

DEBT AND DEFICIT: TRENDS AND CHALLENGES

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For orders and request, please contact:

UNNAYAN ONNESHAN

16/2, Indira Road, Farmgate Dhaka-1215, Bangladesh

Tell: + (880-2) 58150684, 9110636

Fax: + (880-2) 58155804

E-mail: info@unnayan.org

Web: www.unnayan.org



The current issue of the Bangladesh Economic Update analysing the current trends in deficit and debt reveals that increasing per capita debt burden, high debt as percentage of gross domestic product (GDP) and large debt service payment lowering the capacity of government to increase development expenditure are poised to impede the economic growth and increase intergenerational debt burden in the future.

1. INTRODUCTION

The current issue of the Bangladesh Economic Update analysing the current trends in deficit and debt reveals that increasing per capita debt burden, high debt as percentage of gross domestic product (GDP) and large debt service payment lowering the capacity of government to increase development expenditure are poised to impede the economic growth and increase intergenerational debt burden in the future.

Deficit as percentage of GDP is increasing which is not that alarming level but swelling every year can be menacing for the economic growth. The expenditure – both the development and non-development expenditure – is increasing but collection of revenue is not at desirable level to cover the expenditure. In order to meet up this gap, debt from domestic and external sources is mandatory. Debt is, however, common for both the developed and developing economies but success of a country depends on prudent use and efficient management of debt. In this regard, financing and managing the deficit in a best possible way becomes a challenge for the government.

Debt may be considered as a fiscal stimulus which has a multiplier effect on economy if it is used for productive purpose otherwise the debt make the problem worse (Leech, 2012). The per capita debt burden of Bangladesh has been mounting rapidly since FY 2009-10, and debt as a share of GDP is high. A large amount of money is paid every year as a principle and interest to service the domestic and foreign debt which is decreasing the net asset of the country. But the sustainability of debt is questionable because a huge portion of the debt is spent to finance the non development expenditure like the interest payment, salary, food cost, structural adjustment cost etc; narrowing the capacity of the government to spend on social and infrastructural development. The development expenditure is much lower than the non development expenditure which may increase the cost of debt by creating inflationary pressure, crowding out the private investment and may turn to a burden for future generation.

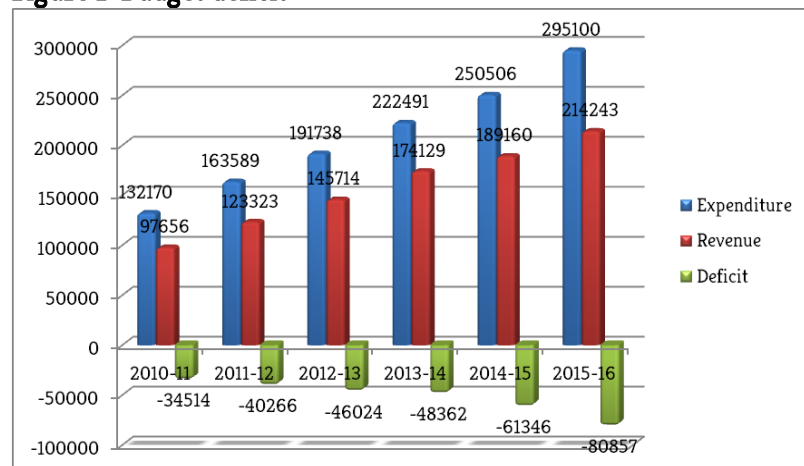
This issue highlights the current trend of deficit which emerges from the shortfall of revenue collection and expenditure, how this deficit is financed through the debt from domestic and external sources and the growth path of per capita debt burden. This issue also studies the cost of debt and suggests some policy prescription for more prudent use of debt and self sustaining growth.

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2. TRENDS IN BUDGET DEFICIT

The overall budget deficit for FY 2015-16 is estimated at Tk. 86657 crore excluding grants which is 5 percent of GDP. The revised deficit in FY 2014-15 was Tk. 76297 crore (5 percent of GDP), which was Tk. 67552 crore in the proposed budget. Since the revenue collection target of the government seems to be ambitious, the government may be forced to cut the expenditure level in FY 2015-16 to keep the budget deficit within the target. The three fiscal targets related to revenue earning, revenue expenditure and budget deficit thus has fallen short and the government had to revise these by a significant margin. Even then, the targets for revenue collection and revenue expenditure in FY 2014-15 were set above the trend observed in the last several fiscal years. In addition, the NBR has missed the budget target to collect Tk. 149720 crore in FY 2014-15. The gap between the total expenditure and total revenue is increasing over the years. Due to the slower rate of collection of revenue as compared to the total expenditure, more borrowing and foreign loans are required to finance the budget deficit.

Figure 1: Budget deficit

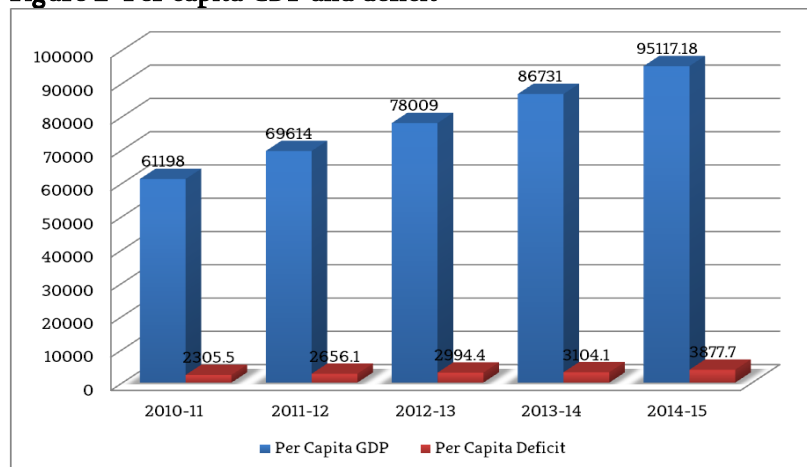


Source: Ministry of Finance, 2015a

Per capita deficit has been increasing over time. As in FY 2015-16, the government has proposed the biggest budget ever, the deficit is the biggest and so is the per capita deficit.

Per capita deficit has been increasing over time. As in FY 2015-16, the government has proposed the biggest budget ever, the deficit is the biggest and so is the per capita deficit. In FY 2014-15, the per capita deficit was Tk. 4248.55. Per capita GDP were Tk. 61198, Tk. 69914, Tk.78089, and Tk. 86731 in FY 2010-11, FY 2011-12, FY 2012-13, and FY 2013-14 respectively whereas the per capita deficit was Tk.2626.79, Tk.2981.79, Tk.3387.64 and Tk. 3533.22 respectively in the same period. The rate of growth in per capita deficit was 13 percent, 13.51 percent, 13.61 percent, 4.27 percent, and 20.24 percent in FY 2010-11, FY 2011-12, FY 2012-13, FY 2013-14, and FY 2014-15 respectively. On the other hand, the rate of growth in per capita GDP was 13.41 percent in FY 2010-11 which increased by 13.75 and 12.03 percent in FY 2011-12 and FY 2012-13; then slightly decreased by 11.18 percent in 2013-14. The per capita GDP is increasing and per capita deficit is keeping pace with it.

Figure 2: Per capita GDP and deficit



Source: Ministry of Finance, 2015a

3. DEFICIT AND DEFICIT FINANCING

The gap between the revenue and the expenditure is mostly financed through the borrowing. Against the deficit of Tk. 86657 crore in budget for FY 2015-16, the targeted borrowing is 80857 crore. Against the deficit of Tk. 67552 crore in budget for FY 2014-15, the targeted borrowing was Tk. 61346 crore. In FY 2013-14, the target of borrowing was Tk. 48362 crore where the revised debt was Tk. 53595 crore. The amount of debt was Tk. 39005 crore, Tk. 41868 crore and Tk. 33218 crore in FY 2012-13, FY 2011-12 and FY 2010-

11 respectively. In the last five fiscal years from FY 2010-11 to FY 2014-15, the borrowing has increased by 103.35 percent. Financing of budget deficit in July-May period of FY 2014-15 stood higher at Tk. 33883.09 crore compared to Tk. 27379.43 crore during the corresponding period of FY 2014-14, representing an increase of 23.8 percent. An obligation or liability to pay later arising from the government borrowing in each year or budget financing is known as debt (Pearce, 1992).

Government debt in Bangladesh consists of domestic and external debt. External Debt is directly linked to borrowing from bilateral and multilateral institutions for project funding through the Annual Development Programme (ADP) and budget support systems.

3.1. Sources of Debt

Government debt in Bangladesh consists of domestic and external debt. External Debt is directly linked to borrowing from bilateral and multilateral institutions for project funding through the Annual Development Programme (ADP) and budget support systems. Domestic borrowing is generated for financing segments of the budget deficit in addition to intra-year cash flow management. In general, external borrowing is applied to long term commitments while domestic borrowing is required for short, medium and long term commitments.

3.1.1. Domestic debt

The domestic resources are always considered as key source of the government for deficit financing. In recent times, the government finances the lion's share of the deficit from the domestic source especially from the banks. Total domestic financing has been showing an increasing trend since FY 2009-10 because of increase in deficit. Domestic borrowing in FY 2009-10 was Tk.7880.14 crore and became Tk. 25597.86 crore in FY 2012-13 and Tk. 21979.52 crore in FY 2013-14 and 19409.26 crore in FY 2014-15 (July-May). The budgetary target set for FY 2015-16 is Tk. 56523 crore.

The government borrows from two domestic sources: banking system and the non- banking system, while the borrowing from banking sector is decreasing in recent times. Government borrowed Tk. 6627.80 in FY 2013-14 whereas the amount was Tk. 17873 crore and Tk. 18875 crore in FY 2012-13 and FY 2011-12 respectively. Government borrowing from banking system has become negative (Tk. -11660.30 crore) in FY 2014-15 (July-May).

The banking system is the main source of borrowing, although the dependency on non -bank system, specially the borrowing through National Savings Deposit (NSD) is increasing. The net borrowing from the non-bank source was Tk. 15351.72 crore in FY 2013-14 and Tk. 31069.56 crore in FY 2014-15 (July-May). In FY 2012-13, the borrowing was Tk. 14153 crore which was Tk. 2887.71 crore in FY 2011-12.

Table 1: Domestic debt

Year	Net borrowing of the Govt. from the banking system	Net non-bank borrowing of the Govt. from the public	Total domestic financing	Outstanding Domestic debt (end period)
2001-02	2487.10	4711.47	7198.57	45181.76
2002-03	-1103.10	4795.22	3692.12	48873.88
2003-04	1246.20	4598.94	5845.14	54719.02
2004-05	3106.60	2907.56	6014.16	60733.18
2005-06	5667.80	2758.90	8426.70	69159.88
2006-07	4937.20	4373.53	9310.73	78470.61
2007-08	11531.50	4008.68	15540.18	94010.79
2008-09	10527.40	4405.51	14932.91	108943.70
2009-10	-4376.00	12256.14	7880.14	116823.84
2010-11	19384.10	3012.93	22397.03	139220.87
2011-12	18875.00	2327.38	21202.38	160423.25
2012-13	17873.00	7724.86	25597.86	181183.96
2013-14*	6627.80	15351.72	21979.52	203163.48
2014-15(July-May)	-11660.30	31069.56	19409.26	222572.74

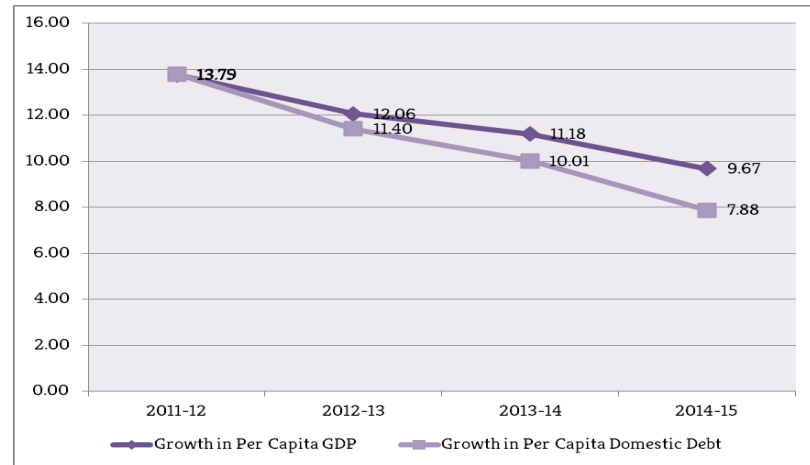
Source: Bangladesh bank, 2015a

Outstanding debt was Tk. 45181.8 crore in FY 2001-02 which reached 78470.4 crore in FY 2006-07 at an annual rate of growth of 14.74 percent. From FY 2006-07 to FY 2008-09, domestic debt increased at an annual rate of 19.42 percent and from FY 2008-09 to FY 2013-14, domestic debt increased at an annual rate of 17.09 percent. In FY 2011-12, debt stood at Tk. 160423 crore, then increased to Tk. 181183.96 crore (17.46 percent as a share of GDP) in 2012-13

and Tk. 202043.80 crore (17.11 percent as a share of GDP) in FY 2013-14 and Tk. 222572.74 crore in FY 2014-15 (July-May).

Per capita domestic debt is increasing over the years with the per capita GDP. In FY 2002-03, the rate of growth in per capita GDP was 8.56 percent which reached at 12.76 percent in FY 2007-08 and rate of growth in per capita domestic debt was 6.71 percent which stood at 18.14 percent in the same time period representing a 4.2 percentage points increase in per capita GDP and 11.43 percent increase in Per capita domestic debt. From FY 2008-09 to FY 2013-14, the rate of growth in per capita GDP increases from 10.61 percent to 11.18 percent where the per capita debt decreases from 14.29 percent to 11.4 percent. In FY 2013-14, the per capita domestic debt was Tk. 12968 which was Tk. 11788.2 and Tk.10582 in FY 2012-13 and 2011-12 respectively. In FY 2014-15 (July-May), the per capita domestic debt rises to Tk. 13989.49 crore.

Figure 3: Growth rate in per capita GDP and per capita domestic debt

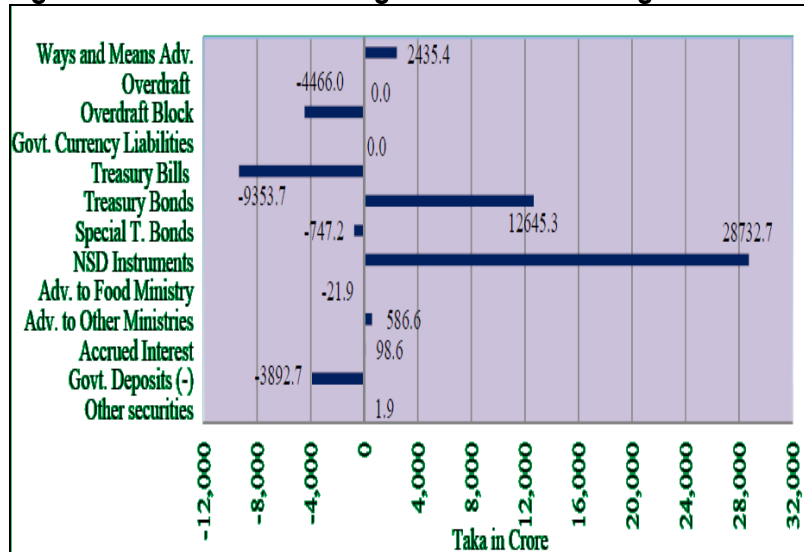


Source: Ministry of Finance, 2015a

Domestic Debt Financing Instruments

In FY 2014-15 (July-May), the net borrowing through NSD was Tk. 26562.46 crore (26 percent higher than revised budget for FY 2014-15) and outstanding borrowing through NSD at end of the year became Tk. 102959.94 crore.

Figure 4: Instrument-wise net government borrowing



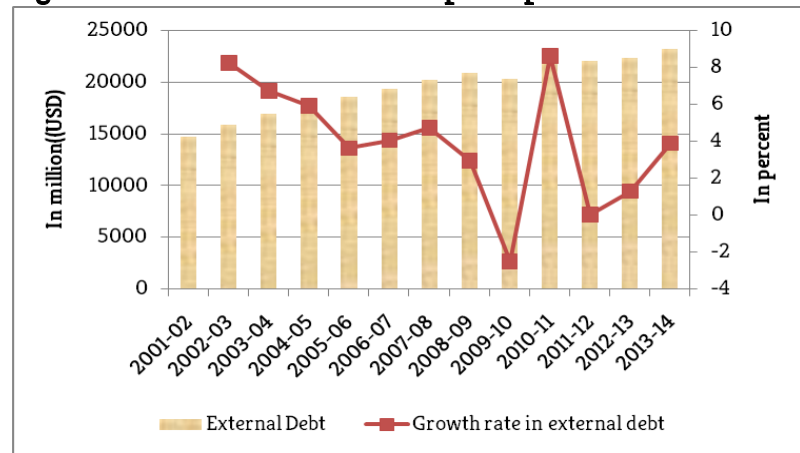
Source: Bangladesh Bank, 2015b

Borrowing from the foreign debt partner is much lower than the domestic one but the dependency is high.

3.1.2. External Debt

External assistance has played a vital role in the economic development of Bangladesh assisting in bridging the internal gap (savings-investment gap) and external gap (export-import gap). Borrowing from the foreign debt partner is much lower than the domestic one but the dependency is high. In FY 2014-15 (July-May), net external financing has stood at Tk. 14473.84 crore. In FY 2013-14, the total external financing were Tk. 14224.04 crore where it was Tk. 15080 crore in FY 2012-13. Outstanding external debt stood at USD 27036 million in FY 2013-14 which was 24907 million in FY 2012-13. From FY 2002-03 to FY 2006-07, the external debt increased at an annual rate of 6.37 percent, then decreased to 2.93 percent for the period FY 2007-08 and FY 2008-09 and again increased to 3.58 percent for the period from FY 2009-10 to FY 2013-14. The fluctuation in the rate of growth in external debt arose from political unrest in different time and also from the diplomatic tactics.

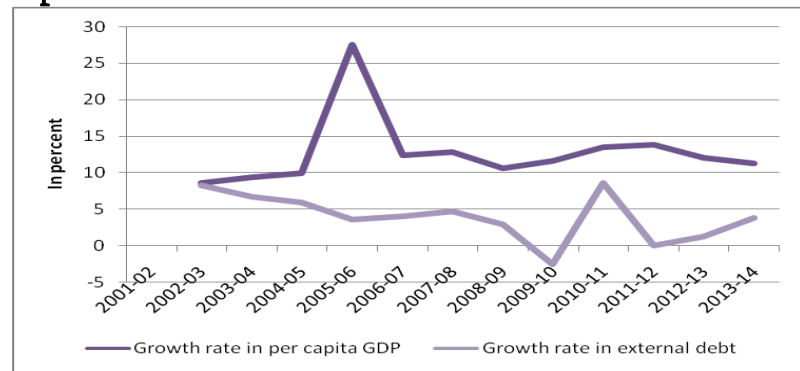
Figure 5: Total external debt and per capita external debt



Source: Ministry of Finance, 2015c

Per capita external debt shows how much burden of external debt each person carry or the liability of each person of the country to the foreigners. In FY 2013-14, each person was burdened with USD 173.53 whereas the amount was USD 162 in FY 2012-13; representing a 7.11 percent within a fiscal year.

Figure 6: Rate of growth in per capita external debt and per capita GDP



Source: Ministry of Finance, 2015c

Generally, Government debt as a percent of GDP is used to measure the ability of a country to make future payments on its debt, thus affecting the country borrowing costs and government bond yields. Debt ratios particularly debt (itself) as a percentage to GDP is the standard parameter for measuring the sustainability of a country's debt. This ratio depicts changes in the position of outstanding debt compared to the changes in the GDP of a particular year (ADB, 2014).

The debt to GDP ratio is showing a declining trend since 2007 implying a visible improvement in the outstanding debt position as a percentage to GDP.

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Table 2: Debt as percentage of GDP

Year	Debt-GDP Ratio(In percent)
2007	30.5
2008	29.1
2009	26.5
2010	25.3
2011	23.5
2012	22.6
2013	18.9
2014	18

Source: ADB, 2014

3.2. Debt-Service Payment

Debt Service Payments is a term used to describe a variable factor within the debt service coverage ratio (DSCR) formula. The DSCR formula is used by investors and lenders to evaluate the potential of an investment property or commercial enterprise by determining its ability to service the debt on a loan given the terms. The Debt Service Payments factor of the equation is simply the amount of the monthly payments made on the interest and principal of a loan. This article provides instructions on how to calculate the Debt Service Payments factor and insert it into the DSCR equation to evaluate the viability of an investment.

Debt-service payment is increasing over the time which indicates a decrease in the net foreign asset of the country. In FY 2005-06, the total debt service payment was USD 678.1 million (where the principal was USD 502 million and interest payment was USD 176.1 million) which stood at USD 855.4 million in FY 2008-09 that was a 26.15 percent increase in payment. In FY 2011-12 and 2012-13, the total service payment was 966.5 million and 1105.7 million respectively; representing a 12.58 percent increase in debt service payment in FY 2012-13. In FY 2013-14, the payment

to the foreigners was USD 1294 million of which USD 1088 million was the principle and USD 206 million was the interest payment. The disbursement of foreign loan is fluctuating each year. In FY 2005-2006, the disbursement of loan was 1067.1 which stood at 1040.4 million in the next fiscal year. The loan disbursed in FY 2011-12 and FY 2012-13 was USD 1588.52 million and USD 2084.7 million respectively which became USD 2404 million in FY 2013-14. This outflow of asset not only creates a pressure on the balance of payment but also makes a burden on the economy.

Table 3: Debt service payment

Year	Loan Disbursement	Principal(In USD million)	Interest (In USD million)	Total (In USD million)	Debt service payment as a share of loan disbursement (in percent)
2005-06	1067.1	502	176.1	678.1	63.55
2006-07	1040.4	540.2	181.8	721.9	69.30
2007-08	1403.4	585.7	184.5	770.2	54.88
2008-09	1189.5	655.6	199.8	855.4	71.91
2009-10	1588.6	685.7	189.8	875.6	55.13
2010-11	1031.6	729.2	200.2	929.4	90.09
2011-12	1588.52	769.9	196.2	966.5	60.84
2012-13	2084.7	908.2	197.5	1105.7	53
2013-14	2404	1088	206	1294	53.83
2014-15*	1495	659	134	794	-

Source: Ministry of Finance, 2015a; *till February, 2015

The size of government expenditure and the gap between total revenue and total expenditure may not necessarily be a matter of concern if the deficit augments growth.

3.3. Heads of Expenditure: Development Vs Non-Development and ADP

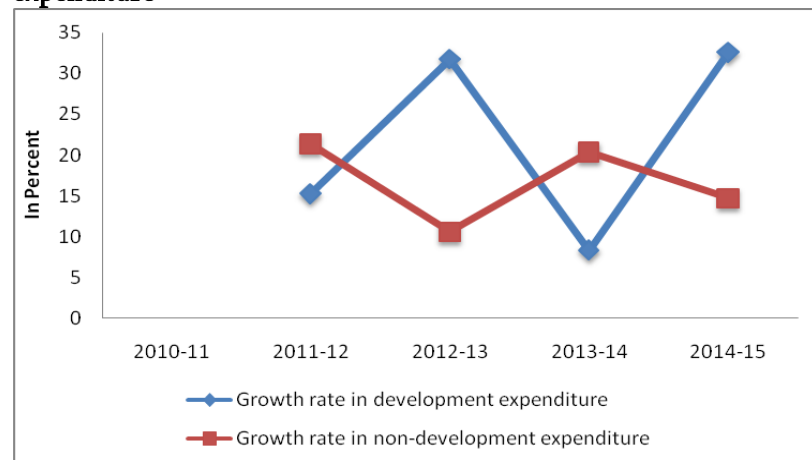
The size of government expenditure and the gap between total revenue and total expenditure may not necessarily be a matter of concern if the deficit augments growth. There is a

The development and non-development expenditure has been heading towards the opposite directions.

need to make a study of the different components of expenditure as well as a distinction between a deficit arising out from wrong policies or distribution of patronage (rent-seeking) and that of an increase in public investment to finance public goods, with a view to inducing growth (UO, 2011).

The development and non-development expenditure has been heading towards the opposite directions. The rate of growth in development expenditure decreased to 18.78 percent in FY 2015-16 from 19.47 percent in FY 2013-14, while the rate of growth in non-development expenditure increased from 14.72 percent in FY 2013-14 to 19.66 percent in FY 2015-16. In the budget for FY 2014-15, development expenditure and non-development expenditure were Tk. 86,345 crore and Tk. 1,54,241 crore respectively. In FY 2015-16, the development and non-development expenditure are Tk. 1,02,559 crore and Tk. 1,84,559 crore respectively.

Figure 7: Growth rate in development and non-development expenditure



Source: Ministry of Finance, 2015b

4. COST OF DEBT

Cost of debt can be direct or indirect. The direct cost of debt is the interest payment and indirect cost can be considered as burden on future generation, tax distortion, inflationary pressure which hinder the sustainable economic growth of the country. In addition, in recent time, government collects a huge amount of money from the domestic banks. The more government borrows from the bank the less loanable funds

are available for the private investment. The private investment in the country therefore decreases which is due to the crowding out effect.

The development and non-development expenditure has been heading towards the opposite directions.

4.1. Interest Payment

The direct cost of the debt is the interest payment to the lender which is considered as unproductive expenditure of a government. The interest payment of both domestic and external debt is increasing which decreases the net asset of the country. In FY 2013-14, the total amount of interest payment was Tk. 31043 crore which was Tk. 23347 crore in FY 2012-13. In FY 2012-13 and FY 2013-14, the interest paid to the foreigners were Tk. 1743 crore and Tk. 1686 crore. On the other hand, interest paid to domestic debtor was Tk.21604 crore and Tk. 24854 crore in FY 2012-13 and FY 2013-14 respectively. The proposed budget for repayment of interest in FY 2014-15 is Tk. 31043 crore in which Tk. 29305 crore is the interest of domestic debt and Tk. 1738 crore is the interest of external debt.

Table 4: Interest payment (in revised budget)

Year	Interest on domestic debt (In crore Tk.)	Interest on Foreign debt (In crore Tk.)	Total Interest (In crore Tk.)
2005-06	6246	1299	7545
2006-07	7854	1300	9154
2007-08	10621	1346	11967
2008-09	12003	1311	13314
2009-10	13255	1391	14646
2010-11	13125	1422	14578
2011-12	18145	1651	19796
2012-13	21604	1743	23347
2013-14	24854	1686	26540
2014-15	29305	1738	31043

Source: Ministry of Finance, 2015a

5. CONCLUSIONS

The continuous rise in per capita debt as well as lower per capita growth in GDP is posing serious challenge to a sustainable growth of economy in Bangladesh. The people in general are bearing the burden of higher prices of electricity, lesser public investment in social sectors resulting in a intergenerational debt burden in the future.

Government needs to take proper policy responses by putting emphasis on debt restructuring. In this regard, harmonising the fiscal and monetary policy, taking an effective debt management policy for long term basis and exercising civil and political rights in decision making process concerning debt issues are needed. The government must concentrate on increasing productive capacities and channel adequate resources to productive sectors and should reform tax structure by progressive tax system (to include the tax payable person under tax regime). Moreover, encouraging domestic productive sectors, developing domestic debt market rather than dependency on banking sector is must.

Finally, deficit financing is a weak fiscal tool for fostering economic growth. Proper steps should be taken to create more investable resource or establish fund for financing the non development expenditure for lessening the dependency on debt which will ensure more allocation on development sector for lessening the dependency on debt.

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UNNAYAN ONNESHAN

16/2 Indira Road, Farmgate
Dhaka-1215, Bangladesh

Tel.: +880 (2) 58150684, +880 (2) 9110636

Fax: +880 (2) 58155804

Email: info@unnayan.org

Web: www.unnayan.org