

Debt Relief for Emerging Economies: An Empirical Investigation

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Abstract : Most of the developing economies, including Pakistan, are confronted with high level of external debt which is adversely affecting their economic performance. The hypothesis of debt overhang is often used to assess the negative relationship between foreign debt and the economic growth of the indebted country. As first objective of the present study, this hypothesis is tested by using Pooled OLS (POLS), Generalized Method of Moment (GMM), Random Effect (RE), and Fixed effect (FE) techniques. As second objective, the study uses the concept of debt Laffer Curve to determine the eligibility condition of the indebted countries for the relief programs. According to this approach, countries lying on the right side of the Laffer Curve are stated to be trapped in the strong debt overhang making them unable to come out of the vicious circle of low growth and high foreign debt. The empirical analysis confirms that only two countries out of twenty two completely fulfill the conditions of being eligible for the debt relief. All other countries continue to face debt burden of different magnitudes. The study further confirms that the debt relief alone is not sufficient for overcoming the debt problem. Instead, sound economic policies and conducive investment decisions are required to lay the foundations of long-term growth and development. Debt relief should be the option for only those countries that meet a minimum measurable criterion of good governance, economic freedom, and consistency of policies.

Keywords : external debt, debt burden, debt overhang, debt laffer curve, debt relief, investment decisions

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