

Debt and Deficit: Trends and Challenges

Bangladesh Economic Update

March 2017



Acknowledgement

Bangladesh Economic Update is a monthly publication of the Economic Policy Unit of Unnayan Onneshan, a multidisciplinary research organisation based in Dhaka, Bangladesh.



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1. Introduction

The current issue of the Bangladesh Economic Update analyzing the current trends in deficit and debt reveals that persistently increasing outstanding external debt, 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.

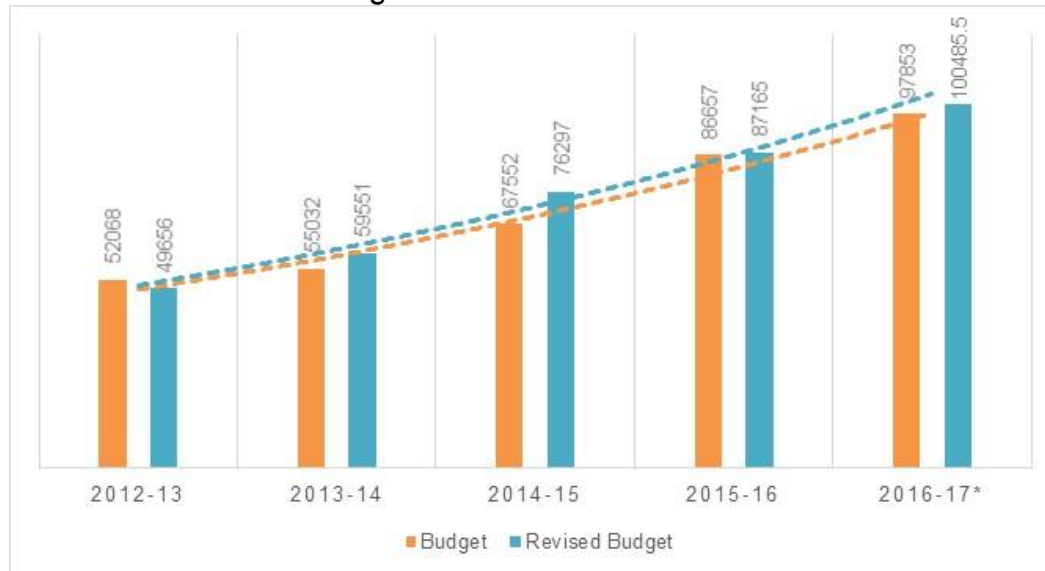
Debt may be considered as a fiscal stimulus which has a multiplier effect on economy if it is used for productive purpose otherwise the debt make the problem worse (Leech, 2012). The per capita debt burden of Bangladesh has been mounting rapidly since FY 2009-10, and debt as a share of GDP is high. A 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.

2. Trends in Budget Deficit

The overall budget deficit has been estimated at Tk. 97,853 crore (excluding grants), which is five percent of GDP. In financing the deficit, Tk. 30,789 crore will be collected from foreign sources, whereas Tk. 61,548 crore will be collected from domestic sources. As far as the domestic sources of financing deficit are concerned, Tk. 38,938 crore will be collected from the banking system and Tk. 22,610 crore will be collected from Non-Banking source (of which Tk. 19,610 will come from savings certificates and Tk. 3,000 from other sources). The projected revised deficit in FY 2016-17, however, stands at Tk. 100485.5 crore.

Figure 1: Trend in Fiscal Deficit



Source: Ministry of Finance, 2016b

In order to Finance the Deficit, the Government relies on both domestic and foreign sources. In FY 2016-17, deficit in Budget is estimated at Tk. 97,853 (excluding grants) crore, of which Tk. 61,548 crore is supposed to come from domestic sources and Tk. 30,789 crore is supposed to come from foreign ones (including grants). Borrowing from banking sector is planned at Tk. 38,938 crore in FY 2016-17.

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.

3. Deficit and Deficit Financing

In FY 2016-17, total public borrowing from banking sector is assumed to be Tk. 38,398 crore and this amount is Tk. 7302 crore higher than that in the budget of previous fiscal year. This high public borrowing from banking sector signals that capacity of deficit financing through revenue collection is not increasing sufficiently. Furthermore, implementation of the budget of Tk. 340605 crore in the FY 2016-17 tends to increase domestic borrowing by a larger amount than the proposed amount since financing the deficit from foreign sources may not reach the targeted amount, thereby causing higher inflationary pressure in the economy on the one hand and retrenchment of allocation from social sectors on the other. 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).

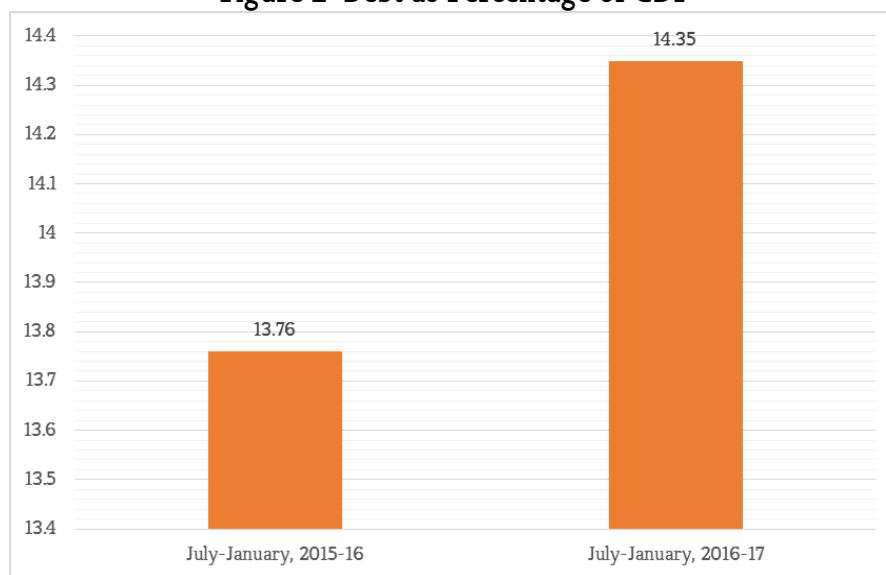
4. Sources of Debt

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.

4.1. 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 27352.87 crore in FY 2014-15 and Tk. 38493.15 crore in FY 2015-16. However, government's budget financing from domestic sources stood higher at Taka 123.22 billion during July-January, 2016-17 as compared to that of Taka 74.76 billion of July-January, 2015-16.

Figure 2: Debt as Percentage of GDP



Source: Bangladesh Bank, 2017a

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. Govt. borrowing stood short from govt.'s repayment and as a result govt.'s net borrowing from the banking system stood negative at Taka 176.75 billion during July-January, 2016-17. While, govt. borrowing from the nonbanking sources stood remarkably higher at Taka 299.98 billion during July-January, 2016-17 as compared to that of July-January, 2015-16.

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. Govt. borrowing from the banking system decreased by Tk.18959.5 crore during July-January of FY 2016-17. On the other hand total non-bank govt. borrowing (net) stood at Tk.29981.4 crore during the period. As a result, govt. borrowing (net) from the domestic sources during July-January of FY'17 stood at Tk. 11021.9 crore.

Table 1: Domestic Borrowing by the Government

Fiscal Year	Net Government Borrowing from the Banking System			Government Borrowing from other than Banks	Total Government Borrowing	Percent of GDP
	Borrowing from Bangladesh Bank	Borrowing from Scheduled Banks	Total Borrowing from Banking System			
2008-09	2958.2	8317.9	11276.1	5877.4	17153.5	2.4
2009-10	-6634.9	2842.0	-3792.9	12419.6	8626.7	1.1
2010-11	9729.2	9314.7	19043.8	2088.8	21132.6	2.3
2011-12	6033.2	12628.6	18661.7	2160.4	20822.1	2.0
2012-13	-6776.6	23441.4	16666.8	7634.7	24299.6	2.0
2013-14	-17497.7	24704.8	7207.2	15344.3	22551.5	1.7
2014-15	-1821.9	-6839.4	-8661.4	34680.3	26018.9	1.7
2015-16 ^P	10750.5	-9733.9	1016.6	34206.0	35222.7	2.0

Source: Ministry of Finance, 2016a

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. 269009.50 crore in FY 2015-16.

Table 2: Domestic Debt

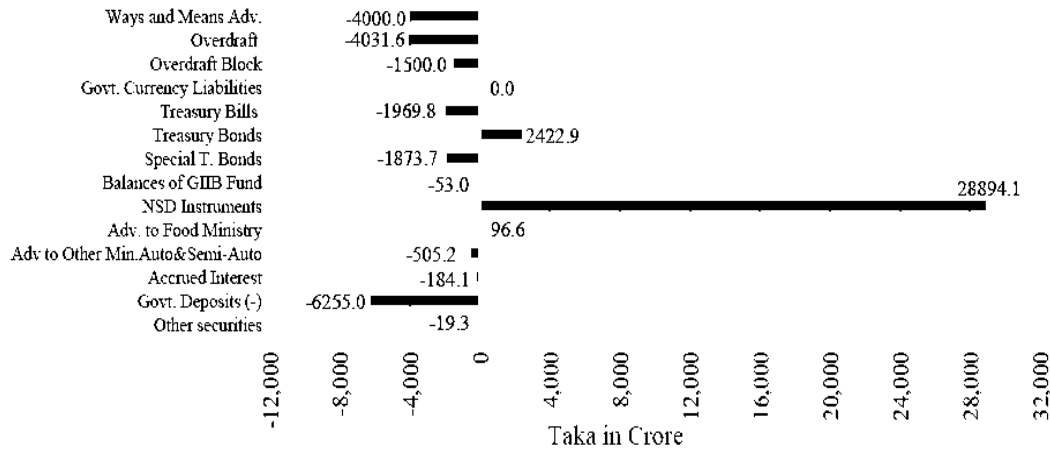
Year	Net borrowing of the Govt. from the banking system	Net non-bank borrowing of the Govt. from the public	Total domestic financing	Outstanding Domestic debt (end period)
2001-02	2487.10	4711.47	7198.57	45181.76
2002-03	-1103.10	4795.22	3692.12	48873.88
2003-04	1246.20	4598.94	5845.14	54719.02
2004-05	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	-7370.70	34723.57	27352.87	230516.35
2015-16	4326.60	34166.55	38493.15	269009.50

Source: Bangladesh Bank, 2017a

Govt. domestic borrowing (net) stood at Tk.11021.9 crore during July-January of FY 2016-17 after the adjustments with Treasury Bills and Bonds, NSD, Ways and Means Advances (WMA), advances to Food Ministry and other Ministries, Overdraft (OD) current and block accounts, accrued interest, and advances and deposits of autonomous and semiautonomous bodies, balances of GIIB (Government Islamic Investment Bond) fund as well as deduction of cash balance in the form of govt. deposits with Bangladesh Bank and scheduled banks (i.e. including banking and nonbanking sources). The sale of National Savings Certificates (NSC) during July-January, 2016-17 stood at Taka 41100.57 crore which was 46.30 percent higher than the amount of sale during JulyJanuary,

2015-16. The net borrowing of the government through NSC during July-January, 2016-17 was Taka 28894.15 crore against Taka 16602.97 crore of July-January, 2015-16. The outstanding borrowing of the government through NSC as of end January 2017 stood at Taka 167712.89 crore which was 37.77 percent higher than that of the previous year.

Figure 3: Government Domestic Borrowing Instruments



Source: Bangladesh Bank, 2017b

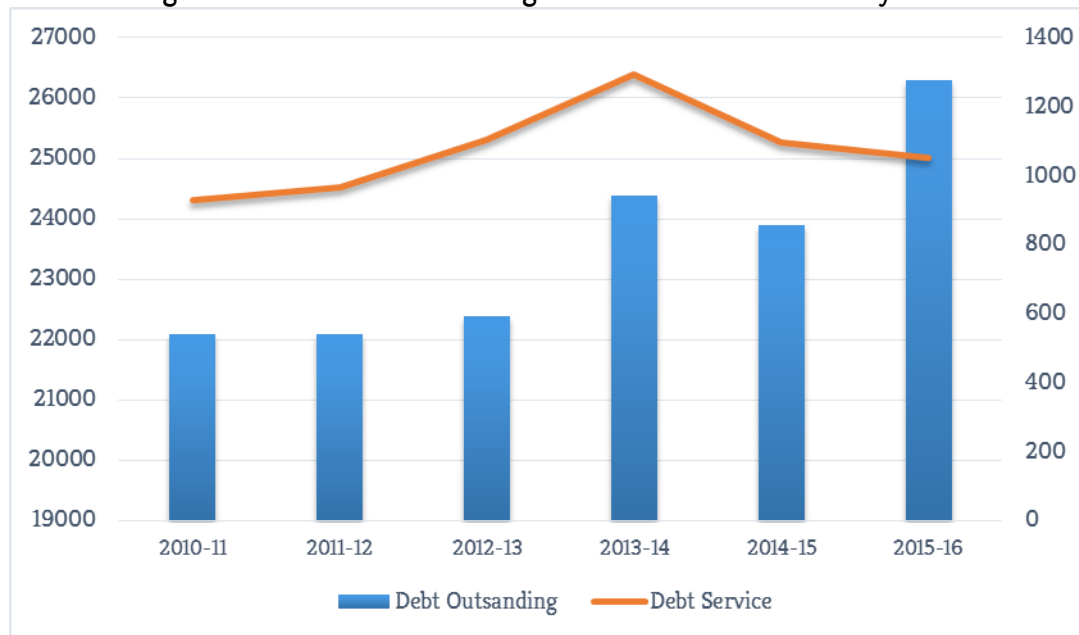
4.2. External Debt

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. Analysing data from external sources it is seen that in FY2014-15 amount of foreign resources stood at US\$3,043 million which is 1.36 percent less than the receipt US\$3,085 million of previous fiscal year. At that time repayment of principal and interest was US\$1,097 million which was 15.22 percent less than the previous fiscal year. As a result, in this fiscal year net flow of foreign assistance increased by 7.30 percent than previous fiscal year. In FY2015-16 disbursement has peaked to a record breaking US\$3,450 million. Compared to FY2014-15, disbursement of FY2015-16 has increased by 13.74 percent. On the other hand debt service (principal and interest) expenditure of FY2015-16 has decreased by US\$53 million compared to last fiscal year. As a result, net external assistance flow (after deducting principal and interest payment) in FY2015-16 has increased by 24.54

percent compared to last fiscal year. Table 4.9 shows the Government borrowing from external sources and its repayment during FY2008-09 to FY2015-16.

The outstanding external debt, which is currently 12 percent of GDP in the country, has exhibited a significant increase in the previous fiscal year. Statistics from the Economic Relations Divisions of the Ministry of Finance demonstrate that year-end outstanding external debt increased to USD 26305.71 million in FY 2015-16 from USD 23901 million in FY 2014-15.

Figure 4: External Outstanding Debt and Debt-Service Payment



Source: Bangladesh Bank, 2017a

However, during the first seven months of the current fiscal year, total foreign aid decreased to USD 1464.88 million from USD 1754.92 million in the corresponding period of FY 2015-16 due to a substantial decline in grants. For instance, grant receipts fell by 45.03 percent in FY 2015-16 compared to FY 2014-15,

5. Debt-Service Payment and Debt Sustainability

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. Interest payment on the external debt has increased of late, although total debt-service payment slightly decreased.

Table 3: Government Borrowing from External Sources

Fiscal Year	Disbursement of Loans and Grants			Principal and Interest Payment			Net Foreign Aid Flow	
	Grant	Loans	Sub-Total	Interest	Principal	Sub-Total	After Principal Payment	After Principal & Interest Payment
1	2	3	4=(2+3)	5	6	7=(5+6)	8=(4-6)	9=(4-7)
2008-09	658	1189	1847	200	655	855	1192	992
2009-10	634	1588	2222	190	685	875	1537	1347
2010-11	745	1032	1777	200	729	929	1048	848
2011-12	588	1538	2126	197	770	957	1357	1160
2012-13	726	2084	2811	195	895	1091	1915	1719
2013-14	681	2404	3085	206	1089	1294	1996	1790
2014-15	571	2472	3043	188	909	1097	938	750
2015-16*	546	2904	3450	202	842	1044	1386	1184

Source: Ministry of Finance, 2016a

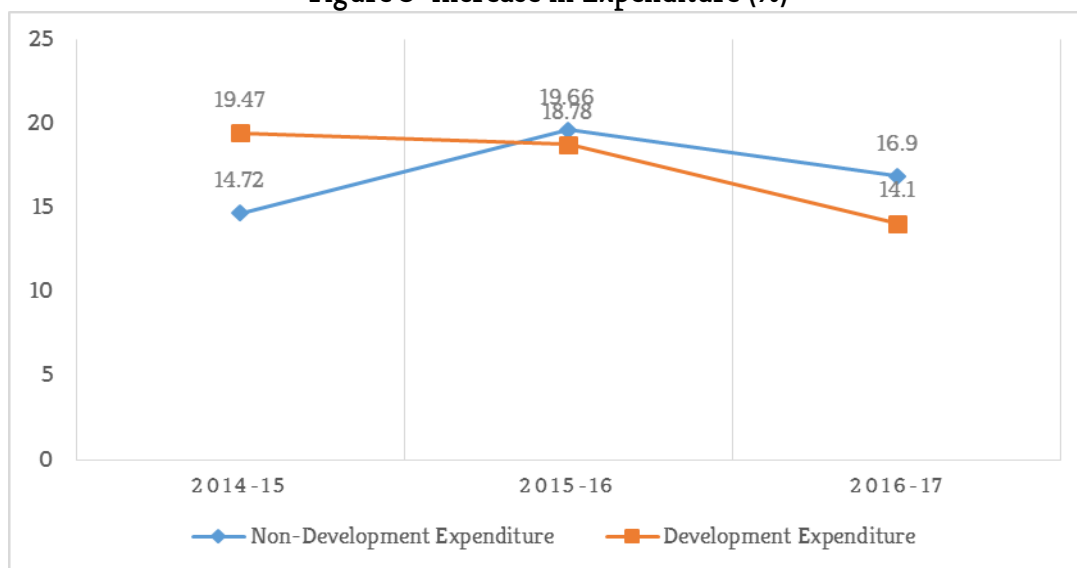
The total debt-service payment stood at USD 929.37 million in FY 2010-11, which increased to USD 1294.44 million in FY 2013-14 and then declined to USD 1050.57 million in FY 2015-16. Interest payment, on the other hand, increased from USD 187.73 million in FY 2014-15 to USD 202.1 million in FY 2015-16. This outflow of asset not only creates a pressure on the balance of payment but also makes a burden on the economy.

In terms of debt sustainability, it is shown that the outstanding external debt represents 53.49 percent of the total amount of export earnings and remittance in FY 2015-16, whereas this ratio was 48.68 percent in FY 2014-15. In addition, total external debt-service payment represents 4.62 percent of total revenue earned and 2.15 percent of the total amount of export earnings and remittance in FY 2015-16.

6. Heads of Expenditure: Development vis-à-vis Non-Development

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 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).

Figure 5: Increase in Expenditure (%)



Source: Ministry of Finance, 2016b

The development and non-development expenditure has been heading towards the opposite directions. While increase in allocation for development expenditure was higher than that in the allocation for non-development expenditure in FY 2014-15, the situation has reversed in the following fiscal years. Non-development expenditure increased from Tk. 134449 crore in FY 2013-14 to Tk. 154241 in FY 2014-15, Tk. 184559 crore in FY 2015-16 and Tk. 215744 crore in FY 2016-17 representing 14.72 percent, 19.66 percent and 17 percent increase in FY 2014-15, FY 2015-15, and FY 2016-17 respectively. Meanwhile, development expenditure increased from Tk. 72275 crore in FY 2013-14 to Tk. 86345 in FY 2014-15, Tk. 102559 crore in FY 2015-16 and Tk. 117027 crore in FY 2016-17 representing 19.47 percent, 18.67 percent and 14.11 percent increase in FY 2014-15, FY 2015-15, and FY 2016-17 respectively.

In case of non-development expenditure, usually the highest allocation goes to interest payment to both domestic and foreign sources. In FY 2015-16, total expenditure on interest payment is estimated to take the highest position, which amounts to be Tk. 351 billion. In FY 2014-15, the total expenditure on interest payment stood at Tk. 298 billion, that is, in FY 2015-16, total expenditure on interest payment is assumed to increase by 17.8 percent. In FY 2016-17, total expenditure on interest payment is estimated Tk. 39,951 crore of which Domestic Interest Payment would be Tk. 38,240 crore and Foreign Interest would be Tk. 1,711 crore.

7. 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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