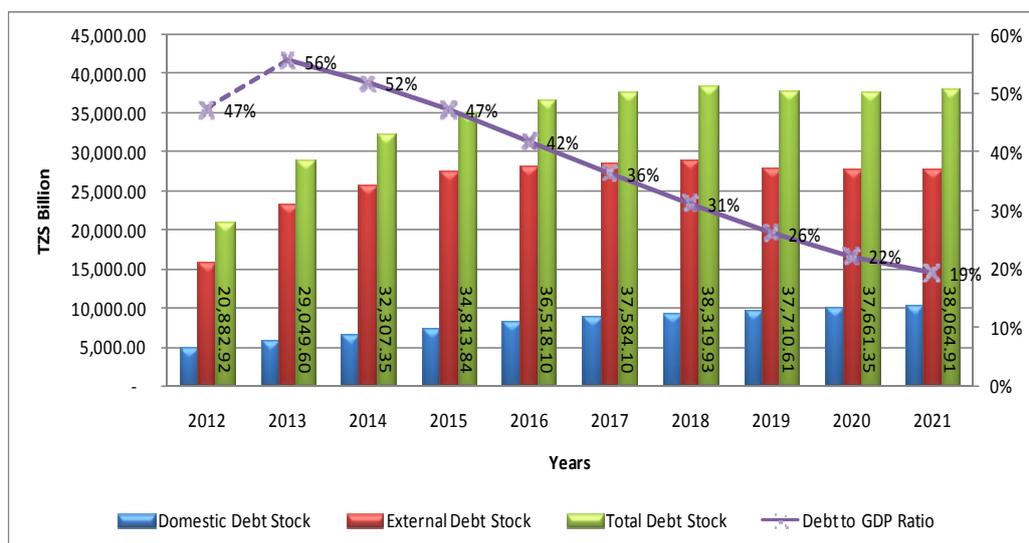


Source: Ministry of Finance, Tanzania, 2013

Tanzania's debt stock in nominal terms is projected to increase over the medium term due to new borrowing from both domestic and external sources to scale up investment in infrastructure in line with the implementation of the Five Year Development Plan. In this regard, debt stock is projected to increase from TZS 20,882.92 billion recorded in

December 2012 to TZS 38,064.91 billion in December 2021. The projected sharp increase of 39.1 percent in 2013 is due to borrowings to finance development projects mainly gas pipeline project which account for 42 percent of the increase as shown in Figure 18 below. Despite the increasing debt stock, ratios of debt to GDP are projected to decrease from 56 percent in 2013 to 19 percent in 2021.

Figure 18: National Debt stock projection

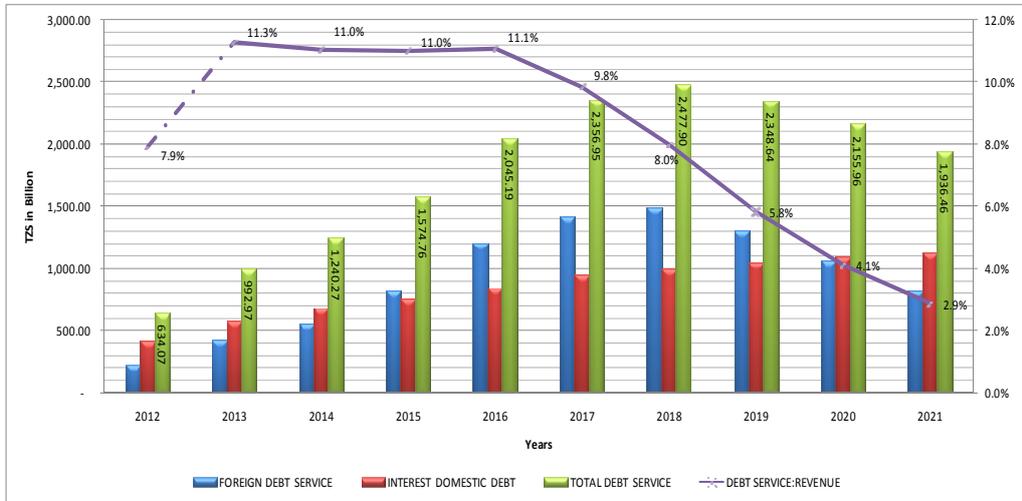


Data Source: Ministry of Finance, Tanzania, 2013

Figure 19 shows that public debt service is projected to increase from TZS. 634.07 billion in 2012 to TZS 2,477.9 billion by 2018 and to decrease to 1,936.49 in 2021. The ratio of debt service to domestic revenue is projected to increase from 7.9 percent in 2012 to an average of 11 percent in 2013 to 2017 mainly due to debt service of external non concessional loans. On the other hand, the ratio of debt service to domestic revenue is projected to decrease from 11.1 percent in 2015 to 2.9 percent by 2021 consistent with the projected improvement in revenue collection and the repayment end of most external non concessional loans. However this will depend on the prevailing

economic situation, should this situation change, the debt service ratio will be higher so as to compromise both GDP and GDP per capita growth.

Figure 19: National Debt Service Projection



Data Source: Ministry of Finance, Tanzania, 2013

On balance, the evidence suggests that the HIPC scheme has considerable effects on the economic growth and development in Tanzania due to the indirect channels which have freed up resources that would otherwise be used to service external debt and due to the stable adjustment policies that were part and parcel of the initiative (see Figure 14).

However, it remains uncertain whether HIPC initiatives contributed to the economic growth and development in Tanzania. In addressing this question, the following subsection of this paper assesses the growth patterns of Tanzania in comparison to five non-HIPCS Low Income Countries in the period under study. Compared to all five countries, Tanzania's GDP growth and GDP per capita growth rate were relatively higher than those of Non- HIPC Low Income Countries.

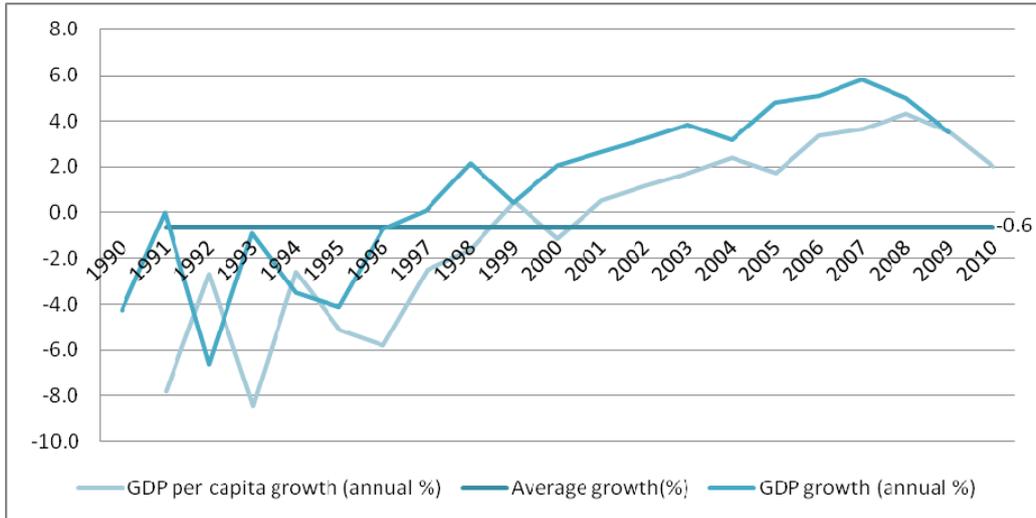
5.4. Comparison of Growth Trend with other Non-HIPCs Low Income Countries

5.4.1. Djibouti's Growth Trends

Djibouti's GDP, as shown in figure 18, grew with a per capita growth rate of -7.8%, -2.7%, -8.4%, -2.6%, -5.1%, -5.8%, -2.5% and -1.6% annually between 1991 to 1998. On average this country's GDP grew at -0.6% per annum for two decades from 1990 to 2010 with growth pattern starting to pick up from 2001 onwards. Despite the country's strategic position at the red sea transit, its economic performance is relatively low. Similarly, the growth of GDP is on average 1.1% for the period from 1990 to 2010; for many years its growth rate was negative especially for the entire period from 1990 to 1998 despite the fact that this country has a population of less than one million.

Largely, the economy depends on commercial services such as banking and port access to neighbouring countries like Ethiopia. Although, this disappointing trend is partly due to the outbreak of ethnic conflicts in early 1990s, the country's external debt as percentage of GNI rose from 42% in 1990 to 80% in 2009 which is indicative of debt overhang and its implications on wider economic growth.

Figure 20: Djibouti Growth Trends

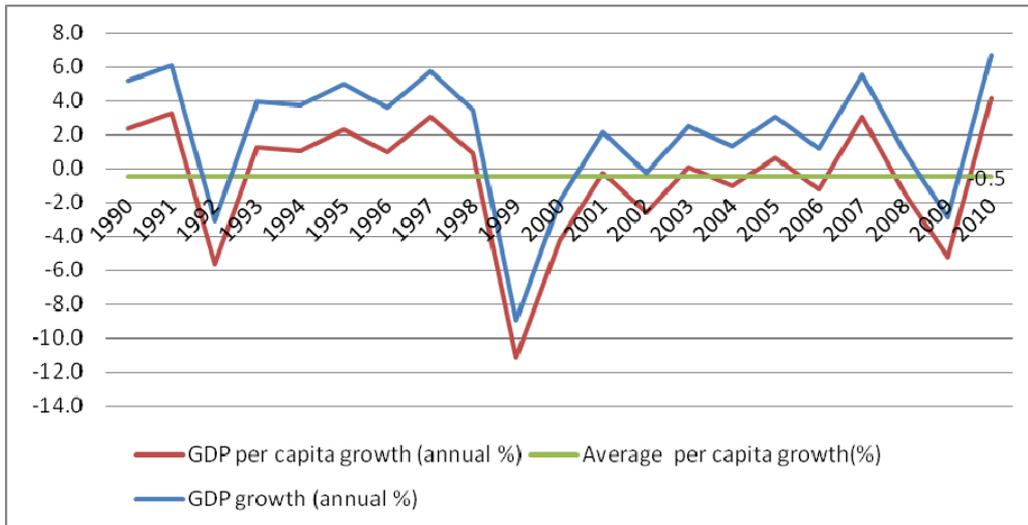


Data Source: World Bank, World Development Indicator, 2013

5.4.2. Gabon Growth Trend

On average Gabon's GDP per capita growth Gabon was only -0.5 % between 1990 and 2010. Growth was negative in 1992, 1999, 2002 and 2009, being at -5.6%, -11.2%, -2.6% and -5.2% respectively as shown in figure 21. Despite the fact that, Gabon has a relatively high GDP per capita and was ranked third in Sub Saharan Africa, it is an oil-dependent country, with over 46% of its revenue and 80% of its export earning per annum. On contrary, projections reveal that oil reserves will be exhausted by 2025, thereby creating pressure for alternative growth plans to ensure sustainability. Overspending on the Transgabona railroad, the oil price shock of 1986, the CFA Franc devaluation of 1994 and low oil price in the late 1990s all caused serious debt problems that still plague the country (US Department of State, 2010).

Figure 21: Gabon growth trend

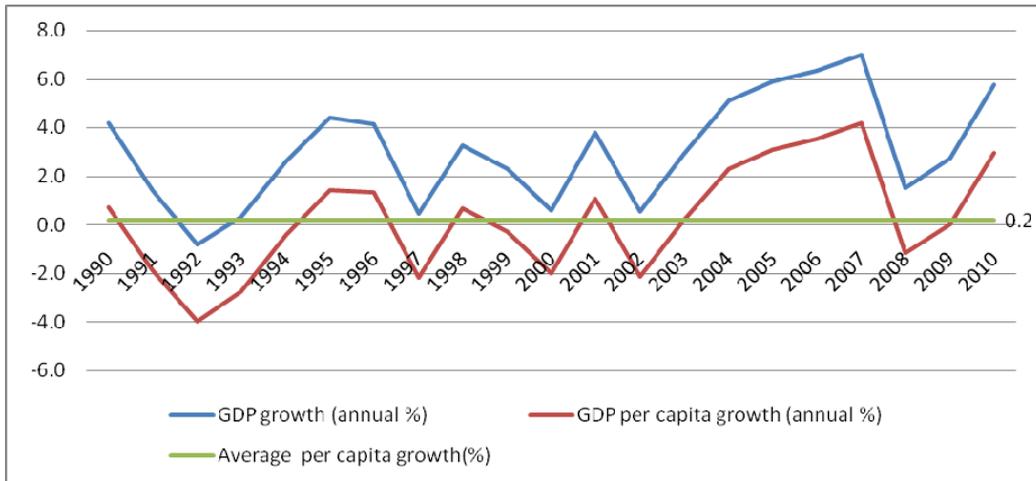


Data Source: World Bank, World Development Indicator, 2013

5.4.3. Kenya's Growth Trend

As shown in figure 22 below, Kenya's GDP and GDP per capita growth grew on average 3.1 percent and 0.2 percent from 1990 to 2010. Despite the fact that Kenya is a relatively stable country, both annual GDP and GDP per capita grew relatively slowly, characterized by unstable and sometimes negative growth rates as was the case for 1991, 1992, 1993, 1994, 1997, 1999, and 2000, with growth rate of GDP per capita being at -1.9%, -4.0%, -2.8%, -0.4%, -2.2%, -0.3% and -2.1% respectively. Although, agriculture employs about 75 percent of Kenya's labour force, the tourism and service sectors are contributing to more than 60 percent of its GDP, gaining only 25 percent from agriculture mainly tea, coffee and flowers.

Figure 22: Kenya Growth Trend



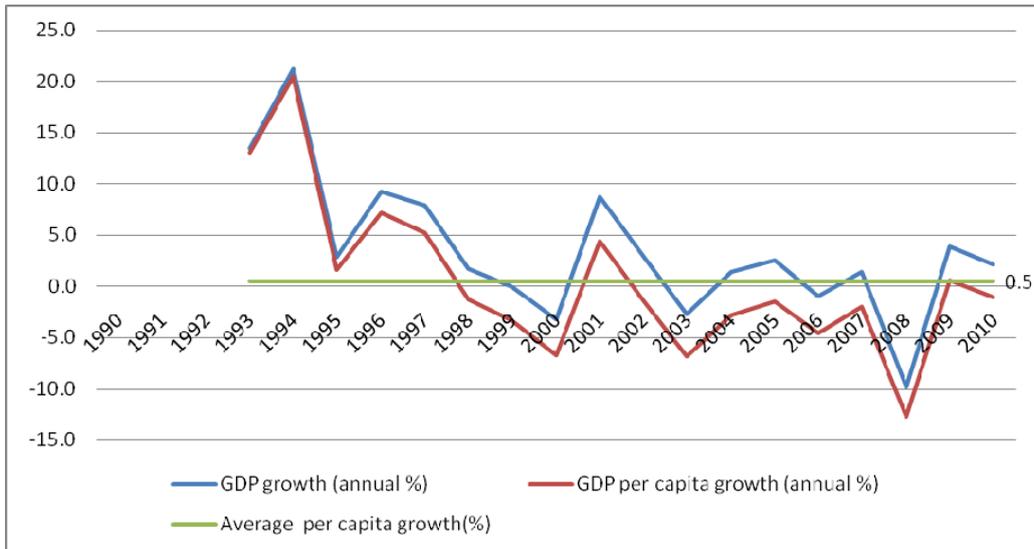
Data Source: World Bank, World Development Indicator, 2013

5.4.4. Eritrea's Economic Growth Trend

From Figure 23, Eritrea's Gross Domestic Product and GDP per capita income between 1990 and 2010 grew on average 3.5 percent and 0.5 percent respectively. Eritrea grew relatively slowly showing negative growth rates in some years, especially in the late 1990s, when the country suffered severe instabilities. The annual growth rate was negative, regardless of the country's potential to grow through its access to the red sea which connects Eritrea to its neighbouring countries. Despite its potential and relatively low population, both GDP growth and per capita income were relatively low compared to the HIPC participating countries. Throughout the entire period of 1998 up until 2010 per capita income growth was either negative or sometimes zero.

The government of Eritrea is now committed to investing in infrastructure projects such as railways; ports and highways which in the future will have enormous growth potential; the 500km coastal highway project connecting Massawa with Asseb as well as the rehabilitation of the Eritrean Railways are prime examples.

Figure 23: Eritrea GDP growth Trend

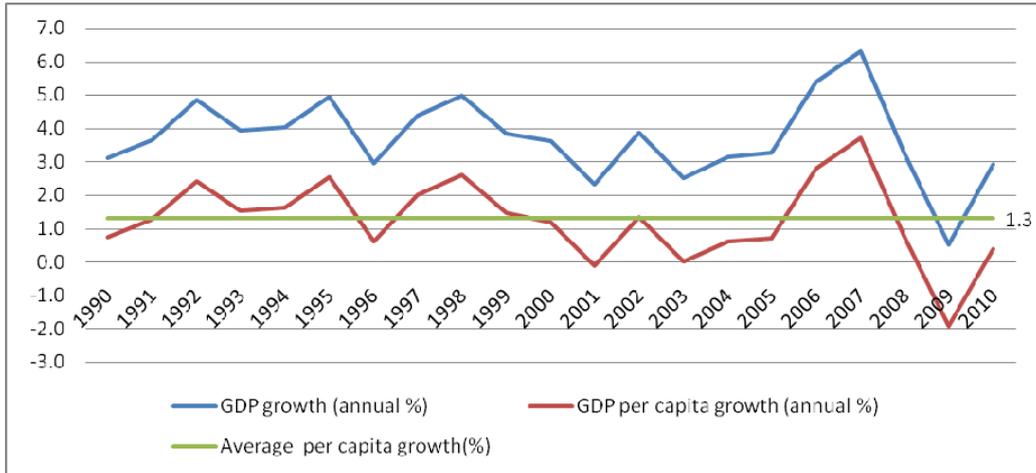


Data Source: World Bank, World Development Indicator, 2013

5.4.5. Guatemala's Growth Trend

On average Guatemala's GDP per capita grew at a rate of 1.3 percent of GDP from 1990 to 2010. Its GDP growth was relatively low approaching only 3.7 percent on average. As shown in Figure 22 below, with GDP per capita being either negative or close to zero in some years, as was the case in 2000, 2001, 2003, 2004, 2005, 2009 and 2010 whereby per capita income growth was only 1.2%, 0.1%, 0.0%, 0.6%, 0.7%, -1.9%, and 0.4% respectively.

Figure 24: Guatemala Growth Trends

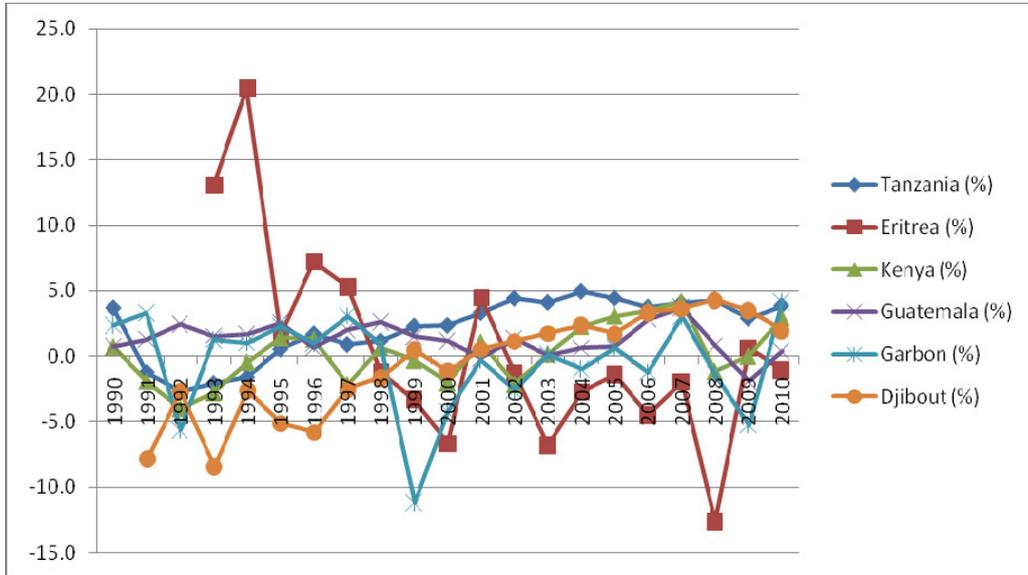


Data Source: World Bank, World Development Indicator, 2013

5.4.6. Tanzania’s Growth Trend in Comparison with non-HIPCS

On average Tanzania’s per annum GDP per capita income grew at a rate of 2.2 percent for the entire period from 1990 to 2010. Figure 25 and Figure 26 below show that Tanzania’s growth rate is relatively higher compared Kenya, Guatemala, Djibouti, Gabon and Eritrea for the entire period from 1990 to 2010, especially during the period after the HIPC initiative which may due to the country’s large population of nearly 47 million people according to 2011 World Bank estimates. Further to that, with exception of Eritrea, Tanzania’s population growth rate is also higher on average than in other non-HIPC s Low Income Countries where the average population growth rate is nearly 3 percent as shown in Figure 22 below.

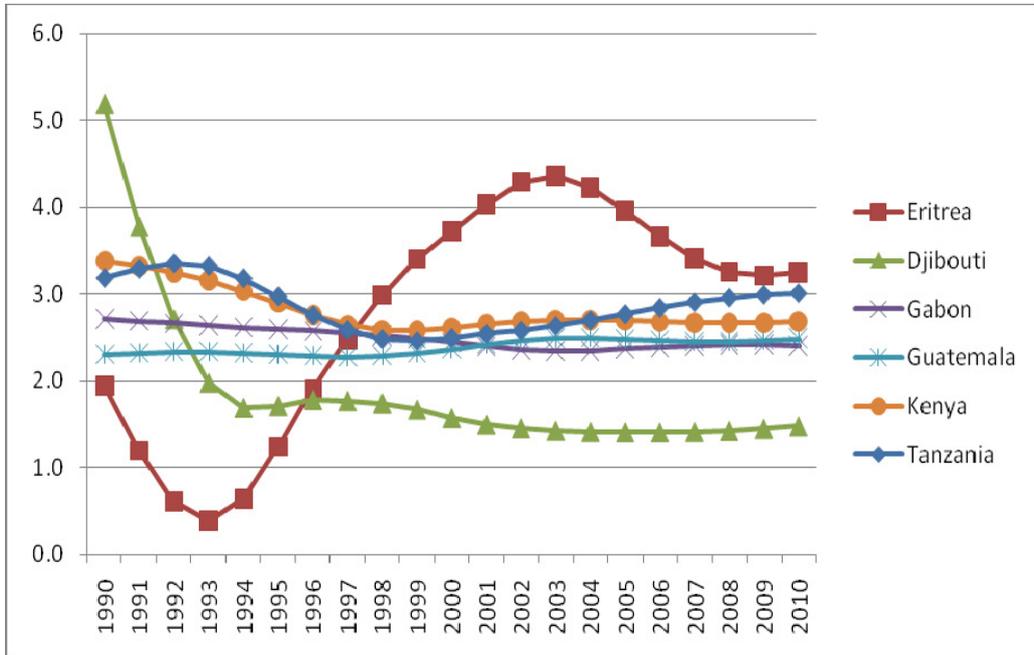
Figure 25: Tanzania Comparison of GDP per capita growth rate with Non-HIPCs



Data Source: World Bank, World Development Indicator, 2013

On balance, the evidence suggests that Tanzania’s relative stability was a crucial factor determining its participation in the HIPC Initiative as well as its rapid economic growth. The country grew relatively faster than other Non-HIPCs in different regions of the world. From this comparative perspective, Tanzania reveals a better performance in both GDP and GDP per capita growth rates, despite its relatively high population growth as shown in Figure 26.

Figure 26: Comparison of Population growth rate (%)



Data Source: World Bank, World Development Indicator, 2013

VI. CONCLUSION

In this research we tried to find out the effects of debt relief on economic growth and development via the Heavily Indebted Poor Countries initiative. With the increase of debt relief from developed countries to low income countries has shown a positive impact on economic growth and development.

Using data of debt relief flow of 26 HIPC recipient countries we ran a cross country regression analysis for the period from 1990 to 2010; our results show that for each percentage point increase in debt relief both GDP and per capita income of Heavily Indebted Countries increased by 0.3 percentage points. We also find that debt relief has a positive relationship with economic growth and development. Furthermore, debt relief will provide fiscal space for spending on social and economic services such as health, education and infrastructure services, which has a direct impact on the economic development of Heavily Indebted Poor Countries.

We also find that debt overhang is negatively correlated with economic growth in Heavily Indebted Poor Countries. Thus, higher external debt will be associated with slow growth and development in Heavily Indebted Poor Countries.

As a relatively stable country the case of Tanzania shows that the relationship between debt relief and economic growth is significant. Furthermore, the adoption of the Poverty Reduction Strategy Paper, the National Strategy for Debt Management and the Legal Framework on Management of National Debt has led to government commitment towards increasing socio-economic financial allocations that helped boost economic growth.

In addition to that, we compared growth rates of GDP and GDP Per Capita of Tanzania with other Non-HIPCs and found that the impact of the Heavily Indebted Poor

Countries initiative on growth cannot be overemphasised. The relationship between the HIPC initiatives, debt relief and growth of GDP per capita income in Tanzania crystallizes with the help of a comparative perspective; a sample was taken of other five low income countries across the regions. As a result we find that debt relief has helped to improve the economic situation in Tanzania which holds important implications for the international community in striving to fulfil the Millennium Development Goals by completing goal number 8D on debt sustainability and management.

Debt relief has helped HIPC countries in creating fiscal space that allowed for an increase in public spending on education, health, roads and water both of which have long term impacts on the economic growth and development of Heavily Indebted Poor Countries. This can be determined from rising social expenditures on education and health, overall across the HIPC countries (from 6.3% in 2001 to 8.8% in 2011), and in Tanzania in particular.

Although, in order for debt relief to be optimally utilized and to generate larger benefits, HIPC countries (majority of which are located in Africa), have to strengthen their government efforts in controlling corruption both on a small and large scale, which is evidenced by their low ranking in terms of control of corruption among developing countries. On average, between 1996 and 2010, Africa has only an overall of 33 percent quite far below Latin America (44%), South Asia and Pacific (35%) and South East Asia (35%) in term of control of corruption.

Furthermore, given the increasing role played by non-OECD members in the field of International Development Cooperation, more research is still required, especially at a meso and micro level to explore the impact of debt relief on economic wellbeing of the people and poverty reduction in particular in these countries. Because of the fungible nature of public financing in many low income countries, more empirical studies are required to see the interaction between debt relief and improvements in health, education and infrastructure.

APPENDIX

LIST OF COUNTRIES INCLUDED IN THE REGRESSION ANALYSIS

Countries			HIPCs		
1	Botswana	38	El Salvador	1	Cameroon
2	Cameroon	39	Peru	2	Ghana
3	Ghana	40	Uruguay	3	Madagascar
4	Lesotho	41	Gabon	4	Mali
5	Madagascar	42	Jordan	5	Mauritania
6	Mali	43	Benin	6	Mozambique
7	Mauritania	44	Morocco	7	Niger
8	Mozambique	45	Angola	8	Rwanda
9	Niger	46	Dominican Republic	9	Senegal
10	Pakistan	47	Ethiopia	10	Togo
11	Rwanda	48	Guatemala	11	Zambia
12	Senegal	49	Albania	12	Burundi
13	Sri Lanka	50	Kazakhstan	13	Chad
14	Togo	51	Nepal	14	Honduras
15	Tunisia	52	Vanuatu	15	Malawi
16	Tanzania	53	Djibouti	16	Tanzania
17	Zambia	54	Guyana	17	Burkina Faso
18	Bangladesh	55	Jamaica	18	Central African Republic
19	Burundi	56	Nicaragua	19	Uganda
20	Cape Verde	57	Belize	20	Benin
21	Chad	58	Philippines	21	Ethiopia
22	Honduras	59	Solomon Islands	22	Guyana
23	India	60	South Africa	23	Nicaragua
24	Malawi	61	Argentina	24	Haiti
25	Nigeria	62	Mexico	25	Comoros
26	Burkina Faso	63	Ecuador	26	Guinea
27	Central African Republic	64	Haiti		
28	Kenya	65	Panama		
29	Uganda	66	Algeria		
30	Colombia	67	Comoros		
31	Costa Rica	68	Guinea		
32	Cambodia	69	Indonesia		
33	Dominica	70	Bosnia and Herzegovina		
34	Tajikistan	71	Sierra Leone		
35	Grenada	72	Thailand		
36	Georgia	73	Seychelles		
37	Mongolia				

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