

ECIPE Press Release, November 27, 2006



From Bad to Better: The Role of Governance in Debt Relief Programmes

In a new ECIPE Working Paper on the determinants of debt relief to developing countries, ECIPE Fellow Andreas Freytag and Gernot Pehnelt present new and original research on the allocation of debt relief. They find a strong pattern of “path dependence”.

Debt relief was neither determined by the quality of governance structures nor by the actual debt burden. On the contrary, debt relief was rather determined by previous programmes to cancel debt of developing countries. Once a country received debt relief in the early 1990s, the probability of getting additional debt forgiveness in the second half of the 1990s is close to one. Furthermore, the higher the amount of the debt relief granted in the past, the higher is the expected relative relief in the future. Governments in donor countries did not change course despite it increasingly became clear that these “expenditures” did not bring out any good with respect to economic development or governance. Rather than admitting past errors donor governments seem to have accepted new ones to prevent political problems.

Debt relief to developing countries in the 1990s was not economically rational. Developing countries need to improve the quality of governance for debt relief to be effective but debt relief programmes in the 1990s did not incentivise governance reforms, say Dr. Andreas Freytag, a Fellow of ECIPE and Professor of Economics at the Friedrich Schiller University.

However, recent debt relief programmes seem to be positively influenced by economic and institutional development. This may be the result of a successful learning process of donor countries’ governments; In addition to the economic need – measured by the degree of poverty – institutional quality and good governance are taken into account in the allocation of new debt relief. But it is too early to tell the extent to which governance quality affects debt relief in the last years – and what role they will play in the new Multilateral Debt Relief Initiative (MDRI) outlined at the G-8 meeting in Gleneagles last year.

It seems as governments in donor countries have learned; whereas governance quality did not play a role in the decision to grant a debt relief in the 1990s, at the beginning of this decade it did. It remains to be seen, if and to what extent the latest debt relief contributes to better economic performance says Dr. Andreas Freytag.

Publication details

ECIPE Working Paper No. 02/06

Debt Relief and Changing Governance Structures in Developing Countries

By: Andreas Freytag (andreas.freytag@ecipe.org) is a Fellow of ECIPE and a Professor of Economics at the Friedrich-Schiller-University in Jena and Gernot Pehnelt (g.pehnelt@wiwi.uni-jena.de) is a Researcher in Economic Policy at the Friedrich-Schiller-University in Jena.

The report can be downloaded at www.ecipe.org

Press information, Anna Wilson anna.Wilson@ecipe.org, Mobile +46 709263177

www.ecipe.org

Phone +32 (0)2 501 53 08 Fax +32 (0)2 501 53 20 info@ecipe.org Rue Du Luxembourg 3, B-1000, Brussels, Belgium