Foreign debt: encourages or inhibits economic growth (empirical study in ASEAN countries)

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Abstract.
This research aims to analyze : (1) The pattern of foreign debt change and economic growth in Asean (South East Asia) countries, (2) does foreign debt encourage or inhibit economic growth in Asean (South East Asia) countries. Technique of data analysis utilising qualitative descriptive method and quantitative. Pattern of foreign debt change and economic growth in Asean countries (South East Asia) utilising descriptive analysis. In analyzing whether foreign debt encourage or inhibit economic growth in Asean (South East Asia) countries is used Panel Data Regression. The result shows the pattern of foreign debt's development in Asean (South East Asia) countries is fluctuated and tend to increase in several countries, as like Indonesia, Malaysia, and Vietnam. In the meantime Myanmar tend to be stable. The pattern of economic growth in Asean countries during 1990-2017 is fluctuated and there are no countries possess an even increasing pattern of growth. Moreover, none even unstable. The result proves that foreign debt has been inhibited economic growth in Asean countries during 1990-2017.

Keywords: foreign debt, ASEAN countries, economic growth

INTRODUCTION

Both theoretically and practically, the lack of fund to finance domestic investment which has been carried out by numerous developing countries over the world is lend abroad in the form of foreign debt and grant, and inviting foreign investment as like *direct investment* in the form of *foreign direct investment* (FDI) or *portfolio* investment. Foreign debt is important financial source used in increasing domestic funding sources to support development and another necessary for a country. Usually, foreign debt is caused by a country that lack domestic savings and foreign exchange needed for achieving development purposes and another national purposes (Abu Siddique, 2016). Foreign debt is still believed to play the important role in accelerating development process and economic growth a country.

As do numerous countries in the world, developing countries in Asean (South East Asia) countries also carry out lend abroad like foreign debt to accelerate development process and encourage the economic growth. Almost all Asean countries during 1990-2017 as like Indonesia, Malaysia, Thailand, Philippines, Vietnam, and Myanmar, commonly the foreign debt tends to increases.

Related to foreign debt and economic growth, the experience of numerous countries shows that there are foreign funds sources in the early stage can encourage the acceleration of economic growth. Grifis and Eros' research cited by Syaparuddin (2013) conducted in fifteen African and Asian countries in period 1962-1964 found that foreign debt had increased economic growth of these countries. Meanwhile in twelve Latin American countries in 1967-1964 concluded foreign debt had inhibited the economic growth of Latin American countries. Research according to Akshaya Kumar Mohanty's (2017) on relations amongst of foreign debt and economic growth in Ethiopia. The fact shows that funds not always distributed into real productive sectors, mismanagement of funds and / or funds diversion into private firms.

Chenery and Strout *in* Sami Al Kharusi and Mbah Stella Ada (2018) explained that the fundamental reason why developing countries and *emerging countries* carry out foreign debt is due to lack of savings and investment. Countries that have insufficient savings will seek loan sources both from domestic and international sources to maintain consumption and economic growth (Sami Al Kharusi and Mbah Stella Ada (2018).

Dornbusch *in* Tulus TH Tambunan (2012), the main cause of the high foreign debt of developing countries is mainly caused by three types of deficits, namely the current transaction deficit (TB) or without looking at other components of TB, the trade gap deficit, namely exports (X) less than import (M), the investment deficit or I-S gap, viz, the funds needed to finance domestic investment (I) are greater than national or domestic savings (S) and fiscal deficits (fiscal gap).

Pattillo et al *in* Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahuddin B. Hassan (2016), argued that according to traditional neo-classical model, foreign debt will increase transition economic growth, due to it is possible to motive capital mobility, and the ability to utilize foreign resource sources. It gives countries that lack capital the incentive to get loans and invest whereby the marginal return of capital is greater than the global interest rate. In countries that have a lot of debt, "debt wrapped around", foreign debt is considered to be the main cause of distortion and slowing economic growth in a country (Sachs, 1989; Bulow and Rogoff, 1990 *in* Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahuddin B. Hassan (2016).

The impact of foreign debt on economic growth has been studied by economists, with positive and negative results. Rashid Zaman and Muhammad Arslan's research (2014), about The Role of External Debt on Economic Growth: Evidence from Pakistan Economy using the OLS regression model for 39 years. Statistical findings from the Study revealed that gross capital formation (GCF) and foreign debt stock have a significant positive effect on Pakistan's economic growth (GDP), while gross domestic savings does not have a significant impact on Pakistan's GDP. A study by Calderón and Fuentes (2013) in Latin America revealed that the impact of foreign debt on economic growth during the 1970 ~ 2010 was negative (Sami Al Kharusi and Mbah Stella Ada (2018)

LITERATURE REVIEW

Pattilo *et al* in Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahudin B.Hasan (2016) stated according to traditional neo-classic model, foreign debt will increase transition economic growth, it is possible capital mobility and ability for utilising foreign source. Some of countries lacking capital, this way is incentive to get loan and investment whereby marginal of capital is higher than common interest rate. Debt or loan are important tools for government to finance a country's development. Eventually, debt is used for expenditure to bring about productivity and stimulate economic (Burhanudin, M. D., Muda, R., Nathan, S. B. and Arshad, R (2017). As stated Rashid Zaman and Muhammad Arslan (2014) about *Role of Foreign Debt To Economic Growth In Pakistan* utilising OLS Regression Model during 39 years proved gross capital formation and foreign debt stock have positive effect to Pakistan's GDP. Aside from numerous benefits, foreign debt has another effects. In countries those have myriad debts, '*debt trapped*' foreign debt is considered as main reason of distortion and slowing down economic growth for a country (Sachs, Bulow and Rogoff, 1990 in Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahuddin B. Hassan (2016).). Slowing down of economic growth due to those countries missing opportunity to pull up private investment. On the other hand, debt payment has been depleted income of indebted countries. (Levy-Livermore and Chowdhury, 1998 in Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahuddin B. Hassan (2016).).

Shahnawaz Malik, Muhammad Khizar Hayat, and Muhammad Umer Hayat (2010) studied *External Debt and Economic Growth: Empirical Evidence from Pakistan*, stated the depend of external financial source become uncontrollable at the end of 80's. Pakistan has relied lot on foreign debt to finance deficit balance of payment and covering saving investment gap. Foreign debt doen't have special role in Pakistan's economic, it's caused *miss-management* foreign debt. Nowadays, foreign debt becomes one of constraints in Pakistan's economic development.

Calderon and Fuentes in Sami Al Kharusi and Mbah Stella Ada (2018) carried out research the foreign debt effect on economy growth's Latin America 1970-2010. The result showed foreign debt had negative effect on economy growth

Panagiotis Pegkas's 2018 studied of The Effects of Government Debt and Other Determinants on Economic Growth: The Greek Experience, has strengthened evidence of the negative impact of foreign debt on economic growth where an increasingly larger debt-to-GDP ratio has an impact on Greek economic growth.

Hadhek Zouhaier and Mrad Fatma (2014) examined "Debt and Economic Growth" using annual data sourced from 2012 World Development Indicators of World Bank. The most important result got from this empirical study was foreign debt negatively affects on economic growth. Debt has made the economic performance of developing countries, especially developing countries, decline including the negative interaction amongst of foreign debt and investment in countries.

The research results of Victor Ushahemba Ijirshar, Fefa Joseph and Mile Godoo (2016), external debt is booster of economic growth if well-managed, repayment of external debt is an inhibiting factor for economic growth. There is a significant relationship amongst of foreign debt and economic growth in Nigeria. Foreign debt stock has a positive impact, while foreign debt services have a negative impact on Nigeria's annual economic growth rate both in the long term and short term.

METHODS

The analysis methods used in this research are descriptive and quantitative methods. While the analysis tools used are: 1).To analyze patterns of changes in foreign debt and economic growth in Southeast Asian countries, utilising descriptive analysis through graphics, 2).To analyze whether foreign debts encourage or inhibit economic growth in Southeast Asian countries, Panel regression analysis by using Fixed effect model method, using the formula:

$$EGit = \beta_0 + \beta_1 EDit + \mu_{it} \quad \text{..} \quad \textbf{(1)}$$

Whereby:

EG = Economic growth
EXD = Foreign debt
α = Intercept
α_I = Coefficient of regression
e = Error term
i = Data *cross section* (south east country)
t = Period (1990-2016)

RESULTS AND DISCUSSION

Patterns of foreign debt change in ASEAN countries

Debt or foreign debt have become an alternative main source of funding for a country's economic development which derive from abroad aside from foreign investment. The role of foreign debt for economy of numerous developing countries, especially in the initial development process no need to be in doubt. The empirical experience of Italy, Japan and Germany which experienced economic collapse after losing the Second World War through the Marshall Plan program has become sufficient evidence of the importance of debt or foreign aid’s role in the economic development of these countries. The empirical experience of Italy, Japan and Germany and many other developing countries have become a booster for many countries to make loans or foreign debt including Southeast Asian countries such as Indonesia, Malaysia, Thailand, Philippines, Vietnam and Myanmar. The picture of foreign debt of Southeast Asian countries during 1990-2017 is presented in Figure 1.

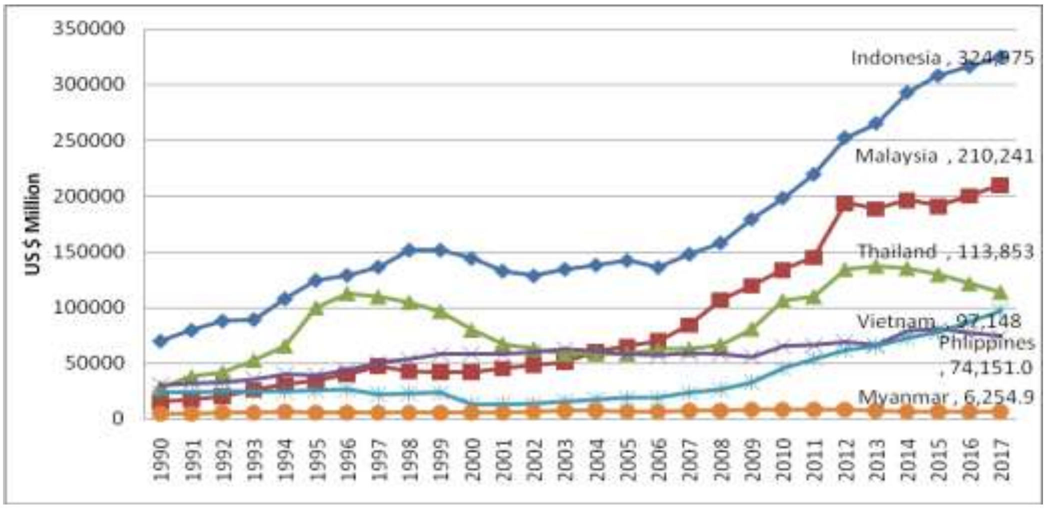


Figure 1. Development of Foreign Debt in South East Asian Countries 1990-2017

Based on Figure 1, it can be revealed that generally the foreign debt of Asean countries during 1990-2017 period tend to be fluctuated. Indonesia as a country with the largest foreign debt, its foreign debt tends to increase. During 1990-1998 Indonesia's foreign debt always increased from US $ 69,872 Million to US $ 151,484 Million, the decline only occurred in 1999-2002 and 2006. Since 2006-2017 amount of Indonesia's foreign debt has always increased. Furthermore, Malaysia also experienced an increase in its foreign debt every year during period 1990-2017 except in 1998,1999, 2013 and 2015. Thailand and Philippines were two countries that were quite successful in suppressing amount of foreign debt, in 1996 Thailand's foreign debt was US $ .112 .. 838 Million Similar conditions also occurred in 2017 with foreign debt predictions of US $. 113,853 Million. While Fhillipines total foreign debt in 1990 amounted to US $ .30,580 Million to US $ .74,151 Million in 2017. Vietnam is a country that has a relatively high increase in the amount of foreign debt. If in 1990 amount of foreign debt in Vietnam was as much as US $ .23270 million to US $ 97,148 Million in 2017 or increasing more than four times. The only Asean country that has committed and consistently maintained the amount of its foreign debt is Myanmar. If in 1990 Myanmar's foreign debt amounted to US $. 4,694.8 Million to US $. 6,254.9 Million in 2017 or 1.3 times over the 1990-2017 period.

Meanwhile, viewed from the pattern of foreign debt development in ASEAN countries as seen in Figure 1, the pattern of foreign debt development in ASEAN countries, generally fluctuated and tends to increase for several countries such as Indonesia, Malaysia and Vienam. Myanmar has a relatively constant development of foreign debt (has a relatively flat trend line). Thailand is also relatively successful in maintaining the amount of its foreign debt, which is the amount of foreign debt in 1996 is almost as large as foreign debt in 2017, it means tend toward to the same point. The only Asean country that has committed and consistently maintained the amount of its foreign debt is Myanmar. If in 1990 Myanmar's foreign debt amounted to US $. 4,694.8 Million to US $. 6,254.9 Million in 2017 or 1.3 times over the 1990-2017 period

Pattern of economic growth

In general, economic growth is still the main target of a country's development goals to be pushed higher. The sustainable, high, and stable of economic growth are ideal condition that is always expected by every country. Many factors can affect the achievement of high, stable and sustainable economic growth both economic and non-economic factors such as investment and national stability. The picture of economic growth in ASEAN countries is presented in Figure 2.

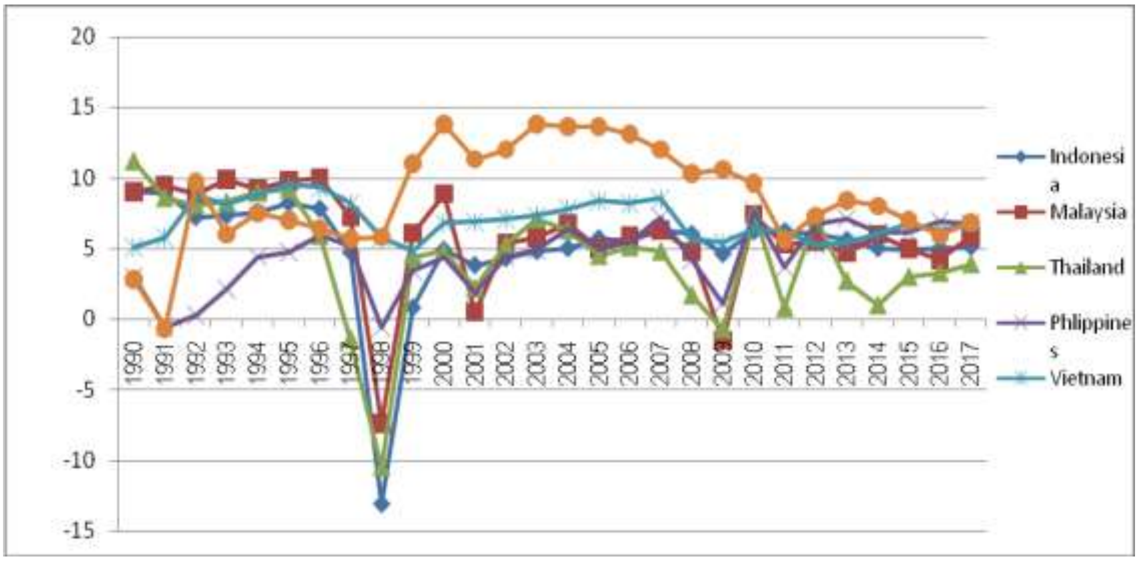
Based on figure 2. it can be revealed during 1990-2017 only two Asean countries were the objects of this study with relatively stable economic growth namely Vietnam and Myanmar, five other countries namely Indonesia, Malaysia, Thailand, Philippines and Cambodia economic growth was relatively unstable especially in period 1997-2001 (Asian economic crisis' period).

The economic growth shocks of several Asean countries especially in the 1997-2001 period indicate that economic openness (dependence on exports and imports) of Indonesia, Thailand, Malaysia and the Philippines is greater than that of Vietnam and Myanmar. This condition also illustrates the vulnerability of the national economy, especially Indonesia, Thailand, Malaysia and the Philippines which are very sensitive due to external factors. The relatively same source of growth and economic structure is also the reason why ASEAN countries, especially Indonesia, Thailand, Malaysia and Philippines experienced the impact of the Asian economic crisis greater than other ASEAN countries. During 1990-2017 the countries with the highest growth rates were Myanmar (8.7%), Vietnam (7.0%), Malaysia (5.9%), Indonesia (5.1%), Thailand and the Philippines, respectively (4.4%).

As viewed from the pattern of economic growth of ASEAN countries during 1990-2017 as presented in figure 2, there are no countries have a pattern of growth that is always increasing, even stable. Thus it can be said that the pattern of economic growth of Asean countries during 1990-2017 is fluctuated. If divided into several periods, in 1990-1996 four ASEAN countries, namely Indonesia, Malaysia, Thailand and Vietnam, had quite a stable economic growth in the range of 7.2-9.0% for Indonesia, Malaysia 8.9-10%, Thailand 5.9-11.2% and Vietnam 5.1-1.5%.

During 1997-2001, Indonesia, Thailand and Malaysia were the three countries which experienced most economic shocks. Economic growth in 1998 dropped to the lowest point reaching -13.1% occurred in Indonesia, Thailand -10.5% and Malaysia -7.4% and Filipina by -0.6%. The economic growth of Indonesia, Thailand, Malaysia and the Philippines in 1998 was the lowest during the 1990-2017..

During 2010-2017, economic growth in Asean countries aside from Thailand was relatively stable, as was also occured in the 2002-2007. Indonesia's growth grew between 5.0-6.2%, then Malaysia grew 4.2-7.4%, Filippina grew 3.7-7.6%, Vietnam grew 5.2-6.8% and Myanmar grew between 5.9-9.6%



Picture 2. Pattern of Economic Growth In Asean Countries 1990-2017

Foreign debt encourages or inhibits economic growth in southeast asian countries

As one source of financing development, the role of foreign debt can not be denied. Foreign debt can be used by the debtor country government to cover the budget gap (fiscal gap), whereby the taxation can not cover the budget needs or in other words the revenue is smaller than the expenditure. Foreign debt, besides having an important role in overcoming the lack of funds for a country in financing its development, especially in financing the public sectors will also have implications for the greater burden arising from foreign debt.

The greater the amount of foreign debt of a country the greater the possibility of debt burden caused by the foreign debt. If the foreign debt burden gets heavier then foreign debt will potentially hamper the development process in a country. Some of the most widely used indicators of foreign debt load are debt services ratio (DSR), debt export ratio (DER) and GNP-ratio debt. In accordance with World Bank criteria, if two of the three indicators exceed the set threshold, the country is included in a heavily indebted country and has the potential to hamper economic growth. Conversely, if a country's foreign debt is well managed and used for productive activities or potential sectors that have repayment capacity, foreign debt can accelerate development while also encouraging economic growth.

On one side can accelerate economic growth and in the other side it can hamper economic growth. The results of research on six Southeast Asian countries namely Indonesia, Malaysia, Thailand, Philippines, Vietnam and Myanmar associated to foreign debt and economic growth by using the Panel Data Regression approach, fixed effect model (FEM) method, can be written as follows:

$$EG_{it} = 6.778846 - 1.18E\text{-}05\ EXD_{it} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (2)$$

(13.4048) (-1.9911) → t statistical value
0.0000 0.0482 → probability value

Based on panel data regression equation above it can be interpreted that the relationship of foreign debt (ED) with economic growth (EG) t is negative, it means that the greater the foreign debt of Asean countries increasingly low the economic growth. The influence of foreign debt on economic growth is negative and significant. This condition indicates that foreign debt has slowed the economic growth of ASEAN countries. Slowing economic growth with the magnitude or increasing amount of foreign debt Asean countries is very understandable, because large foreign debt will increase the debt burden and the amount of debt services that must be paid thereby reducing funds to encourage accelerating economic growth. The use of foreign debt, especially government debt which is used to finance public facilities, does not have a faster or more repayment capacity than private foreign debt.

The results of this study in line with research by Greene (1989), Danso (1990) and Fosu (1996, 1999), then Kenen (1990) and Sachcs (1990) as cited by Syaparuddin (2013). Greene (1989), Danso (1990) and Fosu (1996, 1999) that the increasing payment of debtor countries' foreign debt burden will have implications for the economies of these countries. Fosu (1996, 1999) in his study found that increasing debt burdens had contributed to slowing economic growth especially in sub-Saharan African countries. Research conducted by Kenen (1990) and Sachcs (1990) supports this statement, which states that the greater debt burden will hamper economic growth. Likewise, Hadhek Zouhaier and Mrad Fatma's (2014) research on "Debt and Economic Growth" used annual data where foreign debt negatively affects economic growth. Debt has made the economic performance of developing countries, especially developing countries, decline including the negative interaction between foreign debt and investment in these countries. The results of this study are also in line with Panagiotis Pegkas' study in 2018 on The Effect of Government Debt and Other Determinants on Economic Growth: The Greek Experience, proving that the impact of the debt-to-GDP ratio on Greek economic growth is negative.

The results of this study are not in line with the studies of several researchers as cited by Syaparuddin (2013). Cohen (1993), Bulow and Rogof (1990) and Chowdurry and Levy (1997), Rana and Dowling (1988), White (1992) and Brewster and Yeboah (1994). Cohen (1993), Bulow and Rogof (1990) and Chowdurry and Levy (1997) concluded that foreign debt has been one of the significant factors in driving economic growth in developing countries Rana and Dowling (1988) especially the impact of foreign debt the government concluded that the influence of foreign aid on economic growth was positive but not significant in nine Asian countries (Burma, China, India, South Korea, Nepal. Fhiiipina, Singapore, Sri Lanka and Thailand), but not in line with research carried out by White (1992) The lack of the impact of foreign debt (especially government foreign debt in increasing economic growth in developing countries according to Brewster and Yeboah (1994), is due to the large debt burden on the government sector, so debt funds that should be used to increase investment must be paid return to foreigners from previous debts and the allocation government does not directly touch the production sector of Syaparuddin (2013). Pattilo *et al* in Muhammad Mustapha Abdullahi, Nor Aznin Bt Abu Bakar and Sallahudin B.Hasan (2016) stated according to traditional neo-classic model, foreign debt will increase transition economic growth, it is possible capital mobility and ability for utilising foreign source. Some of countries lacking capital, this way is incentive to get loan and investment whereby marginal of capital is higher than common interest rate. Debt or loan are important tools for government to finance a country's development. Eventually, debt is used for expenditure to bring about productivity and stimulate economic (Burhanudin, M. D., Muda, R., Nathan, S. B. and Arshad, R (2017). As stated Rashid Zaman and Muhammad Arslan (2014) about *Role of Foreign Debt To Economic Growth In Pakistan* utilising OLS Regression Model during 39 years proved gross capital formation and foreign debt stock have positive effect to Pakistan's GDP.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Although foreign debt is still one of the important elements in accelerating the process of development and economic growth, its existence is like a dilemma. Based on the results of this study it has been proven that foreign debt has a negative and significant impact on the economic growth of ASEAN countries (Indonesia, Malaysia, Thailand, the Philippines, Vietnam and Myanmar).

Recommendations

Appropriate Planning and managing foreign debt, right on target and has *repayment capacity* and supervision in its implementation are very important in so doing foreign debt has a positive impact in increasing economic growth, especially in ASEAN countries.

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