

National consultation on
Debt Cancellation & Essential Services



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External Debt- at the cost of Essential services?

Bangladesh needs full Debt Cancellation

Introduction

The Government of Bangladesh (GOB) is spending more on External Debt servicing than education or health. In 2007, the country had to pay \$1551.3 million for external debt servicing which is 18% (2.4% of GDP) of total government expenditure. During the same year, public spending on education and health were 16.5% and 7.4% of total spending respectively. The water and sanitation sector takes out very meager amount money (just 0.94%) from the total allocation pie. A frustrating picture can be observed if one looks at the issue from the window of the Revenue Budget. It clearly demonstrated that Bangladesh has spent 15.65% and 5.89% of its revenue expenditure on education and health respectively in the year 2007 while; she had to pay almost 25% of government revenue for external debt servicing. A recent study on “External Debt serving, essential services and MDGs” conducted by SUPRO revealed these facts.

According to the official statistics published by the GOB, overall external debt servicing rose from \$892.7 million in 2001 to \$1551.3 million in 2007 showing almost 65% increase during the last 7 years. Servicing for Medium and Long-term Debt (MLT), borrowed mostly from multilateral and bilateral donors costs \$721.9 million in 2007 while the figure was \$596.6 for the year 2001. Per-capita debt obligation has increased from \$6.56 in 1974 to \$147.32 in 2007. Due to the increasing rate of exports during the last one and a half decades, the EDT/XGS (Total External Debt/Exports of goods and services) ratio has gone down from 388.5 in 1990 to 116.8 in 2006. Same trend can be observed in TDS/XGS (total external debt servicing/exports of goods and services) ratio: 20.9 in 1990 to 8.8 in 2006.

As of June 2007, total outstanding external debt stood at \$20713.1 million of which MLT is \$19354.8 million, almost 97% of the total debt outstanding. This is very indicative given the context of the political economy of foreign aid manifested in the form of aid conditionalities. Debt servicing for this particular component of overall external debt is also significant as it consumes on an average \$ 875 million every year from 2001 to 2007.

If one takes into account the domestic debt servicing, the overall public debt servicing (external and domestic) picture for the year 2006 would be seen as frightening one consuming almost 13% (2.04 for external and 10.25 for domestic) of revenue expenditure for interest payment only.

Poor people and MDG targets

Widespread poverty, powerlessness and lack of basic services mean that demand for public spending is high. Therefore, the challenge for the government is to contain wasteful public spending and

orient it towards priority sectors. Public expenditure should promote pro-poor growth; basic services, such as education, health, sanitation and housing, should be a priority. However, Bangladesh is paying more on debt servicing (both external and domestic) leaving very little for those vital services.

The poor people of Bangladesh are trapped in a cycle of poverty and powerlessness. This is perpetuated, at least in part, by the unremitting demands of the rich world for money from the country debt service payments. These demands continue regardless of the source of the debts or the impact on the poor of their being paid. It is now almost accepted by all that on current trends the Millennium Development Goals, which 189 governments agreed to achieve by 2015, will not be met for more than 100 years.

Public spending on Essential Services (ES) is crucial to achieving MDG targets for Bangladesh. In addition, the commitment and obligation of the state to provide basic services to its citizens is enshrined in the constitution of Bangladesh. The Constitution mandates that: "it shall be a fundamental responsibility of the state to attain, through planned economic growth, a constant increase of productive forces and a steady improvement in the material and cultural standard of living of the people, with a view to securing to its citizens- (a) the provision of the basic necessities of life, including food, clothing, shelter, education and medical care (Article: 15)".

Developing human capabilities is regarded both as an end and as a means of development. Capabilities related to nutrition, health and education are of special importance. For example, literacy and education (especially female education) make wide-ranging contributions not only to economic growth but also to demographic change, social equality, political democracy, and many other aspects of development. Similarly, good health is a fundamental basis of the quality of life as well as of social progress. Both theory and evidence point to the importance of essential public services as it has direct bearing on poverty alleviation and over all social and economic advancement. Economic theory suggest that due to pervasive "market failures" in the private provision (especially unregulated provision) of essential services such as health care and education, extensive public action is needed to rapid reductions in malnutrition, illiteracy, ill health and related deprivations. In this context, state has an "inalienable responsibility to provide universally accessible and robust public delivery systems for essential services".

Spending on education, health and water-sanitation are seemed to be directly linked with almost all the MDG targets set. It seems reasonable to expect government to let people know how much it is spending on essential services. But this vital information is not, however, readily available from existing budget data. Hence, often we run the risk of making poor arguments in favor/against public spending pattern using that inappropriate data set.

The budgetary allocation on ES i.e. education and health seems to suggest an increase than those of the preceding years. Allocation for education in 2007 was 16.3% of the total public spending from 14.9 for the year 2006 which is 2.3% and 2.2% of GDP respectively and health sector follows the same trend amounting to 7.4% in 2007 while it was 6.7 in 2006. Public spending on water and sanitation sector is quite meager when compared with the former two. However, if the allocation in

different sectors is adjusted with the pace of inflation¹, there seems to be a very meager increase in public spending on those crucial sectors.

Although the government has repeatedly been claiming that the education sector always receives the highest budgetary allocation in term of both Revenue and Development outlays, the real case scenario is somewhat different and misleading². In fact, public spending on pure secular education is quite meager in comparison to other sectors/areas such as Defense or External debt repayment. This poor allocation of resources has huge adverse impact in terms of shortages of teachers, spending less on school buildings, text books and equipments and paying the teachers on whom the education systems rely; shortage of doctors, nurses, medicines, clinics, outposts, hospitals so on and so forth.

Bangladesh has sustained good growth rates, and seen poverty reduced significantly, over the past decade or so. Although the proportion of people living in poverty has decreased by almost 7% during the last 15 years from 1991 to 2005, but half of its population still lives on less than \$1 a day (PPP \$); and 83% on less than \$2 a day. And almost 20 million (over 7%) are extreme poor, living on less than 16p a day³. While the percentage of people living in poverty has decreased; the absolute number of poor people has increased. During 1991-2005, the number of poor people has increased to more than 4.4 million and from 2000 to 2005 the number of hardcore poor has increased to almost 3 million. In addition, inequality and disparity are seen pervasive; the top 5% receives 30% of national income; the poorest 5% receives only a meagre 0.67%.

Given the scenario of public spending pattern on health, education and water-sanitation, it seems logical to raise question whether the existing pattern of spending and amount of money allocated to these vital sectors are sufficient to achieve the MDG targets by 2015.

Although the government of Bangladesh is quite hopeful of realizing majority of the goals (if not all) by the stipulated time the GoB/UNDP Bangladesh MDG Progress Report of February 2005 stated that Bangladesh faces serious challenges in meeting the targets it has set towards attaining the important MDGs in eradicating extreme hunger and poverty, reducing child mortality and improving maternal health. The challenging outlook for Bangladesh with regard to meeting the MDG targets is also strongly emphasized in the ADB report 'MDGs: Progress in Asia and the Pacific 2006', which categorizes Bangladesh as a 'country of greatest concern', by falling further behind and score negatively on both the progress index and the latest status index. Specific reference is made to increasing inequality, severe school drop out rates which undermine the good enrolment

¹ Over all inflation rates for the year 2006 was 6% while it rose to almost 11.5% in the year 2007 (Bangladesh economic Survey 2007 & Monthly Update, March 2008, Bangladesh Bank).

² For example, over all education budgets involves allocations on religious affairs and science and technology making the total outlay a little bigger than the real one. In addition, religious education and military educational institutions take away a substantial amount of public money from the education budget further squeezing the education outlays. Eventually, the allocation on pure secular public education becomes scanty one. Why Education and Religion (and sometimes Science and technology) are reported under the same under the same sector remains a big question as this undermines the transparency in allocation structure.

³ However, in a recent study (April 2008) showed that the number of people living below the poverty line was on the rise in recent times due to exorbitant increases in food prices. The number would now stand at about 90 million, up from previously estimated 60 million or 40 per cent of the country's population. At least 40 million people of the country are currently facing extreme poverty with no work and miserable buying capacity now. 'The government defines that the people with daily food intake of less than 2122 kilo calories are living below the poverty line. I have studied that at least 60 per cent of the country's population at present takes much less calories than required,' said Harun KM Yusuf (the author of the study), professor of Biochemistry and Human Nutrition at Dhaka University. High prices of food commodities are forcing the poor to cut nutrition intake, he observed. Yusuf showed that by spending one taka on coarse rice a consumer ensured only 120 kilo calories in December 2007, which was 50 calories less than what he or she received in January 2006 spending the same amount of money (The New Age: 27 April 2008).

rates, disparities between urban and rural access to education, gender disparities especially at tertiary level in education, alarming child malnutrition, worsening urban access to sanitation and a disastrous environmental situation. In addition, the phenomenon of Climate Change has brought about significant adverse effect on the life and livelihood of a vast majority of people living mostly in the coastal areas. The MDGs progress made in these areas during last couple of years has almost gone due to the devastating SIDR. In this context, the issue of climate change and its adverse effect deserves much attention as far as the MDG progress is concerned.

Assessments by international agencies suggest that most low-income countries are far from achieving these objectives by 2015. Halfway to the target date of 2015, the world is still falling short of meeting the Millennium Development Goals. The World Bank and the United Nations have estimated that anywhere from \$40 billion to \$75 billion annually will be needed globally if we are to achieve the MDGs. A key requirement is to ensure that government and donor resources are increasingly targeted towards the achievement of MDGs.

However, given the rising trend of government revenue earnings in Bangladesh, very scanty part of it is being invested on essential services such as education, health etc. Public expenditure of these vital services account for only 25% of total spending and a meager 5% of GDP. So, where does the public money go?

Where the money goes?

Excessive reliance on debt, whether domestic or external, carries macroeconomic risks that can hinder economic and social development. Country's 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 as education, 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 to finance the 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 2004, Bangladesh's total outstanding international debt quadrupled. What is of immense significance in that statistic is that it was between 1980 and 1990 — during a decade of military dictatorships characterized by rampant corruption and political oppression — Bangladesh's debt figure tripled from \$3,921 million in 1980 to \$12,439 million in 1990. The bulk of this surge in lending to the autocratic regimes came from the International Development Association, 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? Today, nearly two decades later, Bangladesh is still paying back loans that the dictatorial regime availed from the World Bank and the IMF in the 1990s.

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 2007), 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.

Despite lack of actions by the World Bank, IMF, and the Paris Club, some bilateral debt relief agreements have taken place. In recognition of extreme poverty levels and devastating floods, Canada cancelled Bangladesh's bilateral debt of \$600,000 in 1999. In 2000, the United States agreed to a debt-for-nature swap, forgiving \$10 million in debt payments in return for \$8.5 million expenditure by Bangladesh to protect mangrove forests and Bengal tigers. The United Kingdom has reached bilateral agreements with Bangladesh to write off their outstanding debts from loans made for development purposes. As a result, Bangladesh's UK debt, which amounted to \$1.3 million in April 1997, was written off by the end of March 2001.

The G-8 debt cancellation campaign has primarily focused on the Heavily Indebted Poor Countries (HIPC) at the cost of other poor countries, mostly in Asia, who have been repaying their debts regularly. Paradoxically, debt relief is only provided to those countries who default on debt repayment. As such, the poor countries who maintain their repayment schedule, of course at the cost of its peoples' basic needs, are considered "good debtors" and, consequently, penalized for not defaulting. 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.

Assessments by international agencies suggest that most low-income countries are far from achieving these objectives by 2015. A key requirement is to ensure that government and donor resources are increasingly targeted towards the achievement of MDGs. In this respect, debt servicing represents a claim on government resources. International community has provided substantial external debt reduction and relief to Heavily Indebted Poor Countries (HIPCs), with an aim of assisting these countries on their path towards achieving MDGs. Governments also have to service domestic debt, which if freed, could also be utilized for achievement of MDGs.

To date, debt sustainability has been conceived of in terms of variables such as the ratio of debt service payments to export earnings or GDP, which can be criticized for being both arbitrary and overly optimistic in terms of the future path of these variables. However, as well as these shortcomings, these calculations take no account of estimated spending requirements to meet the MDGs, which has led many to argue that the concept of debt sustainability must be redefined to make it compatible with this vital goal.

In 2005, the UN Secretary-General put the argument as follows: “Debt sustainability should be redefined as the level of debt that allows a country to achieve the MDGs and to reach 2015 without an increase in debt ratios.” He further stated that “If current trends persist, there is a risk that many of the poorest countries will not be able to meet many of them [MDGs]. Considering how far we have come, such a failure would mark a tragically missed opportunity...As I said in my March report: ‘Let us be clear about the costs of missing this opportunity: millions of lives that could have been saved will be lost; many freedoms that could have been secured will be denied; and we shall inhabit a more dangerous and unstable world.’” In the July 2007 Report of the UN Secretary General to the General Assembly, Ban Ki Moon noted that “debt relief has been too slow,” and should be expanded to additional low-income countries which were not part of HIPC and MDRI initiatives with the ultimate objective of reaching the Millennium Development Goals.

A growing number of NGOs, governments and analysts have come to the conclusion that debt cancellation should be expanded. As independent expert Bernard 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.”

Alternative to WB-IMF formula

By focusing on the debt-to-export ratio as one of the primary eligibility determinants, the current debt relief initiative falls short. An alternative model would look at poverty levels or a country's per capita income and its ability to use released funds to fight poverty.

Considering that the current debt levels of HIPC countries that have received debt relief under the Multilateral Debt Relief Initiative (MDRI) is far lower than the debt levels of non-HIPC low-income countries, Gunter (2007) questions whether the HIPC program provides equitable distribution of development resources. HIPC eligible countries may benefit from debt relief at the expense of the poorer and now more indebted countries. Gunter proposes to do away with the HIPC debt-to-export ratio criterion described above, and to replace it with a focus on fiscal debt sustainability.

Spratt (2007) developed an alternative to WB-IMF criteria in determining the appropriate levels of debt service costs in the low-income countries from the perspective of MDG process. The alternative suggests that for a genuinely MDG-compatible framework of debt sustainability to be successfully implemented, the primary criteria for determining appropriate levels of debt service costs in developing countries can only be the impact this has on a country's ability to meet the MDGs.

In many ways this turns the traditional approach on its head. In the past, it has been assumed that a country's obligations to its creditors take precedence over other objectives. Thus, the fund available for human development purposes, for example, is whatever is left after debt obligations have been met. In contrast, the alternative proposal argues that the money available for meeting debt obligations should be whatever is left over after needed MDG expenditures have been met.

In this alternative framework⁴ the concept of 'sustainability' is defined in terms of the surplus government revenue left over after the MDG spending commitments have been met, with debt service (& principle) changing in proportion to the size of this 'surplus'.

Taking into account the case of Bangladesh, Cambodia, Ghana and Uganda, Spratt clearly demonstrated the case for Bangladesh's full debt cancellation as its required MDG expenditure is greater than 70% of government revenue.

In lieu of conclusion

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 Development Goals, every year a staggering US\$7.5 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"**.

⁴ For details of this alternative framework, please see Spratt, S (2007), "External Debt and the Millennium Development Goals: A New Sustainable Framework" (a joint UNDP /UN Department for Economic and Social Affairs- UNDESA initiative on defining more MDG –consistent debt sustainability frameworks)

We, therefore demand:

- 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 of responsibility in 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 of Climate Change and its adverse effect must be taken into account and additional fund should be released to overcome the adversity linking 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
- Developed countries must fulfill their commitment of ODA target of 0.7% of national income without any conditionality and fully cancel the external debt.

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