

# Aid, Debt, and Development in Bangladesh: Synergies or Contradictions

Presentation made at  
**Bangladesh in the 21<sup>st</sup> Century**

Harvard University, Cambridge, MA, USA (June 13-14, 2008)

**Bernhard G. Gunter, Ph.D.\***

**Bangladesh Development Research Center (BDRC)**

<http://www.bangladeshstudies.org>



**\*Coauthors (of paper): A. F. M. Ataur Rahman (NSU) and Jesmin Rahman (IMF)**

The views expressed here are those of the authors and should not be reported as representing the views of any organization.

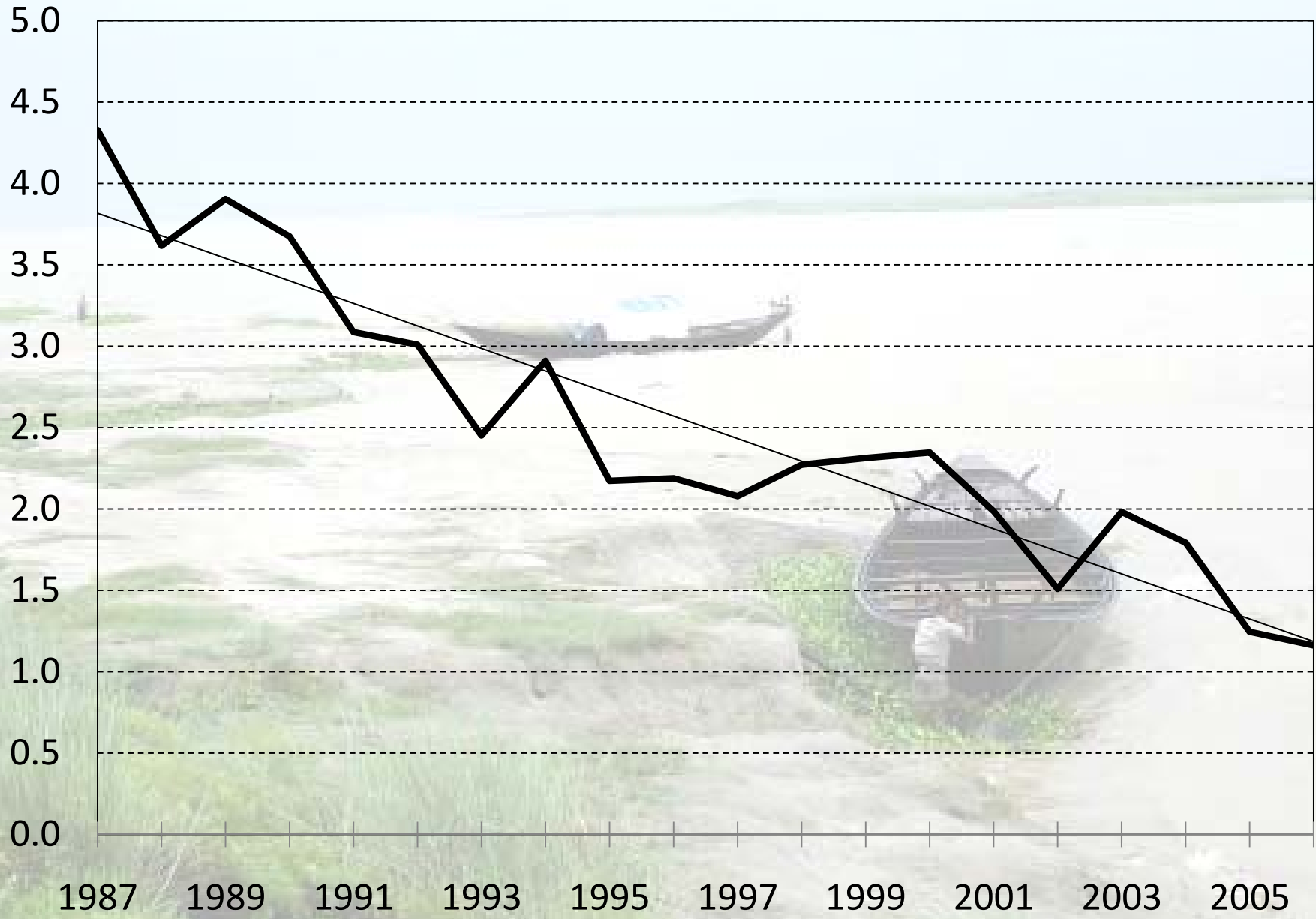
# Bangladesh's Progress

- Some 30 years ago, Bangladesh was one of the poorest countries of the world. It was openly referred to as an international basket case.
- Today, there are some 40 countries that are poorer in terms of both income per capita and human development.

# Aid Flows

- During 1972-83, the amount of net official development assistance (ODA) to Bangladesh was about the same as the sum of net ODA to the nine Sahelian countries.
- However, for every year since 1983, Bangladesh has received less ODA than the nine Sahelian countries.
- From 2000 to 2006, Bangladesh received even less than half of the net ODA the nine Sahelian countries received.

# Net ODA to Bangladesh, 1987-2006 (as % of Net ODA to all developing countries)



# Bangladesh's Challenges



- About 40 million people remain to be living below \$1-a-day.
- There are more poor people in Bangladesh than there are in the nine Sahelian countries.
- Additional investments needed to achieve the MDGs in Bangladesh are estimated to amount to about US\$8 billion per year.

# Bangladesh's Challenges

- Inequality is rising and could lead to social unrest.
- Bangladesh is one of the most vulnerable countries to the impacts of climate change.

# Current Biases in Aid Flows

- **Population Bias:**

Populous countries receive far less aid than countries with small populations.

- **Regional Bias:**

Asia receives far less aid than Africa.

Beyond current biases in aid flows, there are likely future biases due to recent debt relief initiatives

- HIPCs get debt relief
- Non-HIPCs do not get debt relief



# Possible Impact of Debt Relief Initiatives on Future Aid Allocations to Bangladesh

- Overall costs of recent debt relief initiatives (HIPC, Post-HIPC Paris Club, and MDRI) are estimated to cost about US\$90 billion in 2004 NPV terms.
- The two key questions are:
  - 1) Will debt relief be additional at the aggregate level?
  - 2) Will donors make reallocations in their traditional aid allocations?

# Possible Impact of Debt Relief Initiatives

Assuming that

- a) debt relief will—in the long run—not be additional,
- b) the costs of the three debt relief initiatives are equally distributed over 40 years, and
- c) the concessionality level of the cancelled debts is 40 percent;

would imply that Bangladesh's aid levels would decrease between zero and US\$580 million for every year over the next 40 years.

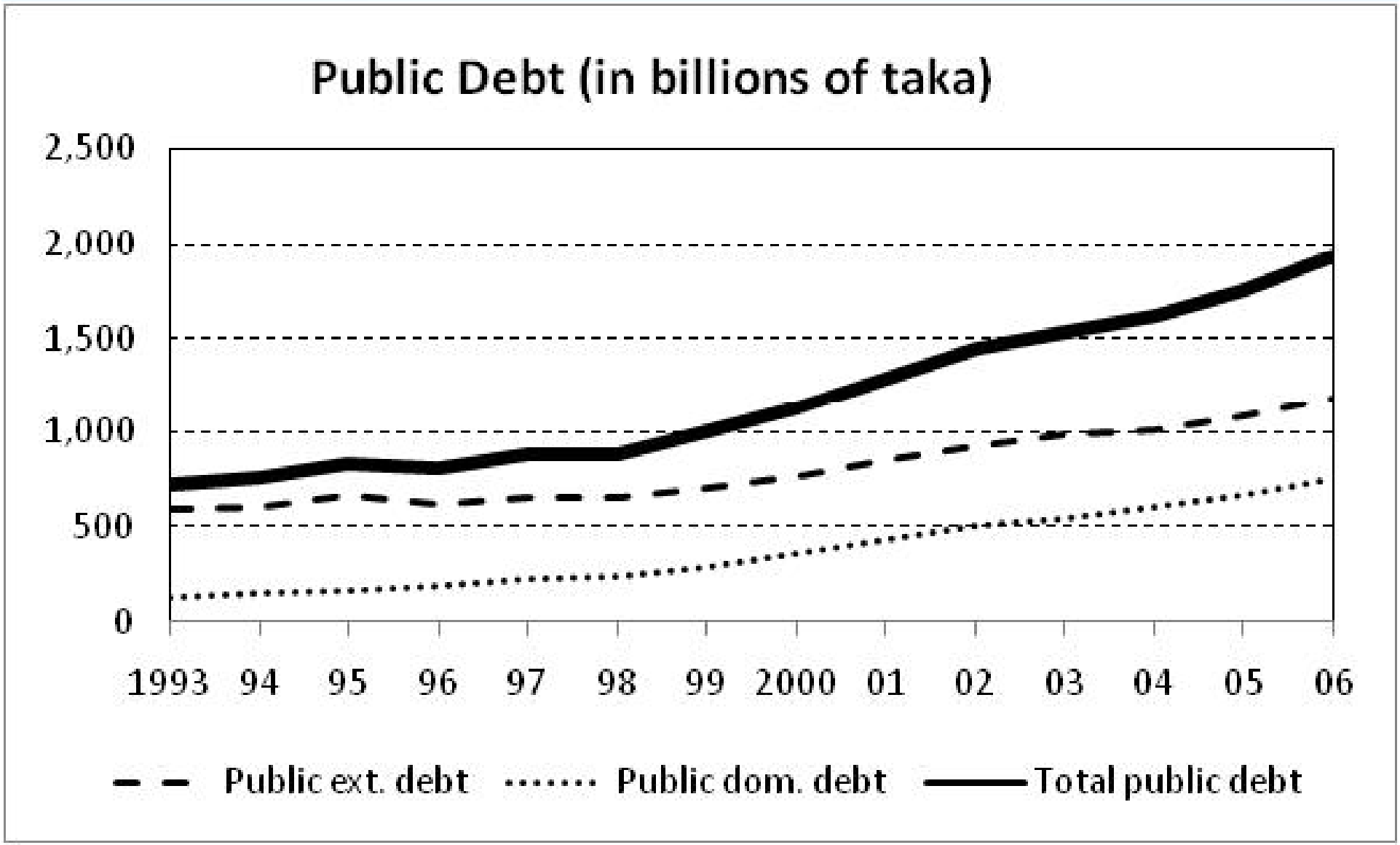
# Possible Impact of Debt Relief Initiatives

- The case of zero costs for Bangladesh would imply that the donors would deduct all debt relief costs from the HIPCs' traditional aid.
- The case of US\$580 million aid reduction per year to Bangladesh reflects the case in which the donors would deduct all debt relief costs from the non-HIPCs' traditional aid.
- Assuming that the costs of the recent debt relief initiatives will be shared equally among HIPCs and non-HIPCs, would imply that Bangladesh's future aid would be reduced by US\$265 million a year.

# Let's look at Bangladesh's public debt

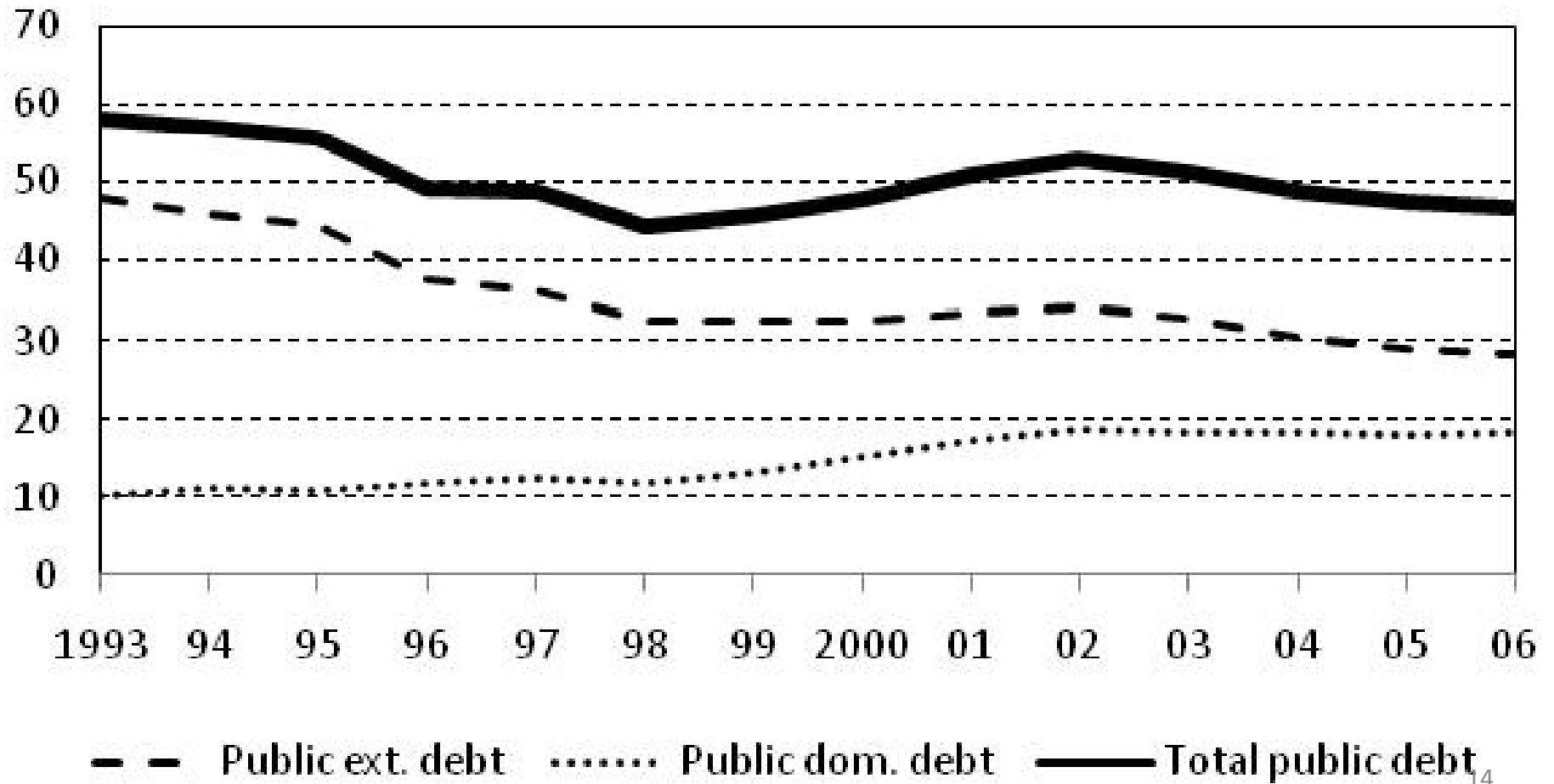


# Bangladesh's Public Debt is Increasing in Nominal Terms

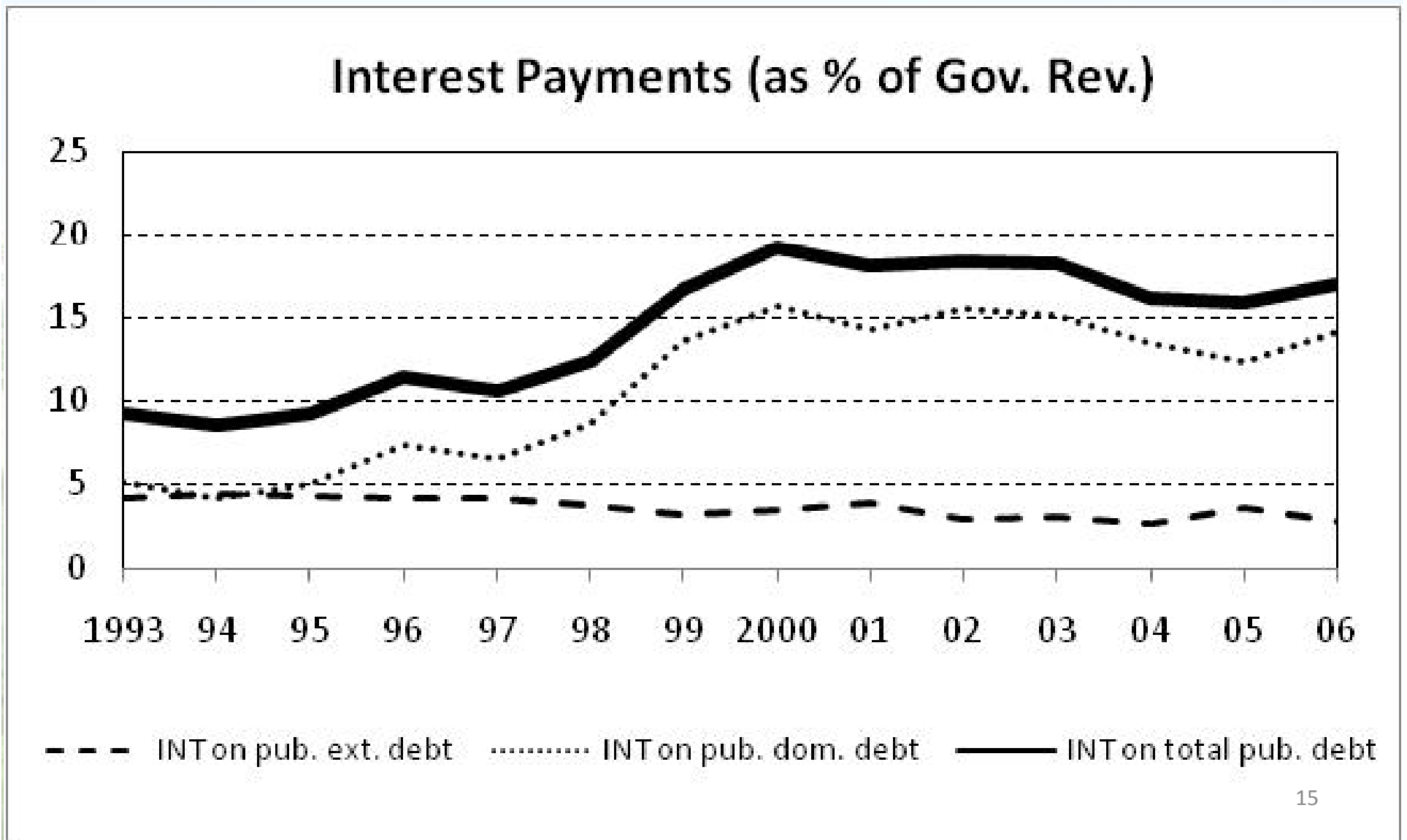


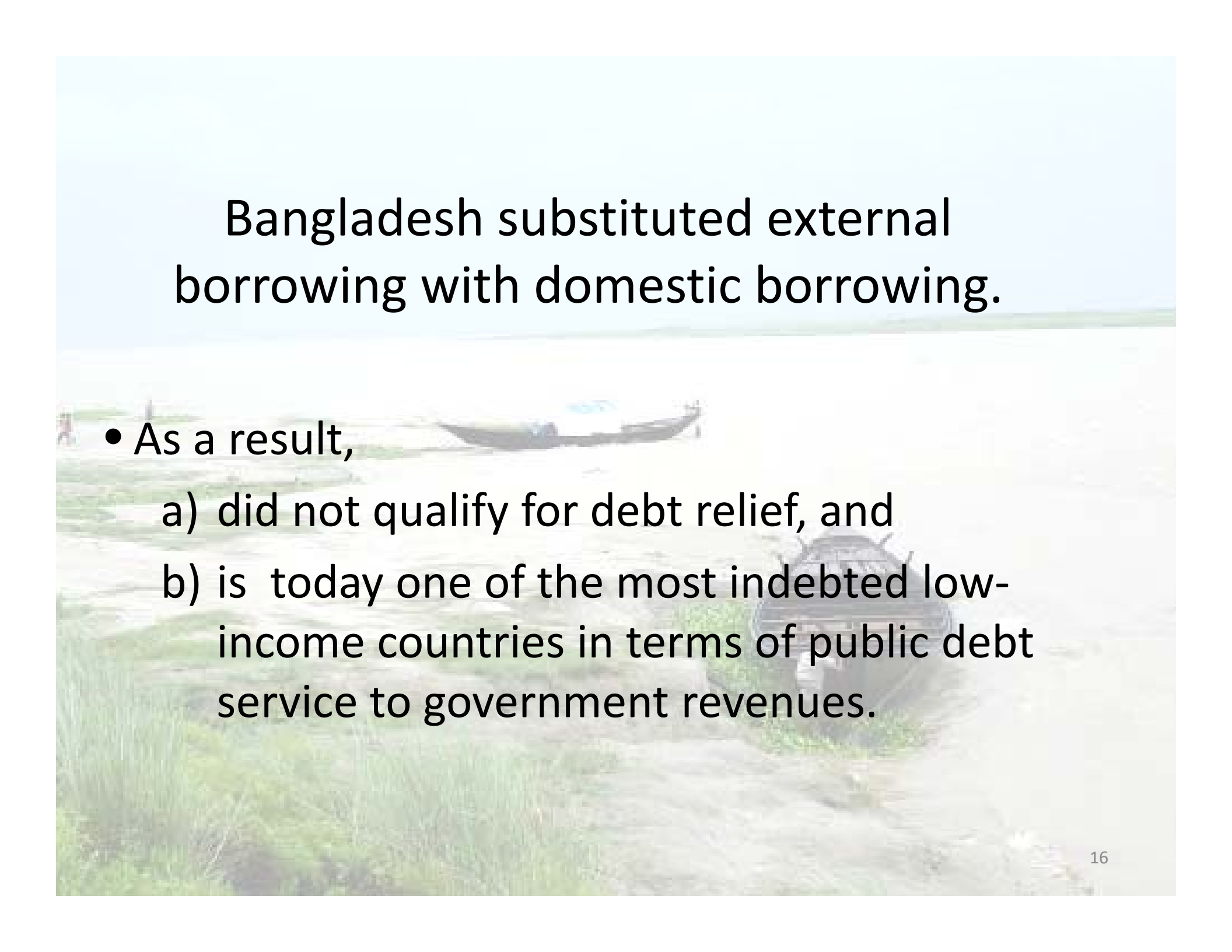
# However, as Percentage of GDP, Bangladesh's Total Public Debt is Decreasing

## Public Debt (as percent of GDP)



# Interest Payments on Domestic Debt are Increasing in Percentage of Gov. Rev.





Bangladesh substituted external borrowing with domestic borrowing.

- As a result,
  - a) did not qualify for debt relief, and
  - b) is today one of the most indebted low-income countries in terms of public debt service to government revenues.



# Bangladesh's Future Debt Sustainability

- We have used SimSIP Debt (a debt projection module) to simulate the evolution of Bangladesh's public debt from FY2006-FY2021.
- Given that Bangladesh has considerable amounts of both concessional external and non-concessional domestic debts, we calculate the debt stock indicators in net present value (NPV) terms.

# Bangladesh's Future Debt Sustainability

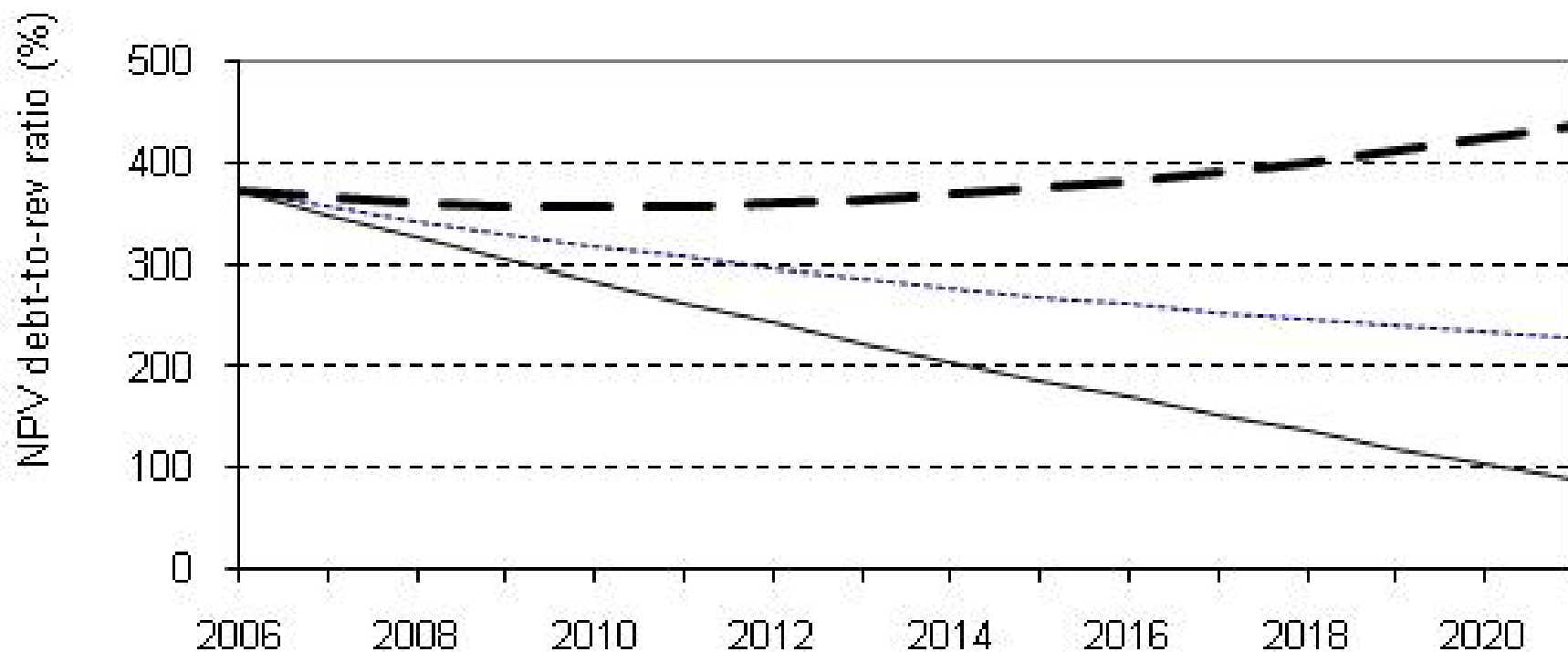
- First, we analyze Bangladesh's fiscal public debt sustainability under three different macroeconomic scenarios: baseline, optimistic, and pessimistic scenarios.
- We then simulate the sustainability of Bangladesh's fiscal debt for two alternative financing scenarios of an ambitious government-led investment strategy to achieve the MDGs.

## Alternative Assumptions Under Different Macroeconomic Scenarios

		baseline scenario	pessimistic scenario	optimistic scenario
<b>GDP growth rate (%)</b>	FY06	6.6	6.6	6.6
	FY21	5.7 (h)	3.7	7.7
<b>Exports growth rate (%)</b>	FY06	17.7	17.7	17.7
	FY21	8.3 (h)	4	12
<b>Inflation rate (%)</b>	FY06	7.2	7.2	7.2
	FY21	5.3 (h)	7.3	3.3
<b>Depreciation rate (%)</b>	FY06	9.4	9.4	9.4
	FY21	5.0 (h)	6	4
<b>Share of priority spending to GDP (%)</b>	FY06	12.1	12.1	12.1
	FY21	17.1	17.1	17.1
<b>Share of gov. rev. to GDP (%)</b>	FY06	10.7	10.7	10.7
	FY21	15.7 (h)	12.7	18.7

# Bangladesh's Future Debt Sustainability

## Impact on NPV debt-to-revenue ratio



----- base line s.

— — pessimistic s.

—— optimistic s.

# Bangladesh's Future Debt Sustainability

Let's look at the government-led investment strategy to achieve the MDGs:

Given the limitations Bangladesh faces to raise revenues to finance such an investment strategy, most of these expenditures would initially be covered by loans and grants.

# Bangladesh's Future Debt Sustainability

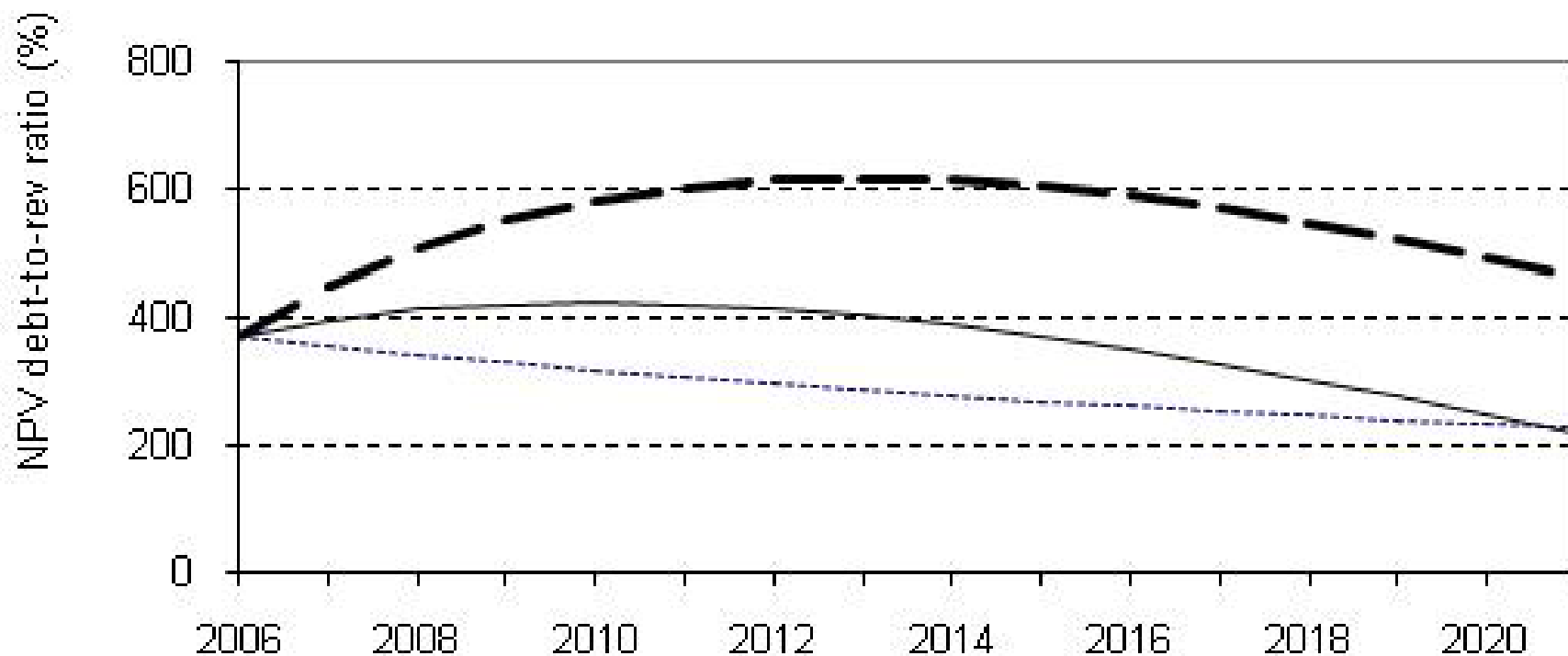
We consider two illustrative scenarios as follows:

a) the debt scenario assumes that the resulting financing gap in the government's budget would be covered exclusively by debt financing;

b) the grant scenario assumes that half (US\$4 billion) of the annual costs would be covered by external grants, while the other half would be debt-financed.

# Bangladesh's Future Debt Sustainability

## Impact on NPV debt-to-revenue ratio



..... base line s.

- - - - debt scenario

———— grant scenario

# Conclusions and Recommendations

First, we have shown that the share of aid allocations to Bangladesh has fallen considerably over the last 20 years, from 4.4 percent of all ODA provided to all developing countries in 1987 to 1.2 percent in 2006, and possibly even below 1 percent in 2007.

Both, the reduction in aid flows as well as not having used the aid received in the most effective way imply that Bangladesh paid a high price in terms of foregone development opportunities.



## Conclusions and Recommendations

Second, while the switching from external financing to domestic financing improved Bangladesh's external debt sustainability, it also implied that Bangladesh missed to qualify for any of the recent debt relief initiatives and is therefore today one of the highest indebted LDCs (in terms of total public debt).

Considering debt sustainability from a human development approach, Bangladesh's debt is clearly not sustainable.

# Conclusions and Recommendations

Third, as was shown with the pessimistic scenario, slightly less favorable macroeconomic circumstances than what Bangladesh is currently experiencing would seriously threaten Bangladesh's long-term debt sustainability.

Furthermore, debt sustainability would also be compromised if embarking on an ambitious public-investment-led poverty elimination strategy, unless at least half of these investments would be covered by grants.

# Conclusions and Recommendations

Fourth, even with a significant share of such an investment strategy covered by grants, all debt ratios would increase on a temporary basis.

So unless debt sustainability is defined by an MDG-consistent debt sustainability concept, it is unlikely that there would be sufficient domestic as well as external support for such an investment strategy.

# Conclusions and Recommendations

Fifth, taking recent changes in international aid and debt frameworks into account, aid to Bangladesh may likely continue to decrease in the future.

Worse, most of the aid may not be provided as grants, unless more emphasis is put on fiscal implications of Bangladesh's debt.

Hence, more efforts are needed to increase as well as to improve the provision of aid to Bangladesh and to increase the share of grants.

## Conclusions and Recommendations

Sixth, taking Bangladesh's record of achievement into account, Bangladesh should be "fast-tracked" for a rapid scale-up of aid, whereby the development agenda and development policies need to be designed based on a broad majority of domestic stakeholders.

# Conclusions and Recommendations

Seventh, taking recent efforts of making aid more effective into account,


- a) we should be more optimistic that aid can be effective, and
- b) work together to make it more effective, instead of continuing to be pessimistic about the impact of aid.

# Conclusions and Recommendations

Finally, while aid critics have voiced concerns about negative macroeconomic implications of a scaling up of aid, experience has shown that there is no evidence for such concerns.

The way forward is twofold:

- First, minimize possible future Dutch disease effects by
  - a) spending aid on productivity enhancing public investments and
  - b) by central banks providing credit to stimulate private investment.
- Second, minimize domestic capacity constraints by removing specific supply bottlenecks, e.g., lack of infrastructure or skilled personnel.

A wide, calm body of water, possibly a river or lake, stretches across the frame. In the foreground, a small, dark wooden boat with a thatched roof is beached on a rocky shore. A person is visible near the boat. In the middle ground, another similar boat is floating on the water. The background shows a distant, flat horizon under a clear sky. The text "Thank you for your attention." is overlaid in the center of the image.

Thank you for your attention.