DEBT SERVICES, CAPITAL INFLOWS AND ECONOMIC GROWTH IN NORTH AFRICAN COUNTRIES

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ABSTRACT

The North African countries namely Algeria, Egypt, Mauritania, Morocco and Tunisia rely heavily on external funds for financing its development. Such external funding usually takes the form of external loans. This study advances the argument that the real problem that impedes the process of economic growth is the challenge of inadequate real resources for capital formation, due to high external debt servicing. The mounting debt stocks have discouraged the inflow of foreign capital in the form of Foreign Direct Investment (FDI) for fear of macroeconomic distortions. It is scarcely surprising that high debt-service obligation has not only made North African economies to perform poorly but also to rely heavily on foreign sources of budgetary support, thereby creating an unending cycle of economic crisis. In a nutshell, this study used a simultaneous equations model to test the process of interaction between FDI inflows, external debt service and economic growth. The analysis uses the Three Stage Least Square and panel cointegration test to investigate the relationship between debt service, FDI inflow and other determinants and economic growth. The results showed a negative sign and significant relation between debt service and economic growth. The results also show that FDI inflows play an important role and increased the economic growth. The interaction variables between debt crisis with FDI inflows, debt crisis and domestic saving show a negative effect on economic growth in some countries and a positive effect on economic growth in others. In terms of policy, the governments should promote rational and proper utilization of resources, while trying to get more concession on newly acquired debt inflows. It also indicates that policymakers should act early when choosing to lean against credit booms, before the debt service reaches critical levels.

Keywords: debt service, capital inflows, multi-simultaneous equation, panel cointegration, economic growth

ABSTRAK

Negara-negara Afrika Utara seperti Algeria, Mesir, Mauritania, Maghribi dan Tunisia amat bergantung kepada dana luar untuk membiayai pembangunannya. Pembiayaan luar seperti ini biasanya dalam bentuk pinjaman luar negara. Kajian ini mengutarakan hujah bahawa masalah sebenar yang menghalang proses pertumbuhan ekonomi adalah cabaran dari segi sumber sebenar yang tidak mencukupi untuk pembentukan modal, kerana khidmat hutang luar negara yang tinggi. Peningkatan dalam stok hutang tidak menggalakkan aliran masuk modal dalam bentuk pelaburan langsung asing (PLA) kerana bimbangkan keherotan ekonomi makro. Adalah tidak menghairankan bahawa obligasi terhadap khidmat hutang yang tinggi bukan sahaja telah membuatkanekonomi Afrika Utara berprestasi lemah tetapi juga terpaksa bergantung sepenuhnya kepada sokongan belanjawan sumber asing, dan keadaan ini mewujudkan kitaran krisis ekonomi yang tidak berkesudahan. Secara ringkasnya, kajian ini menggunakan model persamaan serentak untuk menguji proses interaksi antara aliran masuk PLA, khidmat hutang luar dan pertumbuhan ekonomi. Data kajian akan dianalisis menggunakan ujian Kuasa Dua Terkecil Tiga Peringkat dan ujian kointegrasi panel untuk menyiasat hubungan antara khidmat hutang, aliran masuk PLA serta penentu lain dan pertumbuhan ekonomi. Keputusan menunjukkan tanda negatif dan hubungan yang signifikan antara khidmat hutang dan pertumbuhan ekonomi. Dapatan kajian juga menunjukkan bahawa aliran masuk PLA memainkan peranan yang penting dan telah meningkatkan pertumbuhan ekonomi. Pembolehubah interaksi antara krisis hutang dengan aliran masuk PLA, krisis hutang dan tabungan domestik menunjukkan kesan negatif ke atas pertumbuhan ekonomi di beberapa buah negara dan kesan positif kepada pertumbuhan ekonomi di negara-negara yang lain. Dari segi dasar, kerajaan harus menggalakkan penggunaan sumber secara rasional dan sebaik-baiknya, disamping cuba mendapat lebih konsesi untuk aliran masukperolehan hutang yang baharu.Hal ini juga menunjukkan bahawa pembuat dasar perlu bertindak awal apabila memilih untuk bersandar kepada hutang yang banyak, sebelum khidmat hutang sampai ke tahap kritikal.

Kata kunci: khidmat hutang, aliran masuk modal, persamaan serentak berbilang, kointegrasi panel, pertumbuhan ekonomi

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LIST OF ABBREVIATION

2SLS	=	Two Stages Least Square
3SLS	=	Three Stages Least Square
ADF	=	Augmented Dickey-Fuller
BOP	=	Balance of Payment
DF	=	Dickey-Fuller
DSR	=	Debt Service Ratio
FCI	=	Foreign Capital Inflows
FDI	=	Foreign Direct Investment
GDP	=	Gross Domestic Product
GMM	=	Generalized Method of Moments
GNP	=	Gross National Product
HIPC	=	Heavily Indebted Poor Countries
IMF	=	International Monetary Fund
IV	=	Instrumental Variables
LDC	=	Less-Developed Country
LR	=	Likelihood Ratio
NPV	=	Net Present Value
OLS	=	Ordinary Least Squares
WAMZ	=	West African Monetary Zone

CHAPTER ONE

INTRODUCTION

This chapter outlines the introduction of the thesis. In this context, the rationale of the study is presented in the form of a problem statement, research questions and research objectives. The importance and scope of the study are also outlined in this chapter. The chapter closes with the research organization.

1.1 Background of the Study

At the global scene, external debt and foreign direct investment (FDI) have been considered as major sources of capital financing. FDI is the main form of capital inflow to many countries, while nations experiencing account deficit are advised to borrow funds, external debt, from the international community to boost their economic growth (Malik, Hayat and Hayat, 2010). Unfortunately, external debt and its repayment have become a hindrance to several developing North African countries' economic growth like in Algeria, Egypt, Mauritania, Morocco and Tunisia. As noted by Malik *et al.*, (2010), in the past thirty years, it has been seen that foreign debt had been the major culprit in the decline in investment and growth performance of many countries. International debt can be likened to unnecessary tax paid by future generations on wasted services; in addition, the rise of debt servicing ratio can adversely affect economic growth of any country (Chowdhury, 1994).

The contents of the thesis is for internal user only

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