

Bangladesh Economic Update

DEFICIT AND DEBT

November 2012



উন্নয়ন অন্বেষণ

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1. INTRODUCTION

Deficit and debt have become major concerns facing the economy of Bangladesh. The average rate of growth in deficit is increasing rapidly. The revenue collection has not matched the rate of increase in expenditure. The increased subsidy, particularly for the energy sector has increased the revenue expenditure. The increased subsidy in the wake of unmatched growth in revenue has caused augmented borrowing, which in turn has also enlarged interest payment, consequentially increasing revenue expenditure, and again that too has led to further borrowing, making a cycle of increased deficit and debt.

The deficit itself may not necessarily be a matter of concern if such is occurred to augment growth. There is a need to make a distinction between a deficit arising out of wrong policies or distribution of patronage (rent-seeking) and that of an increase in public investment to finance public good, with a view to inducing growth.

An examination into the sources of deficit points to the reasons of secular increase in deficit. The expenditure in fuel and energy as percent of total revenue expenditure is increasing whereas the shares of agriculture and social sectors to revenue expenditure are decreasing. Again, in the case of subsidy, energy and power sectors have surpassed agriculture and social sectors, which have implications and may harm the marginalized people through hike in prices of essential goods.

There is also another phenomenon. The government revenue is subsidizing power generation in the private sector while the share of the public sector in total generation is declining and the earmarked implementation of capital investment (annual development programme) for increased generation in the public sector has remained slow. But the energy tariff has been increased several times, having differential impacts in terms of levels of income.

To finance the deficit, the government exceeded the target of borrowing from the banking sector. The government borrowing

from banking sector in the revised budget has increased than the proposed target mentioned in the budget of 2011-12. Even, in FY 2012-13, the government has proposed to borrow from banking sectors more than that of non-banking sectors indicating a sharp crowding out effect to dampen the private investment.

The government has been continuously failing to maintain the budgetary target of net foreign borrowing for the last two fiscal years. Though the rate of growth in net foreign borrowing and the foreign borrowing follows erratic trends, the rate of growth of amortization (the paying off of debt in regular installments over a period of time) has sharply increased. The net inflow of foreign aid has become nearly half of the total disbursement of loan and grants. This means half the amount of the total disbursement of loan and grants goes to the interest and principle payment. Moreover, the conditions imposed on loan and grants hinder the flexibility of the growth of the economy.

Over the years, per capita debt burden is increasing and half the amount of the total disbursement of loan and grants goes to the interest and principle payment. The ever-rising public debt has been exerting a serious pressure on the macro-economic stability of the country. As a result debt is creating more debt instead of becoming growth augmenting debt.

The current issue seeks to provide a balance sheet of revenue and expenditure, the reasons for increased deficit and debt, and implications on the economy.

2. GOVERNMENT REVENUE AND EXPENDITURE

The gap between expenditure and revenue is increasing year on year basis in the economy of Bangladesh. This happened as government expenditure is increasing more rapidly than the earning.

In FY 2011-12, revenue collection was Tk.1148850 million which was Tk. 218940 million more than that of FY 2010-11.

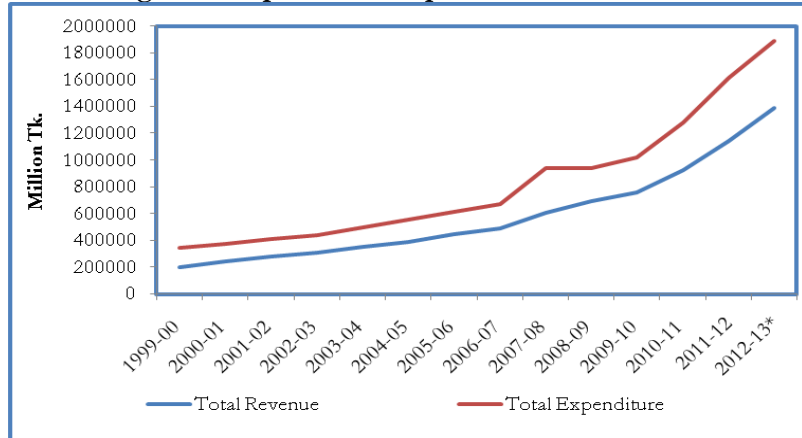
In FY 2011-12, revenue collection was Tk.1148850 million which was Tk. 218940 million more than that of FY 2010-11 and government expenditure was Tk. 1612130 million which was Tk. 329450 million more than that of FY 2010-11. That means, in FY 2011-12, government expenditure increased more than the government revenue.

In FY 2011-12, the gap between expenditure and revenue was TK. 348200 million. The gaps were Tk. 348200 million, Tk. 310400 million, Tk. 249600 million, Tk. 330700 million and Tk.

In FY 2011-12, the gap between expenditure and revenue was TK. 348200 million.

173600 million respectively in FY 2010-11, FY 2009-10, FY 2008-09, FY 2007-08 and FY 2006-07. The reason behind the insufficient growth of revenue is that the collection of NBR-tax revenue (which has the highest share of government revenue) is far less than the potential level.

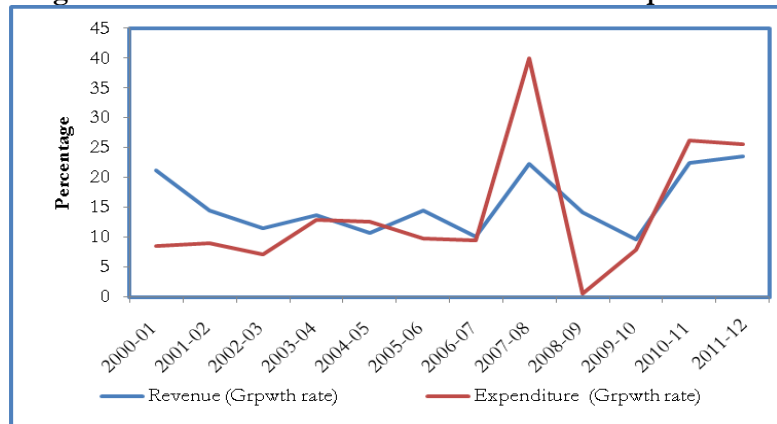
Figure 1: Gap between expenditure and revenue



Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

The MTMF (Medium Term Macroeconomic Frameworks) target for revenue collection as percentage of GDP for FY 2012-13 is 13.40 percent whereas the IMF-MEFP (Memorandum of Economic and Financial Policies with the International Monetary Fund) target is 13.00 percent. If an estimate is done based upon the historical track record of the revenue collection, this may stand in the range of 13.12 percent, indicating that the government may find it difficult to achieve such targets.

Figure 2: Growth rate of revenue collection and expenditure



Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

In FY 2011-12 the growth rate of government revenue was 23.54 percent, which was 1.03 percent higher than that of FY 2010-11.

Over the years, the rate of growth of government expenditure has fluctuated more than that of the rate of growth in revenue. During FY 1999-00 to 2011-12 the growth rate of government revenue varies from 9 percent to 23 percent whereas the growth rate of government expenditure varies from 0.5 percent to 40 percent.

In FY 2011-12 the growth rate of government revenue was 23.54 percent, which was 1.03 percent higher than that of FY 2010-11. On the other hand, the growth rate of government expenditure was 25.68 percent.

2.1 Components of Government Expenditure

In the FY 2011-12, government expenditure was Tk. 1612130 million which was 25.7 percent higher than that of FY 2010-11.

The government expenditure in FY 2011-12 was higher than that of FY 2010-11. In the FY 2011-12, government expenditure was Tk. 1612130 million which was 25.7 percent higher than that of FY 2010-11.

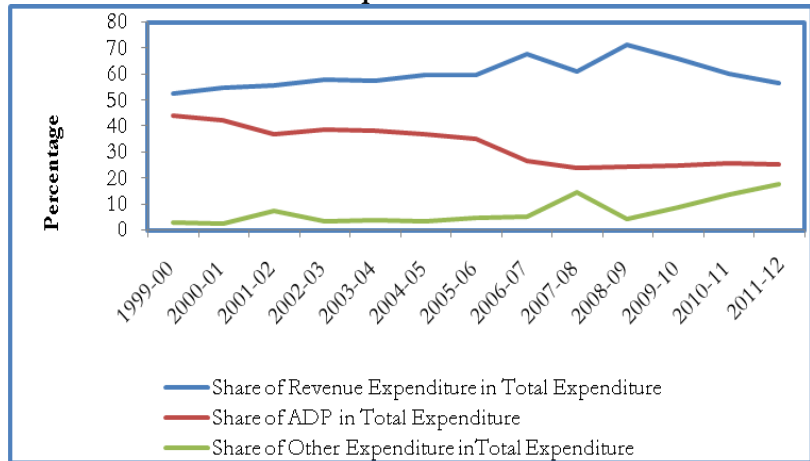
Though the highest share of government expenditure (revenue expenditure) is decreasing and the second highest share (ADP) has stagnated, the government expenditure is increasing as the share of others expenditure (exclude revenue expenditure and ADP) is increasing since FY 2009-10.

The decomposition of total expenditure into different categories indicate that the share of revenue expenditure has declined while the share of ADP has stagnated and the expenditure lumped as others (non-development capital expenditure, net outlay for food account operation, loans & advances (net), and structural adjustment expenditure, employment generation & development programmers financed from non-development budget, non-ADP project and non-ADP FFW transfer) have increased secularly since 2009-10.

The share of revenue expenditure in total expenditure was 71.29 percent in FY 2008-09, whereas it was 65.95 percent, 60.39 percent and 56.95 percent in the FY 2009-10, FY 2010-11 and FY 2011-12 respectively.

The share of revenue expenditure in total expenditure was 71.29 percent in FY 2008-09, whereas it was 65.95 percent, 60.39 percent and 56.95 percent in the FY 2009-10, FY 2010-11 and FY 2011-12 respectively. The share of ADP in total expenditure was 24.43 percent in FY 2008-09, whereas it was 25.15 percent, 25.89 percent and 25.48 percent in the FY 2009-10, FY 2010-11 and FY 2011-12 respectively. On the other hand, the share of others expenditure (exclude revenue expenditure and ADP) in total expenditure was 4.27 percent in FY 2008-09, whereas it was 8.89 percent, 13.70 percent and 17.56 percent in the FY 2009-10, FY 2010-11 and FY 2011-12 respectively.

Figure 3: Share of components of expenditure in total expenditure



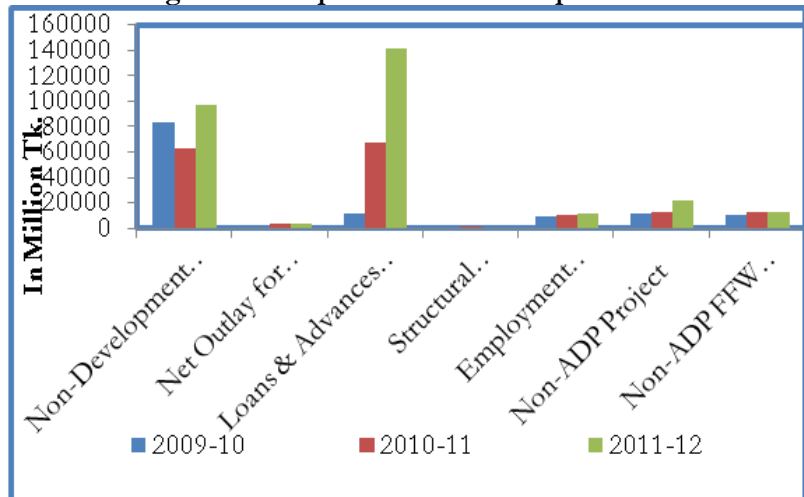
Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

A careful examination into the so-called “others” reveals that there has been manifold increase into loans and advances and non-development capital expenditure.

In FY 2012-13, other expenditures (exclude revenue expenditure and ADP) have increased at 74.73 percent. Among the other expenditures, loan and advances (Net), non-development capital expenditure and non-ADP project were responsible for higher deficit. Expenditure on loan and advances (net) was Tk. 141930 million, which is 111.45 percent higher in FY 2011-12 than that of FY 2010-11.

Expenditure on loan and advances (net) was Tk. 141930 million, which is 111.45 percent higher in FY 2011-12 than that of FY 2010-11.

Figure 4: Components of other expenditure



Source: Ministry of Finance, Finance Division, 2012

2.2 Components of Government Revenue

Over the years, total revenue is increasing, though the increment is not enough to fill in the gap between the expenditure and the revenue.

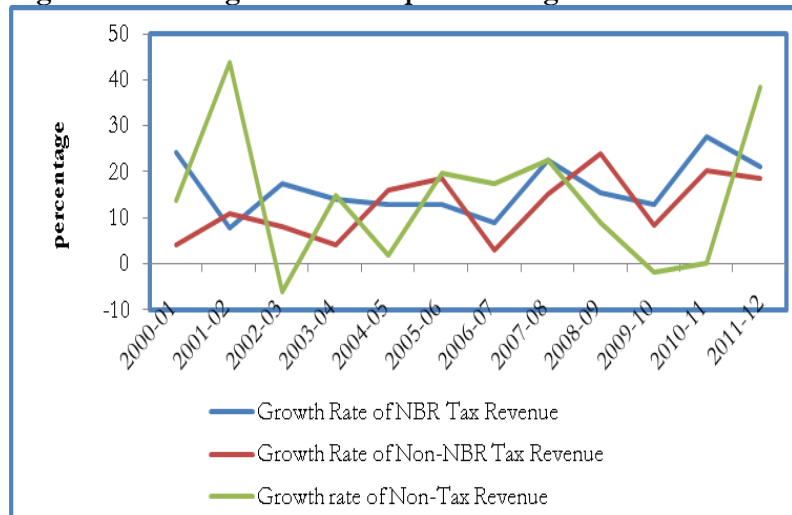
In FY 2011-12, NBR-tax revenue was Tk. 923700 million which was Tk. 762480 million in FY 2010-11.

The NBR-tax revenue has the highest share in government revenue, amounting on an average more than 78 percent whereas non- NBR tax revenue and non-tax revenue make up four and 18 percent respectively of the total revenue during the last decade. In FY 2011-12, NBR-tax revenue was Tk. 923700 million which was Tk. 762480 million in FY 2010-11. Even though the volume of NBR-tax revenue has increased, the rate of growth decreased by 6.4 percent during the same time.

In FY 2011-12, the rate of growth in non-NBR revenue decreased by 2 percent while the rate of growth in non-tax revenue was 36 percent.

Besides, in FY 2011-12, the rate of growth in non-NBR revenue decreased by 2 percent while the rate of growth in non-tax revenue was 36 percent. However, non-NBR tax revenue and non-tax revenue have a little effect in the total revenue and these two compose of only 20 percent share in total revenue in FY 2011-12.

Figure 5: Rate of growth of components in government revenue



Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

In the last five years (FY 2007-08 to FY 2011-12), the collected tax on account of income and profit was higher than the targets fixed by the NBR. Even a casual examination suggests that the NBR makes a lower target either to show the so-called “efficiency” of the system for political gains or to be endowed with so called bonuses that the NBR dishes away to its employees.

Nevertheless, if the NBR is endowed with “efficiency,” the collection of income tax would have limited to only 1.1 million out of about 3.5 million having Tax Identification Numbers (TINs), meaning only a third’s tax has been collected. Had it been possible to collect tax from all TIN holders, the deficit would disappear and even a surplus budget might be imagined.

2.3 Comparative Revenue Expenditure in Agriculture, Energy and Power Sectors

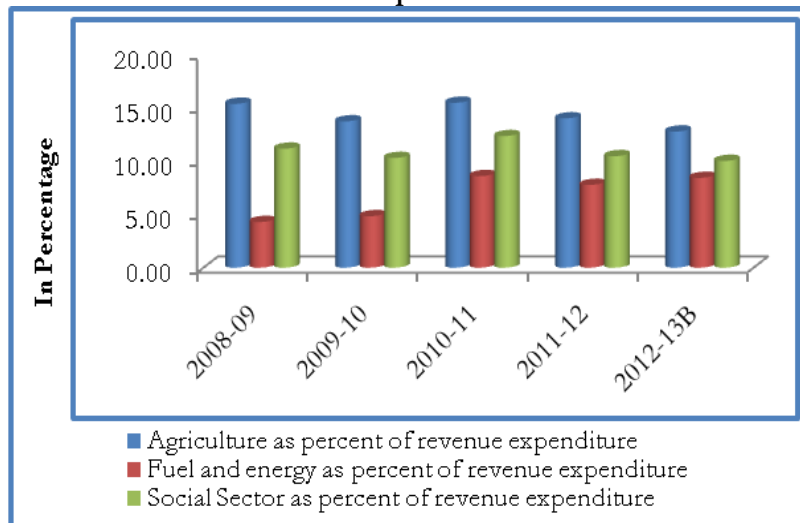
The total allocation of energy and power sector is Tk. 95440 million in FY 2012-13, which is an increase by 19.95 percent than that of the revised budget of the previous fiscal year. Out of the total allocation, Tk. 78960 million and Tk. 16480 million have been allocated for the energy and power sector and for the energy and petroleum sector respectively. The rate of the growth in the allocation of agriculture and social sector were 0.79 and 5.84 percent respectively in FY 2012-13 than that of the previous fiscal year. In FY 2012-13, the share of fuel and energy sector has been proposed at 8.45 percent as the quick rental power plants, while the shares of agriculture and social sectors have declined and stand at 12.81 and 10.05 percent respectively. In FY 2008-09, fuel and energy as percent of revenue expenditure was 4.30 percent, which increased by 3.49 percent in FY 2010-11. Simultaneously, agriculture and social sector as percent of revenue expenditure witnessed decrease by 1.37 and 0.71 percent in FY 2011-10.

The total allocation of energy and power sector is Tk. 95440 million in FY 2012-13, which is an increase by 19.95 percent than that of the revised budget of the previous fiscal year.

Out of the total allocation, Tk. 78960 million and Tk. 16480 million have been allocated for the energy and power sector and for the energy and petroleum sector respectively.

In FY 2012-13, the share of fuel and energy sector has been proposed at 8.45 percent as the quick rental power plants, while the shares of agriculture and social sectors have declined and stand at 12.81 and 10.05 percent respectively.

Figure 6: Revenue expenditure among on agriculture, energy and power



Source: Bangladesh Bureau of Statistics and Finance division, Ministry of finance, 2012

2.4 Subsidies in Energy and Power Sectors

Due to the rise in global fuel price and necessity for import of petroleum products for the quick rental power plants, subsidy was targeted at Tk. 144450 million, which is up by 30.31 percent in FY 2012-13 than that of the revised budget of the previous fiscal year.

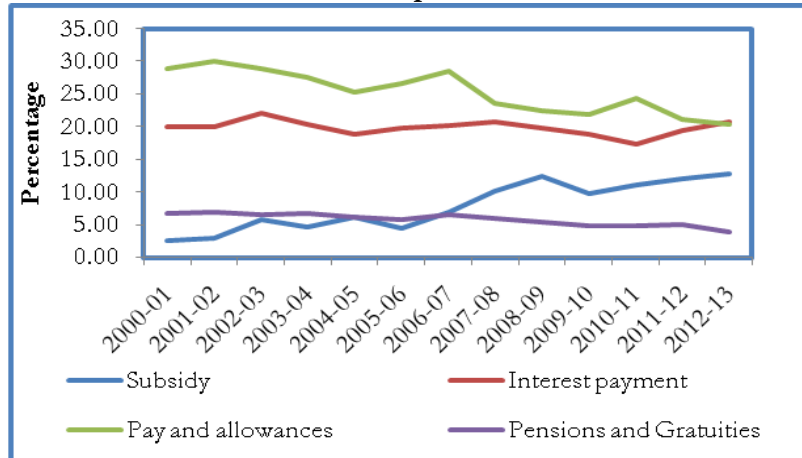
The subsidy in power sector has increased by 6.67 percent for purchasing electricity from rental power plants as well as subsidy in agricultural sector has decreased by 7.69 percent in the current fiscal year.

In FY 2011-12, the shares of subsidy and interest payment in non-development revenue expenditure were 12.01 percent and 19.38 percent respectively which were 9.78 percent and 18.74 percent in FY 2009-10.

In the case of subsidy, energy and power sectors have surpassed agriculture and social sectors, which may harm the marginalized people through the hikes in price of essential goods. An uncertainty of the flow of crude oil supply is created due to the political unrest of Middle East region. The New-York Mercantile Exchange witnessed increase in light suit crude oil by USD 1.22 per barrel and reached at USD 86.67 on 16 November, 2012. In the London Intercontinental Exchange, the Brent crude oil rose by USD 0.98 per barrel. Due to the rise in global fuel price and necessity for import of petroleum products for the quick rental power plants, subsidy was targeted at Tk. 144450 million, which is up by 30.31 percent in FY 2012-13 than that of the revised budget of the previous fiscal year. The subsidy in power sector has increased by 6.67 percent for purchasing electricity from rental power plants as well as subsidy in agricultural sector has decreased by 7.69 percent in the current fiscal year. In the power sector, subsidy is increasing, as government has to pay more money for buying electricity from the private sectors. In the current fiscal year, additional cost to refuel these power plants is between Tk. 52.00 and Tk. 56.00 billion, which is about 0.6 percent or 0.7 percent of the GDP, as projected by the World Bank (Energy Bangla, 2012). To reduce the subsidy demand, the price of electricity is continuously increasing which ultimately increases the price of the essential consumer goods and these frequent increases in prices of electricity may hamper the marginalized sections (Rahman 2012).

The allocation on subsidy has been increasing since FY 2006-07. Simultaneously, the allocation of the interest payment, pay and allowances as well as pensions and gratuities in non-development revenue expenditure are decreasing. In FY 2012-13, government has proposed to allocate Tk. 144450 million as subsidy, Tk. 233020 million as interest payment, Tk. 229400 million as pay and allowances, Tk. 43960 million as pensions and gratuities. In FY 2011-12, the shares of subsidy and interest payment in non-development revenue expenditure were 12.01 percent and 19.38 percent respectively which were 9.78 percent and 18.74 percent in FY 2009-10. However, pay and allowances as well as pensions and gratuities in non-development revenue expenditure reduced by 5.51 percent and 0.87 percent.

Figure 7: The share of subsidy, interest payment, pay and allowances and pensions and gratuities in non-development revenue expenditure



Source: Ministry of Finance, Budget in a brief, 2012

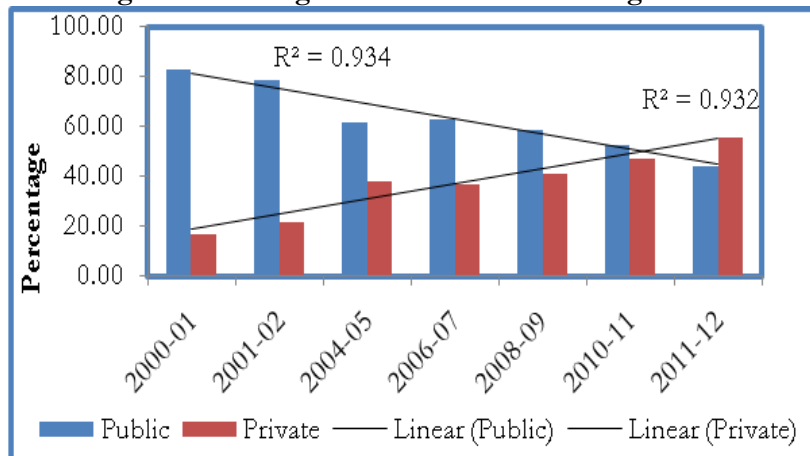
2.5 Power Generation

In FY 2011-12, the net power generation in public sector decreased by 9 percent and 38.90 percent respectively than those of FY 2010-11 and FY 2000-01.

In FY 2011-12, (during July to February) a total of 21716 million-kilo watt hour (MKWh) net energy was generated, comprising 9632 million MKWh in public sector and 12084 MKWh in private sector.

Being highly subsidized, share of the private sector in power generation is increasing the share of public sector is decreasing. A major chunk of tax revenue goes to the private sector as subsidy. The dependency on the private sector may induce rent seeking and simultaneous increase in price of power. In FY 2011-12, the net power generation in public sector decreased by 9 percent and 38.90 percent respectively than those of FY 2010-11 and FY 2000-01. In FY 2011-12, (during July to February) a total of 21716 million-kilo watt hour (MKWh) net energy was generated, comprising 9632 million MKWh in public sector and 12084 MKWh in private sector. Of the total net power generation, 44.35 percent was generated in the public sector whereas 55.64 percent was in the private sector.

Figure 8: Power generation scenario in Bangladesh



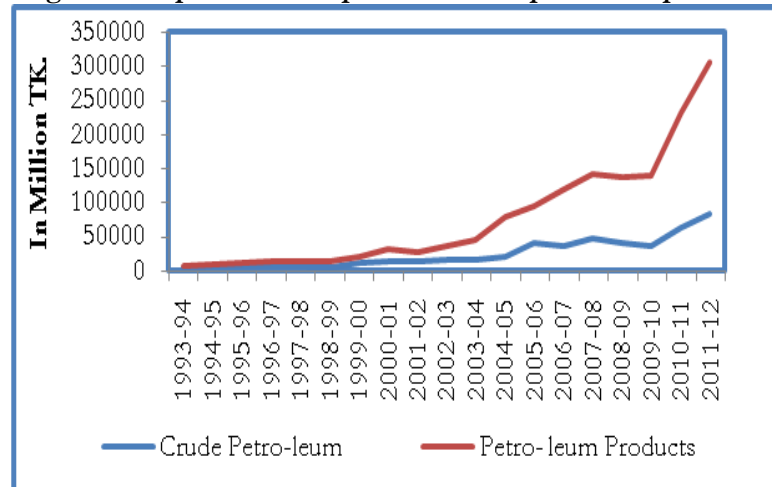
Source: Ministry of Finance, Finance Division, archive, 2012

2.6 Import of Petroleum and Crude Petroleum

In FY 2011-12, total imported crude petroleum and petroleum product were Tk. 83870 and Tk. 304840 million respectively, which were respectively 32.09 and 32.19 percent more than those of FY 2010-11.

Due to the establishment of some new quick rental power plants, the import bills of crude petroleum and petroleum products in Bangladesh have been increasing sharply since FY 2009-10. In FY 2011-12, total imported crude petroleum and petroleum product were Tk. 83870 and Tk. 304840 million respectively, which were respectively 32.09 and 32.19 percent more than those of FY 2010-11. This might craft a long term depressing impact on the economy of Bangladesh. The shares of crude petroleum and petroleum product in total import were 2.99 and 10.85 percent, which were respectively 0.34 percent and 1.24 percent more than those of the previous fiscal year. In FY 1998-99, total imported amount of these two products were Tk. 5670 and 12980 million respectively, which were respectively 1.78 and 3.37 percent of the total import. The rates of growth in crude petroleum and petroleum product were respectively 71.62 and 64.90 percent, which are the highest in the last seven fiscal years.

Figure 9: Import of crude petroleum and petroleum products



Source: Bangladesh Bank, 2012

2.7 Electricity Price

The distribution companies namely DPDC (Dhaka Power Distribution Company Limited), DESCO (Dhaka Electric Supply Company Ltd.), REB (Rural Electrification Board) and WZPDCL (West Zone Power Distribution Company Limited.) have proposed to increase their electricity price at 11.31, 11.69, 9.00 and 10.50 percent respectively from the average price per unit are Tk. 6.35, 6.45, 5.17 and 5.82 respectively. According to the DPDC, DESCO, REB and WZPDCL, Tk. 960 million, Tk. 3250 million, Tk. 5160 million and Tk. 6450 million respectively

will be needed as subsidy, if the Bangladesh Energy Regulatory Commission (BERC) does not increase the proposed electricity price. The distribution companies have included development expenditure to calculate the electricity price. According to the BERC, the shown system loss by the distribution companies is more than that of the real loss accompanied with embezzled electricity.

Table 2: Increase in the proposed electricity price

Distributor Company	Proposed Power Price (Percentage)	Average Present Price (Tk. per Unit)
DPDC	11.31	6.35
DESCO	11.69	6.45
REB	9.00	5.17
WZPDCL	10.50	5.82

Source: Bangladesh Energy Regulatory Commission, 2012

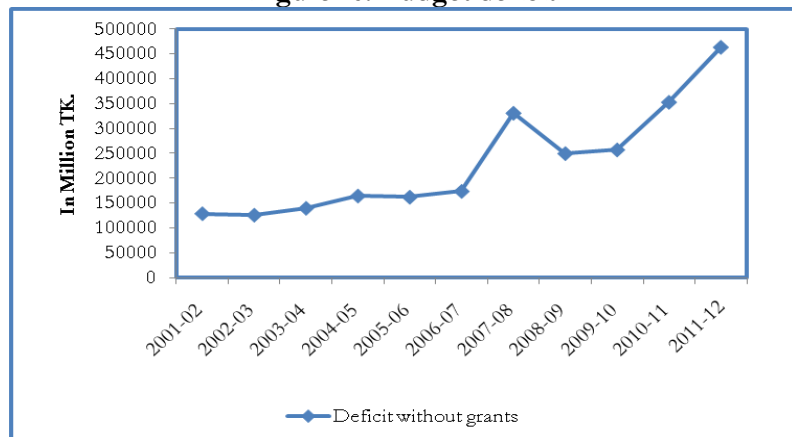
3. SCENARIO OF DEFICIT

In FY 2011-12, the rate of growth of deficit was 31.33 percent, which was 37.25 and 2.98 percent respectively in FY 2010-11 and FY 2009-10.

The budget deficit is increasing day by day and was the highest in the last fiscal year. In FY 2011-12, the rate of growth of deficit was 31.33 percent, which was 37.25 and 2.98 percent respectively in FY 2010-11 and FY 2009-10. According to budget of FY 2012-13, the government targeted budget deficit is Tk. 520680 million, which is 12.39 percent more than that of FY 2011-12.

In the budget of FY 2012-13, the government targeted budget deficit is Tk. 520680 million, which is 12.39 percent more than that of FY 2011-12.

Figure 10: Budget deficit



Source: Bangladesh Bank, 2012

During FY 2006-07 to 2011-12, the average rate of growth in deficit increased by 900.05 percent than that of FY 2000-01 to 2005-06. During the last three fiscal years, the rate of growth in deficit has been showing an increasing trend. The average rate of growth in deficit during FY 2000-01 to 2005-06 was 2.37

During FY 2006-07 to 2011-12, the average rate of growth in deficit increased by 900.05 percent than that of FY 2000-01 to 2005-06.

percent which was 23.75 percent in FY 2006-07 to 2011-12. In the FY 2011-12, deficits were Tk. 463280 million and Tk. 352770 million in FY 2010-11.

In FY 2011-12, the rate of growth in loan and advances in expenditure and the rate of lower growth in NBR tax revenue were responsible for budget deficit. Another reason for higher deficit was increase in revenue expenditure and ADP. The analysis regarding this is shown here (Table 3).

The average rate of growth in deficit during FY 2000-01 to 2005-06 was 2.37 percent which was 23.75 percent in FY 2006-07 to 2011-12.

Table 3: Rate of growth in various components of deficit

FY	Deficit In million Tk.	Rate of Growth in Deficit (Percentage)	Growth of Expenditure (Percentage)	Growth of Revenue (Percentage)	Rate of Growth in revenue expenditure (Percentage)	Growth rate of NBR tax revenue (Percentage)
2010-11	348200	12.17	17.63	19.76	12.21	23.93
2011-12	452000	29.81	25.82	24.37	13.94	21.52

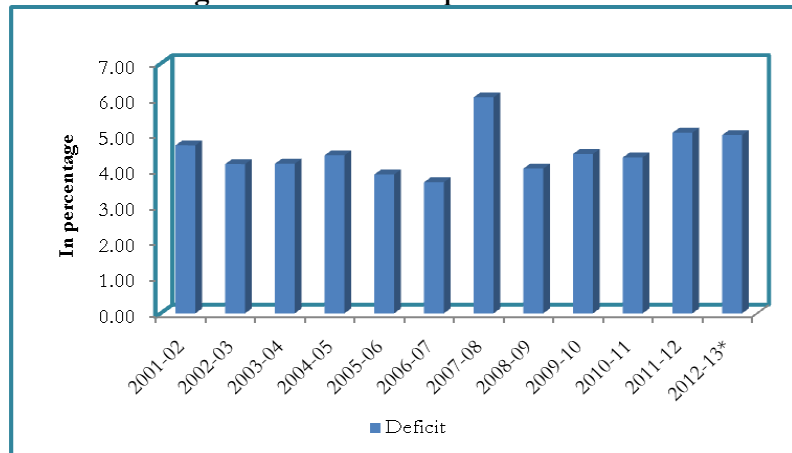
Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

3.1 Deficit as a Percent of GDP

In FY 2012-13, Tk. 520680 million (without grants) is estimated as deficit, which is 5 percent of the GDP.

Deficit as percentage of GDP is increasing day by day. In FY 2012-13, Tk. 520680 million (without grants) is estimated as deficit, which is 5 percent of the GDP. Deficit as percentage of GDP touched its highest amount in FY 2011-12 (only except the period of care taker government in FY 2007-08) during FY 2011-12 to FY 2001-02.

Figure 11: Deficit as a percent of GDP



Source: Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012.

In FY 2011-12, deficits without grants and with grants reached at 5.1 and 4.5 percent respectively for the first time except only FY 2007-08.

In FY 2011-12, budget deficit was equal to Tk. 463280 million (without grants) which was 5.1 percent of the GDP in the country as well as 0.7 percent higher than that of FY 2010-11.

In FY 2011-12, deficits without grants and with grants reached at 5.1 and 4.5 percent respectively for the first time except only FY 2007-08. In FY 2011-12, budget deficit was equal to Tk. 463280 million (without grants) which was 5.1 percent of the GDP in the country as well as 0.7 percent higher than that of FY 2010-11. Moreover, the rate of growth in deficit has been experiencing a positive rate since FY 2009-10. In FY 2009-10, FY 2010-11 and FY 2011-12, the rates of growth in deficit were respectively 24.36, 12.18 and 33.05 percent. If the government can maintain the target of deficit of current fiscal year, the rate of growth in deficit might be 12.39 percent.

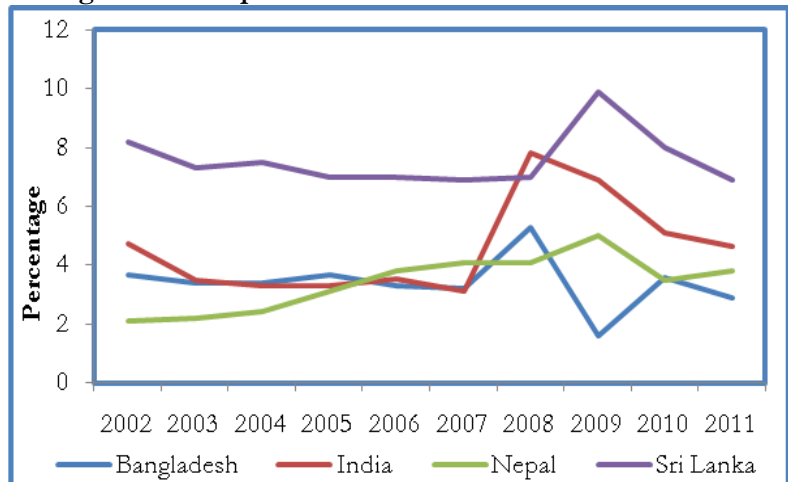
In FY 2012-13, the targets in MTMF and IMF-MEFP on overall balance as percentage of GDP are 5.0 and 5.5 percent respectively. According to the MTMF target, the overall balance (excluding grants) as percentage of GDP will decrease, but given the sources of increased deficit remain unabated, it would be difficult to achieve such target and rather it might increase.

3.2 Comparison with Some South Asian Countries

Comparing with some south-Asian countries, Bangladesh stands relatively is in a better position regarding deficit as a percentage of GDP. In the last four or five years, deficit as a percentage of GDP was the lowest in Bangladesh than those of India, Nepal and Sri Lanka. In 2011, deficit as a percentage of GDP was 2.9, 4.6, 3.8 and 6.9 percent in Bangladesh, India, Nepal and Sri Lanka respectively.

In 2011, deficit as a percentage of GDP was 2.9, 4.6, 3.8 and 6.9 percent in Bangladesh, India, Nepal and Sri Lanka respectively.

Figure 11: Comparison with some South Asian countries



Source: Bangladesh Bank, World Bank Indicators, 2012

4. DEFICIT FINANCING AND DEBT MANAGEMENT

Two sources of deficit financing are being used i.e. internal debt and external debt. The government has become more dependent on banking sector rather than non-banking ones for the domestic financing. Over the past few years, the overall budget deficit registered an increasing trend that put a serious pressure on total debt of the country.

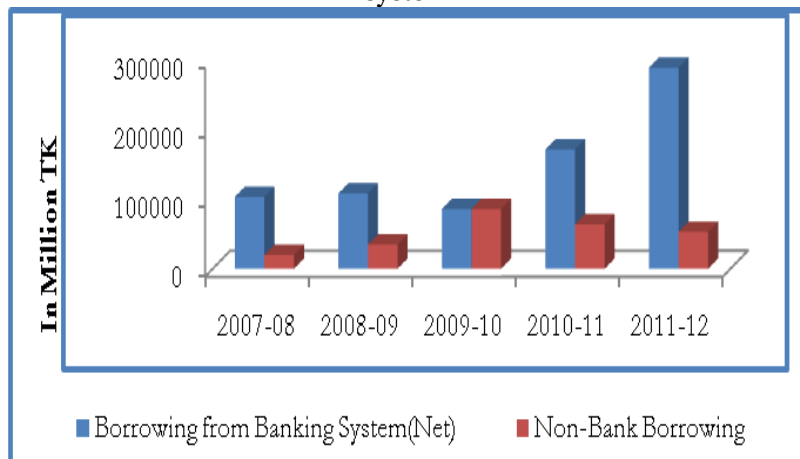
4.1 Government Domestic Borrowing (Net)

During the last two fiscal years, the government exceeded its set targets of borrowing from banking sector. In FY 2012-13, the government has proposed to borrow 119.38 percent from banking sectors more than that of non-banking sectors indicating a sharp crowding out effect to reduce the private investment.

In FY 2012-13, the government has proposed to borrow 119.38 percent from banking sectors.

The government borrowing from the banking sector in the revised budget increased by Tk. 101580 million against the budgetary target in FY 2011-12. On the other hand, the government borrowing from non-banking sector in the revised budget decreased by Tk.28970 million against the target. In FY 2011-12, the rate of growth in government borrowing from banking sector is 68.49 percent. On the other hand, borrowing from non-banking sector decreased by 16.89 percent in FY 2011-12.

Figure 12: Domestic borrowing from banks and non banking system



Source: Bangladesh Bank, 2012

In FY 2011-12, the rate of growth in government borrowing from banking sector is 68.49 percent. On the other hand, borrowing from non-banking sector decreased by 16.89 percent in FY 2011-12.

The estimated government borrowing from domestic sources in FY 2012-13 is Tk. 334840 million, which is 23.07 percent higher than that of budget of FY 2011-12 and 96.99 percent higher than that of FY 2007-08. The continuation of current trend might result into an increasing movement in the domestic debt.

The net government borrowing from banking sector in FY 2012-13 (up to August, 2012) is Tk. 12637.0 million, which is Tk. 34323.0 million less than that of the same time of the previous fiscal year. However, during July to August of the current fiscal year, government borrowing from non-banking system has increased by Tk. 3083.2 million and the total outstanding domestic debt at the end of August, 2012 has increased by Tk. 178530.2 million. The MTMF target of lowering the rate of domestic borrowing as percentage of GDP may not be realised.

4.2 Government Foreign Borrowing (Net)

The government of Bangladesh has been failing to maintain the budgetary targets of net foreign borrowing during the last two fiscal years while the repayment is increasing. For the current fiscal year, the government estimated Tk. 125400 million as net borrowing, which is Tk. 51,410 million less than that of budget of FY 2011-12. In FY 2011-12, the rate of growth in government amortization (the paying off of debt in regular installments over a period of time) was 29.21 percent, which were respectively 13.62, and 3.15 percent in FY 2010-11 and FY 2009-10. Moreover, government borrowing from foreign sources in the revised budget decreased by Tk. 51,870 million and Tk.56,590 million against the targets.

In FY 2011-12, the rate of growth in government amortization (the paying off of debt in regular installments over a period of time) was 29.21 percent, which were respectively 13.62, and 3.15 percent in FY 2010-11 and FY 2009-10.

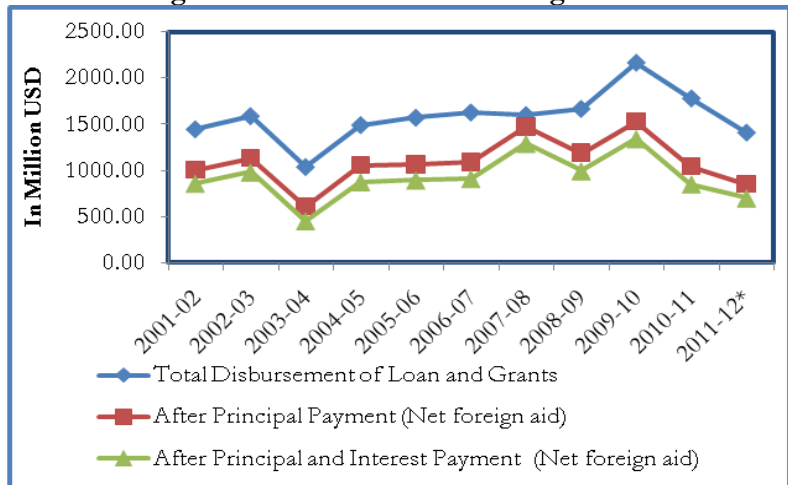
In FY 2011-12, Government net foreign borrowing was 47.19 percent lower than that FY 2010-11. The net government foreign financing in FY 2012-13 (up to August, 2012) is Tk. 17365.8 million, which is Tk. 16897.3 million more than that of the same time of FY 2011-12. The total financing (net) in FY 2012-13 (up to August, 2012) is Tk. 37179.1 million, which is Tk. 14342.5 million less than that of the same time of the previous fiscal year.

4.3 Net Foreign Aid Flow

The net inflow of foreign aid has been becoming nearly half the total disbursement of loan and grants, meaning half of the amount of the total disbursement of loan and grants goes to the interest and principle payment. Net receipts of foreign aid is USD 212.71 million (only considering the payment of principal)

during July August of 2012-13 which was USD 162.71 million more than the corresponding period of the previous fiscal year whereas the payment of principal was USD 100 million.

Figure 13: Comparison between total disbursement of loan and grants and the flow of net foreign aid

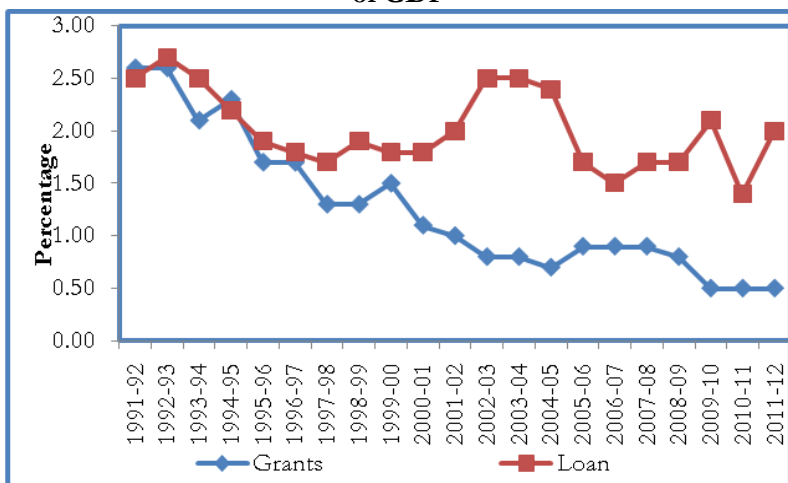


Source: Economic Relation Division, Ministry of Finance, 2012
 * Data available up to March, 2012

In FY 2011-12 (July to March), total disbursement of loan and grants was USD 1407 million (total grants was USD 452 million and loan was USD 955 million which was USD 370 million lower than that of the FY 2010-11.

In FY 2012-13, during July-August total disbursement of loan and grants stood higher at USD 196.14 million or 168 percent to USD 312.90 million compared to USD 116.75 million during July- August of FY 2011-12.

Figure 14: Comparison between loan and grants as percentage of GDP



Source: Ministry of Finance, Bangladesh Bank, 2012

In FY 2011-12, loan and grants as percentage of GDP were only 2.00 and 0.50 percent whereas these were only 1.50 and 0.90 percent respectively in FY 2006-07.

In FY 2011-12 (July to March), total disbursement of loan and grants was USD 1407 million (total grants was USD 452 million and loan was USD 955 million which was USD 370 million lower than that of the FY 2010-11. During July to March of FY

2011-12, net foreign aid flows after principal payment was USD 850 million and after principal and interest payment it was USD 696 million. In the meantime, payment of principal has been increasing; a lesser net foreign aid is being received.

Foreign loan as percentage of GDP is stable whereas loan as percentage of GDP has increased by 60 percent in FY 2011-12 compared to FY 2010-11.

The foreign grant as percentage of GDP is decreasing day by day. On the other hand, foreign loan as percentage of GDP is not decreasing as much as grants. In FY 2011-12, loan and grants as percentage of GDP were only 2.00 and 0.50 percent whereas these were only 1.50 and 0.90 percent respectively in FY 2006-07. Foreign loan as percentage of GDP is stable whereas loan as percentage of GDP has increased by 60 percent in FY 2011-12 compared to FY 2010-11.

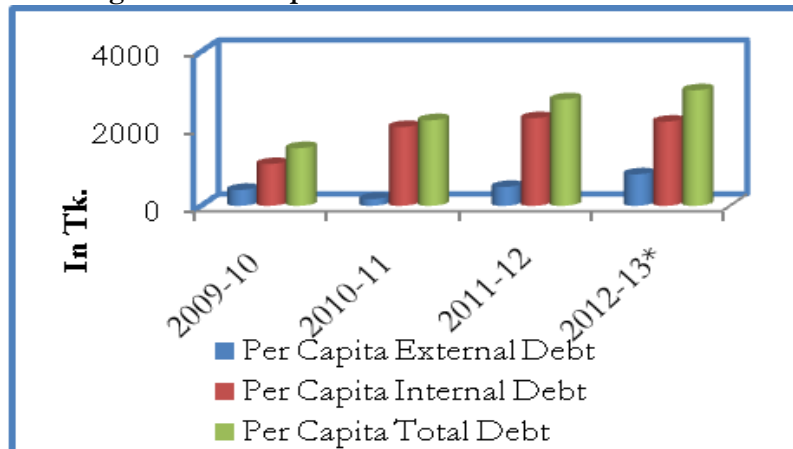
Moreover, after FY 2009-10 loans as percentage of GDP has shown an increasing trend. The higher gap between foreign grants and loan in the recent years compared to FY 1991-92 induces higher amount of principal and interest payment. After FY 1997-98, grants have been showing a decreasing trend. On the other hand, loan has been increasing after FY 2006-07.

5. PER CAPITA DEBT BURDEN

The per capita debt burden in FY 2011-12 in Bangladesh was Tk. 2761.74, which increased by 24.42 percent than that of FY 2010-11.

Over the years, per capita debt burden is increasing. According to the current budget estimation, per capita debt is Tk. 2998.61. The per capita debt burden in FY 2011-12 in Bangladesh was Tk. 2761.74, which increased by 24.42 percent than that of FY 2010-11.

Figure 15: Per capita external debt and internal debt



Source: Author's calculation based on Bangladesh Bank, Bangladesh Bureau of Statistics and Finance Division, 2012

However, in FY 2010-11, per capita debt burden was Tk. 2219.64 that was 48.38 percent higher than that of the previous

In FY 2010-11, per capita debt burden was Tk. 2219.64 that was 48.38 percent higher than that of the previous fiscal year.

fiscal year. Moreover, the gap between per capita debt burden of internal and foreign borrowing were Tk. 669.68, Tk. 1867.07 and Tk. 1785.62 in FY 2009-10, FY 2010-11, FY 2011-12 respectively. However, since FY 2005-06 per capita debt burdens have been showing a sharp increasing trend. The ever-rising public debt has been exerting a serious pressure on the macro-economic stability of the country. It puts an upward pressure on real rate of interest by crowding the private investment out.

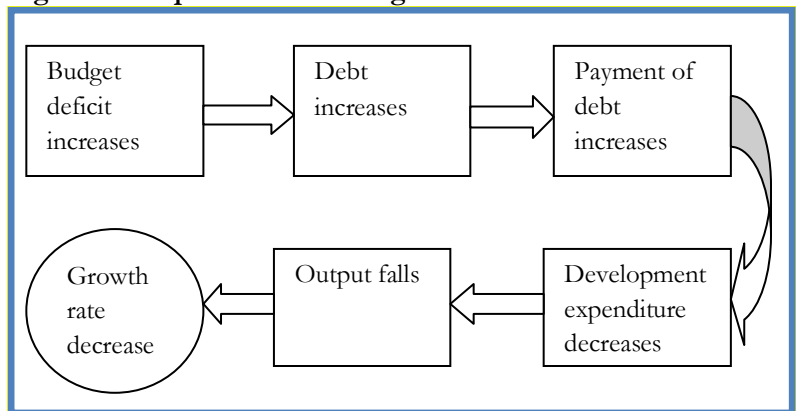
6. IMPACT OF DEFICIT

The increase of deficit puts a negative impact on the growth of economy. Hence, the public investment in social sectors is being deprived of the expected budget allocation. To financing the large deficit, government borrows a large amount from the banking sectors, which also increases the rate of inflation.

6.1 Impact of Deficit on Growth

When deficit is financing through debt, it affects the people through monetary mechanism. At that condition, total debt service increases and development expenditure decreases as well. In addition, domestic currency is devalued due to payment of excessive principal and interest. Therefore, the output and employment cannot reach at potential level and the rate of growth in GDP falls.

Figure 16: Impact of deficit on growth

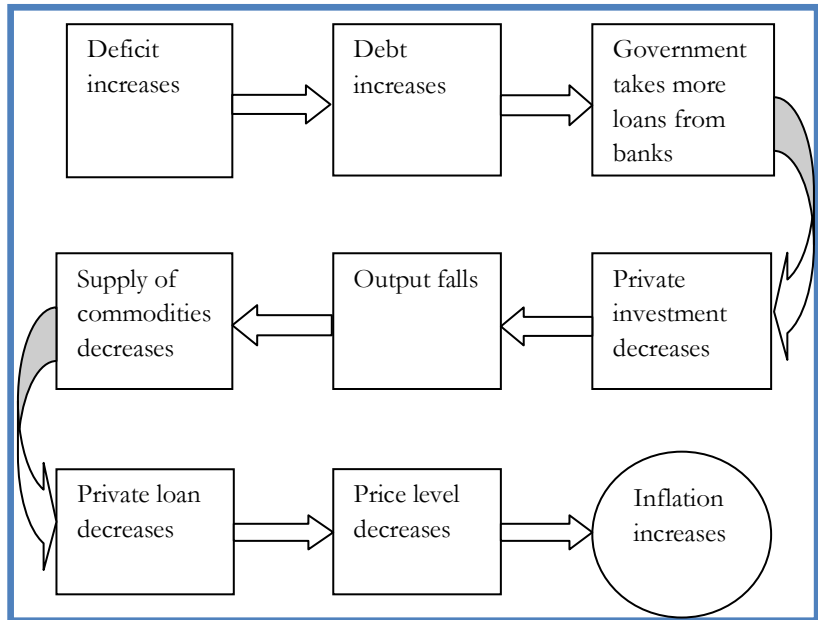


6.2 Impact of Deficit on Inflation

The government often finances from the banking sector and over the time, government borrowing from banking sector rises sharply to finance the deficit. Government does this function through open market operation, which is crowding out the

private investment. Consequently, output and supply of the commodities decreases as well as private loan decreases along with the increase in the price level of the economy. Moreover, all these are responsible for raising the inflation as well as fall of the real income of the people making the situation worse off.

Figure 17: Impact of deficit on inflation



7. CONCLUSIONS

The continuous increase in deficit and the consequential rise in debt are resultant of the government’s lack of far sightedness and associated rent seeking behaviour. The people in general are bearing the burden in terms of higher prices in electricity, lesser public investment in energy and social sectors, inflation and higher taxes.

The ever-rising public debt has been exerting a serious pressure on the macro-economic stability of the country. It puts an upward pressure on real interest rate crowding private investment out. It increases demand for servicing debt payment, reducing the government capacity for public investment. The social sector spending becomes the prime causality. The government has become more dependent on banking sectors other than non-banking ones for domestic financing over the time.

The amount government has to pay per year as principal and interest of debt mainly creates deficit. For huge payment of principal and interest of debt, the government has been

imposing regressive tax like value added tax (VAT) and has to reduce allocation in social safety-net programmes which adversely affect the economy of the country. Increasing level of tax has two-fold effects on people: firstly, it increases the price level of the economy and secondly, it reduces the disposable income of the people. These two effects result into the fall of real income of the people and make the situation worse off.

When deficit is financed through debt, it also affects people through monetary mechanism. The government often finances from banking sector and over the time government borrowing from the banking sector has risen sharply. In addition, domestic currency is devalued due to payment of excessive principal and interest. Therefore, the output and employment cannot reach its potential level.

The policy suggestion given by the IMF and other like-minded groups are also far from removing miseries of the people. The suggestion of doing away with energy subsidies or increasing the energy tariff to match the generation cost does address the root cause of the problem. The government should close the rental and the quick rental power plants and embark on a thought through programme, including increased public investment in power and energy sector.

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