# Debt and Deficit: Trends and Challenges

## Bangladesh Economic Update

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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.

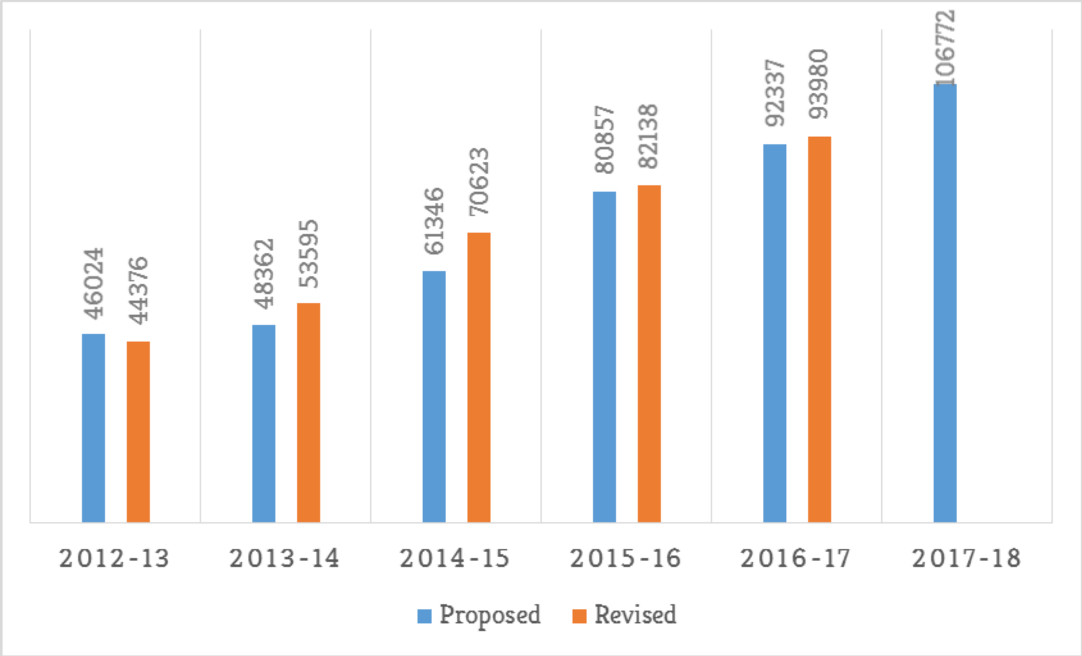
This issue highlights the current trend of deficit which emerges from the shortfall of revenue collection and expenditure, how this deficit is financed through the debt from domestic and external sources and the growth path of per capita debt burden. This issue also studies the cost of debt and suggests 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. 112,276 crore (excluding grants), which is five percent of GDP. The Government relies on both domestic and foreign sources to Finance the Deficit. In FY 2017-18, Tk. 46,420 crore will be collected from foreign sources, whereas Tk. 60,352 crore will be collected from domestic sources to Finance the Deficit. 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 will come from national savings schemes and Tk. 1,999 from other sources).

There are two sources of debt financing; one is external and another is internal. The main sources of the domestic borrowings are Bangladesh bank, scheduled banks, and other non-bank financial institutions. In FY 2017-18, total public borrowing from banking sector is assumed to be Tk. 28,203 crore whereas in FY 2016-17, total public borrowing from banking sector was estimated to be Tk. 38,398 crore in proposed budget and Tk. 23,903 crore in revised budget. This high public borrowing from banking sector signals that capacity of deficit financing through revenue collection is not increasing sufficiently.

Figure 1: Trend in Fiscal Deficit (in crore Tk.)




Source: Ministry of Finance, 2017a

Although, the total amount of Domestic borrowing in FY 2017-18 is slightly lower than that of the previous budget, the borrowing from non-banking sector is Tk. 32,149 crore in FY 2017-18 compared to Tk. 22,610 crore and 46,000 crore in proposed and revised budget in FY 2016-17. However, the implementation of the budget of Tk. 400,226 crore in the FY 2017-18 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.

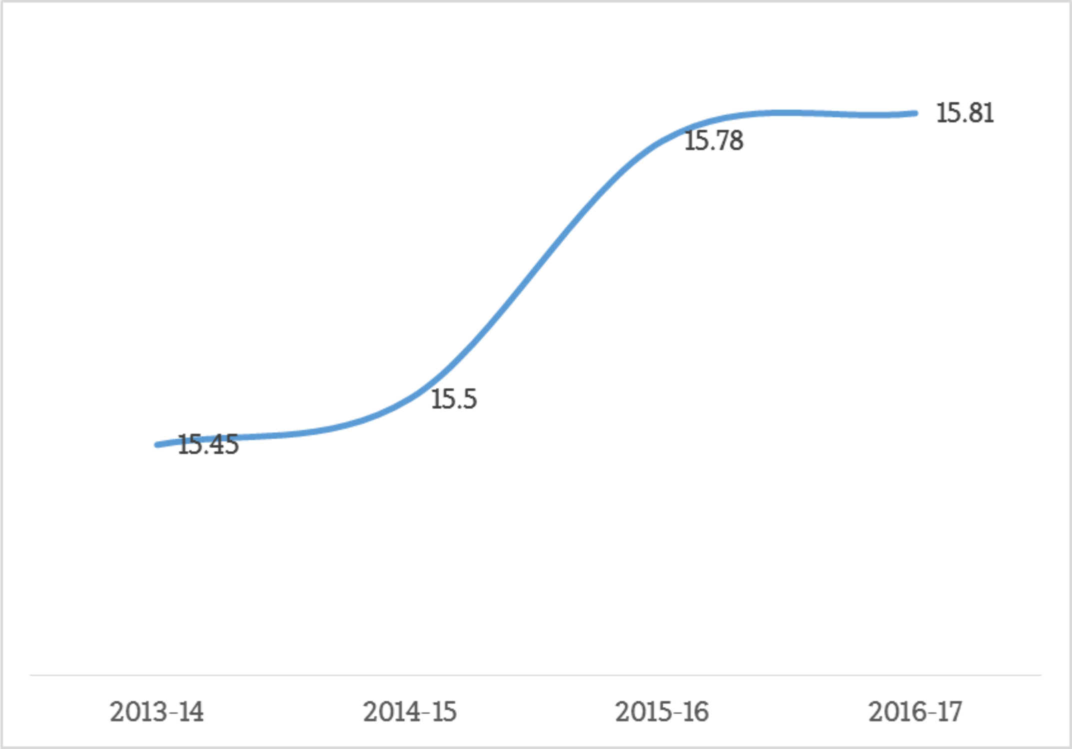
## 3. Sources of Debt

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. 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. At the end of FY 2016-17, the total outstanding domestic debt has increased by 13.25 percent. Outstanding domestic debt as percentage of GDP was 15.45 percent in FY 2013-14, 15.50 percent in FY 2014-15, and 15.78 percent in FY 2015-16, and 15.83 percent in FY 2016-17. Of late, the government has been borrowing more from the non-banking sources than the banking system, primarily by selling national savings directorate (NSD) certificates at a significantly higher interest rate. Higher domestic borrowing by the government through NSD certificates reflects sluggish demand for investible funds in the private sector. The outstanding domestic debt stood at Tk. 309682.37 crore at the end of June 2017 compared to Tk. 273461.37 crore in the corresponding period of the previous fiscal year. Analysing the increasing trend in outstanding domestic debt over the last eight years, it can however be said that the amount of outstanding domestic debt has become 2.65 times higher in FY 2016-17 than the outstanding domestic debt of Tk. 116823.84 crore in FY 2009-10.

Figure 2: Outstanding Domestic 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. According to Bangladesh Bank (2017:23), "Government's budget financing from domestic sources stood lower at Taka 362.21 billion in FY17 as compared to that of Taka 384.93 billion of FY16. Net foreign financing stood at Taka 208.63 billion in the period under review. Therefore, the total budget financing of the government in FY17 stood lower at Taka 570.84 billion against Taka 587.07 billion in FY16. However, Govt. borrowings stood short from govt.'s repayment and as a result govt.'s net borrowing from the banking system stood negative at Taka 174.64 billion in FY17. While, govt. borrowing from the non-banking sources stood remarkably higher at Taka 536.85 billion in FY17 as compared to that of FY16. The total budget financing in FY17 stood at 2.92 percent of projected GDP against 4.80 percent as envisaged in the revised national budget for FY17."

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. As outlined by Bangladesh Bank (2017: 22), "The sale of National Savings Certificates (NSC) in FY17 stood at Taka 75134.74 crore which was 39.88 percent higher than the amount of sale in FY16. The net borrowing of the government through NSC in FY17 was Taka 52417.48 crore against Taka 33688.60 crore of FY16. The outstanding borrowing of the government through NSC as of end June 2017 stood at Taka 191236.22 crore."

Table 1: Domestic Debt

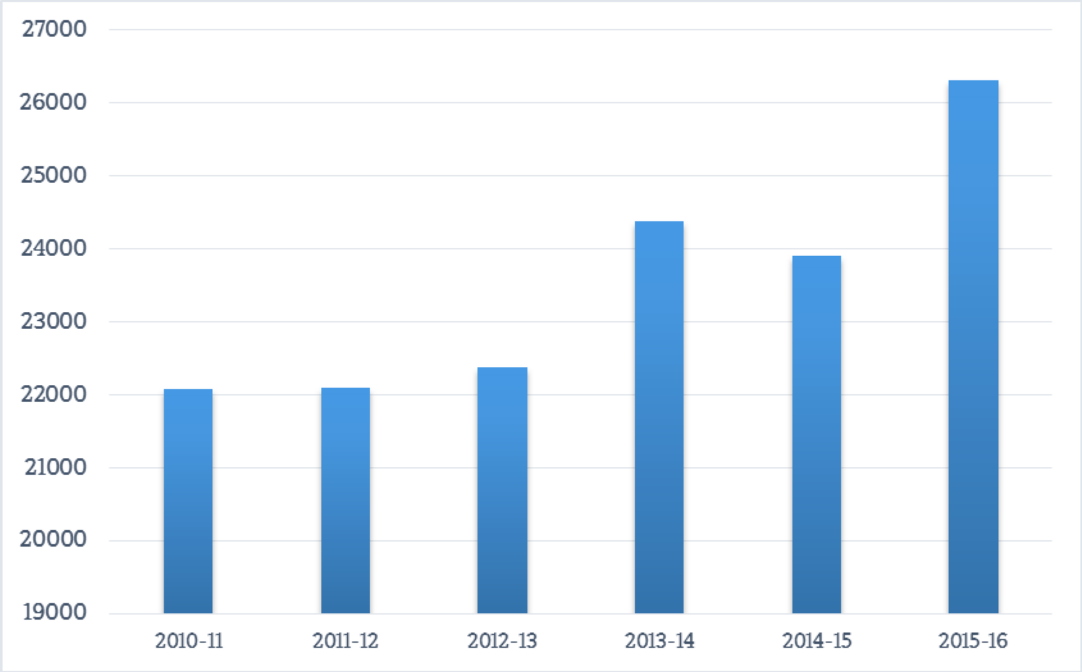
| Year | Net borrowing of the Govt. from the banking system | Net non-bank borrowing of the Govt. from the public | Total domestic financing | Outstanding Domestic debt (end period |
|---|---|---|---|---|
| 2001-02 | 2487.10 | 4711.47 | 7198.57 | 45181.76 |
| 2002-03 | -1103.10 | 4795.22 | 3692.12 | 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 | -7370.70 | 34723.57 | 27352.87 | 230516.35 |
| 2015-16 | 4326.60 | 34166.55 | 38493.15 | 273461.37 |
| 2016-17 | -17464.30 | 53685.30 | 36221.0 | 309682.37 |

Source: Bangladesh Bank, 2017a

### 3.2. 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 FY 2014-15 amount of foreign resources stood at USD 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 USD 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 USD 3,450 million. Compared to FY2014-15, disbursement of FY 2015-16 has increased by 13.74 percent. On the other hand debt service (principal and interest) expenditure of FY2015-16 has decreased by USD 53 million compared to last fiscal year. As a result, net external assistance flow (after deducting principal and interest payment) in FY 2015-16 has increased by 24.54 percent compared to last fiscal year.

Figure 3: External Outstanding Debt (in million USD)




Source: Ministry of Finance, 2017b

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.

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,

**4. 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.

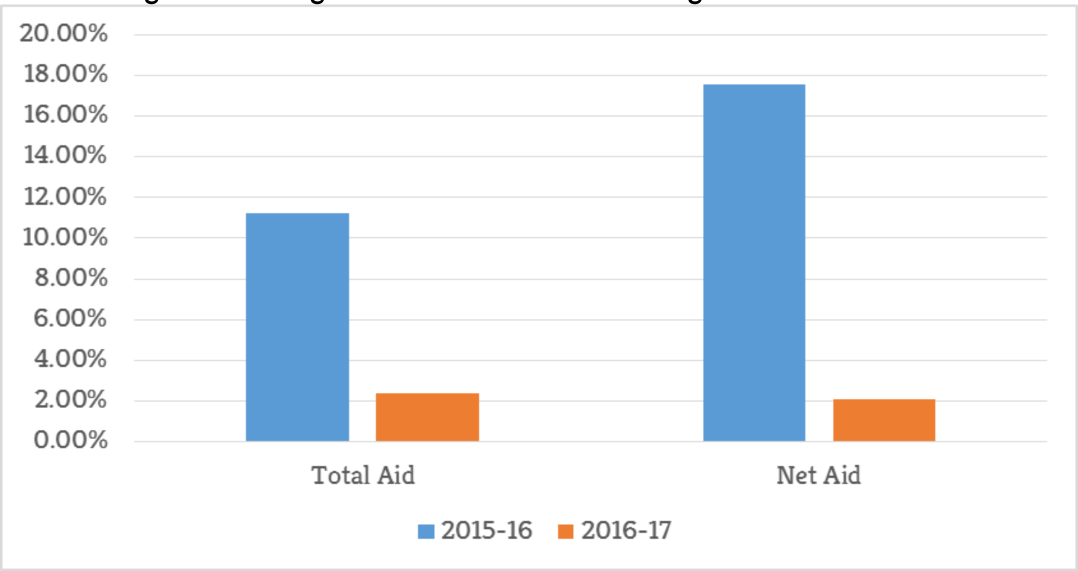
The total debt-service payment stood at USD 929.37 million in FY 2010-11, which increased to USD 1294.44 million in FY 2013-14 and then declined to USD 1050.57 million in FY 2015-16. Interest payment, on the other hand, increased from USD 187.73 million in FY 2014-15 to USD 202.1 million in FY 2015-16. 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.

## 5. 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 FY17 increased by USD 0.08 billion or 2.36 percent 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 FY17 as compared to USD 2.58 billion of the same period of the previous year.

Figure 4: Change in Rate of Growth in Foreign Aid Disbursement




Source: Bangladesh Bank, 2017a

## 6. 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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