

## ABSTRACT

In recent years, the debt burden of most of the emerging economies has reached to a level that has put these economies into distress. Economic and political factors play an important role in determining the debt carrying capacity of a country. The present study is an attempt to examine the role of economic indicators and political environment in assessing the debt tolerance. To carry out the investigation, a sample of 29 highly indebted countries (HIPC) has been taken for the time span 2000-2015. Economic performance is measured through GDP and inflation level. Political environment is assessed through the voice and accountability index and political stability index as given by ICRG. Exchange rate, FDI, credit to private sector, governance indicators and money supply (M2) are included as control variable. Governance indicator is used to determine the quality of institutions working and execution of the policies formulated. To examine the relation, fixed effect model along with panel corrected standard error techniques has been employed to get rid of the problems of heteroskedasticity and serial correlation. The results of the study indicate that GDP and inflation has a significant impact on debt tolerance. The positive impact of inflation on debt to GDP ratio shows an increase in inflation increases the debt intolerance thereby reducing the debt carrying capacity. Voice and accountability has also a significant and positive impact on debt tolerance. Political stability and violence is also positively and significantly related to debt tolerance. Based on the results it is concluded that stable economic performance and political environment increases the debt carrying capacity of an economy. Furthermore, it has been suggested that the government of these highly indebted countries should utilize the debt resources for the productive activities. Moreover, the quality of institutions working in the economy must be increased and there must be no frequent changes in the policies.