

The Impact of Foreign Debt on GDP growth (Cameroon)

A Thesis in partial fulfillment of an MBA in
Comparative Institution Design for Transition
Economy and Business Management

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Dedication

This is dedicated to my family

Declaration

This is to declare that I, AKUM Gawum Joseph, am submitting this piece of work, under the supervision of Professor Suzuki Yasushi, to the Graduate School of Management of Ritsumeikan Asia Pacific University in partial fulfillment of the requirements for a Masters degree in Business Administration. I hereby declare that this research paper has not been earlier on submitted, and that all data from other sources has been duly acknowledged.

AKUM Gawum Joseph

Signature

15th July 2011

Certification

This is to certify that this research was performed by AKUM Gawum Joseph under the supervision of Professor Suzuki Yasushi in partial fulfillment of the requirements for a Masters of Business Administration, specializing in Comparative Institution Design for Transition Economy and Business Management. This work has not until now been submitted or published.

Signature

Acknowledgement

At the end of this research, I feel the deep need to express my heartfelt gratitude to my Sensei, Professor Suzuki Yasushi whose guidance and correction served as a source of direction and motivation. Also, to the interim review committee: Professor Kayhan Tajeddini and Professor Ken Suzuki, I am ever so grateful for their constructive criticism. I would like to thank the members of the CID seminar for their inputs which contributed to my point of focus.

I would like to thank Doctor Nair, and all the other lecturers in APU who, through their insight contributed to the ideas which made this work possible. It would be unfair to go without expressing my gratitude to the APU administration and management who do not cease to provide the student community with a wide range of facilities to guide and support research.

Finally, I would like to thank the Japanese Government for the support provided through the MEXT scholarship program, without which this study, as well as the last two years of study would not have been possible. I am deeply grateful to all the members of the MBA Fall 2011 graduating class for the growth enhancing atmosphere they created as we all engaged in this exchange through which we learnt from each other.

Abstract

The important role of institutions is hereby evoked by studying the relationship between Cameroon's foreign debt and its GDP growth. This study observes that it could be misleading to set foreign debt management targets on a strictly quantitative basis, considering the diversity of debtors and their needs. A conceptual framework using the circular flow of resources within the economy is used to qualitatively analyze the areas where the flow is subjected to frictions due to institutional inefficiency. The country's readiness to convert its foreign debts to gross capital formation, thus stimulating consumption, and earning fiscal revenues is studied. Through this, the depth of changes initiated by foreign debt management programs is assessed. The changes resulting from these programs, especially the latest one, (HIPC initiative) are observed to evaluate how these programs have affected decision making within the economy. It examines the degree to which the country's long term immunity to a future foreign debt has been enhanced, and also, the chances that the economy can internally stimulate its future GDP growth without tuning to foreign debt. It concludes that the efficiency of domestic institutions as well as its major creditors has a significant impact on debt sustainability. Therefore, the HIPC' initiative's failure to adequately address institutional weaknesses in the economy, only paves the way for a future debt crisis.

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List of Abbreviations

GDP: Gross Domestic Product

IMF: International Monetary Fund

IFI: International Financial Institutions

VAT: Value Added Tax

MTEF: Medium Term Expenditure Framework

CFA: African Financial Community

HIPC: Highly Indebted Poor Country

OECD: Organization for Economic Cooperation and Development

SONARA: National Refineries' Corporation

SNH: National Hydrocarbons Commission

CHAPTER 1

1. Introduction

Following the oil shocks in the 70's, until the 2000's many African economies, including Cameroon, have suffered huge balance of payment deficits. This phenomenon made foreign debts necessary. Within this period, Cameroon's economy has faced difficulties in the repayment of its foreign debt while promoting growth of its GDP (Gross Domestic Product). This situation has been met with numerous programs through which international financial institutions sought to improve the situation either by awarding loans, changing the terms of existing loans, or cancelling loans. This has led to diverse reactions of the economy in the periods within which each of the programs was carried out.

This problem therefore created the motivation to study the reasons why the economy reacted as observed, following the actions initiated through its relations with creditors. This is an internally focused study which is more interested in the internal actions or reactions to stimuli which could influence the country's foreign debt to GDP relationship over a period which ranges from the 1970 until 2006.

The theories of institutional economics are applied to explain the results of government action. This is done by using the Keynesian concept of government spending. By linking this theory to Minsky's theory of financial fragility, determinants of government financing are analyzed. This is done by a qualitative

analysis of the flow of foreign debt to capital formation, and the government's ability to trap its spending through fiscal revenues, as the country went through economic changes to enhance the efficiency of foreign debt management.

In general, the country's long run financial fragility is evaluated by analyzing the degree to which its foreign debt dependency has evolved within each era of the country's GDP growth, as it responds to actions of international financial institutions regarding the degree of institutional efficiency.

1.1 Background

Cameroon falls among the many African economies which fell into a debt trap after the Oil shocks in the mid 1970's. The world wide rise in fuel prices led to the accumulation of cash reserves in western Banks. In the face of recession in developed countries, there arose excess supplies over demand of credits, and thus a fall in the cost of loans. The low cost of loans, at the time, represented an opportunity for African economies which later on became a threat. This happened as the western economies emerged from recession and began to compete in the demand for credits. This growth in the demand for credits led to a rise in interest rates which affected the price to be paid by the Cameroonian economy in reimbursement of their foreign loans.

The country's independence in 1960 came with a lot of optimism, as the average real economic growth of 6% was achieved between 1965 and 1986. The country's petroleum resources played a key role in the boom experienced in the 70's, as

foreign reserves were positive, in the face of growing domestic investments which rose from 21% of GDP in 1977 to greater than 30% in 1986. This boom was characterized by high inefficiency in the management of state enterprises in charge of non-petroleum products, and thus enhancing the country's dependence on its oil revenues (Nkama, 2005).

Heightened public sector mismanagement combined with the sudden fall of the prices of Cameroon agricultural and petroleum revenues. This trapped the economy in a crisis which was recognized by the state in 1987. As a consequence, between 1985 and 1992, terms of trade declined by about 55%, while the average GDP growth fell to a yearly of 3.8% from 1986 to 1994. At the same time, external debt rose from 39% of GDP in 1986 to 65% of GDP in 65% of GDP in 1992. Then the national currency (CFA franc) underwent a 105% in 1994 (Nkama, 2005) .

1.1.1 Cameroon's economic structure in relation to its foreign debt

Among the goals of the HIPC initiative was the achievement of a 150% ratio of net present value of foreign debt to GDP. But this ought to have gotten beyond this single quantitative dimension. It ought to have taken account of other aspects of the economy, such as its structure, the structure of its foreign debt, and the strength of institutions which can make for economic stability in spite of high debt to GDP ratios.

Contributors to Cameroon's GDP (1966-1976)

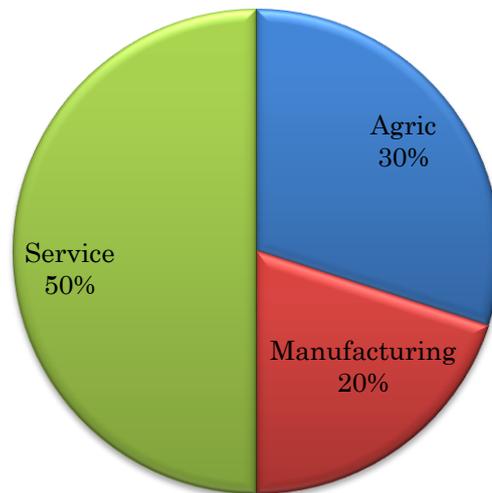


Fig 1 Sectors' Percentage Contributions to GDP 1966-1976

Source: Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000

The heart of Cameroon's economic boom came in the early half of the 70's, an era within which the service sector supplied half of the country's GDP. Given that the majority of this service sector belonged to the civil service, an important component of government revenue could be earned from fiscal sources. The large civil service served, not only as a source of fiscal revenue through income taxes, but also, as a huge source of current government expenditure. At the time, the country's agric sector contributed 30% of the country's GDP, while the manufacturing sector contributed 20% of the economy's GDP as shown in fig 1.

Contributors to Cameroon's GDP (1977-1985)

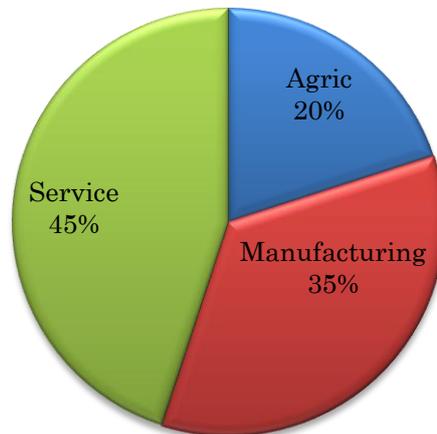


Fig 2 Sectors' Contributions to Cameroon's GDP 1977-1985

Source: Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000

The discovery of petroleum in the country's South West Coast line in 1970 influenced the contribution of each sector to the country's GDP as shown in the figure above. The effect of this discovery was perceptible between the late 70's and the first half of the 80's. The agric sector and the service sector both lost 10% and 5% respectively to the manufacturing sector whose contribution to GDP had grown to from 20% to 35%, as demonstrated in figure 2. This growth arose from the annual 32% rise in petroleum earnings realized between 1980 and 1985. After the petroleum discovery, until the economic crisis, only the service sector faced a relatively stable growth rate, as the manufacturing and agricultural sectors experienced significant growth rate drops. (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000, p. 18).

With this GDP contribution structure, the economy fell into a structural crisis (1985-1994) as it depended on unstable oil revenues to finance its growing recurrent expenses. This called for the country's subjection to the structural adjustment program.

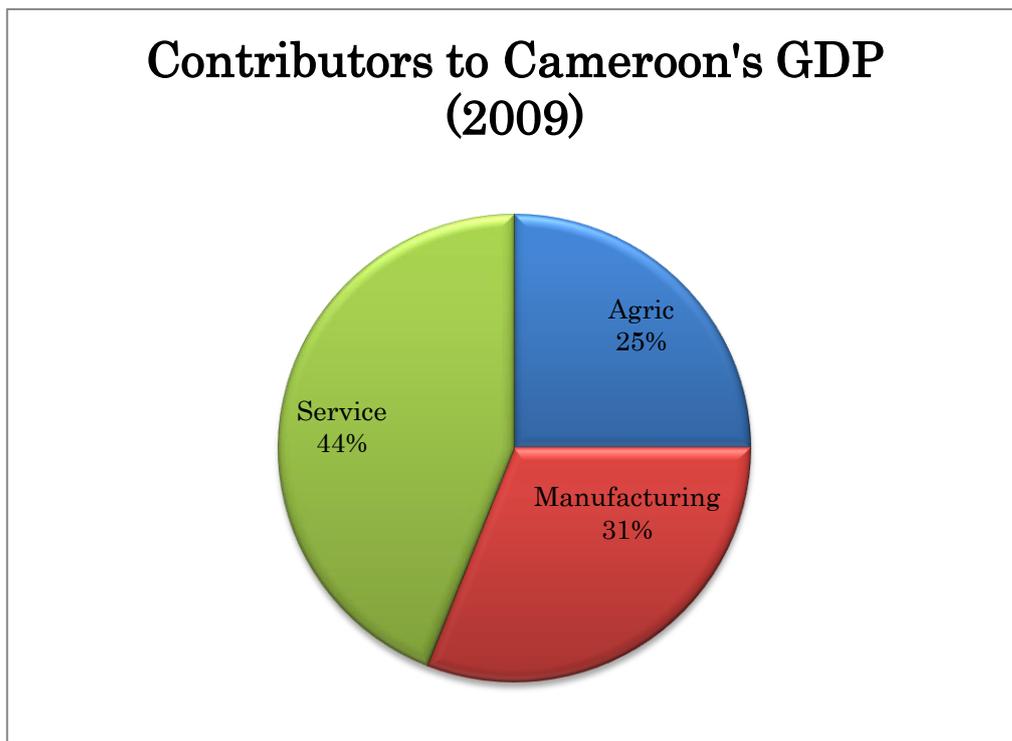


Fig 3 Sectors' Contributions to Cameroon's GDP 2009

Source: IMF Country Report No.10/259 July 2010

After the Structural Adjustment programme, the sectors which contribute to Cameroon's GDP are classified as shown in figure 3 with respect to their percentage contribution to GDP. The largest component is the service sector which earns 44% of the country's GDP. This sector and the construction sector do not yield direct income for the state by which its foreign debt can be serviced. This is

because the state only earns taxes from income earned by individuals rendering services and executing construction contracts. Thus the state's ability to raise income from this sector tends to depend on how efficiently its institutions can spread its tax base to trap revenue from these sectors.

The state is therefore left with the remaining 56% (Manufacturing, Oil and mining, Agriculture, Forestry and livestock) from which it expects to earn substantial amounts of foreign income, considering its participation in these sectors, such as its 66% shares in the National Refineries Company, SONARA (US Department of the interior, 2009). According to AfDB and OECD (2008), the forestry sector realizes income through environmental regulation. Given that this sector's products are not locally processed, it could earn a deeper component of its potential by adding the value of its products before they get exported. In the agricultural sector, the potential is not exploited, due to inadequacy of financing, road networks, and fertilizers.

The non-petroleum manufacturing sector holds 19.2% of the economy's GDP. The country's technological base is relatively weak, as is the case with low income less economically developed countries. The trade liberalization which followed the Structural Adjustment programme opened the country's markets to competition from foreign manufactured products. It is therefore difficult to perceive this sector as a source of foreign income, considering the recent declining terms of trade in the economy.

It is therefore important to understand how an economy whose GDP arises predominantly from the service sector will react to the growing mass of foreign debt, considering the need for externally earned income to finance maturing foreign loans. Also, considering the relative instability of the externally earned income due to export price fluctuations (See Annex) , it is important to assess the means by which such a small economy can generate GDP growth from internal sources, thus reducing its dependence on foreign debt.

1.1.2 The structure of Cameroon's Public debt

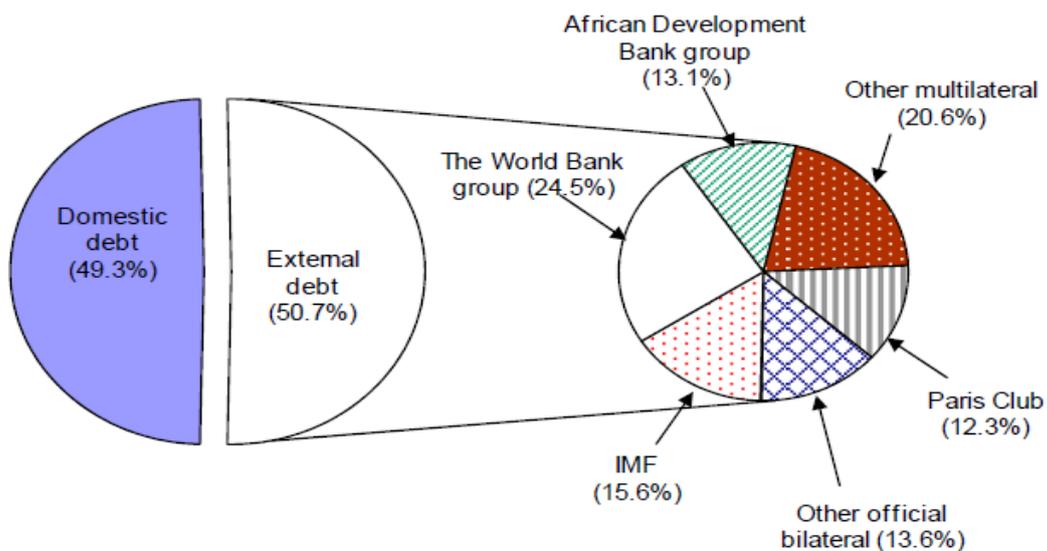


Fig 4. The Structure of Cameroon's Public Debt

Source: IMF Country Report No.10/259 2010

Cameroon's economy owes 50.7% of its debts to foreign creditors. Figure 4 shows its foreign debt structure with a vast majority of its creditors being multilateral. This leaves the country with a limited percentage of bilateral foreign loans to worry about. In this case, the country's commitments to commercial bank loans

(which have tighter conditionality than multilateral loans) are quite negligible, given that they are not visible in the debt structure.

Thus, the bulk of the country's external debt is highly concessional, leading to more preferential interest rates and longer grace periods. This inspires the worry on whether the absence of tight loan agreements (such as high interest rates and short maturity terms) lures the economy into the substitution of fiscal revenues with these external debts, thus being permanently dependent on foreign loans and thus getting caught in a debt trap.

1.1.3 Evolution of Cameroon's stock of foreign debt and GDP growth

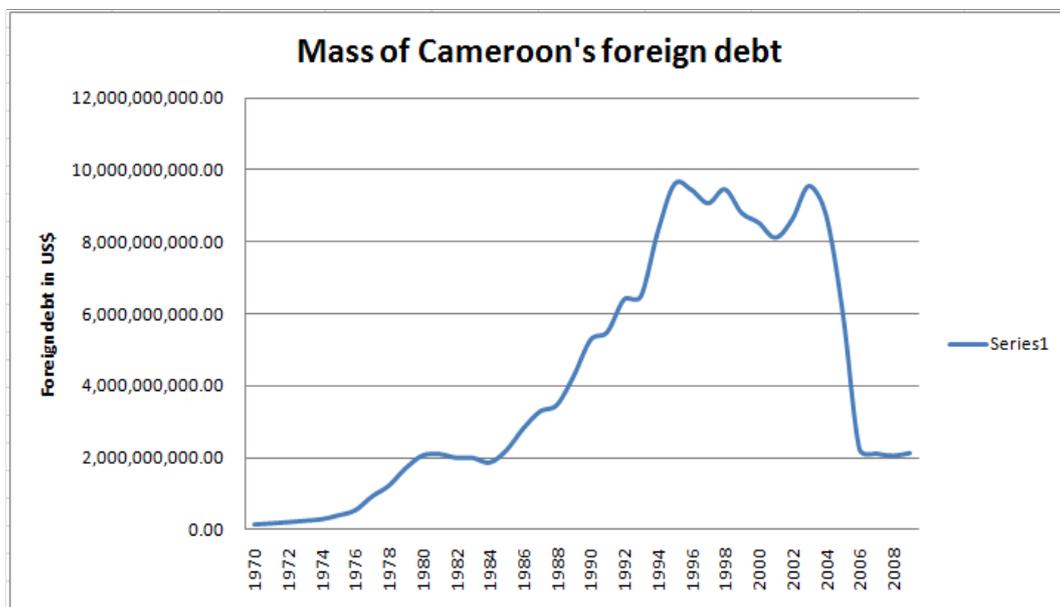


Fig 5 Mass of Cameroon's Foreign debt Stock
Source: World Bank Database

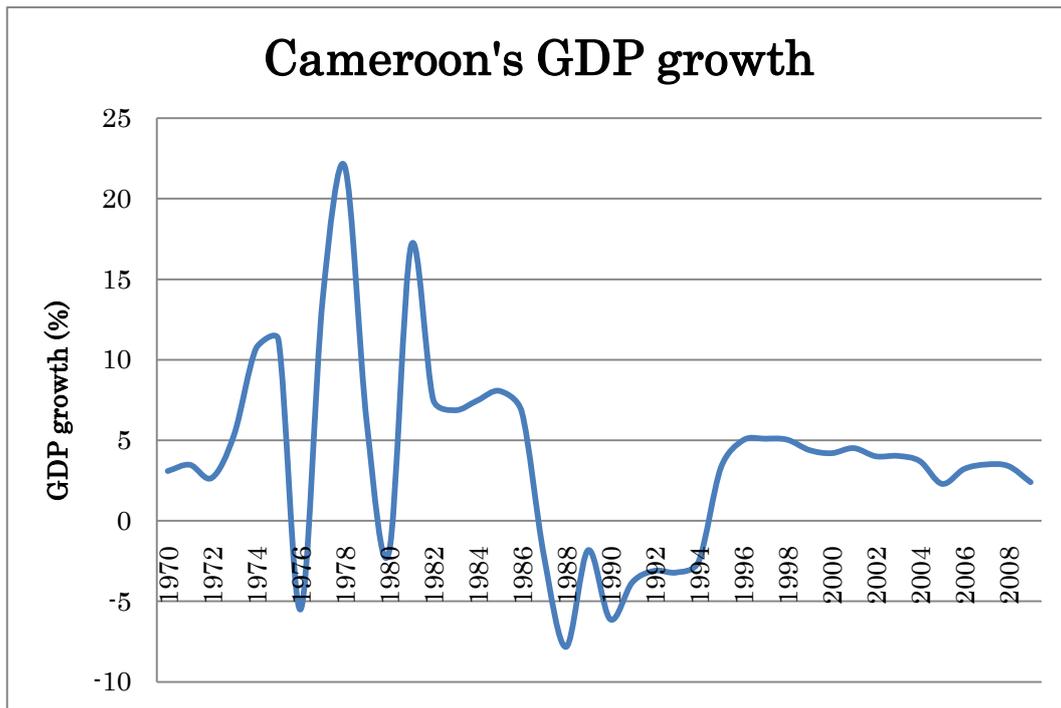


Fig 6 Evolution of Cameroon's GDP growth,
Source: World Bank Database

The relative instability in the country's GDP growth rate between 1970 and 1980 arose from the discovery of petroleum resources in the country's coast line in the early 70's; and eventually the production which began in 1978. The price hikes in petroleum products during the 80's "oil boom", as well as the availability of these resources are temporary. This had a strong impact on the economy, as it led to investment choices which prioritized petroleum, as well as other non-tradable resource sectors over the agriculture and other tradable resources whose prices were relatively unstable at the time. This investment policy failed to consider the fact that the agricultural sector held a high percentage of the country's labor force. This instability resulted from the need to return to the country's initial GDP contributor mix, focusing on agriculture, after the drop in fuel prices (Benjamin &

Devarajan, 1985)

According to Benjamin & Devarajan (1985), by injecting oil revenues into the economy, inflation levels rose. This increased the prices of locally manufactured agricultural products, making them less competitive on local and foreign market, following exchange rate appreciation. This was a challenge to the economy's quest to use import substitution policy as a driver of growth in the late 70's. Therefore, allowing the contraction of the country's agric sector in the face of oil discovery was not a proper orientation of the state's economic policy. This was responsible for the unstable growth of the economy after the "Oil boom".

In the 80's the economy faced the effects of the concentration of state investments in the petroleum sector. This can be observed from the sharp fall in GDP growth in 1982 and 1988, following the fall of the prices of the country's main export commodities: Cocoa, coffee, cotton and petroleum. This led to a rise in the country's current account and fiscal deficits, as the economy fell into an economic crisis in the late 80's. These deficits were financed by arrears from civil servants and local suppliers which escalated into a crisis in the banking sector within which the country saw the peak of recession (Gauthier, Soloage, & Tybout, 2000). This led to the need to comply with World Bank conditionality, which was characterized by the Structural Adjustment program in 1989, which sought to restructure the economy. This program's objectives constituted reducing the gap between state revenues and expenses, in order to enhance GDP growth.

Within the economic crisis which plagued Cameroon's economy between 1985 and 1995, the country's external debt to Gross National Income (GNI) ratio rose to 133% in 1995. Thus, the programs lunched with the help of the major International Financial Institutions (IFI), seeking to enhance economic rigor went on until the 90's. These programs had painful effects on those who contributed to the "more costly" part of the economy, as they sought to minimize state spending and increase state revenues. Among these was the more than 50% reduction of civil servants' salaries in 1993 as a measure to reduce cost. Then in January 1994 came the 105% devaluation of the national currency (CFA Franc). This was a major turning point for the economy following the "oil boom" which led to an overvaluation of the CFA Franc. Hence, the country's main commodities got relatively cheaper and more competitive on foreign markets.

In 1997, the Enhanced Structural Adjustment Facility focused on methods of maintaining the country's GDP growth at a 5% level by strengthening non-oil sources of revenue, raising savings by the initiation of privatization procedures, reducing the country's external debt burden, and improving the quality and management of state spending by allocating more resources to education, health, the judiciary, infrastructure and the rural sector. (International Monetary Fund, 2001)

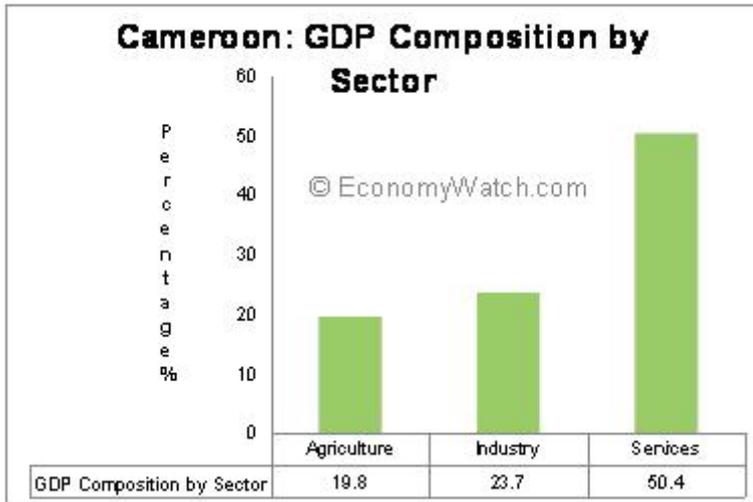


Fig 7 Composition of Cameroon's GDP per sector

, Source: economywatch.com (2009 statistics)

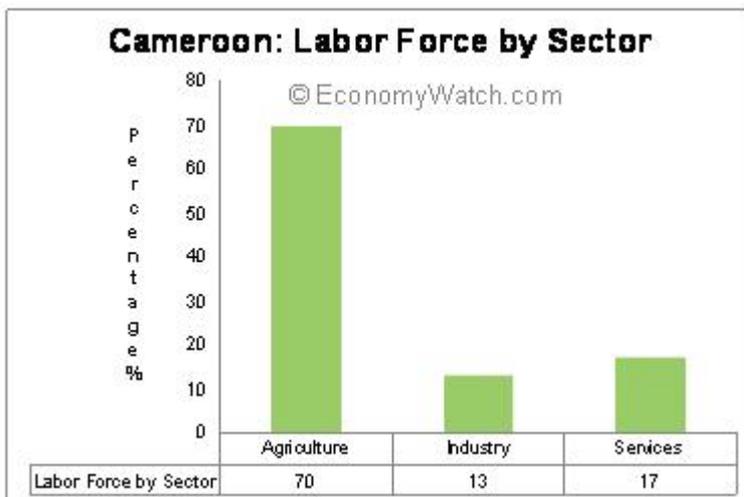


Fig 8 Cameroon's Labor Force by Sector

Source: economywatch.com (2009 statistics)

Following the quest to revitalize the rural sector, agriculture which plays a key role in the economy, as it employs 70% of the country's population, would be expected to be a high contributor to the country's GDP. This emphasizes the need to redirect investment in agriculture after the end of the "oil shocks". A higher

percentage of the country's labor force is devoted to this sector, yet it supplies the lowest contribution to the country's GDP. It could thus be argued that country's fast growing foreign debt was not invested in the mechanization of the agricultural sector. This process could revolutionize this sector and make it capital intensive, by the provision of infrastructure, improved access to markets, and educational facilities for improved research in this sector; and therefore have a greater impact on the sector's contribution of the country's GDP.

GDP growth dropped only slightly from 3.5% in 2007 to 3.4 in 2008 despite the global financial crisis due to positive performance of the petroleum sector, as well as an increase in the supply of infrastructure and energy. This relative stability was also boosted by programs to improve on the agriculture, livestock, and fisheries sectors. But in 2009, the global financial crisis caught up with the country's GDP growth. It dropped to 2.4%, as the global recession pushed down prices and demand for the country's major export commodities: Oil, wood, cotton and rubber. For many years, the country has faced the huge challenge of stabilizing its GDP. This goal could be achieved by improving on export diversification in order to reduce its dependence on oil revenues, as well as fighting against falling commodity prices through sufficient processing of raw material exports. (OECD, 2009)

1.2 Problem statement

The economic crisis in Cameroon in the 80's led the country to experience the least growth ever recorded in its history. To reverse the situation, it was necessary

to seek external support in the form of loans from the World Bank, the International Monetary Fund (IMF), as well as other multilateral or bilateral creditors. Thus, between the mid 80's and the mid 90's the mass of the country's foreign debt grew rapidly. Considering the fact that these loans were granted to stimulate growth, an issue arises when one considers the fact that the period within which the country's debt grew fastest was the period within which it recorded the lowest GDP growth. This in mind, the high positive impact of foreign debt on GDP growth has not yet been experienced in spite of the country's huge debt cancellation.

It is worth noting that after the cancellation of the country's foreign debt, following the achievement point of the HIPC initiative in 2006, the country's GDP growth rate has not improved remarkably. The observed impact of the country's foreign debt on its GDP growth portrays a gap which needs to be filled to achieve foreign debt sustainability through improved efficiency of institutions. It is therefore important to understand why the long term effect of the country's foreign debt on its GDP growth is still awaited, and to understand the likelihood that the expected growth results would be achieved.

In earlier research works, causes of the observed relationship between the country's foreign debt and GDP growth, the debt to export ratio has been observed, as well as the debt service to export ratio, to evaluate whether the country spends more of its export revenue on debt repayment. It is therefore important to integrate the percentage of the country's GDP spent on capital investments, as well as the

efficiency of institutions. This will measure the country's commitment to the use of local institutions in its quest to internally stimulate GDP growth and thus reduce the likelihood of a future debt crisis.

1.3 Research Objectives

1.3.1 General objectives:

1.3.1.1 To study the relationship between foreign debt and GDP growth

This is an effort to test the significance of the relationship between foreign debt and GDP growth. Here, a number of economic variables are analyzed. By so doing, the changes in the sectors of the economy are assessed. These constitute measures of the country's debt repayment ability and the efficiency of its foreign debt management in the past. This will be used to make recommendations on how the economy can better manage its foreign debt in the face of an anticipated debt crisis.

1.3.1.2 To establish arguments on why this relationship exists.

To argue reasons for the observed relationship between foreign debt and GDP growth, institutional variables¹ will be observed to measure the country's degree of commitment towards the sustainable monitoring and management of its most valuable sources of income, its ability to effectively utilize its foreign debt, and its ability to recollect the resources spent as fiscal revenues, and the impact of all these on the growth of the country's foreign debt. Using these variables it is expected to advance the argument that the "qualitative" strength or efficiency of

¹ **Institutional Variables** are data sets summarized to represent perception-based indicators of governance. These are split into six interdependent dimensions: Accountability, Political Stability, Government effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. (Kaufmann, Kraay, & Mastruzzi, 2010)

institutions is as important as the “quantitative” debt to export ratios. These quantitative measures, as suggested by the HIPC initiative, seek to attain a 150% debt-to-export ratio, which should serve as a debt sustainability benchmark, in spite of the other characteristics of the economy.

1.3.2 Specific objectives:

1.3.2.1 To study the changes in the main contributors to the country’s GDP as a measure of the country’s credit worthiness.

This will present the evolution, over time, of the sectors through which the economy earns income, or the major GDP contributors. A decline in any GDP contributor demonstrates deterioration in the economy’s debt sustainability situation. By observing economic happenings which lead to the major variations in the GDP contributors (agric exports, service sector, and the manufacturing sector), arguments will be raised on the impact of foreign debt on GDP growth, as well as foreign debt management mechanisms within the economy.

1.3.2.2 To assess whether an increasing foreign debt stock implies rising government spending on Gross Capital Formation

By comparing the evolution of foreign debt with Gross Capital Formation, it is expected to observe whether the accumulated foreign debt is spent on the acquisition of infrastructure and technology. A higher rate of spending on capital expenditures, following the accumulation of foreign debt hypothetically demonstrates growth sustainability for the future. This is expected to pave the way for debt sustainability and eventually, result in high GDP growth.

1.3.2.3 To observe how the country's foreign debt and debt relief affect the percentage contribution of fiscal revenues to its GDP.

This seeks to analyze whether debt and debt relief have served as compliments or substitutes to fiscal revenue. A complimentary or positive relationship between foreign debt and fiscal revenues suggests that the growth in foreign debt and debt relief has a positive impact on the fiscal policy performance. Conversely, a substitutive or negative relationship between the stock of foreign debt and the percentage contribution of fiscal revenues to GDP leads to the claim that foreign debt has a dampening effect on the efficiency of the country's fiscal policy.

1.3.2.4 To identify and explain the factors of institutional efficiency which could be responsible for the observed relationship between foreign debt and GDP growth relationship.

Factors of institutional efficiency include: Government effectiveness, voice and accountability, Political stability, Regulatory quality, Rule of Law, and Control of corruption. These variables will be considered within a circular flow framework to explain efficiency problems which act as a friction or leakage of resources, thus affecting the economy's ability to generate GDP growth by the use of its foreign debt and debt relief.

1.4 Significance of study

1.4.1 Significance to developing economies

The debt relief programs, especially the HIPC initiative, mark an important phase in the history of low income developing countries' indebtedness. It is therefore important to monitor the changes they initiated in debt related macroeconomic and institutional variables. By so doing, the possibility of recurrence of a debt

crisis is tested. And the means by which this may be avoided are suggested.

1.4.2 Significance to research and academic bodies

This is an effort to demonstrate the shift of interests in the execution of economic programs through the past, and to guide priorities for the future. It seeks to demonstrate the importance of a given economic school of thought with due consideration of the environment within which the problem which seeks to be solved exists. By this, it is attempted to demonstrate the need to evolve from the Classical school of thought that suggests a free market mechanism. It also seeks to demonstrate the need for strong institutions in an economy, as a prerequisite for the smooth circular flow of resources in the economy as suggested in the Keynesian school of thought. It thus seeks to enhance the importance the Neo-classical school of thought, especially in low income economies where institutions are relatively inefficient. This is sought by paying more attention to the role of institutions in the use of foreign debt to generate GDP growth.

There have been arguments on the exogenous reasons why foreign debt fails to generate GDP growth. These arguments take into account export barriers on products, high fluctuation of commodity prices, interest rates, loan conditions, scarcity of concessional financing, and natural disaster in low income economies to explain the relationship between foreign debt and GDP growth. Hence the need to analyze the same issue from an internal perspective, considering how the internal factors have influenced low income countries' potential to simultaneously repay foreign debt and trigger GDP growth.

The HIPC initiative turned a new page in the country's foreign debt history. This was characterized by a fall in the country's stock of foreign debt at the completion point from US\$ 6 billion in 2005 to US\$ 2 billion since 2006 (World Bank database, 2011). This has not been met by corresponding changes in the country's credit rating, which has fluctuated from B- in 2006 (Daly & Cavanuagh, 2007) to B in 2009 (Beers, 2010) . Thus by understanding the channels through which foreign debt is expected to influence GDP growth positively, and gathering facts on how this happens in the country's economy, a relevant amount of contribution will be made. This will either support or contest the negligible change in the country's credit rating after the HIPC debt cancellation.

CHAPTER 2

2.0 Literature Review

Birdsall & Williamson (2002) used ratios to analyze the impact of debt burden on GDP growth in countries that benefited from debt cancellation through the HIPC initiative. They criticized debtor governments for wrong economic policies and poor governance. At the same time, creditors were criticized for cancelling debt to achieve their own commercial and political aims, rather than cancelling enough debt to save these developing economies from the debt trap (Pp 33). Their method is strictly quantitative. It pays little attention to the reasons for, or the degree to which the debtor countries' institutions influence the performance of foreign debt management policy. Therefore, this study comes to disagree with the need for increased debt cancellation, to suggest that an increase in the magnitude of debt cancellation in the absence of improvement in the countries' institutions and policy efficiency will not have a durable or significant impact on the country's debt sustainability.

Moss, Standley, & Birdsall, (2005) suggest, in the case of Nigeria, that the cost of external debt to a low income economy, or the debt burden could be so heavy that it crowds out the effects of the government's debt-sustainability policy. External debt can therefore be considered as a major impediment, which limits the government's ability to convince the public and parliament toward the adoption of economic reforms. This falls in line with the Cameroon economy's case, as it faced the economic crisis in the mid 1990's within which, due to large mass of

foreign debt, the devaluation of the country's currency could not lead to continuously growing GDP growth rates. But after the year 2000, when the country's debt burden had substantially fallen, the country's falling GDP ratio cannot be justified by high foreign debt burden.

Dijkstra (2006), claims that the World Bank has contributed to the **debt overhang**² in developing countries. She argues that this institution, by monopolizing the dual role of Creditor and Controller in the International Finance framework, faces an obligation to finance failing economies. In Niall Ferguson's forward in *Dead Aid*, (Moyo, 2009) he supports this notion as he condemns concessional loans. He claims that they are awarded under relatively easy terms, which reduce the distinction between these loans and aid. This distinction problem makes government control difficult, and suppresses the government's motivation to save and invest. He further suggests that aid provided in kind kills the motivation of developing countries to persist in the learning process which eventually enforces GDP growth(Pp x). Moyo (2009) argues that the unclear distinction between debts and grants in developing countries has a negative effect on the commitment of institutions in charge of external debt management, and these go a long way to reduce GDP growth. This creates the problems of Moral Hazard and adverse selection. This argument is supported in this study, but here, the focus is on the domestic economy, and to a

² Debt overhang: As defined by Krugman (1988), this happens when a country's expected debt repayment is less than the value stipulated in the debt contract. In this situation, the country's output is used to pay off existing foreign loans at the expense of investment towards economic growth [Clements, Bhattacharya, Nguyen, 2003]

lesser extent, on the actions of the international financial institutions.

Cobbe (1990), suggests that the IMF and World Bank are greatly liable to be blamed for the failure of their credit allocation programs to generate GDP growth in developing countries. Considering the fact that the servicing of foreign debt leads to a leakage of resources which would otherwise have been allocated to domestic investment, he claims that foreign debt has a negative impact on GDP growth. He goes further to question the degree of commitment of the World Bank and the IMF, as well as African governments to the search for future solutions to the lasting debt crisis in Africa. The African governments are hereby blamed for their vague objectives and economic performance standards, which serves as a first step in the failure to achieve long term results. This point of view is supported, given that in the absence of very high debt burden, the Cameroon economy's failure to enjoy increasingly high GDP growth comes as a result of inefficient institutions, both local and foreign.

Todaro and Smith, (2009) consider foreign debt to be a threat to GDP growth when the payments exceed revenues, due to mismanagement. They claim that as long as these piled up debts are being productively invested in projects whose domestic rates of return exceed the market interest rate, these debts could yield growth. This idea is countered by this study in the sense that the economy could experience high domestic rates of return, yet if the government's institutions in charge of fiscal revenue are not efficient enough to trap a share in this domestic rate of return, the high returns on local markets will have no impact on the

government's ability to raise funds, and thus no effect on the country's high dependence on foreign debt.

Yang and Nyberg (2009), argue that the majority of countries that attained the completion point of the HIPC initiative still depend to a great extent on a single export product for a large percentage of their export revenue. Thus the degree of exposure to external shocks, which could arise in these economies, following changes in the prices of these products has not been mitigated. Also, it is noticed, using the revenue to GDP ratio, that an average of less than 20% of the HIPCs' GDP is earned from the countries' fiscal revenues. Thus suggesting that their degree of dependence on foreign revenues was not improved after the cancellation of their foreign loans. Considering the strength of institutions, they used the CPIA and KKM governance indices to suggest that despite the relative improvements in institutional frameworks, HIPCs' initiative did not initiate changes strong enough to achievement of external debt sustainability. This point of view is strongly supported, considering the fact that the HIPC initiative focused on making resources available, and cancelling foreign debt, without taking into account the means by which these countries' institutions can be designed to raise their own revenues and run efficiently in the absence of debt.

Cohen and Vellutini (2004) argued that the HIPC initiative was not the final solution to the debt crisis in low income economies for two reasons: The first being very weak practices in the monitoring and management of debt; and the second, poor performance and diversification of exports. Hence the HIPCs' degree

of susceptibility to exogenous shocks (e.g. changes in the prices of countries' main exports) has not changed following the completion point of the HIPC initiative.

They questioned the criteria of the allocation of resources to countries in the HIPC initiative by seeking to understand the relationship between debt relief and policy performance. This resulted from the fact that larger amounts of resources from the initiative were allocated to countries with worse policy performance. Logically, therefore, this could lead to moral hazard. Here, economies with relatively better policy performance tend to make decisions which negatively affect their debt burden, as a means to attract debt relief assistance. Following such conditions, external debts have a negative impact on GDP growth. This suggestion does not quite fall in line with the arguments of this research on one condition. If the International Financial Institutions and the economies are both efficient, then through the pre-completion point surveillance by the IMF and the World Bank, there is no means by which the economies may manipulate policy to attract debt relief. But, if the supervisory institution is inefficient, there are chances of the HIPC's to inappropriately manage its economic policy in order to attract debt relief.

Cohen & Vellutini (2004), suggest that the HIPC initiative achieved the reform of policy which brought about policy dialogue, strengthened institutions, and the reduced the burden of external debts. They claim that it improved cross donor surveillance through which debtor information may be centralized for better monitoring of foreign debts in low income countries. Also, that apart from

quantitative variables like debt to export or debt to GDP ratios, more consideration should be given to variables like the quality of external debt monitoring and management. This is said to be achievable through the enhanced governance to fine-tune ex-ante management of state spending and the establishment of loan contracts. They claim that such management will generate the information which will increase the selectivity of foreign donors, and thus keep the mass of foreign debt under control. This argument is more focused on the external part of the foreign debt contract, and covers the information interests of the creditors more. This study goes in the opposite direction to study the reasons why the debtors fail to maximize the use of these debts.

Kraay & Nehru, (2006) focus on “debt distress” in their study on external debt. They refer to debt distress as a period within which countries resort to external debt arrears, Paris club debt rescheduling, and non-concessional IMF loans. They argue that debt distress is caused by: Debt burden, policy and institutional inefficiency, and external shocks which affect GDP growth. They suggest that policy improvements have the same impact as the reduction of debt burden, but improved institutional efficiency is more important in the fight against debt distress in low income economies. This argument is hereby supported, given that the financial support supplied by the HIPC initiative was relatively high, but the institutional changes were relatively inadequate. This implies that, in the absence of relevant changes in the levels of corruption and government efficiency, the HIPCs are not far from the next debt crisis.

Gunter (2002) argues that the enhanced HIPC initiative's failure to achieve debt sustainability results from the inadequacy of resources allocated to this programme, as well as the political instability such as wars going on in these poor countries. This study comes to argue that political instability has a stronger impact on debt sustainability than the adequacy of resources. It can therefore be suggested that corruption and government inefficiency have similarly destructive impacts on the HIPC initiative's ability to generate debt sustainability.

Hence, they claim that the use of a single (quantitative) debt sustainability indicator: Present value of debt to export ratio is not enough for the measurement of debt sustainability in a group of countries which portray diverse institutional characteristics, such as diverse governance mechanisms. So, a country's debt sustainability should be measured with more attention to the quality of its policies and institutions. This is supported by a strong relationship between the policy performance and debt distress. They therefore state that the appropriate debt burden of an economy should reflect the quality of its policies and institutions. They conclude that the prioritization of aid and concessional loans to low income economies could create an implicit reward to countries that portray poor policy performance, therefore weakening their policy performance in the long run. This position is supported, considering the fact that HIPC economies do not gain any foreign debt management or institutional experience through debt relief programs. In this regard, the debt relief programs are a very temporal solution to the debt crisis in developing countries.

CHAPTER 3

3.0 Research Method

3.1 Hypotheses

3.1.1 Foreign debt has a positive impact on GDP growth.

3.1.2 Foreign debt leads to a rise in Gross Capital Formation.

3.1.3 Foreign debt has a positive impact on GDP percentage contribution of fiscal revenues.

3.1.4 The institutional efficiency of local and foreign institutions has improved the foreign debt to GDP growth relationship.

3.2 Conceptual and Theoretical Framework

3.2.1 Debt sustainability

Cohen & Vellutini (2004) made allusion to debt sustainability, as one of the goals of the HIPC initiative. Debt sustainability is defined as the economic stabilization goal sought by keeping the mass of NPV of debt at a targeted level; such as one where the ratio of debt to export is less than 150%, as was the case in the HIPC initiative.

But this study seeks to argue against the arbitrary 150% debt level, and attribute debt sustainability to the efficiency of the country's institutions. Considering the foreign debt to GDP growth relationship, institutions exert strong influence on the

channel through which foreign debts are used to acquire technological advancement in the form of Gross Capital Formation. They influence the amount of consumption stimulated by government spending, as well as the government's ability to raise fiscal revenue earned from domestic consumption to finance the government's new spending needs and reduce their dependence on foreign debt.

According to the IMF Fact Sheet(2011), the degree of indebtedness that can be tolerated by a given low income economy needs to be set with regards to the strength of policies or institutions within the country in question. It was therefore suggested that the countries with stronger institutions and better policy performance would be able to manage higher ratios of debt-to-export and debt-to-GDP, as illustrated by the following table:

Table 3.1 HIPC Debt Sustainability Thresholds

	Debt-to-Export ratio	Debt-to-GDP ratio
Weak policy efficiency	100%	30%
Medium policy efficiency	150%	40%
Strong policy efficiency	200%	50%

Table 1 HIPC Debt Sustainability Thresholds

(Source: IMF Fact Sheet , 2011)

3.2.2 Keynesian Concept of Government Spending

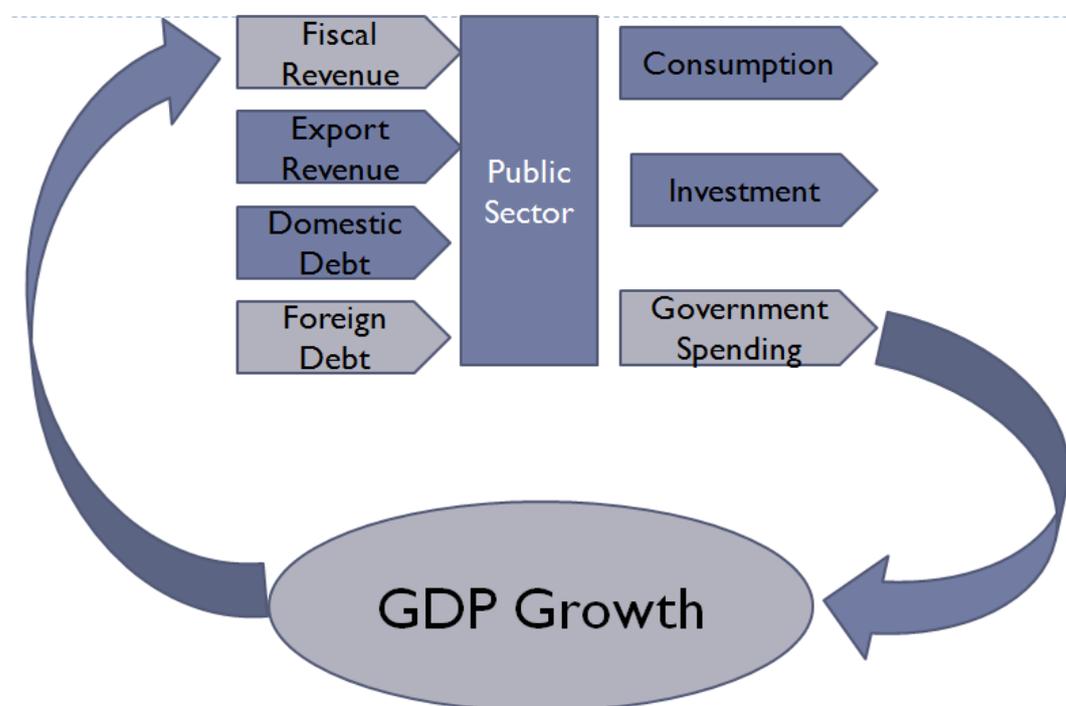


Fig 9 Conceptual Framework

Source: Developed by the in the course of this research; inspired by H.P. Minsky.

The figure above was inspired by the following quote from Hyman P Minsky, “Investment must be financed, and how it is financed makes a difference. As the proportion that is externally financed grows, fragility increases...” [Minsky, 2008, p: xv]

This quote finds its origins in the Keynesian General Theory of government spending: $Y = (C + I + G + X) / (s + t + m)$, where Y: income, C: Consumption, I: investment, G: government spending, X: net exports, s: propensity to save, t: propensity to tax, m: propensity to import. It was motivated by the suggestion that Keynes General Theory is not very precise on the constituents of Y. Therefore,

Minsky sought to fill up this gap by considering local and external sources of public finance.

This constitutes the conceptual framework which guides the assessment of the impact of foreign debt not only on GDP growth, but also on the sustainability of GDP growth. The cycle assumes that economic activity needs to be financed from various sources which include: Fiscal revenue, Export revenue, Domestic debt, and foreign debt. The economy commits itself to foreign debt contracts with the sole aim of orientating government spending to trigger GDP growth. The amount of growth generated would depend on how the foreign debt was spent. And the sustainability of this growth would depend on the economy's potential to finance itself from internal sources (such as fiscal revenue), and hence reduce the need of foreign debt financing, as well as financing from unstable export revenues which increases the fragility in the economy.

For the economy to be able to efficiently manage its foreign debt and invest it in infrastructure that will stimulate consumption and hence fiscal revenue, the public sector, through which the foreign debt flows needs to be characterized by efficient institutions. These efficient institutions are expected to have a mastery of the best interests of the economy, and therefore are expected to be able to negotiate with, guide international financial institutions as they award these loans, towards the best interests of the economy, as well as decide on how these loans can be spent in order to reduce the country's dependence on foreign debt financing to the barest minimum.

3.3 Research Approach

3.3.1 Data types and Sources

This paper will apply a Qualitative Case Study approach, and will use secondary data. This approach will be used to answer the questions and test the research hypotheses. It will consider the economy of Cameroon as a single unit or institution with various attributes. Analyses and arguments will be raised based on the suitability of policies which arose in this unit to stimulate positive impacts or to mitigate the negative impacts of foreign debt on GDP growth over the period in consideration. The time frame is further split into four GDP growth regimes: Oil Boom, Crisis, Recovery, Post HIPC initiative.

An uninterrupted flow of foreign debt to gross capital formation or infrastructural development is expected to stimulate consumption. Through this consumption, the government's ability to earn taxes would determine the degree to which the country stays dependent on other sources of income, especially foreign debt for GDP growth to be stable. It is therefore worth studying how the system works by using the conceptual framework (Page 25), to identify and raise arguments on the reasons for the frictions and other failures. These failures keep resources from being spent on Gross Capital Formation and stimulating consumption. The same failures prevent the government from earning fiscal revenues from consumption as expected. These frictions, defined by the inefficiency of institutions, are expected to inherently have an impact on the country's ability to stabilize GDP growth using domestic sources, thus the increasing need for financing from external sources.

The variables to be considered include in the study:

3.3.1.1 Economic Indicators (1970-2008)

- **External Debt Stock (Public and Publicly Guaranteed, in USD).**

External debt stock is the value of long term obligations owed to foreign creditors by debtors within an economy. These **creditors** should include other governments, foreign commercial banks, and International Organizations. The debtors on the other hand should include the government, independent public institutions, and private entities. The obligations resulting from public or private loan contracts are guaranteed for repayment by a public entity. (World Bank, Global Development Finance, 2010) This variable will be compared with the fluctuations in the country's GDP contributors, in order to assess the country's ability to generate GDP growth while financing its foreign debt.

- **Gross Domestic Product (GDP, in current USD value).**

This is the value of all goods and services produced within an economy over a period of time. It includes the total value added by producers within the territory, as well as taxes levied on products, less the subsidies rendered for their production. This variable is observed in terms of contributors to the economy's output, such as agricultural products, manufactured products, and services. Changes in the magnitude of these contributors will be observed to evaluate changes in the country's ability to repay its foreign debt in the presence of economic stability.

- **GDP growth (Annual Percentage).**

This is the annual change, positive or negative observed in the total value of goods and services produced within an economy including taxes less subsidies, and it is expressed in percentages which represent each year. By observing changes in this variable, compared with the growth in the country's foreign debt, growth enhancing nature of the country's foreign debt will be analyzed.

- **Exports of goods and services (Current USD value).**

This represents the value of goods supplied and services rendered by the country's economy to the rest of the world. These goods include petroleum, cocoa, coffee, cotton, bananas, etc. The country's export services include transportation, insurance and information technology services rendered by resident companies to non-residents. Considering the fact that the petroleum boom led to a rise in the country's export prices, this variable will be observed to demonstrate impact of the devaluation of the country's currency on its export performance, and therefore, on debt sustainability in the long run.

- **Gross Fixed Capital Formation (Percentage of GDP).**

These are additions to fixed assets, including the net changes on the value of existing assets such as land improvements and the acquisition of materials and machinery, the construction of roads, railways, schools, hospitals, private accommodation facilities, etc. By observing the changes in this variable in comparison with the growth of the country's foreign debt, this study seeks to identify the degree to which the country's budgetary deficits and its growing

foreign debt affected its acquisition of infrastructure. By this means, the economy's attitude towards long run GDP growth in the face of budgetary deficits and rising foreign debt are assessed.

All of the above variables are obtained through internet downloads from the Data base of National Accounts held at the World Bank website. The World Bank collects this data through the governments of its member states. Standards and guidelines for data collection are set by this International financial institution. After data collection by the governments, the World Bank tests the data for consistency before its compilation and eventual publication.

3.3.1.2 Review of Publications

- **Article IV Consultations on Cameroon.**

Through these documents, the IMF seeks to assess the economic health of the economy and develop policies which seek to improve economic performance on a regular basis. Results of these consultations, published within the years within each of the stages of the economic growth regimes will be analyzed. These analyses will supply arguments to support or reject each hypothesis. From this, information will be obtained on the sources of friction which impede the flow of resources from foreign debt to Gross Capital formation, and from government spending to fiscal revenue, thus influencing the country's ability to generate GDP growth from its foreign debt.

- **Cameroon Economic Outlook Publications and Other Publications related to the Cameroon Economy from non-Bretton woods publishers.**

The Bretton woods institutions played a central role in the provision of solutions to the structural problems experienced within the country's economic history. To enhance neutrality of results, it is therefore important to use non-Bretton woods sources in the provision of answers to the issues raised in the research questions. For this reason, critical analyses of independent authors on foreign debt management in the economy will be useful in the comparison of the existing debt related data and the observed GDP growth. By this, the origin and early evolution of the country's foreign debt will be captured to suggest historical root causes for the country's observed foreign debt to GDP growth relationship.

3.3.1.3 World Governance Indicators in six dimensions (1996-2009)

(Kaufmann, Kraay, & Mastruzzi, 2010)

- **Voice and Accountability**

This measures the degree to which the country's people are allowed to participate in the choice of the bodies which govern them. It also takes into account the people's freedom to express themselves, to associate, and the freedom held by the media.

- **Political Stability and no violence**

This estimates the likelihood of a violent change of government, such as violence arising due to political reasons or terrorist action.

- **Government effectiveness**

This estimates the value of services rendered by the public sector or the civil service. It takes into consideration this sector's independence to political influence. It also takes into account the degree of quality of policy conception and implementation, as well as the government's degree of commitment to these policies.

- **Regulatory Quality**

This measures the government's ability to conceive and implement policies and regulations which make the economic environment more suitable for private sector development. This also measures the degree to which citizens respect the laws which govern social transaction.

- **Rule of Law**

This measures the extent to which citizens trust and abide by social rules, including the quality of social enforcement of contracts, property rights, and the frequency of violence.

- **Control of Corruption**

This considers the degree to which public powers are exercised to yield private gains.

These variables are interdependent, and therefore, cannot be considered in isolation. But the most interesting for this study are the country's control over

corruption, as well as its government efficiency. The government efficiency figures are justified by the attitude of the country's economic decision makers towards the country's long term debt sustainability, export diversification, and the monitoring of major sources of state revenue. These will guide the choice of a position in the current debate on whether the observed debt to GDP growth relationship results from excessive debt burden with tight conditionality, or from mismanagement.

This data is obtained from the World Governance indicators' data base coordinated by Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, working under the World Bank development research group, in the Macroeconomics and growth team. These variables are obtained using an Unobserved Component Model (UCM). The authors gathered the results via country surveys from individuals, domestic firms, multilateral development agencies, as well as Public Sector Data providers. It is suggested that these indicators expected to be strongly interdependent on one another, considering, for example, the fact that a country's accountability mechanism is expected to exert significant influence on the country's degree of corruption. [Kaufmann, Kraay, Mastruzzi, 2010, p: 5]

Conditional means were used to bundle up data. These averages gave more weight to sources providing more information. The measurements demonstrate a 90% degree of confidence that the stated indicators fall within the given range. Values of these indicators range from +2.5 for countries with more efficient institutional environment, and -2.5 for countries with relatively inefficient institutional

environment. [Kaufmann, Kraay, Mastruzzi, 2010, pp 12]

3.3.1.3.1 Why the KKM World Governance Indicators?

These indicators were developed within the World Bank research development unit. The World Bank, in partnership with the IMF are the country's important partners in its debt sustainability framework. This results from the fact that they are involved in macroeconomic supervision, and offer the economy 37.1% of its foreign debt (IMF Country Report No.10/259 2010).

The development of this data by the World Bank in 1996 came after the structural adjustment program had failed to produce sustainable results due to inadequate consideration of institutional efficiency. Considering the World Bank group's strong involvement in the management of the country's macroeconomic stability and foreign debt management, this data is expected play an important role in the choice of policy recommendations to the developing countries, especially in cases where macroeconomic aggregates fail to portray the expected relationship, such as that of foreign debt or debt relief failing to positively influence GDP growth.

3.4 Methods of analysis

The country's economy has been through three main growth regimes. Of these, the third can be further divided into two periods, considering the economic happenings within the country. This begins from the reunification of the Eastern and Southern Cameroons in 1972:

Period I

- The **crude oil boom** began after 1972 when the economy experienced a wave of **eratic growth** until the end of 1982 when groth stabilized, in the face of a **smooth growth** in the country's **foreign debt** which stayed stable between 1980 and 1984.

Period II

- The **Economic Crisis** which ran from 1985 to 1994 when the country experienced a transtition from steady GDP growth at 8% to **negative GDP growth**. Within this period the country's stock of foreign debt more than quadrupled.

Period III

- The **Economic Recovery** between 1995 and 2005 within which the economy regained positive growth and a relative restabilization of the country's mass of foreign debt.
- The **Post-HIPC** (Heavily Indebted Poor Countries) Initiative within which the economy's GDP growth rate remained stable despite the fact that the stock of the country's foreign debt had fallen to close to one fifth of the level at which it was four years earlier.

Considering the split of the country's economic history using the observed levels of debt and GDP growth, it is observable that the debt to GDP growth relationship is distinct within each of these periods. Thus the findings to answer the resarch questions and test the reserch hypotheses will be split with respect to these periods. (See figure below)

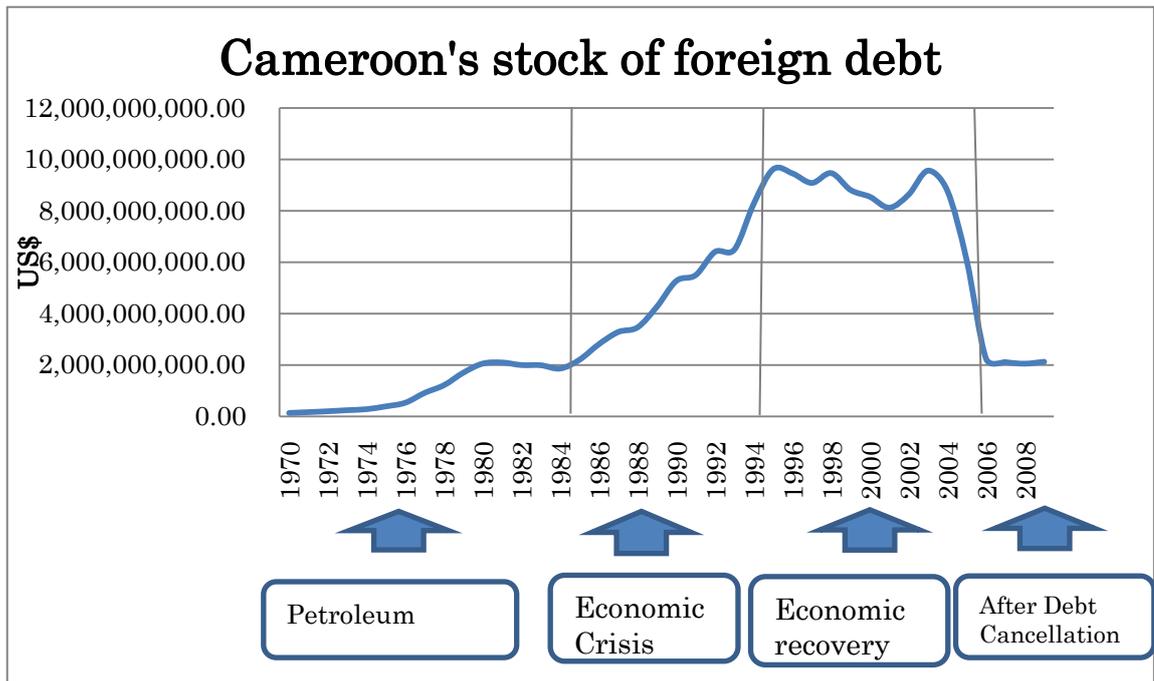


Fig 10 Periodic Partition of Foreign Debt Stock

Source: World Bank Database 2010.

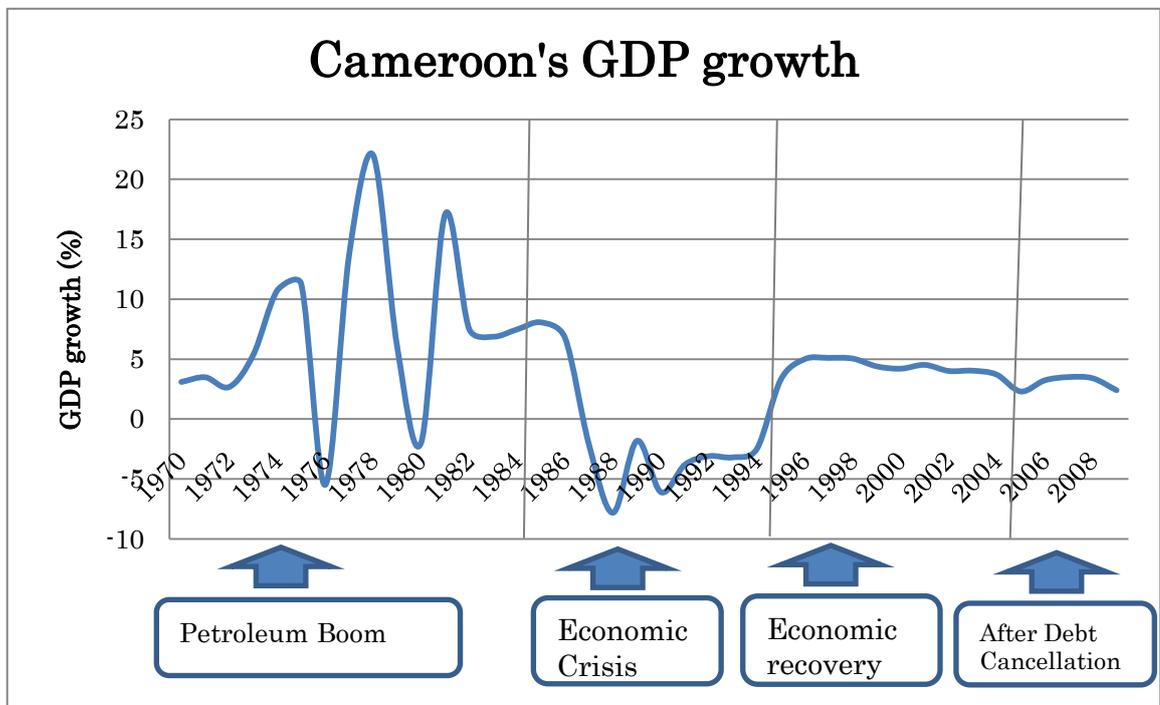


Fig 11 Periodic Partition of Cameroon's GDP growth

Source: World Bank database 2010

In this light, arguments will be raised based on each hypothesis assessing the institutional efficiency of the economy, as government officials serve as agents in the implementation of policies recommended by Multilateral or International Financial Institutions who stand as the principal. These will be guided by data from the World Bank Database, World Governance indicators, as well as publications from corporate and academic bodies.

Current and expected behaviours of local and international financial institutions will be examined using concept such as:

3.5 Other Concepts

3.5.1 Moral Hazard problem:

This is the situation whereby debtors or beneficiaries of investment projects fail to keep the profitability promise earlier made to stakeholders, either due to incompetence or laziness of managers (in this case: Government authorities), considering the fact that the causes of these failures can hardly be identified (Suzuki, 2011, p. 22).

This therefore depends on the investor or the creditor's ability to bridge the information gap which exists with his debtor through monitoring and the establishment of appropriate incentives for the keep the debtor's actions under control, in order to avoid mismanagement and laziness of managers. Conversely, by setting inappropriate incentives, such as easy availability of credit, creditors only help to increase mismanagement and thus the moral hazard problem

(Suzuki, 2011, p. 67).

Also, a regulatory structure which emphasizes on the regulation of the regulators will have a strong reduce moral hazard (Suzuki, 2011, p. 73). By ensuring that both parties in a debt contract do not abuse their rights to their own advantage, debtor behaviour can be properly managed, as opposed to systems where the role of creditor and regulator is monopolized.

This concept is used by assessing the economy's reaction to the availability of World Bank financing, such as the reaction of the GDP percentage contribution of Fiscal revenue to the provision of funds by the IFI's. A fall in the GDP percentage contribution of fiscal revenue in the face of increased allocation of funds to the country will indicate Moral hazard and thus increased dependency on external financing. Also, considering the fact that the IFI's play both the roles of creditor and supervisor, their behaviour cannot be controlled. The efficiency of IFI's in their regulatory process is observed, as well as the reaction of the debtor economy to failures of these IFI's. In the case of over-stated targets by the World Bank (such as the effect of raising interest rates above the optimal level), a loose economic policy reaction by the Cameroon economy will be interpreted as Moral Hazard.

3.5.2 Transaction Cost

High Transaction Cost is defined as the economic dimension of friction as perceived within a physical system, or the cost of information needed to keep an

economic system operational. It could result from the existing institutional structure or arrangement. This phenomenon could be the root cause of government or market failures, and may be avoided by migrating to an institutional arrangement which allows a lower transaction cost. (Suzuki, 2011, p. 44)

It may take two forms: Ex-ante and Ex-post high transaction cost.

Ex-ante high transaction cost includes the cost of:

- Determining appropriate trading partners,
- Deciding prices with trading partners,
- Setting up written terms which govern trading deals,

And Ex-post high transaction cost include the cost of:

- Controlling trading partners,
- Ensuring compliance with trading terms,

Transaction cost generally rises due to the spread of bargaining power, and cultural similarities or differences which exist between business partners. These in turn could influence the degree of trust. It is relatively difficult to quantify, and can be measured in a comparative institutional manner. But it is worth noting that institutional designs which are efficient in one case might not produce the same results in another. (Suzuki, 2011, p. 44)

By observing what percentage of the allocated funds is effectively invested in the years following the decision point of the HIPC initiative, the degree of friction between allocation of funds and their investment will be observed. A low percentage of investment of allocated funds will be interpreted as high friction in the economy. This will indicate a low level of trust and the absence of projects ready to be financed, and therefore high transaction cost.

3.5.3 Export Diversification

Yang and Nyberg (2009) use the concept of export diversification to measure a country's vulnerability to external shocks. This is measured by taking into account a country's export commodities, and evaluating the percentage contribution of its best performing exports to its total export revenue. In my opinion, therefore, economies whose best performing exports account for less than 30% of their their total export revenue would suffer less devastating effects in the event of external shocks which come to reduce the prices of these leading export commodities. According to Yang and Nyberg, export diversification is an issue which has not been efficiently dealt with in most HIPC's, therefore leaving them as exposed to external shocks as was the case before the debt crisis.

3.5.1 Agency Cost

Davis (1995; p 6), defines agency cost using its origin. He states that under normal circumstances, it comes up as a result of differences between the incentives of borrowers (agent) and lenders (principal) involved in a debt contract. This could result from the information gap which exists between

borrowers and lenders due to limited monitoring.

In this case, in the absence of full information on the financing needs of the economies (debtors) involved in the structural adjustment programme, the funds made available to cover the budgetary deficits would be likely to fail to take account of additional information, thus increasing the probability that the structural adjustment debt will lead to stabilized GDP growth. This concept will be used to justify the argument that the loans awarded in the Structural Adjustment Programme were used to cover the balance of payment deficits, rather than investment on capital as expected by the creditors. This generated an information gap between the debtors and creditors and therefore reduced the expected positive impact of foreign debt on GDP growth.

CHAPTER 4

4.0 Results

Discussion of findings

4.1. What relationship exists between the country's foreign debt and the contributors to its repayment, and Why?

4.1.1 Pre Crisis Period (Petroleum revenue Boom) 1976-1984

In the mid 70's, Cameroon experienced a new growth regime with the discovery of petroleum resources. The realization of these revenues gave room for euphoria within the economy, in the face of uncertainty on how long the petroleum prices were going to remain stable. This led the economy to an unhealthy level of dependence on fuel revenues which were needed to finance current expenses such as state personnel remuneration. This constituted a structural problem in the economy, as it depended on relatively volatile revenues for the financing of less flexible spending. (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000)

In the face of high expectation of sustained growth in the size of fuel exports and price stability, there was high dependence on expected cash inflows from petroleum exports, which were relatively unstable, to finance permanent government expenses. The economy experienced more than proportionate growth in the contribution of petroleum to the country's GDP. Between 1976 and 85, there was uncontrolled growth in the petroleum sector. This sector led the manufacturing segment of the economy which contributed 35% of the country's GDP. It can therefore be argued that this unfavorable export diversification of the manufacturing portfolio was dangerous for the economy, as the West Texas

Intermediate Crude oil price per barrel fell to less than half, from US \$ 28.82 in April 1985 to US\$ 12.85 (indexmundi.com, 2011).

The rapid fall in the price of petroleum was accompanied by minimal unfavorable variations in the prices of other exports such as banana, cotton, coffee, and cocoa within the same time frame. It can therefore be argued that for economies which play the role of price takers rather than price makers in global markets, heavy dependence on export revenue, with a relatively undiversified export portfolio can be detrimental to the economy. Aerts et al (2000, p 31) consider the issue from a micro perspective. They suggest that the economic crisis results from the fall in the petroleum prices as well as the fall in the exchange rate of the US Dollar with respect to the local currency. Rather, from a macro perspective, Cameroon's petroleum intensive export portfolio, which accounted for 60% of export revenue [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000], can be cited as a source of the vulnerability to Balance of Payment deficits experienced by the state in the mid 80's. A more diversified export portfolio would have eased the absorption of rapidly falling petroleum prices in the mist of more stable prices of the country's alternative exports in 1985.

This period thus represented an apparently stable era. The economy witnessed erratic growth and a relatively stable mass of foreign debt. The future vulnerability arose from the lack of control of export revenues, and high expectation of sustained growth in production and export price stability which led to increased dependence on these export revenues as the economy experienced an

upturn.

Between 1965 and 1985, the driver of Cameroon's economy shifted from domestic consumption to exports, having experienced a period of intensive capital investment. After developing strong export potentials, following the discovery of petroleum resources, foreign markets got targeted at the expense of local consumers, thus shifting the drivers of GDP growth abroad [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, p 20] and therefore exposing contributors to the country's payment ability to external shocks. Given that Cameroon does not hold major market shares in any of the products it exports, it has no control over the prices of its exports. Its relatively low export diversification makes the export driven growth (at the expense of consumption driven growth) a very risky choice for the economy, thus making it more difficult predict the country's GDP contributors' performance and therefore rise up to future foreign debt commitments. Rather, by stimulating domestic consumption, and earning taxes from them, the domestic contributors to GDP growth are expected to earn stability and improve the country's ability to pay off its growing foreign debt.

4.1.2 Crisis Period 1985-1994

Foreign debts were contracted within this period to cover the state's budgetary deficits. In the absence of these deficits, debts would effectively generate GDP growth. This era, which represents the economic crisis, was characterized by a high accumulation of the country's foreign debt in the absence of accumulation of tradable commodities which could be sold to finance the repayment of foreign

debt (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000, p. 8)

The vulnerability triggered in the economy during the petroleum boom created the need for structural adjustment within this period. The country's economic crisis was characterized by the failure of the economy to immediately respond to the structural reforms launched in the late 80's. This is seen in the fact that GDP growth is negative from 1986 to 1994, thus erasing the impact of earnings realized from the petroleum boom (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000, p. 9), and rapidly increasing the mass of the country's foreign debt to more than three times its value at the start of this economic crisis.

The absence and the very late request for external debt financing after the fall in government revenues, led to an aggravation of the balance of payment deficit and a rapid growth of the country's foreign debt [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, P: 50]

4.1.3 Post Crisis Period 1994-2010

This period is further divided into two parts:

- The **economic recovery**, which followed the '94 currency devaluation.
- The **post HIPC completion**, which followed the '06 debt cancellation.

4.1.3.1 Economic recovery

The devaluation of the country's currency can be perceived as an effort to re-launch the economy which had earlier on been trapped in a quasi Dutch disease

by the rapid growing petroleum earnings from the oil boom which occurred in the 70's. This re-launch followed an over-valuation of the local currency which made the country's non-petroleum exports less attractive on the global markets. After the devaluation, hypothetically, the country's non-petroleum exports performed better on global markets. This helped in the absorption of the economic crisis, and the eventual emergence positive GDP growth.

In the long term, it can be argued that the devaluation had a by-product of curing the Dutch disease through the empowerment of non-petroleum sectors which seemed less competitive earlier on. The post-devaluation recovery program constituted the Enhances Structural Adjustment Facility (ESAF) under the supervision of the World Bank and related multilateral organizations. It sought to stabilize the newly earned positive GDP growth, and not only achieve, but strengthen the positive relationship between foreign debts to GDP growth; contrary to the negative foreign debt to GDP growth relationship witnessed within the Structural Adjustment Program (SAP) during the economic crisis (1985-1994). The ESAF sought to achieve its results by increasing the investment level, emphasizing on institutional reforms, enforcing the economy's domestic revenue generating potential, improving expenditure management, and enhancing external competitiveness via a modern civil service and reinforced infrastructure (Cameroon Authorities, IMF, and World Bank Staff, 1999).

It can therefore be argued that the effective implementation of these polices would achieve tightened monitoring, poverty alleviation, and a relative efficiency in the

establishment of sustainable GDP growth. Related policies included:

- The development of an action plan aimed at improving the management and control of public expenditure.
- Fiscal sustainability program which aimed at increasing the domestic government revenues from non-oil producing sectors in the face of a falling trend in petroleum revenues due to falling fuel revenues.

Within this period, the government achieved significant progress in its privatization program. This led to a reduction of government spending through the cancellation of subsidies as formerly state owned companies got privatized. This was characterized by the privatization of the Cameroon Sugar Corporation (CAMSUCO) at the end of 1998, as well as improvements in the process of privatization of the National Palm Oil Company (SOCAPALM), the Cameroon Development Corporation (CDC), the Cameroon Mobile Telephone company (CAMTEL), the national electricity corporation (SONEL) and the national water corporation (SNEC).

By cancelling subsidies expenditure, the state sought to allocate more resources to the refund of its foreign debt. It can be argued that the absence of state ownership of these companies which provide basic necessities would reduce state control over the costs of services rendered within these sectors. This therefore will have adverse effects on the alignment of policies within these sectors with government's aim of enhancing growth through poverty alleviation, and achieving its Millennium Development Goals of making these basic necessities available to

its entire population. By prioritizing profit maximization through private ownership, social needs such as consumption of the lower class are compromised. This therefore has a negative impact on the durability of the country's control of its foreign debt repayment contributors.

Given the country's relatively high Gini-Coefficient of 44.56% (World Bank Group, 2001), it portrays a high concentration of the country's wealth within the limited higher class of the population. Considering the fact that 33% of the country's population living on 1.25 dollars a day (World Bank Group, 2001), it can be argued that privatization needs to be a gradual process, which goes through several steps. The first of these steps should aim at reducing social exclusion, and broadening the country's tax base by identifying consumers of low priced necessities. By controlling the prices of products within these privatized sectors, and including the low income population in the country's tax base, the country's efficiency in internally stimulating growth could be enhanced therefore increasing the performance of domestic GDP contributors, and reducing its dependence on foreign debt and stabilizing its GDP growth.

The IMF suggests a symbiotic relationship between capital formation and Export diversification by 2005. It observes that the improvement in the country's export diversification can help to further improve the country's investment in infrastructure. But the missing link in this symbiotic relationship is the country's weak revenue side of fiscal performance (International Monetary Fund, 2005). It is therefore argued that the establishment of this link would lead a great

improvement in the country's ability to internally generate the resources needed for the financing of its capital investments, and therefore stimulate growth without depending on foreign debt. Considering the fact that the 2002 policy recommendations of this paper (Article IV Consultation 2002) remain valid in 2004 it can be observed that the economy did not achieve significant improvement in its policy implementation. [International Monetary Fund, 2001, p: 6]

The country's non-petroleum sector on which it depended for export diversification was made up of agriculture, lumbering, and electricity generation and distribution, the transportation and communication sectors. These accounted for the economy's robustness in the early 2000's, as the petroleum reserves face diminishing output. The export share of the petroleum sector, in spite of its downward trend accounts for 40% of the country's export revenue and 25% of its total revenue. [International Monetary Fund, 2001, p: 8]

Considering the relative height of petroleum contribution to the country's export revenue, it can be argued that the country's export diversification has not been greatly improved in the short term, thus the economy remains as exposed to external shock as it was before the economic crisis triggered by the fall in petroleum prices. This susceptibility to external shocks demonstrates the ease with which GDP growth can be affected by foreign debt, therefore making the economy permanently dependent on foreign debt as a driver of growth.

The first hypothesis suggests that foreign debt has a positive impact on GDP

growth. Considering the fact that the country's growing foreign debt has been constantly used to cover the balance of payment deficits resulting from falling fuel prices, and not invested in programs to enhance export diversification, the first hypothesis is rejected.

4.2 How does a rise in the country's foreign debt level affect the percentage of its GDP spent on Capital investments and why?

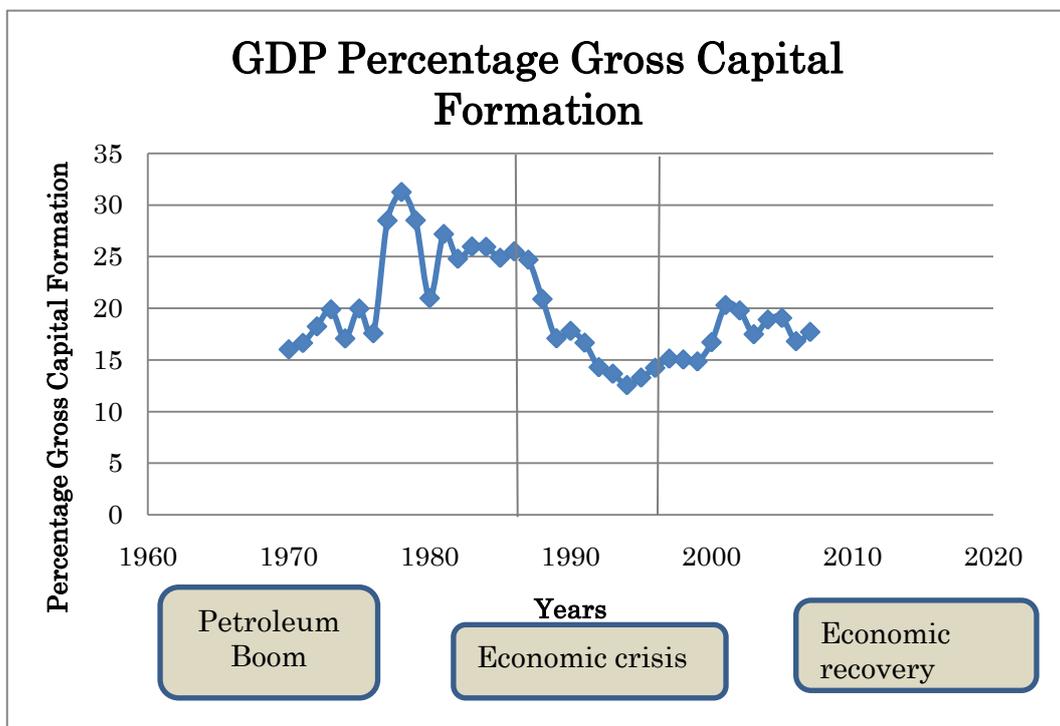


Fig 12 Periodic partition of Cameroon's GDP percentage of Gross Capital Formation

Source: World Bank Database 2010

4.2.1 Pre Crisis Period

Until 1985, there was a rise, though not smooth, in national investment spending, which could be seen as a means of stimulating GDP growth in the long term, as gross capital formation rose from 20% in the 70's to stabilize at 25% of GDP on

the 80's (World Bank Database, 2010). It can be argued that the relative stability of Gross Capital Formation in the pre-crisis period was dependent on petroleum income. Given that crude oil prices were relatively stable until 1985, the country experienced its record GDP growth in 1978, with petroleum revenues being the major contributor. In the same year, the GDP percentage of Gross Capital formation hit its all time peak. This implies that the country's Gross Capital formation was strongly dependent on petroleum revenues, but the crisis in 1985 proved that the stability of the Gross Capital formation depends more on the country's export diversification than on the revenues concentrated on a given export.

Within the petroleum boom, the country faced an erratic state of GDP growth and slow growth of its foreign debt. From observation, during the two years of negative GDP growth during the oil boom (1976, 1980), the country's percentage GDP fell below the smooth trend line. Within this period, the country's Gross Capital Formation fell less proportionately than fall in its GDP growth. Hence, it can be argued that the country's foreign debt plays a vital role in absorbing the shocks which could be suffered by the economy in the face of negative GDP growth.

Also, it can be argued that in the presence of rapid growth in the petroleum sector earnings, the economy faced a growing incentive to direct capital formation to this sector at the expense of other sectors. This is demonstrated by the petroleum sector's 60% contribution to the country's export revenue [Aerts, Cogneau,

Herrera, de Monchy, Roubaud, 2000]. This incentive to focus capital formation to a single sector works against the development of other sectors, and on a broader scale, it counters export diversification. This in turn makes the economy more vulnerable to external shocks.

4.2.2 Crisis Period

In 1987, in the face of growing budgetary deficits, government investment in fixed assets rapidly fell. In the face of negative GDP growth, the country's GDP percentage of gross capital formation fell from 24.7% in 1987 to 20.9% in 1988. This was the first sector to be negatively affected by the government expenditure reduction strategy. Through this decision it can be argued that the government's investment policy orientation was inclined towards addressing its short term needs, as the economy faced an economic crisis. Within this period, foreign financial investments stayed stable as spending on investment in local infrastructure through gross capital formation fell, as the country borrowed to finance the budgetary deficit. [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000]

Gross capital formation fell further in 1989, thus demonstrating a fall in the country's future potential to produce and therefore generate GDP growth, considering the choice of the government to prioritize consumption expenses which grew while investment spending fell. The falling Gross Capital formation within this period therefore lays a foundation for the future difficulties faced by the country in its quest to trigger GDP growth through its infrastructural development. Hence the economy's growing foreign debt within this period

covered its budgetary deficit and had no impact on the Gross Capital Formation.

4.2.3 Post Crisis Period

4.2.3.1 Recovery period

The ESAF aimed at stimulating and improving investment in social and economic infrastructure. Through privatization, the government aimed at expanding investment in new infrastructures as well as developing the existing ones. In this light therefore, the transport sector enjoyed the creation of a road fund for the financing of the construction and maintenance of the country's road network. This increment in the country's gross capital formation comes with an institutional mechanism. This mechanism requires financial and operational audits twice a year. This is expected to improve the choice of projects being financed and to strengthen the efficiency of executions within the road construction sector. (Cameroon Authorities, IMF, and World Bank Staff, 1999)

Not only did this program seek to strengthen the institutional dimension of Gross Capital Formation within the economy. It also sought to raise the country's Capital investments to a stable value of 20% of its GDP. By improving the efficiency of investment in infrastructure, it can be argued that the state expects to ease its task in stimulating consumption, earning taxes from the consumed products, and therefore using the locally raised revenue from taxes to finance future investment, thus depending less on foreign debt and unstable export revenue earnings.

Following the ESAF, in 2003/04, the country's external reserve deficit dropped by 2% of the country's GDP [International Monetary Fund, 2005, p: 10], demonstrating an overall improvement in the country's exports in the mist of relatively stable export prices (See Annexes 1-5). Considering the government's strong quest for stability through the reduction of reserve deficits, the rise in export revenues did not affect the country's foreign debt balance, its Gross Capital formation, or its GDP growth. Rather, the country's foreign debt balance falls due to debt relief in the absence of any significant impact of the foreign debt on Gross Capital formation.

4.2.3.2 HIPC and Capital investments

The achievement point of the HIPC initiative had no significant impact on the country's Gross Capital formation. Following the decision point of the HIPC initiative (2000), funds were made available for investment in infrastructure. This led to a 5% rise in the country's GDP percentage of Gross Capital Formation. This stayed stable until after the achievement point of the HIPC initiative in 2006. Within this period, the economy experienced a slight fall in its GDP growth.

Resource allocations for the HIPC initiative in the year 2004 stood at CFAF 61 billion. Yet, in the same year, the total value of approved projects equaled CFAF 300 million (0.5% of funds made available). This failure to respond to the allocated funds with projects to be financed is attributed to high administrative procedures in the provision of funds to the entitled ministries. [International Monetary Fund, 2005; p. 12] This friction in the spending of resources allocated

to stimulate growth in a slow growing economy can be argued to be an institutional weakness associated with high transaction cost.

The second hypothesis which suggests that foreign debt has a positive impact on Gross Capital Formation is not fully accepted, considering the fact that the foreign debt was not enough to cover budgetary deficits in the crisis period. Considering the slow pace of investment of funds allocated for project financing during the decision point of the HIPC initiative, high transaction cost can be said to make Gross Capital Formation less responsive to foreign debt. This demonstrates a weak relationship between foreign debt and Gross Capital formation, as foreign debt tends to be unproductive. Thus, regarding the conceptual framework, a failure to efficiently utilize foreign debt will lead to a failure to stimulate consumption and fiscal revenue. This will therefore keep the economy dependent on foreign debt in the absence of GDP growth.

4.3 To what extent did the rise in Cameroon's foreign debt level improve the GDP percentage of the country's fiscal revenues in the long run?

4.3.1 Pre Crisis Period

Between 1980 and 1985, petroleum revenues served as the strongest source of direct taxes in the economy. Within this period, the percentage contribution of such fiscal revenues to the GDP rose from 8 to 12%, as the direct tax rate on petroleum exports rose from 40% to 70% (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000, p. 28). It can therefore be argued that such a rise in the percentage tax contribution of a single product to the country's global tax revenue justifies the government's incentive to reduce public investment in other sectors of

the economy.

Increased investment in the petroleum refining sector led to a rise in the percentage GDP contribution of the manufacturing segment to 35% of the economy at the expense of the agric segment of the economy (20%), having a negative impact on the country's export diversification. This would in the long run reduce the alternatives of reaction to falling fuel prices, given the limited alternative sources of revenue.

Thus the economy's increased dependence on petroleum export income taxes relatively reduced the country's dependence on foreign debt before the economic crisis. But the strong dependence of income taxes on the value of the country's leading export (petroleum) only postponed the country's dependence on foreign debt to the era after the fall of fuel prices; when taxes could not be earned from low priced petroleum.

4.3.2 Crisis Period

Cameroon's fiscal policy allocated high tax rates on the petroleum exploitation sector. This created an unfavorable environment for the growth of this sector. As a consequence, it turned investors away from the country. [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, p: 35] The fall in fiscal revenues earned within the country in the mid 80's, and consequently, the increasing dependence on foreign debt, can be associated to this tight fiscal policy on the petroleum exploitation sector. This tendency was later on reversed by the rise in petroleum prices which

followed the invasion of Kuwait (Iraq) in 1990.

Contrary to this opinion, the government fiscal policy which fixes high tax rates on the petroleum sector could be used simultaneously as a means of controlling the growth of this sector (to improve export diversification) and maximizing government income from petroleum taxes, which could be advantageous in the stimulation of GDP growth in the long run on condition that the high revenues were used to implement export diversification projects.

Investment in petroleum exploitation comes with no commitment on the investors to develop infrastructure. Therefore, the only means by which the government can ensure infrastructural development via the super profits arising from petroleum exploitation is by the resulting fiscal revenues. Also, the high stakes (66% shares) held by the government in the National Refinery Company, SONARA, (US Department of the interior, 2009) increases the magnitude of the loss suffered by the state in the case of falling petroleum prices, given that it loses net income and fiscal revenues. This increases its dependence on foreign debts.

In 1985/86, following initial signs of the exhaustion of petroleum deposits, the government adopts fiscal policies which seek to attract petroleum exploiting companies towards the discovery of new oil deposits in the national territory [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, p: 37]. Such a policy is oriented towards the short run without consideration of the fiscal policy orientation in case of eventual oil discovery, could have a negative impact on the

country's investment environment and therefore cannot be growth enhancing in the long run.

The economy's excessive dependence on petroleum revenues cannot be over emphasized. Considering the high tax rates on petroleum income compared to income earned from other sectors, the government faces a limited incentive to harness earnings from other sectors, therefore prolonging its dependence on petroleum earnings [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, p: 52]

This dependence of the fiscal policy on revenues earned from a single export compromises the country's financial stability. By depending more on taxes earned from one export whose prices the economy does not directly control, the government's control of its fiscal earnings are subjected to external shocks and are therefore uncontrollable. This therefore implies a greater dependence on foreign debt financing, and a failure to use the existing stock of foreign debt to generate consumption in other sectors of the economy, which ought to be taxed to generate stabilized GDP growth from within.

4.3.3 Post Crisis Period

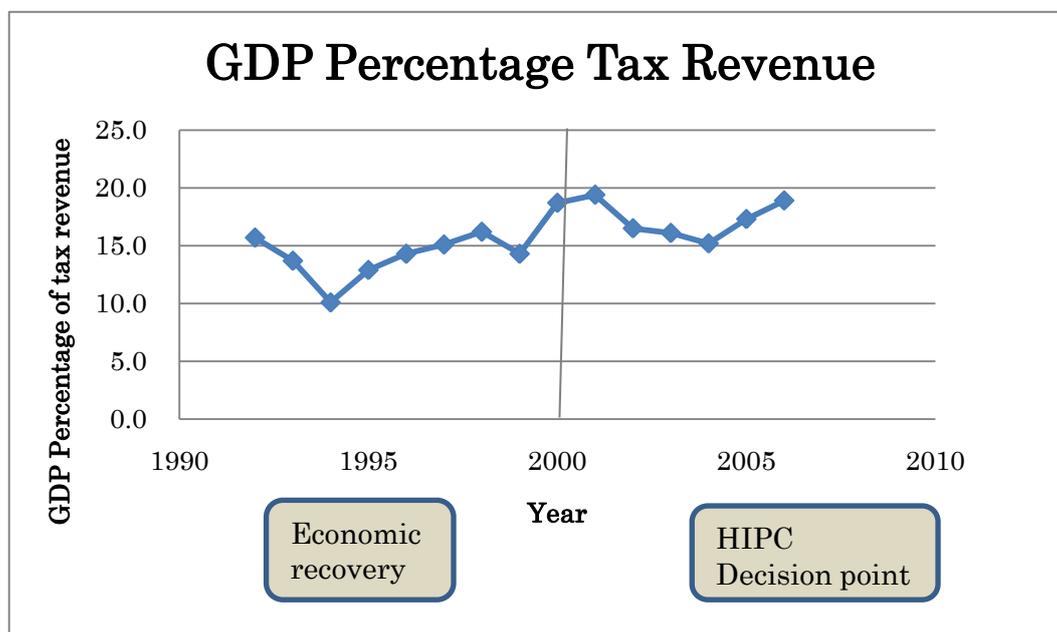


Fig 13 Periodic Partition of GDP percentage of fiscal revenue

Source: Yang & Nyberg, 2009

4.3.3.1 Economic recovery

The ESAF was guided by a board of experts from the IMF's Fiscal Affairs Department to evaluate the country's tax system and propose solutions to existing difficulties. It sought to enhance fiscal earnings through which it could meet the growing social spending needs within the economy. This was achievable through the implementation of major tax reforms which constituted the implementation of a tax on global income as well as property, and the widening of the tax base.

Following the ESAF, in 1998/99, it can be argued that the policy paper's objectives were achieved, given that the concentration of the country's fiscal revenues on the petroleum sector earnings was beginning to be diluted (Cameroon

Authorities, IMF, and World Bank Staff, 1999). This was achieved by the effective implementation of the Value Added Tax (VAT) in 1999. The results of this policy were positive as the country's percentage contribution of taxes to GDP registered a 20% all time peak between 2000 and 2001 (Yang & Nyberg, 2009).

There is therefore a need to further reduce the economy's dependence on the country's external revenues (e.g. foreign debt or export earnings) to stabilize GDP growth. Considering the fact that Cameroon is not a price maker, but rather a price taker in the global market of primary products, it tends to have less control of its export revenues. It can therefore be claimed that the 20% percentage contribution of tax earnings to GDP demonstrates the strong need to go beyond seeking to enhance earnings from the non-petroleum sectors. It creates the need to strengthen institutions to broaden the country's tax base. Such institutions are expected to enhance the enforceability of policies implemented by the ESAF aimed at reducing of tax exemptions, and creating a system to make tax payer registration and identification necessary.

The weak fiscal management within the economy in 2004 resulted from weak fiscal administration. This emerged from the sudden drift of activities to the country's informal sector, in 2003, in the absence of adaptation of the fiscal administration [International Monetary Fund, 2005; p 10]. This slow adaptation limits the government's ability to raise revenue from domestic sources to finance its growing capital investment needs, and thus, negatively influences growth stability. In the further future, if this phenomenon prevails, foreign debts will be

the only source of capital investment. This will set the stage for a future foreign debt crisis as long as the economy does not develop a mechanism for the collection of taxes expected to result from consumption stimulated by government spending.

4.3.3.2 HIPC initiative and Fiscal revenues

Following the decision point of the HIPC initiative (2000), the contribution of the country's fiscal revenue to its GDP continuously fell until 2004 (Yang & Nyberg, 2009), when the IMF recommended increased government attention to the implementation of fiscal targets with medium term perspectives [International Monetary Fund, 2005; p. 14]. The HIPC funding in this case acted as a substitute to fiscal earnings which dropped by 5% of GDP between 2000 and 2004 (Yang & Nyberg, 2009). In this light, the HIPC's decision point, through the easily accessible funding allocations, can be argued to have triggered negative impacts on the country's domestic fund raising potential, and therefore increasing the economy's dependence on foreign debt.

In this light therefore, the third hypothesis which suggests that the country's foreign debt has a positive impact on the percentage contribution of fiscal revenues to GDP is rejected. The fiscal revenues are still tied to the petroleum sector, and the tax base is still relatively narrow after the rapid growth of the country's foreign debt. The substitutive effect of HIPC funding on taxes demonstrates the fact that the availability of foreign funding has a negative impact on fiscal revenues.

4.4 How have the country's foreign debt management institutions and its major creditors affected the foreign debt to GDP growth relationship?

4.4.1 Pre Crisis Period

According to Aerts et al (2000), Cameroon's transition from a centralized government system to a democracy meant a new social need. In this case the new form of decision making which came to be applied in the late 80's, with the coming of democracy. This called for a stronger involvement of individuals in decision making. The alignment of the population with the government's objectives is achievable only in the presence of efficient institutions. Such objectives include the establishment of policies which will lead to long run foreign debt sustainability.

The transition of the Cameroon economy from high growth in the late 70's to negative growth in the mid 80's strongly questions the efficiency of the country's policy making mechanism and its public sector management. This is explained by the rapid increase in government spending (especially current expenditures which include salaries), following the rise in petroleum earnings (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000). This in mind, the country's economic policy managers were expected to take advantage of the high earnings from petroleum products, as a means to finance export diversification and reduce the adverse effects which could arise from falling petroleum prices. Failure to do so can be interpreted as government inefficiency which is demonstrated by the devastating impact of the falling petroleum prices in 1985.

It can therefore be argued that the country's foreign debt was triggered by the failure to consider uncertainty as the economy developed euphoria in the face of the economic upturn arising between 1976 and 1984. This led to an economic policy framework within which export revenues occupied a central role in the financing essential current government expenditure. This policy framework proved the limitations of government efficiency in the 1980's in the face of violent fluctuations in the prices of all the country's primary export commodity products.

The slow government policy response to falling revenues is observed between 1982 and 1986, when the country's GDP growth settled at 8%, the growth of salaries paid to the public service stayed consistently at 12%, 4% greater than GDP growth [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000 p. 19]. This demonstrates a consistent growth in spending in the face of falling revenues after 1985 and therefore a deepening of the balance of payment deficit. This turned out to contribute to the rapid growth of the country's foreign debt stock in an effort to cover the balance of payment deficit.

4.4.2 Crisis Period

Following the sharp fall in the public revenues in 1986, total public expenses still rose by 20%. Also, between 1985 and 1988, government revenues fell by 29%, while government spending fell by 16%, far below the fall in revenues (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000, p. 49). This late adaptation of government spending to revenues defines the degree of discipline demonstrated by policy makers. It paves the way for future inertia in the use of automatic

stabilizers in managing future government spending needs in the face of a crisis. Such a decision will serve to increase the amplitude of a crisis resulting from budgetary deficit, and thus strengthens the need for foreign debts to trigger GDP growth following the exhaustion of national financial reserves.

The contraction of public investment while increasing current expenditure can be interpreted as short term policy inclination. This emerges from an “obligation trap”. This is a situation in which the public sector’s commitment to current expenditure financing reduced the necessity if financing long term needs in capital investments. This can be argued to constitute an agency cost issue arising from the public policy inclination. Hence the public sector will face the incentive to pursue short term micro interests while international financial creditor institutions pursue long term macro interests of restructuring the economy and therefore stimulate GDP growth by financing capital investment. This divergence of goals of the institutions tends to increase the cost of financing, and therefore limits the propensity of foreign debt stimulating GDP growth.

It can be argued that government inefficiency is greatly exposed by the occurrence of the economic crisis between 1985 and 1994. This is demonstrated by the impact of policies enhancing the reduction of public expenditure on the mass of the budgetary deficit. Despite the magnitude of measures to reduce government expenditure, budgetary deficits prevailed. These deficits stimulated demand which was a lot greater than the supply of debts from foreign creditors. (Aerts, Cogneau, Herrera, de Monchy, & Roubaud, 2000) The failure of the state policies to invert

the country's budgetary deficit situation was responsible for the consistent growth of the country's foreign debt and its failure to generate GDP growth.

In 1985, the state, unable to fully finance its accumulated commitments, turns to local suppliers and banks, thus deepening the insolvency situation in the economy. [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000] This can be used to measure government efficiency. It can be interpreted as state-triggered systemic risk, whereby the state creates a liquidity crisis which infects their suppliers as well as the banking system. This dried out credits from banks, limiting their ability to serve depositors and reduced the companies' ability to award credits, and therefore deepens the recessionary situation in the economy. Furthermore, after the failure of local loans to cover budgetary deficits, and the fall in the confidence within the banking sector which fell into a liquidity crisis, the state faced the obligation to finance its outstanding obligations towards the banking sector. The rise of Cameroon's foreign debt in the absence of GDP growth in 1985 can therefore be attributed to the need to reestablish confidence in the banking sector, to help this sector enhance its contribution to GDP growth.

Following the fall in public sector revenues in 1985, the country's ministry of finance sought to reduce government spending in order to reduce the magnitude of the country's Balance of Payment deficit. The first sector to get affected was capital investment, whose GDP percentage fell greatly in 1987. Next was the acquisition of materials for the manufacturing sector, which fell slightly in 1989 at the onset of the supervision of the IMF and the World Bank within the structural

adjustment program. Then, foreign investment of the government abroad dropped in 1991, to cover accruing interests on government loans, while the level of state subsidies fell a year later. And the last sector to get affected by the revenue reduction was the salary allocation to the national civil service which fell below the level from which it had been rising in 1985 when the crisis hit. [Aerts, Cogneau, Herrera, de Monchy, Roubaud, 2000, p: 55] This represents inefficiency in state policy which sought to increase consumption through rising salary expenses at the expense of gross capital formation for future growth enhancement, while simultaneously maintaining the level of foreign financial investments in the face of budgetary deficits.

The negative control of corruption in the mid and late 90's can therefore be attributed to the falling efficiency in the civil service which arose from falling motivation which came as a result of the continuous fall in the civil service salaries for two consecutive years :1992 and 1993.

4.4.3 Post Crisis Period

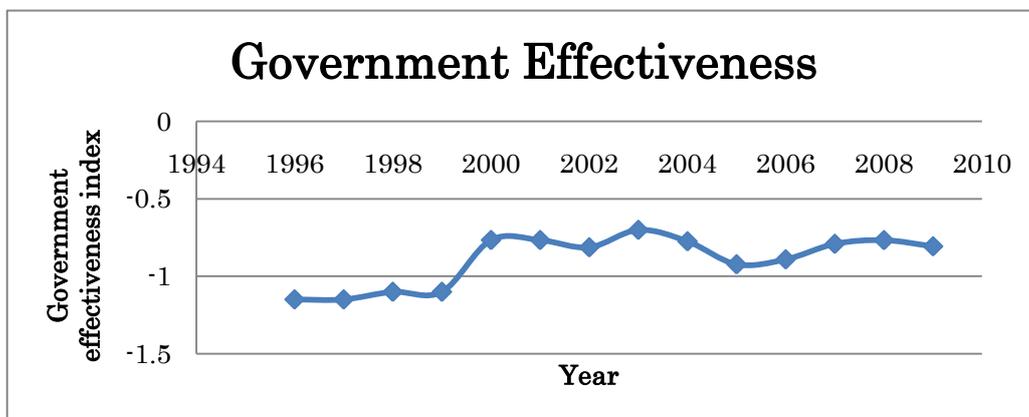


Fig 14 World Governance indicators' value for Government effectiveness

Source: KKM Global Governance Perception indices

4.4.3.1 Economic recovery

The institutional development mechanism was guided by a Medium Term Expenditure framework (MTEF) which ran for three to five years starting from 2000/2001, with closer monitoring, through quarterly budgetary execution reviews in the sectors through which GDP growth is sought (Cameroon Authorities, IMF, and World Bank Staff, 1999). This is expected to have accounted for the improvement and stabilization in the country's governance perception indices in the years which followed 2000 as seen in the government effectiveness figure. This factor is influenced by the other institutional indicators (See Annex)

The ESAF recommended a strong collaboration of state authorities with the United Nations Development Program (UNDP) in creating awareness on governance issues, prior to an anti-corruption policy implementation in 1999/2000. This program also requested an improvement in the exercise of discipline in the collection and management of public finance statistics.

It can be argued that this led to an amelioration of the country's monitoring mechanism which controlled the objectives and achievements of the state budget, local and foreign debt, as well as the performances of state owned companies to ensure their growth enhancing potential. (Cameroon Authorities, IMF, and World Bank Staff, 1999). These policy evolutions support the argument which that there

has been a relative improvement in the country's governance perception indices in the latter years of Cameroon's economic recovery.

This revenue earned from petroleum, which constituted 25% of the state's total revenue in 2004 is managed by the National Hydrocarbons Corporation (SNH). This institution still faces the strong need for enhanced transparency and accountability, considering the regular untimely submission of its financial audit reports by local auditing firms [International Monetary Fund, 2005, p: 7]. Given the limited disclosure or publication of the financial information generated within this corporation which manages 70% of petroleum earnings, government effectiveness is quite questionable, as demonstrated by the KKM Global Governance Perception indices.

4.4.3.2 HIPC initiative and institutions' efficiency

The HIPC initiative, prior to the completion point, created an incentive for the creation of institutions to enhance the country's institutional efficiency. In spite of the creation of governance enhancing entities which include the ministerial anti-corruption departments, the office in charge of audits, and the constitutional court, most observers judge the country's governance mechanism as relatively inefficient [International Monetary Fund, 2005; P. 14] It can therefore be argued that this initiative created a relative, rather than an absolute improvement in the country's governance mechanism. It raised awareness on the need for institutions in the quest for debt sustainability. It can therefore be interpreted as a starting point in the use of institutional mechanisms to unlock the economy's potential.

The IMF admits that the blame for failures in achieving the goals set in the country's foreign debt and growth management is not entirely to be borne by government authorities. Rather, these are due to the changes in the definitions of performance targets by the fund, as well as the setting of unrealistic and unachievable goals by the fund. [International Monetary Fund, 2005; p. 14].

The IMF authorities, despite their good intentions towards setting global financial stability, are hereby trapped in a state of bounded rationality, whereby the targets they set were not achievable, and so needed to be redefined. Such inefficiency from this International Financial Institution (IFI) leads to a question on whether they should be monitored or regulated. This has a negative impact on the incentives of the country's institutions as they seek efficient foreign debt management.

It can therefore be argued that the admission of inefficiency in monitoring bodies like the IMF creates a moral hazard effect on their borrowers as they seek to bare more risk as well as inefficiently utilize the resources they make available. The "unconditional" availability of IMF credits therefore increases the moral hazard among the economies that are financed by this IFI, as the less efficient economies tend to attract financing. This is observed by the acceptance of Cameroon at the achievement point of the HIPC initiative in 2006, in spite of its relatively stable GDP growth and its rapidly falling debt to GDP ratio between 2000 and 2005 (See Annex). This comes a long way to question the necessity of a massive debt

cancellation program through the HIPC initiative in this relatively stable economy. Furthermore, it questions the incentive created in the mind set of the country's foreign debt management, and the future of the country's foreign debt dependence, and its ability to generate and stabilize growth using domestic sources.

Considering the fact that only 0.5% of the resources made available for the HIPC fund was utilized (International Monetary Fund, 2005, p. 13), the country's institutional framework can be argued to be one of the strong reasons why the country's foreign debt cancellation and increased provision of financial resources tends to have no significant positive impact on the country's GDP growth. This friction which leads to slow use of HIPC funds can be interpreted as a form of ex-ante high transaction cost which results from the high cost of identifying business partners, and drafting appropriate contracts and projects. Each of these demonstrates lack of trust and technical knowhow in the system. In general, it slows the flow of foreign funding to government spending.

The quantitative (less than 150% debt to GDP growth) rather than the institutional conditionality focus of the HIPC initiative prevents the HIPCs from achieving long term debt sustainability results. Furthermore, the decision point of the HIPC initiative (2000) led to a relative enhancement of the country's overall institutional efficiency. Then the country was admitted into the HIPC initiative's achievement point in 2006. In the absence of an absolute improvement of the country's institutional efficiency by the IMF and the World Bank; and in the absence of a political will of the government which has ruled the country for the past 29 years,

the economy will remain unable to raise taxes to finance capital investment. This will only help to enhance the country's dependence on foreign debt, and thus pave the way for the country's next debt crisis. Hence, regarding the fourth hypothesis, which suggests that the relationship between the local and foreign debt management institutions improves the foreign debt to GDP relationship, is rejected. This results from the fact that the impact of the relationship between local and international foreign debt management institutions has not led to a significant impact on the efficiency of domestic institutions which are the key to the development of the country's GDP.

4.5 Limitations

1. Qualitative, therefore values are relative and not absolute. Therefore, this work simply disqualifies the fixed 150% debt to GDP ratio which stands as a measure of debt sustainability sought by the HIPC initiative. It therefore suggests that the debt to GDP ratio at which debt sustainability can be achieved depends on the efficiency of the institutions within the country. It does not go as far as prescribing a debt to GDP ratio at which Cameroon's foreign debt will be sustainable. It recommends improved institutional efficiency, through which the economy will be able to repay its foreign debt without compromising its GDP growth.
2. Focus is turned towards domestic, rather than international institutions designing. The country's foreign debt is governed by contracts signed between the country's representatives and its creditors. Therefore, a full analysis of the

impact of foreign debt on GDP growth is expected to study with equal precision the debtors, as well as the creditors. But this study focuses more on the debtors, paying little attention to how the creditors influence this relationship.

3. This work does not deeply consider the political underpinnings which could have a deep impact on economic decision making within the economy. It therefore considers the country's government as an entirely economic entity with basic social interests, rather than one with political and environmental constraints which could influence its spending and investment decisions, leading them contrary to GDP growth enhancement.
4. The World Governance indicators are grossly interdependent on each other. They therefore portray institutional efficiency by comparing governance practices between selected of countries. Due to this interdependence between governance indicators, the attribution of the observed debt to growth relationship cannot efficiently be attributed to a specific indicator.

CHAPTER 5

Conclusion and Recommendations

5.1 Conclusion

Birdsall & Williamson (2002) established critiques of the HIPC initiative and its ability to serve HIPC's long term social welfare and debt sustainability needs. This was done by taking consideration of two major opposing schools of thought. This debate tends to divide beneficiaries of this initiative into two groups: Countries too poor to earn adequate benefits from the initiative, and countries which are relatively endowed yet not properly managed.

5.1.1 “Foreign debt down the rat hole”

This concept is used to claim that developing economies are too wasteful and corrupt. It perceives the International Financial Institutions as being relatively loose with funding criteria, and therefore deepening the corruption problem, therefore keeping the developing countries within a vicious circle, in which there is the permanent need for foreign debt.

5.1.2 “Poverty trap”

Conversely, this concept claims that the International Financial Institutions provide relatively tight conditionality, and limited funding. With this in mind, the developing countries are too poor to retain any long run benefits from foreign debt, considering the fund supply-to-conditionality mix.

5.2 Cameroon's position in the existing debate

5.2.1 Debt and aid are so easy to get

- Creditors are said to be partially responsible for the mismanagement of foreign debt, considering the fact that the choice of debtors is guided by a combination of bureaucratic and political reasons, in the absence of accountability, as the international financial institutions seek to meet lending targets rather than having long term agendas which attend to the true needs of the HIPC's.
- In the case of Cameroon, the systemic failures which create friction within the economy, preventing foreign debt from creating sustainable GDP growth are not addressed as these debt relief programs are being administered. Therefore, the solutions they offer tend to be relatively superficial.
- The institutional framework between the debtors and creditors, as well as the major debt relief actors, demonstrates increased political pressure for a speedier reduction of the country's foreign debt. This would increase the waste of resources by debtor countries and fight against the tough decisions of donors.

Cameroon's admission into the decision point of the HIPC initiative (2006) in the midst of relatively stable GDP growth and falling debt to GDP ratios is a sign of pressure for a more speedy foreign debt reduction. Speedy debt reduction in the presence of a relatively stable economy reduces the country's incentive to efficiently manage its foreign debt, and therefore could make decision makers

relatively more wasteful or highly risk seeking.

5.2.2 Receivers of debt relief are often wasteful and corrupt

- The relatively shallow quantitative dimension of the existing foreign debt management mechanisms does not run for long enough to adequately address the issue of governance. The enhanced HIPC initiative provided more resources and was faster, as countries could achieve completion point within nine months instead of nine years. They therefore leave the HIPCs relatively corrupt, thus questioning the long term efficiency of such a program.

Cameroon falls within this category in the sense that this program brought about increased control from world governance bodies. The debt cancellation therefore only had a temporal effect on governance enhancement, leaving the levels of corruption relatively high in the long run, and therefore cancelling the institutional effect of the program in the long run.

5.2.3 Debt relief covers immediate needs, hence the persistence of bad policy

Considering the fact that the HIPC seeks to improve the social welfare within the HIPCs, the criteria for selecting eligible countries included the debt to export ratio. By reducing the expected debt servicing ratio, the creditors seek to free resources for social expenditure. In the presence of a poor policy mechanism, there is no transmission of the freed resources to the satisfaction of social needs.

The changes initiated in the HIPC initiative were relatively less inclined to the “Debt down the rat hole” debate. These changes favored of larger debt relief and softer conditionality in order to enhance the flight of HIPC’s off the poverty trap. They are expected to have more favorable effects on very poor countries which could not grow in spite of good governance. The effects of this policy framework on economies with poor governance indicators could be destructive in the long run, thus making them more dependent on foreign debt.

Regarding Cameroon’s governance indicators, it can be argued that the country falls among those with weak policy efficiency. Therefore, its economy can tolerate indebtedness as high as 100% of its exports and 30% of its GDP (World Bank and IMF, 2011). Its eligibility for debt relief under the HIPC initiative can be supported by the fact that, in 2004, before the decision point of the country’s debt covered 56% of its GDP, which exceeded the 30% threshold. Contrary to this, the country’s debt-to-export ratio was 67%, which is below the debt sustainability threshold, thus making the country’s eligibility to foreign debt questionable.

5.3 Recommendations

5.3.1 General Recommendations

For improved efficiency of debt relief initiatives recommendations at the level of regulators should include: tighter conditionality within good macroeconomic policy and good governance. In case of failure of conditionality, debt relief should be awarded as remuneration to countries for their observation of good governance and efficient macroeconomic policy. (Birdsall & Williamson, 2002, p. 33)

According to Cohen & Vellutini (2004) low income countries, such as Cameroon need local debt surveillance mechanisms. These institutions should be designed to operate within the country's financial markets. Here, they can benefit from the quantitative and institutional information held in these markets, to generate information which can be useful to future creditors. For enhanced power, credibility, and independence, these debt management monitors they need to be backed by a strong presence of international financial institutions. This will improve the management of the country's foreign debt, keep it from growing beyond control, as well as guide foreign creditors to award loans in a growth enhancing manner.

For small countries which lack the price making bargaining power on global markets, as they seek to establish the drivers of their economic growth on foreign markets, via export revenue, export diversification is a necessary measure for the prevention of future budgetary deficits. Through export diversification, the state budget will cease to depend on one type of resource for more than 40% of its export revenue, as is the case with Cameroon which still depends on petroleum for 49.8% of its export revenues (Yang & Nyberg, 2009). This is expected to improve the absorption of external shocks resulting from price fluctuations on international markets, as rising prices of one export are expected to offset the falling prices of the other.

5.3.2 Recommendations under the existing debate

Recommendations on Cameroon's argued position

Foreign debt down the rat hole

- Conditionality in the provision of debt relief should be more disciplined, and increasingly be turned onto governance and policy rather than the eagerness to meet their credit award quota.
- In case of failure of policy oriented conditionality, increased selectiveness of countries receiving debt relief should be used as a means of remunerating countries with good governance and policy, to serve as an incentive for the improvement of policy and governance in countries with poor performing policies.

5.3.3 Recommendations under the

Foreign debt and the Poverty trap

- To ensure the trickle-down effect of foreign debt to the population in the quest for poverty alleviation, the debt relief and new aid initiatives should be associated with programs in an institutional framework within which empowers the poor, giving them a voice in the government's allocation of resources.

5.3.4 Recommendations arising from the Conceptual framework

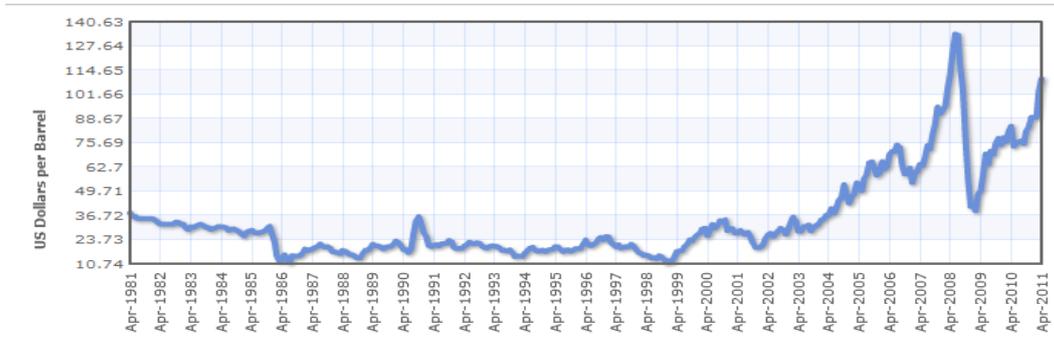
- Through the debt management programs, policy adjustments should include modification of the institutional design. This design should be built in order to reduce transaction cost. By reducing transaction cost, the time interval between the receipt and investment of funds can be reduced by the

development of long term plans and projects which will come to reduce the cost of identifying business partners and restore trust in the system.

- There arises the need to improve the governance mechanism of the country, in order to channel government revenue to growth enhancing projects. Therefore the major sources of government revenue need to be subjected to more frequent monitoring and increased transparency.
- Considering the country's limited tax base and its high GINI coefficient, a long term poverty reduction program will be needed to identify the population living on less than a dollar a day so that they may be included in the tax base. By this means, the enforceability of their fiscal obligations may be enhanced and their benefits from the countries infrastructural investments will be retransmitted to the government in order to boost tax revenues.

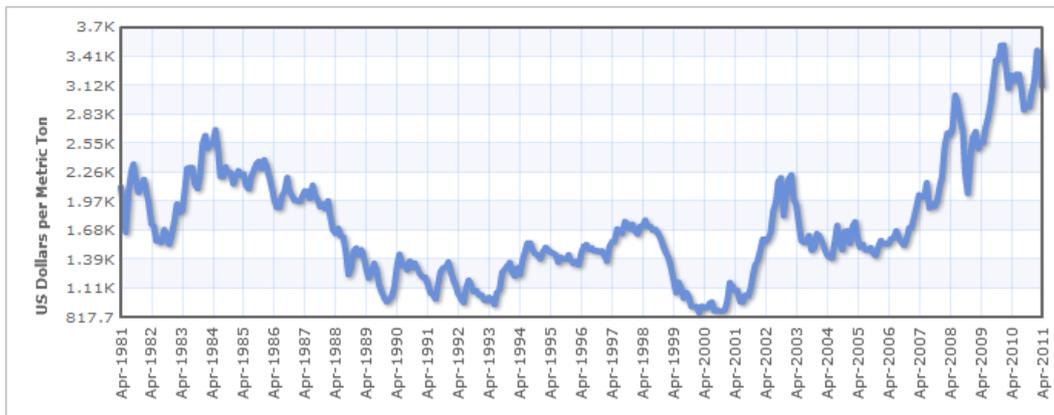
ANNEXES

1.1 Petroleum Annual price index (indexmundi.com, 2011)

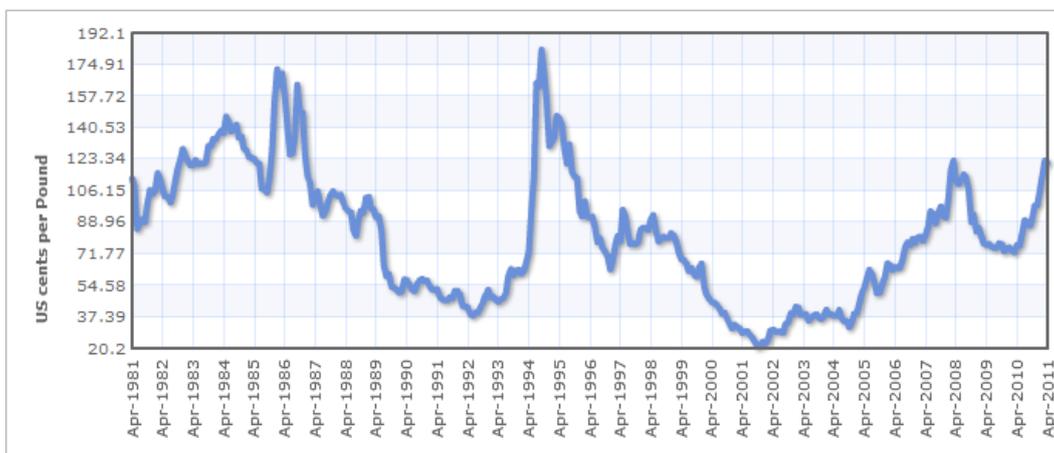


Description: Crude Oil (petroleum); West Texas Intermediate, US\$ per barrel

1.2 Cocoa Beans Annual Price Index (indexmundi.com, 2011)



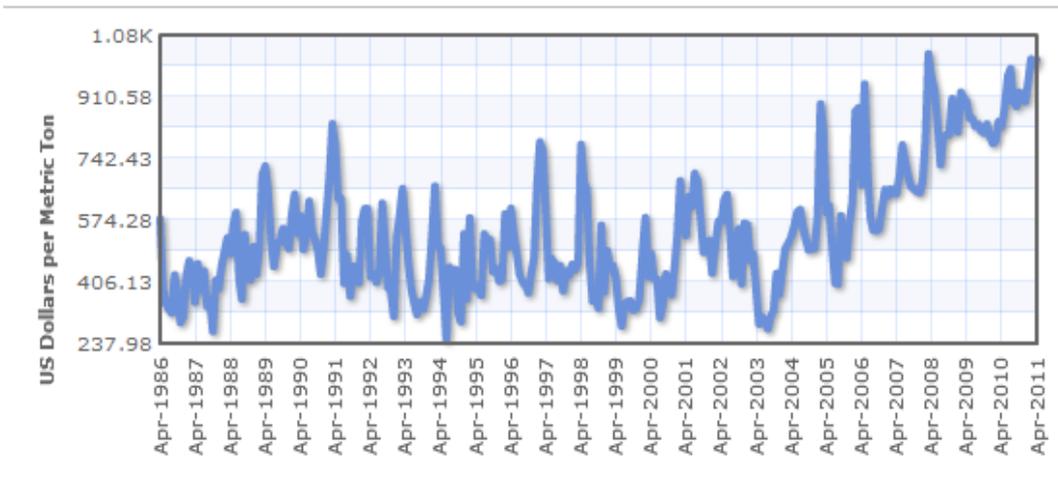
1.3 Coffee Annual Price index (indexmundi.com, 2011)



1.4 Cotton Annual Price index (indexmundi.com, 2011)

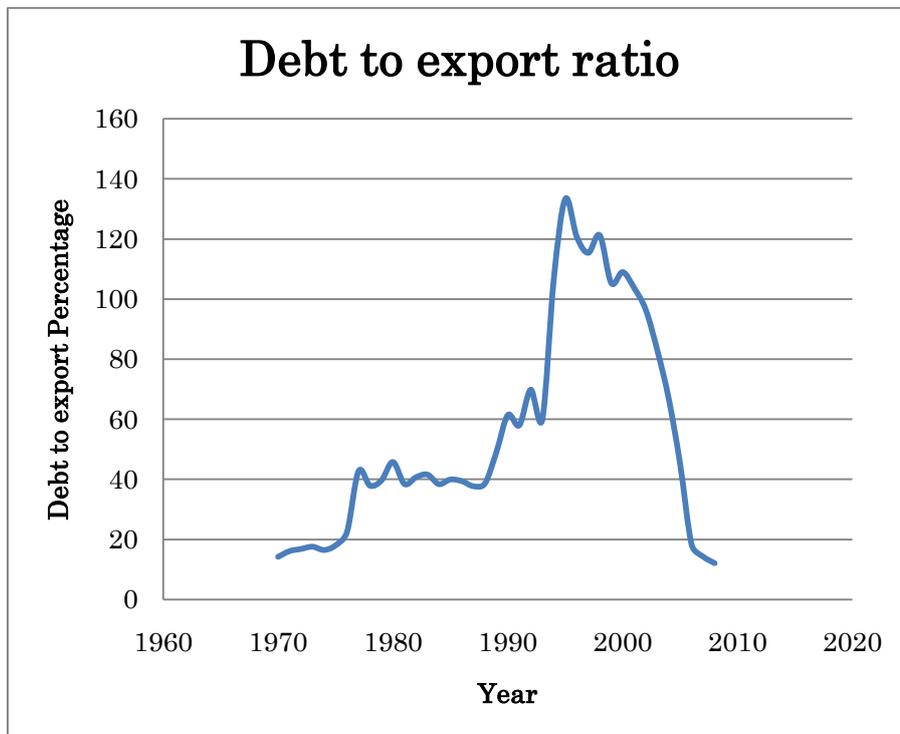
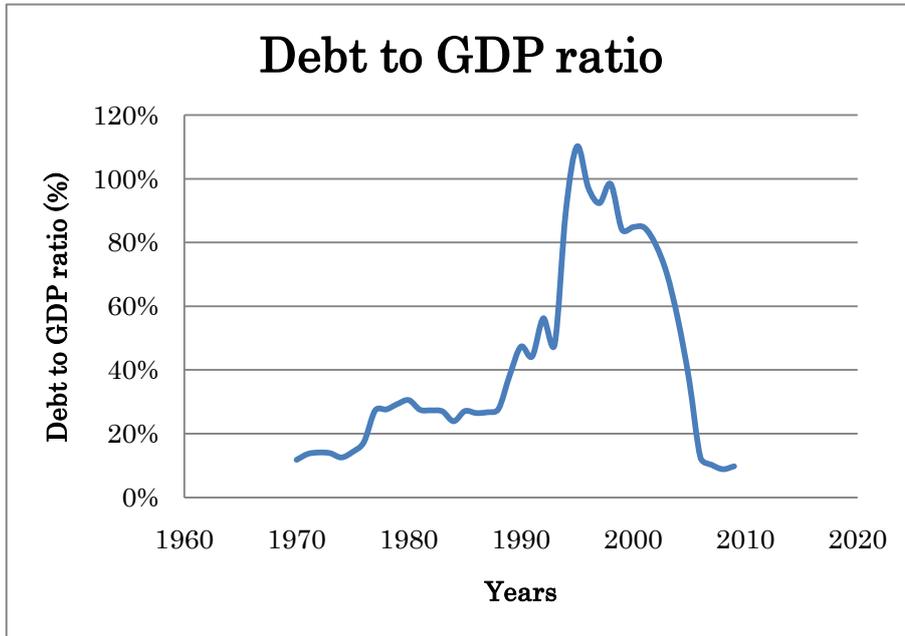


1.5 Banana Annual Price per metric ton (indexmundi.com, 2011)

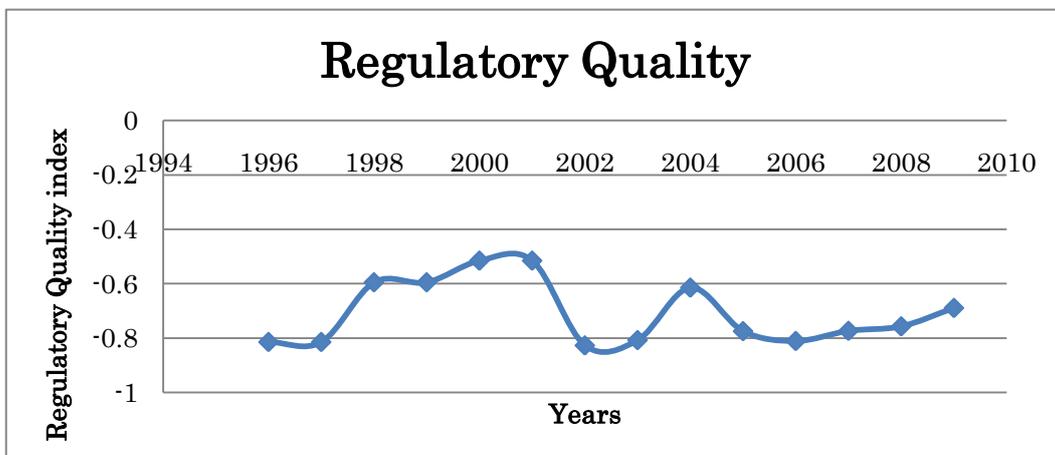
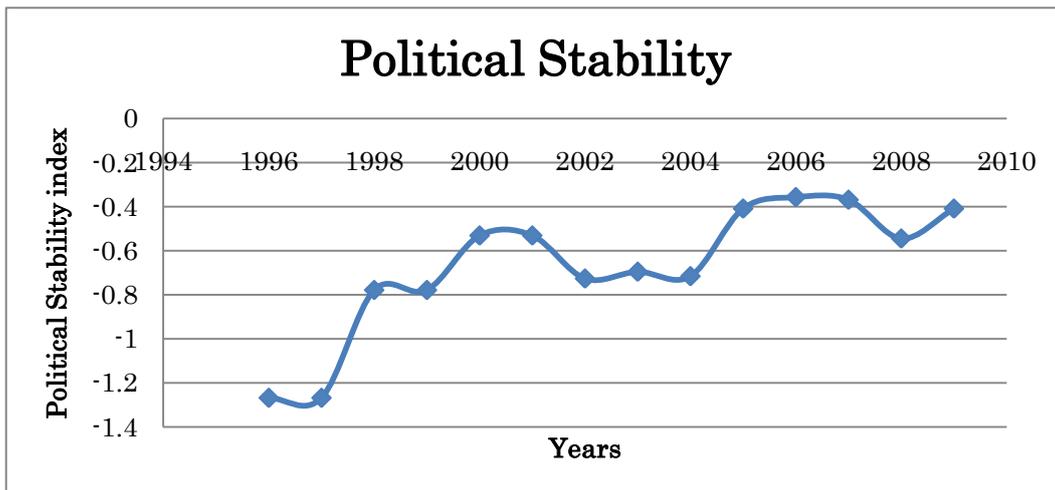
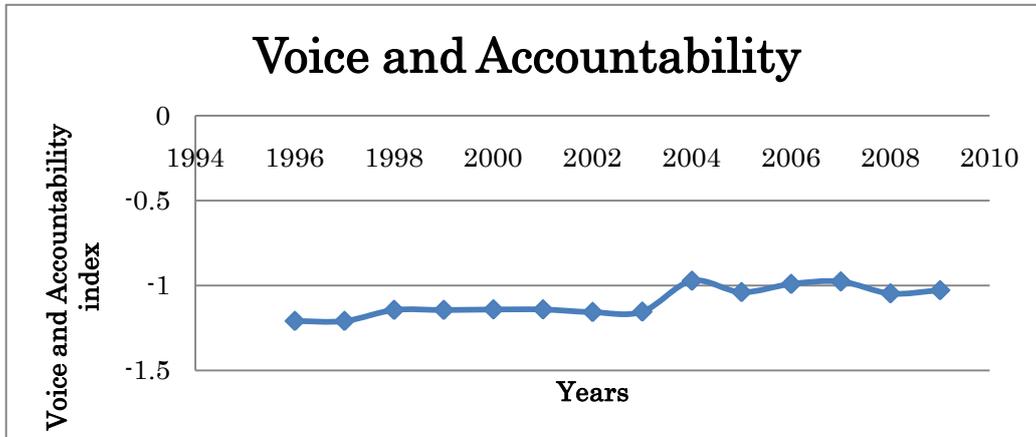


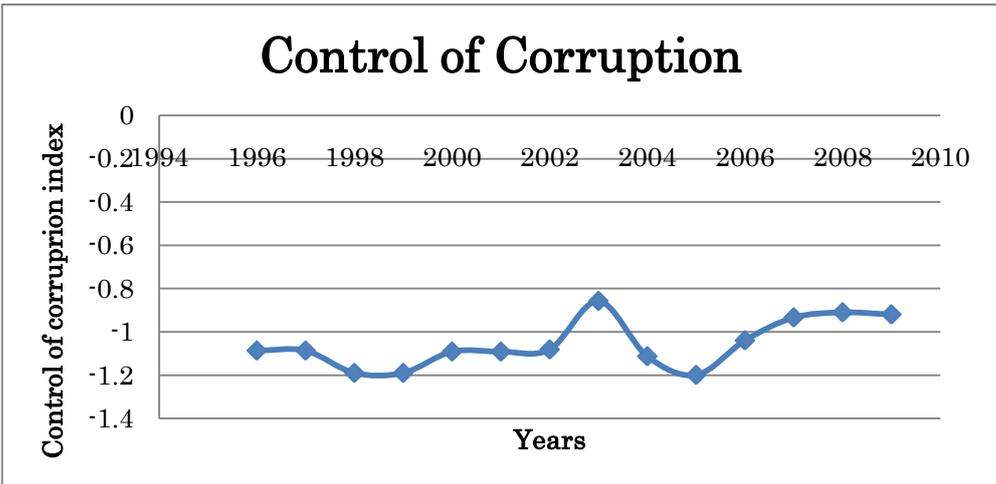
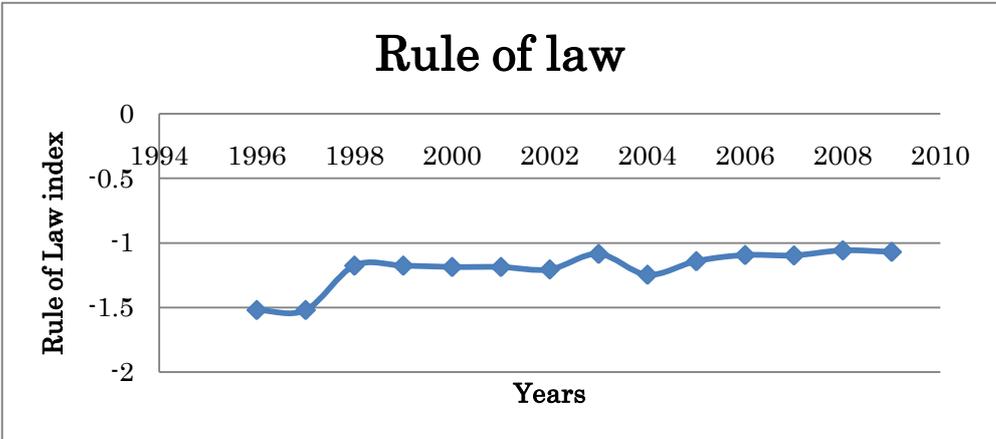
Cameroon's Performances on HIPC Debt Sustainability Thresholds

Source: World Bank database 2010



World Governance Indicators for Cameroon: Source KKM database





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