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Debts and Debt Servicing

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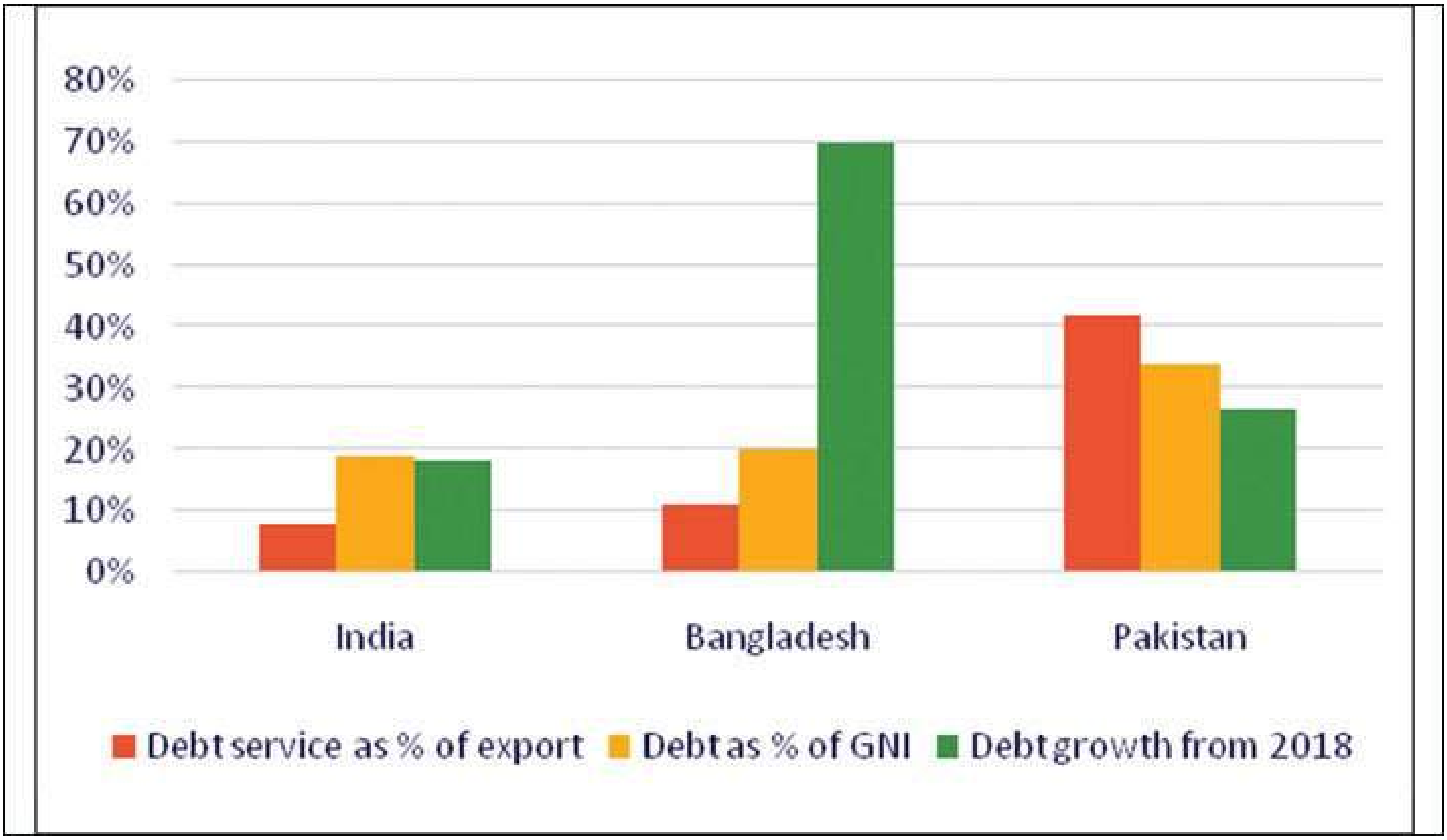

A K Ziauddin Ahmed

Sometimes we may need to borrow money to meet financial exigencies. In the modern world, we need not ask our friends or relatives to lend us money. We now have banks and other financial institutions. They are always offering loans with eye-catching advertisements. However, in addition to charging interests, they also ask for collaterals. Thus, to avail of these loans you have to be sufficiently wealthy.

In the good old days, there were Kabuliwalas who used to lend money without collaterals. Who were those generous people? According to an article published in the Business Standard in 2017, during the late 19th and early 20th centuries, many Afghans migrated to the then-British Bengal to sell dry fruits. These Afghans were popularly called Kabuliwalas relating them with the Afghan capital city Kabul.

Kabuliwalas subsequently started a money-lending business with the profits derived from their dry fruits trade. They provided collateral-free loans characterised by high rates of interest to both urban and rural communities. So, the reason behind their generosity was the gain they made from the high rate of interest that they charged on their loans. It's said that the Kabuliwalas never asked for the repayment of the principal amount because that would terminate the loan and stop the cash flow from interest. Kabuliwalas are long gone but their business model persists internationally.

Countries with surplus foreign exchange reserves and organisations like the World Bank and IMF lend money to needy countries without collateral. According to Statista, Chinese reserves amounted to $3.46 trillion in 2022 being the highest in the world. Only two more countries - Japan and Switzerland - had reserves of over a trillion dollars in 2022. Such countries will be interested in providing loans to other countries from their excess reserves to gain from interest and other benefits according to the terms of the loan agreement. For example, a country may provide a loan to another country for building a power plant with the condition of buying all required machinery and employing the services of experts and engineers from it. Thus, the creditor country earns interest on the loan amount, profits from selling machinery, and benefits from the employment of its experts and engineers. Of course, the loan recipient country can also benefit by investing the loan in appropriate sectors that with good governance might lead to economic growth and poverty reduction.

The borrowing countries need extra foreign currency to pay back periodic loan installments called debt servicing. If the country doesn't achieve enough economic growth to cover the extra requirement of funds for debt servicing, it will have to divert funds from other sectors like health, education, and energy to meet the obligation. In the worst-case scenario, the country may have to look for more loans to pay the loan installments. That's called a debt trap.

Recently the World Bank has published "International Debt Report 2023" which mentions that debt has become a paralysing burden for many countries. Low and middle-income countries paid a staggering $443.5 billion for debt servicing in 2022. South Asian countries contributed over $86 billion to this amount. India, Bangladesh, and Pakistan are the top three South Asian countries in terms of the size of the economy. The Gross National Income (GNI) of India, Bangladesh, and Pakistan were $3.32 trillion, $478.43 billion, and $371.24 billion respectively in 2022. The accompanying graph with this article presents the comparative positions of these three countries in 2022 in terms of foreign debt based on the data provided in the report.

From the chart, it appears that India's debt situation is the best among these three countries. Its total debt is 19% of GNI and the debt servicing cost is 8% of export earnings. Bangladesh's performance is more or less comparable to India's and conspicuously better than that of Pakistan. However, Bangladesh's debt growth since 2018 has been rather fast which could pose difficulties in maintaining consistency with the required growth of debt-servicing capacity.

Low and middle-income countries typically lack the technology and financial ability needed to develop infrastructure, industry, education, health care, etc. to improve the standard of living for their people. Consequently, they have to seek foreign loans, often conceding unfavorable conditions tied to them and the burden of debt servicing. Currently, the global situation of rising interest rates, higher energy prices, impacts of climate change, and geopolitical turmoil are putting strain on the debt servicing capacity of the borrowing countries. As of July 2023, a report from the UN Global Crisis Response Group highlights that over 41% of the world's population lives in nations where the expenditure on interest payments surpasses that on education or health. The situation is only expected to get worse in the coming days. Therefore, it's time for countries to exercise caution against 'too much and too fast' increases in foreign debts.

The writer is a former Corporate Professional and Academic