Is foreign debt a problem for bangladesh?

Countries, Bangladesh

Is Foreign Debt a Problem for Bangladesh? Part-A Foreign debt in Bangladesh Introduction: External debt is one of the sources of financing capital formation in any economy. Developing countries like Bangladesh are characterized by inadequate internal capital formation due to the vicious circle of low productivity, low income, and low savings. Therefore, this situation calls for technical, managerial, and financial support from Western countries to bridge the resource gap. On the other hand, external debt acts as a major constraint to capital formation in developing nations.

The burden and dynamics of external debt show that they do not contribute significantly to financing economic development in developing countries. In most cases, debt accumulates because of the servicing requirements and the principal itself. In view of the above, external debt becomes a self-perpetuating mechanism ofpovertyaggravation, work over-exploitation, and a constraint on development in developing economies. Public borrowing can be seen by private investors as a warning signal of the government becoming bankrupt within the foreseeable future.

They may also fear that government will impose higher taxes in future in order to facilitate the repayment and servicing of the loan. In that case private investors will become less enthusiastic to invest. However, policy makers have to know whether public borrowing is followed by any crowding-out effect on investment, through whatever channel, and to what extent and whether the detrimental effect of such actions outweighs the benefit coming from the use of borrowedmoney, as is argued by the classical. What is public debt?

Public debt is the entry records of cumulative total of all government borrowings less repayments that are denominated in a country's home currency. Public debt should not be confused with external debt, which reflects the foreign currency liabilities of both the private and public sector and must be financed out of foreign exchange earnings. Government debt is one method of financing government operations, but it is not the only method. Governments can also create money to monetize their debts, thereby removing the need to pay interest.

But this practice simply reduces government interest costs rather than truly canceling government debt and can result in hyperinflation if used unsparingly. Governments usually borrow by issuing securities, government bonds and bills. Less creditworthy countries sometimes borrow directly from a supranational organization (e. g. the World Bank) or international financial institutions. Sources of public debt: A. Internal Sources. I. Borrowing from individual by issuing govt bond, notes, etc II. Borrowing from commercial bank III. Borrowing from central bank

IV. Borrowing from nan-bank Financial institution B. External Sources I. Foreign Government II. Foreign private institution III. International financial institution like IMF, WB etc. WhyBangladesh economyis dependent on Public debt? To utilize natural resources Economic development Financing deficit budget Strong social and economic structure Crucial economic contingencies Implement annual development Program Import financing Implementation of fiscal policy To strong national defense Modernization of agriculture Facilitate quick industrialization.

Factors Which Influence How Much a Government Can Borrow • Domestic Savings. If consumers have a high savings ratio, there will be a greater ability for the private sector to buy bonds. • Relative Interest rates. If government bonds pay a relatively high interest rate compared to other investments, then ceteris paribus, it should be easier for the government to borrow. Sometimes, the government can borrow large amounts, even with low interest rates because government bonds are seen as more attractive than other investments. • Lender of Last Resort.

If a country has a Central Bank willing to buy bonds in case of a liquidity shortages, investors are less likely to fear a liquidity shortage. If there is no lender of last resort (e. g. in the Euro) then markets have a greater fear of liquidity shortages and so are more reluctant to buy bonds. • Prospects for Economic Growth. If one country faces prospect of recession, then tax revenues will fall, the debt to GDP ratio will rise. Markets will be much more reluctant to buy bonds. If there is forecast for higher growth. This will make it much easier to reduce debt to GDP ratios.

The irony is that cutting government spending to reduce deficits, can lead to lower economic growth and increase debt to GDP ratios. • Confidence and Security. Usually, governments are seen as a safe investment. Many governments have never defaulted on debt payments so people are willing to buy bonds because at least they are safe. However, if investors feel a government is too stretched and could default, then it will be more difficult to borrow. • Foreign Purchase. A country like the US attracts substantial foreign buyers for its debt (Japan, China, UK).

This foreign demand makes it easier for government to borrow. However, if investors feared a country could experience inflation and a rapid devaluation, foreigners would not want to hold securities in that country. • Inflation. Financing the debt by increasing the money supply is risky because of the inflationary effect. Inflation reduces the real value of the government debt, but, that means people will be less willing to hold government bonds. Inflation will require higher interest rates to attract people to keep bonds.

In theory, the government can print money to reduce the real value of debt; but existing savers will lose out. If the government creates inflation, it will be more difficult to attract savings in the future. Is foreign debt a problem to Bangladesh? Excessive reliance on debt, whether domestic or external, carries macroeconomic risks that can hinder economic and social development. Countries macro-economic is thus disturbed by this factor alone. Scarcity of resources has already compelled the government to borrow afresh and/or impose new taxes on the citizenry to meet debt service obligations.

High domestic public debt pushes up interest rates and crowds out private investment, which is much needed to promote economic growth. When most government revenues are devoted to debt servicing, fiscal policy cannot be used to provide basic services, such aseducation, health, safe drinking water and housing. Unfortunately, the national budget — annual statement of the government’s income and expenditure — does not recognize the gravity of the situation characterized by its serious problem tofinancethe external debt servicing at the cost of basic human services.

Every year Bangladesh pays, on an average $ 1070 million, to its foreign creditors. A 2003 study (SUPRO: 2003) exclusively revealed the fact that for every dollar in foreign grant aid received, the government spends over $1. 5 in debt service to foreign creditors annually. While there is no denying that Bangladesh is heavily dependent on foreign aid and loans to finance its annual budget, it is also true that aid agencies and multilateral lenders in the West have to carry a lion’s share of the blame for Bangladesh’s burden of debt. Between 1980 and 2012, Bangladesh’s total outstanding international debt quadrupled.

The bulk of this surge in lending to the autocratic regimes came from theInternational DevelopmentAssociation, the soft-loan window of the World Bank. Can the World Bank and the IMF morally impose the burden of this debt on the Bangladeshi people, when in fact that money provided valuable succor to an autocratic regime that the people were struggling to topple at the time? How sustainable Bangladesh Debt is? Bangladesh is classified as a low-income country and is home to the third highest absolute number of poor people in the world, after China and India.

Despite the huge amounts it spends servicing debt ($1551. 3 million in 2011), the World Bank describes it neither as ‘ severely’ nor even ‘ moderately’ indebted, but instead classifies Bangladesh as ‘ less indebted’. Instead of rewarding Bangladesh for its track record of prompt debt servicing, the World Bank has interpreted this to mean that Bangladesh’s debt must be sustainable. Arbitrary thresholds on indicators like debt/exports made Bangladesh ineligible for the Heavily Indebted Poor Countries (HIPC) initiative or the Multilateral Debt Relief Initiative.

Bangladesh will not receive through either of these initiatives the debt relief that it desperately needs to finance public expenditures on school and hospitals among other basic necessities. One of the Bangladeshi development experts remarked that- “ Bangladesh has regularly paid its debts, expanded exports and are now being punished for its success” (Bhattacharya: 2006). The whole argument is that, since these countries are able to repay they must have “ sustainable” levels of debt.

The sustainability of debt is primarily measured on the economic matrix called Debt Sustainable Analysis (DSA) introduced by the World Bank and IMF, which lays too much emphasis on the country’s exports and does not fully reflect the true nature of the debt burden on government expenses. How can Bangladesh’s debt be sustainable especially when it pays back on an average $1070 million to its foreign creditors in general and $870 million to its so-called benevolent development partners (multi-lateral and bi-lateral donors) annually?

For a poor country like Bangladesh, would it be realistic to calculate ‘ debt sustainability’ without looking at how much money it spends on schools, hospitals and roads, on teachers, medicines, clean water and on everything else that is needed to combat the dire poverty blighting so many lives? If a country cannot afford to meet the basic needs of its own people, then how can one argue that giving money to the rich world is affordable or “ sustainable”? How can its debt be sustainable when the cost of external debt servicing exceeds the public spending on health and education, for example?

In what criteria, the Bangladesh external debt can be measured as sustainable when it clearly demonstrates that MDG progress is being seriously hampered due to the excesses of debt servicing? Presumably, the international community has left a single choice for Bangladesh: servicing external debt at the cost of basic services let alone the MDG progress! Why Bangladesh deserves full debt cancellation? Undeniably, Bangladesh cannot afford to pay on average $1060 million a year to foreign creditors.

Even though the country is making some progress with regard to the implementation of the MDGs, it is still home to 70 million people living in poverty. It has the highest incidence of poverty in South-Asia. In fact, Bangladesh cannot afford to pay a single dollar in debt service. If debt sustainability is based on the financing needs for the MDGs, Bangladesh would receive full debt cancellation. Bangladesh needs US$ 7. 5 billion a year to finance the implementation of the MDGs. A growing number of NGOs, governments and analysts have come to the conclusion that debt cancellation should be expanded.

As independent expert Bernards Mudho explained earlier this year (2007) in a report commissioned for the United Nations: “ There… is a need for further comprehensive solutions to the debt problems of poor countries, including further debt relief by other multilateral institutions and for permanent solutions to the problems of bilateral and commercial debts. Bangladesh Debt must be cancelled, because … ? Debt costs too much to Bangladeshi people in general and poor and marginalized in particular. People need a healthy and prosperous life that requires increased government spending on basic services such as health, education, water-sanitation etc. ? Bangladesh needs to achieve the MDG targets in time. To finance the Millennium DevelopmentGoals, every year a staggering US7. 5 billion in external budget support is needed. This is about four times the amount of aid and concessional loans currently provided by foreign donors and creditors. ? At this juncture, Bangladesh can no longer afford to pay a single dollar for debt servicing. Because….. Every dollar paid in debt service is a dollar lost for the MDGs". Part-B Impact of Foreign debt on Bangladesh 1. Effects on Economic growth 2. Effects on NNP 3. Effects on Inflation 4. Effects on Investment 5. Effects on consumption 6. Effects on Production 7. Effects on Distribution 8. Effects on Risk, uncertainty, liquidity Part-C Statistical Analysis 1. Trend Analysis of Foreign Debt: Trend Analysis of External debt of last 10 years is given below Y= 1714. 5+0. 8647x R? = 0. 9247 Appendix Table 1 shows the summary of trend equation and r2 of External debt of Bangladesh.

The trend equation of Foreign debt is, Y= 1714. 5+0. 8647x and the square of correlation coefficient (r2) = . 9247. Interpretation: The trend equation indicates that during the period from 2003 to 2012 debt increase at the rate of . 8647 billion per year and 1714. 5 is the average external debt of Bangladesh. It is reflected from the table that trend equation of foreign debt are positive and goodness of fit of all the equations are very high. 2. Descriptive Analysis of Foreign Debt: Descriptive Statistical Analysis of External debt of last 10 years is given below: (All amounts are in billions) Descriptive Statistics | | N | Range | Minimum | Maximum | Mean | Std. Deviation | Variance | Skewness | Kurtosis | | | Statistic | Statistic | Statistic | Statistic | Statistic | Statistic | Statistic | Statistic | Std. Error | Statistic | Std. Error | | Foreign_Debt | 11 | 8. 7200 | 16. 5000 | 25. 2200 | 2. 103273E1 | 2. 9825127 | 8. 895 |-. 169 |. 661 |-1. 108 | 1. 279 | | Valid N (listwise) | 11 | | | | | | | | | | | | | Interpretation: This table provides statistical information about the data set, such as showing mean value of foreign debt individually and its deviation.

For this information, for instance we found that minimum value of the variable is 16. 5bill, Maximum value is 25. 22billon, its mean 2. 103273e1 and Standard deviation is 2. 9825127. 3. Correlation Analysis: Table shows the correlation matrix for estimating interrelationships between chosen economic parameters of Bangladesh. Variables | GDP real Growth | Amount of Foreign Debt | Inflation rate | Investment Amount | Remittance Inflow | Import | Export Amount | Foreign Reserve | | GDP real Growth Rate | 1 |. 635 |. 638 |. 748 |. 427 |. 457 |. 485 |. 352 | | Amount of Foreign Debt |. 35 | 1 |. 819 |. 555 |. 919 |. 901 |. 920 |. 846 | | Inflation rate |. 638 |. 819 | 1 |. 518 |. 686 |. 742 |. 763 |. 494 | | Investment Amount |. 748 |. 555 |. 518 | 1 |. 406 |. 433 |. 468 |. 222 | | Remittance Inflow Amount |. 427 |. 919 |. 686 |. 406 | 1 |. 915 |. 935 |. 920 | | Import Amount |. 457 |. 901 |. 742 |. 433 |. 915 | 1 |. 994 |. 888 | | Export Amount |. 485 |. 920 |. 763 |. 468 |. 935 |. 994 | 1 |. 885 | | Foreign Reserve Amount |. 352 |. 846 |. 494 |. 222 |. 920 |. 888 |. 885 | 1 | | From the correlation matrix we have observed the followings; GDP real Growth has moderate correlation with foreign debt, inflation rate, investment and low degree of correlation with remittance, import, export and very low correlation with GDP per capita. • Foreign debt has strong correlation with. • Inflation rate have strong correlation with. • Investment have strong correlation with. • Remittance inflow has moderate correlation with • Import has strong correlation with • Export has low correlation with • Foreign exchange Reserve has low correlation with Part-D Recommendation & Conclusion Recommendation: The international community including the G-8 must take necessary steps immediately to ensure full Debt cancellation for Bangladesh; • Debts must be cancelled as a matter of justice: creditors must accept their share ofresponsibilityin creating the current debt crisis, and cancel debts on this basis; • A “ MDG-consistent” frame-work of Debt Sustainability should be applied and cancellation must be available to all that need it; • The issue ofClimate Changeand its adverse effect must be taken into account and additional fund should be released to overcome theadversitylinking it with MDG process; • The governments of indebted countries must demonstrate to their citizens that they are spending money well and accountably.

But this must not be used as an excuse to impose economic policy conditions or to limit those countries receiving debt cancellation by the donor community; • Rich countries, institutions and commercial creditors must cancel all illegitimate and un-payable debts being claimed from all poor countries; • Total Debt stocks must be cancelled, not just Service; debt service cancellation for a limited period is not enough. • Debt cancellation of any kind must not be conditional and it must not be considered again as ODA Conclusion: The study has been conducted with a view to examining the presence of crowding- out effect of public borrowing on the private investment in the Bangladesh economy.

To accomplish the task, a model for investment function has been specified and estimated considering public borrowing, GDP and interest rate as independent variables. A long -run relationship has been estimated and analyzed by performing unit root test, co - integration test and an error correction model. The main findings of the study confirm with statistical significance that there is no crowding- out effect in Bangladesh, rather, the crowding- in effect is evident. This result is indeed somewhat paradoxical in terms of conventional wisdom. The study has attempted to offer a rationale for this seemingly paradoxical finding from a macroeconomic point of view.

In doing so, it has analyzed a couple of macroeconomic issues and ended up with the conclusion that the presence of crowding- in instead of crowding - out effect can be attributed to such factors as excess liquidity in the banking system, imperceptible government competition with the private sector, relatively sustainable public debt scenario, government expenditure for transfer payment program , significant development expenditure for producing those goods and services which has the potential to discharge positive externalities, government microcredit programs and ADP -black money linkages. The results of the study have important implications for the fiscal management.

Existence of excess liquidity and possibility of crowding - in effect together put the fiscal authority in a position to foster private investment and hence economic growth through expanding borrowing backed public expenditure. However, the overall criteria that public expenditure authority ought to ensure is the transparency and efficiency in its programs. Moreover, government can avoid unnecessary inflation and external indebtedness by reducing reliance for funds on Bangladesh Bank and foreign sources as long as excess liquidity in the banking system prevails. In view of the perceived limitations inherent in this study, the following aspects may be taken up by future researchers: Decomposing private investment by category and taking each of them as separate dependent variable; • Segregating borrowing by government itself and borrowing by other public sector corporations, and considering them as separate explanatory variables; • Splitting public borrowing by sources (not only banks, NBDC or general public but also Bangladesh Bank and external sources) and taking all of them as explanatory variable s; • Incorporating a dummy variable for capturing the issue of economic reform and structural variation between after and before 1990 periods; and • Finally, if possible, carrying on the whole study on the basis of quarterly data to make the analytical framework parsimonious. [pic] ------------------------ 10