

# **Debt and Deficit: Recent Trends and Challenges**

Bangladesh Economic Update

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### **Acknowledgement**

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## 1. Introduction

The current issue of the Bangladesh Economic Update analysing 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.

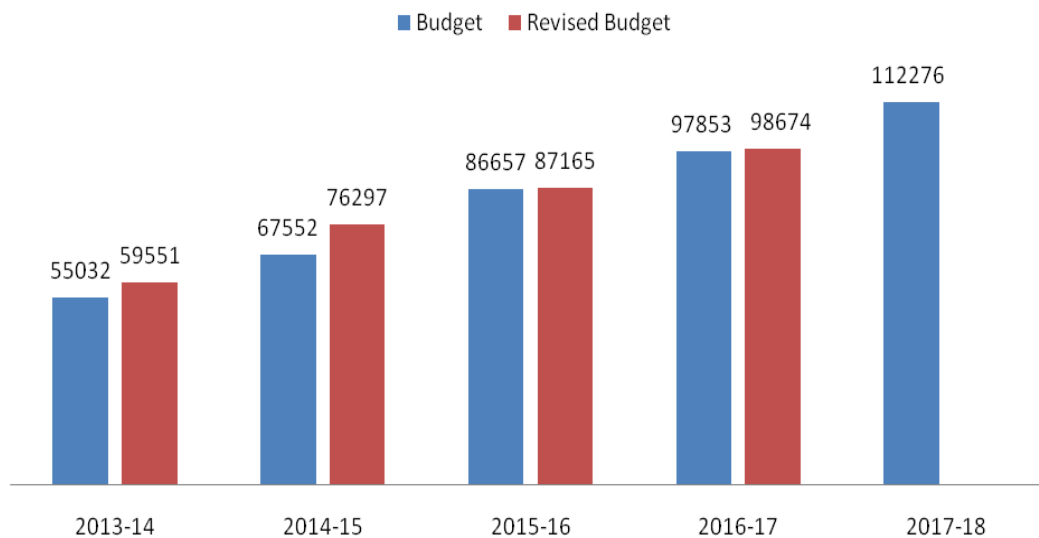
Debt may be considered as a fiscal stimulus which has a multiplier effect on economy if it is used for productive purpose otherwise the debt make the problem worse (Leech, 2012). The per capita debt burden of Bangladesh has been mounting rapidly since FY 2009-10, and debt as a share of GDP is high. A 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. 112,276 crore (excluding grants), which is five percent of GDP. In financing the deficit, Tk. 46,420 crore will be collected from foreign sources, whereas Tk. 60,352 crore will be collected from domestic sources. As far as the domestic sources of financing deficit are concerned, Tk. 28,203 crore will be collected from the banking system and Tk. 32,149 crore will be collected from Non-Banking source (of which Tk. 30,150 crore will come from savings certificates and Tk. 1,999 crore from other sources).

Figure 1: Trends in fiscal deficit



Source: Ministry of Finance, 2017b

In order to finance the deficit, the government relies on both domestic and foreign sources. In FY 2017-18, deficit in budget is estimated at Tk. 112,276 (excluding grants) crore, of which Tk. 60,352 crore is supposed to come from domestic sources and Tk. 46,420 crore is supposed to come from foreign ones (including grants). Borrowing from banking sector is planned at Tk. 28,203 crore in FY 2017-18.

The overall budget deficit for FY 2016-17 is estimated at Tk. 97,853 crore (excluding grants) which is 4.9 percent of GDP. The actual deficit in FY 2015-16 was Tk. 65,482 crore, which was 3.8 percent of GDP. Since the revenue collection

target of the government seems to be ambitious, the government may be forced to cut the expenditure level in FY 2017-18 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 target for revenue collection in FY 2017-18 (31.80% growth over revised target for FY'17) has been set above the trend observed in the last several fiscal years. Average revenue collection growth was 14.28% in the last five fiscal years. In FY 2016-17 the NBR has missed the budget target for revenue collection by 9.9%. The gap between the total expenditure and total revenue is increasing over the years. Due to the slower growth rate of revenue collection 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 2017-18, total public borrowing from banking sector is assumed to be Tk. 28,203 crore and this amount is Tk. 4300 crore higher than that in the revised budget for the 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. 400,266 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 borrowing. Against the deficit of Tk. 112,276 crore in budget for FY 2017-18, the targeted borrowing is 106,772 crore while the targeted borrowing was Tk. 93,980 crore against the deficit of Tk. 98,674 crore in the revised budget for FY 2016-17.

The actual amount of debt was Tk. 63,596 crore, Tk. 56,077 crore and Tk. 41,485 crore in FY 2015-16, FY 2014-15 and FY 2013-14 respectively. In the last six fiscal years from FY 2010-11 to FY 2015-16, the borrowing has increased by 191.45 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).

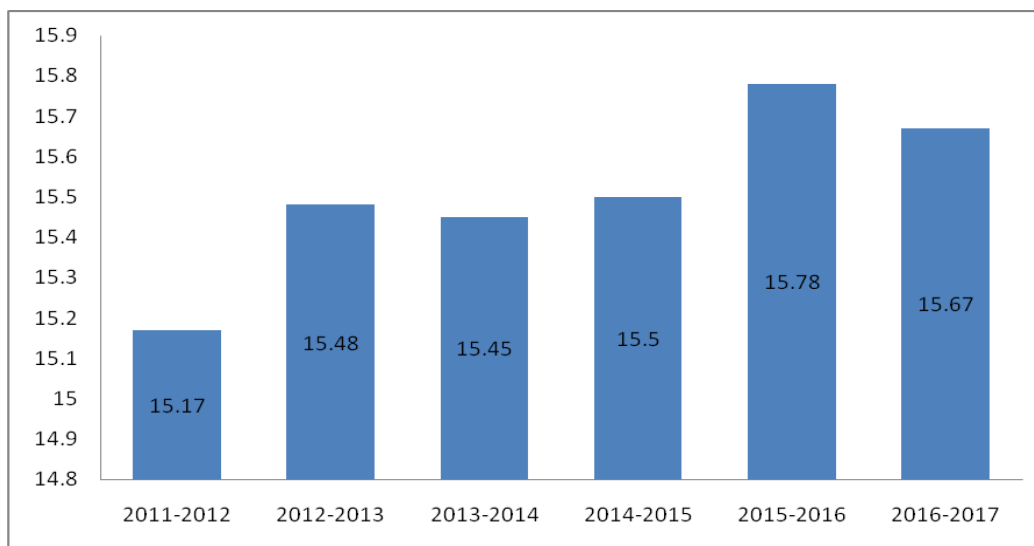
#### 4. Sources of Debt

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 financing in FY 2009-10 was Tk.7880.14 crore and became Tk. 25597.86 crore in FY 2012-13, Tk. 21979.52 crore in FY 2013-14, Tk.27352.87 crore in FY 2014-15, Tk. 38493.15 crore in FY 2015-16 and Tk. 36220.50 crore in FY 2016-17. However, net govt. domestic borrowing during July-December FY2017-18 is 79.1 percent higher than that of the same period of the previous year.

Figure 2: Outstanding domestic debt as % of GDP



Source: Bangladesh Bank, 2018a

The government borrows from two domestic sources: banking system and 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 Tk. 8693.30 crore during July-December, 2017-18 while net govt. borrowing from the nonbanking sources stood Tk. 24861.27 crore in July-December, 2017-18 from Tk. 24302.05 crore in July-December, 2016-17. Govt. borrowing from the banking system decreased by Tk. 10101.2 crore during July-December, 2017-18 while that from the non-banking sources stood higher at Tk. 24861 crore during July-December 2017-18 as compared to that of July- December, 2016-17.

Outstanding debt was Tk. 69159 crore in FY 2005-06 which reached 116823crore in FY 2009-10 at an annual rate of growth of 13.8 percent. From FY 2009-10 to FY 2013-14, domestic debt increased at an annual rate of 14.8 percent. In FY 2014-15, debt stood at Tk. 230516 crore, then increased to Tk. 269009 crore (16.7% increase) in 2015-16 and Tk. 309681crore (15.12% increase) in FY 2016-17.

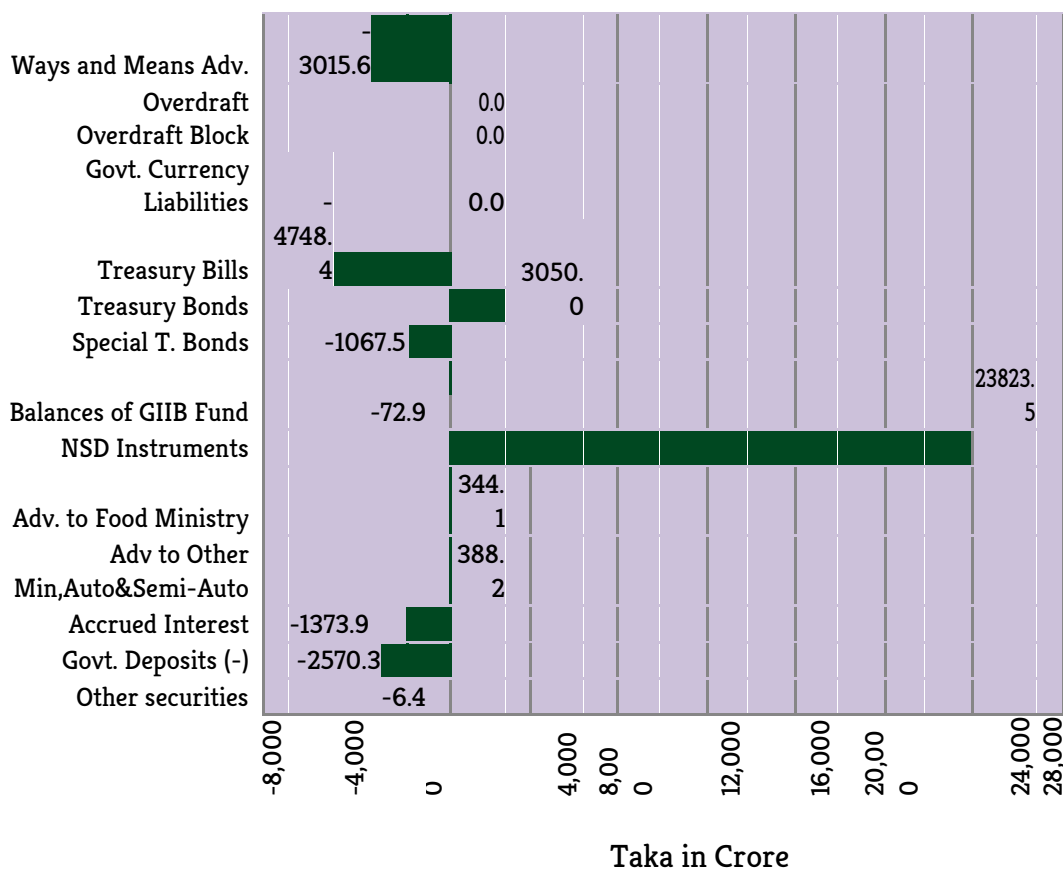
Table 1: Domestic debt

Year	Net govt. borrowing from the banking system	Net non-bank borrowing of the govt.	Total domestic financing	Outstanding domestic debt (end period)
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
2016-17	-17464.80	53685.30	36220.50	309681.87

Source: Bangladesh Bank, 2018a

The sale of National Savings Certificates (NSC) during July-December, FY 2017-18 stood at Tk. 39168.76 crore which was 16.08 percent higher than the amount of sale during July-December FY 2016-17. The net borrowing of the government through NSC during July-December, FY 2017-18 was Tk. 23823.54 crore against Tk. 23473.56 crore of July-December, FY 2016-17. The outstanding borrowing of the government through NSC as of end December, FY 2017-18 stood at Tk. 215059.76 crore which was 32.5 percent higher than that of the previous year.

Figure 3: Instrument-wise net govt. domestic borrowing (July-Dec, 2017-18)



Source: Bangladesh Bank, 2018b

#### 4.2. External Debt

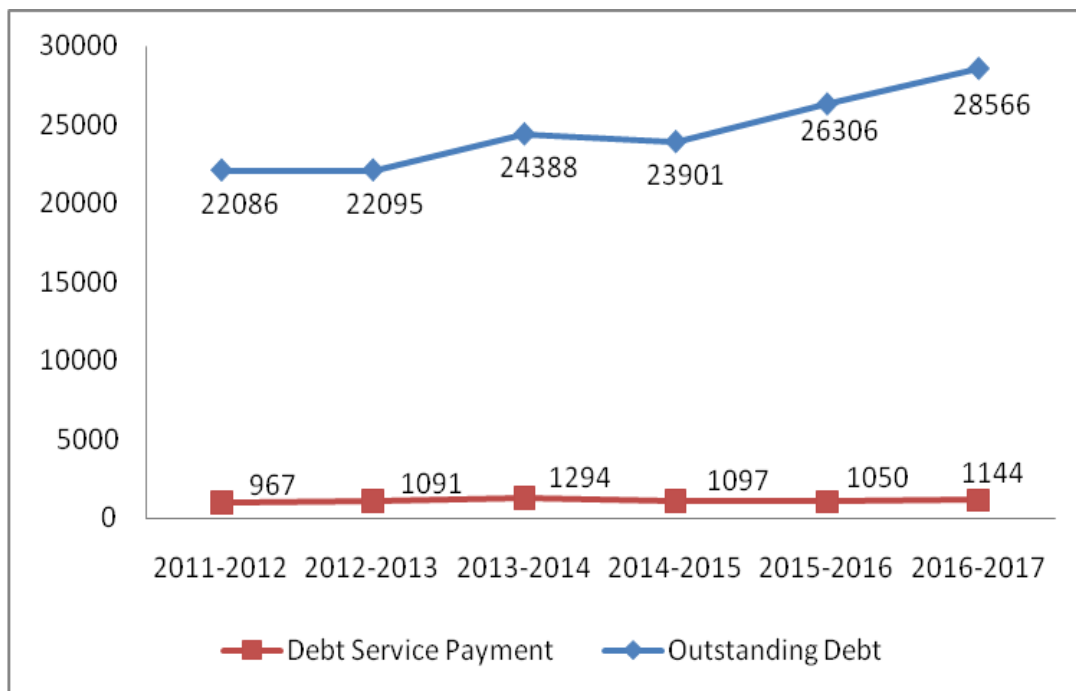
External assistance has played a vital role in the economic development of Bangladesh assisting in bridging the internal gap (savings-investment gap) and external gap (export-import gap). Borrowing from the foreign debt partner is



much lower than the domestic one but the dependency is high. Analysing data from external sources it is seen that in FY2016-17 amount of foreign resources stood at US\$ 3531 million which is 0.93 percent less than the receipt US\$ 3564 million of previous fiscal year. At that time repayment of principal and interest was US\$1144 million which was 8.21 percent less than the previous fiscal year. Compared to FY2015-16, disbursement of FY2016-17 has decreased by 0.87 percent. On the other hand debt service (principal and interest) expenditure of FY2016-17 has increased by US\$94 million compared to last fiscal year. As a result, net external assistance flow (after deducting principal and interest payment) in FY2016-17 has decreased by US\$127 million compared to last fiscal year.

The outstanding external debt has exhibited an 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 US\$28566 million in FY 2016-17 from US\$ 26306 million in FY 2015-16. The following figure depicts the increasing trend of the outstanding external debt.

Figure 4: External outstanding debt and debt-service payment



Source: Bangladesh Bank, 2018a

## 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 million (where the principal was USD 502 million and interest payment was USD 176 million) which stood at USD 855.4 million in FY 2008-09 that was a 26.11 percent increase in payment.

In FY 2011-12 and 2012-13, the total service payment was 966 million and 1105 million respectively; representing a 12.6 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 increasing each year. In FY 2010-2011, the disbursement of loan was 1032 which stood at 1538 million in the next fiscal year. The loan disbursed in FY 2012-13 and FY 2013-14 was USD 2085 million and USD 2403 million respectively which became USD 2472 million in FY 2014-15 and USD 3033 million in FY 2015-16. Interest payment on the external debt has increased of late, although total debt-service payment slightly decreased. The total debt-service payment stood at USD 929 million in FY 2010-11, which increased to USD 1294 million in FY 2013-14 and then declined to USD 1097 million in FY 2014-15 and USD 1050 million in FY 2015-16. Interest payment, on the other hand, increased from USD 188 million in FY 2014-15 to USD 202 million in FY 2015-16 and USD 231 million (provisional) in FY 2016-17. This outflow of asset not only creates a pressure on the balance of payment but also makes a burden on the economy.

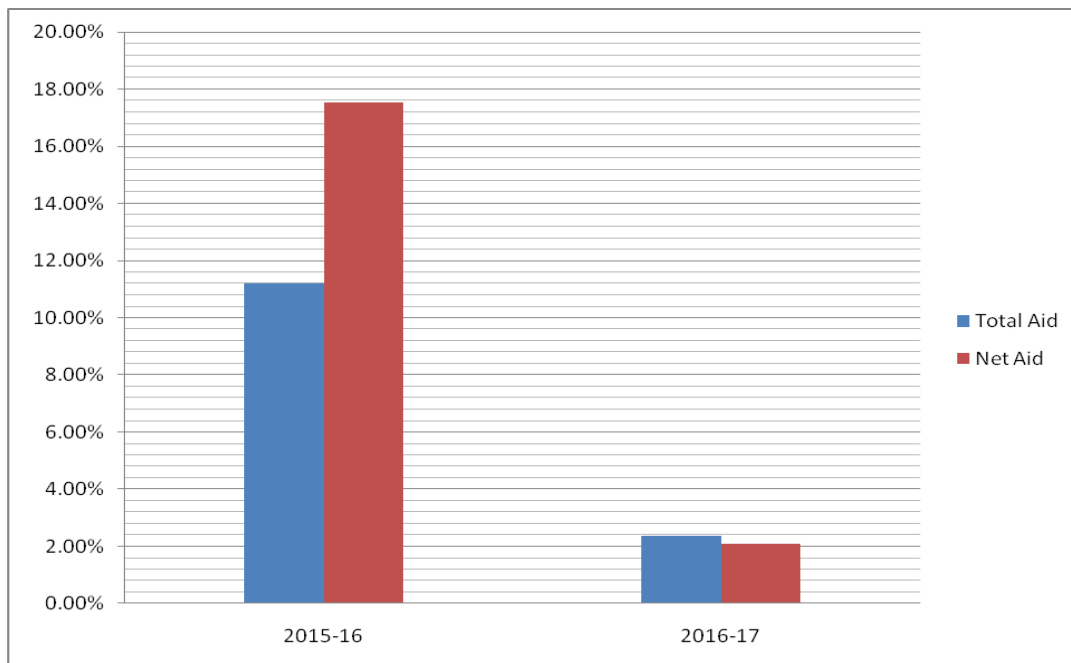
In terms of debt sustainability, it is shown that the outstanding external debt represents 53.49 percent of the total amount of export earnings and remittance in

FY 2015-16, whereas this ratio was 48.68 percent in FY 2014-15. In addition, total external debt-service payment represents 3.1 percent of total export earnings and 2.15 percent of the total amount of export earnings and remittance in FY 2015-16.

## 6. Foreign Aid

Total foreign aid grew by only 2.36 percent in FY 2016-17 compared to 11.21 percent in FY 2015-16. With 3.15 percent increase in principle repayment, net foreign aid grew by 2.1 percent in FY 2016-17 compared to 17.54 percent in FY 2015-16. However, total foreign aid disbursements in FY 2016-17 increased by USD 0.08 billion and stood at USD 3.53 billion. After principle repayment of USD 0.89 billion, the net receipt of foreign aid stood at USD 2.64 billion in FY 2016-17 as compared to USD 2.58 billion of the same period of the previous year.

Figure 5: Change in rate of growth in foreign aid disbursement



Source: Bangladesh Bank, 2018a

## 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 an intergenerational debt burden in the future.

Government needs to take proper policy responses by putting emphasis on debt restructuring. In this regard, harmonizing 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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