

Debt financed development cannot be sustainable

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A few months back credit agencies from the western world gave Bangladesh higher rating of economic stability. They normally consider certain macroeconomic indicators of a country, such as growth rate, export performance, inflation, budget deficits and foreign exchange reserve data to construct such ratings. It seems the ratings came at a time when things were going well for the country, despite the economic and financial crisis in the western world. Some people in the official circle expressed their jubilation in attaining the status for Bangladesh. It is expected that such favourable rating will attract investors in the country as they can be assured of the returns from investment. The question is does Bangladesh need such foreign funds and if so what type and for what projects? It is known that Bangladesh has not suffered fund crisis during the last decade or so. What has been the hardest problem is lack of political stability and capacity to use available funds for major national development projects, mostly in the infrastructure sector, such as power, roads and water development, port modernization, railway and airlines etc. Even the government departments fail to utilize allocated money under the ADP projects.

The private sector has increased its capability over the last two decades but due to lack of policy support from the government they also do not undertake large infrastructure projects such as building power plants and flyover and express ways. Over the last two decades the capital markets in Bangladesh have grown significantly. The market capitalization of companies has exceeded 25% of GDP and it might grow farther if good companies in the private and public sector get listed in stock exchanges. Credit rating agencies, of course, deal with debts and it is not known if Bangladesh government is negotiating loans from some banks from the western countries. Or some private sector companies are trying to raise money from the international markets following the rating given by the agencies. As noted below there is a glut of cash in these countries and interest rates are very low,

may be within 3-5% range as opposed to 12-14% in the local markets from banks or debentures issued in DSE. Lenders from abroad will, of course, charge 2-3% premium for foreign exchange coverage although the Taka is not likely to fall in value given the potential inflows from exports of goods and manpower.

It should be mentioned that at this point of time western countries/agencies are flooded with huge liquidity as they are not finding worthwhile projects in their own countries for investment. For example, newspaper reports say private equity funds are sitting with 500 billion dollar and ready to buy existing assets or companies, and US non-financial corporations are holding 1.8 trillion dollar in cash and waiting on the fence when demand for their products rise. At the moment spare capacities are abundant in most industries in the USA. That is why the emerging market economies are likely targets for western fund managers and they seem to be moving out to China and India. If such investments move to Bangladesh in the gas and power sector, it will be most welcome. Such equity capital from abroad can provide a basis for the local companies to upgrade their management systems and also attract more equity capital from the local investors, who seem to be too hungry for investment outlets. This is more the case with remittances being pumped into the country by its growing number of workers abroad. The fund flow from this sector has already exceeded 10% the GDP.

Southeast Asian countries also suffered badly in 1997-98 from the sudden outflow of capital from these countries that left millions of poor in lost jobs and income. Some of the nations in Europe became bankrupt so to say for excessive borrowing from local and foreign sources. Iceland, Ireland and recently Greece are mentioned for that. Even the USA has piled up 14+ trillion dollar of foreign debts to finance its bulging budget deficits. As a result of such heavy debt burdens many of these countries are faced with declining standards of living now and in the coming years.

The Economist reported from a survey by the McKinsey Global Institute on how "debt increased at every level, from consumers to companies to banks to whole countries. Average total debt (private and public combined) in ten mature economies rose from 200% of GDP in 1995 to 300% in 2008, ranging as high as 450% in Japan to 250% in Canada.

The Economists traced the back ground of the rising debts on the expected growth impacts from which such debt burdens were to be repaid. "But in parts of the rich world that may now be misplaced. With ageing population and shrinking work force their economies may grow more slowly than they have done in the past. They may have borrowed from the

future using debt to enjoy a higher standard of living that is unsustainable. Greece provides a stark example. Standard and Poor, rating agency, estimates that its GDP will not regain its 2008 level until 2017".

The important thing to point out here is that why this fatal attraction to borrowing was encouraged by governments, especially in the mature economies when there were enough sources of revenue to be collected from taxes. Modern economics have propounded the theory of progressive taxes to benefit all sections of the society. It is the crux of the problem. Governments in the USA did not want to collect taxes from the richer people and also profit making corporations under one pretext or another. A recent TV show indicated that the Fed collects taxes just to cover expenses for three major public services such as Medicare. For rest of all public expenditure including financing the two on going wars the US government has been using borrowed money most of it from China and Japan. China sells its goods in the US markets and buys US government bonds with the trade surplus. It is like a form of vendor financing scheme that is going in one direction only.

The newly elected Tory and Liberal government in the UK announced a tough budget to cut many programmes and raise taxes to reduce budget deficit in the short term. It was reported in the Newsweek that the government's popularity inched up instead of declining despite the harsh budget. This indicates that the people in general like fiscal discipline and reign in public expenditure to increase as it can not go on for long without higher taxes.

The situation in Bangladesh and other developing countries are different as they can attain higher growth rates with so much of young and unemployed people. However, the problem is with inefficiency and corruption that is associated with public expenditure. As a result expected higher growth rate is not materialised and the nation is burdened with debt which the future generation will have to repay, creating a vicious cycle of poverty for the poorer sections of the population. As it is known income inequality has increased in Bangladesh during the last two decades due to inappropriate fiscal policies, collecting more taxes from the poor as VAT and allowing the better off people to avoid paying taxes and even not putting their capital to productive uses within the economy.

Higher economic growth should be attained with sustainable sources of financing from within the country in the public and private sector. Let the capital market expand and encourage the corporate sector to invest and assume the risk for the returns they expect. The common people should not be burdened with unnecessary debts.

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