

CHAPTER 4

Fiscal Performance and Strategy for FY 11-15

4.1 Credible fiscal policies and a well-managed fiscal environment are considered important determinants for achieving sustainable growth, development and poverty reduction. The government of Bangladesh has undertaken expansionary and prudent fiscal policies for accelerating economic growth and reducing poverty. While the government's fiscal strategy emphasizes the need for maintaining overall macroeconomic stability and fiscal sustainability, the government is investing substantially in building physical infrastructure especially in the communication and power sector as well as in developing human resources for achieving growth and augmenting the development process – necessary conditions for reducing poverty. The present government has planned to raise the level of investment to 30-32 percent of GDP in order to achieve a GDP Growth rate of 8 percent by 2013 as envisaged in "Vision 2021". This investment may come from the government, the private sector as well as FDI.

4.2 To generate higher public investment, measures have been taken for the gradual increase of internal revenue collection as the revenue-GDP ratio has been forecast to increase from 10.8 percent in FY08 to 14.1 percent in FY15. At the same time, for mitigating the adverse impacts of the global financial crisis, two stimulus packages (including both fiscal and policy support) have been declared by the government whose financing requirements as well as other priority expenditures have recently increased the overall public expenditure. Total expenditure is thus forecast to increase from 15.9 percent of GDP in FY08 to 18.1 percent in FY15. Despite this higher level of expenditure, government is resolute to maintain a sustainable budget deficit that is forecast to be contained within 5 percent of GDP over the next few years (forecast as 4.0 percent of GDP in FY15).

4.3 This chapter provides a detailed account of the recent fiscal performance of the government, particularly in terms of various categories of public expenditure. It will also provide the forecasts on the probable pattern of public expenditure that is likely to emerge within the medium-term framework between FY11 to FY15.

The Budget Balance

Changes to the Budget Balance since FY10 Budget

4.4 Table 4.1 lists key economic factors that affect the fiscal framework and compares the forecast factors between FY11-15 and FY10-12 MTBS. It shows that the forecast figures for GDP growth rate have been set at a higher level for FY11-15 MTBS than the FY10-12 MTBS. Notable underlying assumptions behind these optimistic scenarios include substantial contributions from the agriculture sector induced by broad-based government support followed by a substantial contribution of

the manufacturing sector, higher level of exports, investment, and remittance. In a recent report, IMF also forecast a similar upward trend for economic growth with the conditions of higher ADP expenditure and Tax-GDP ratio. The inflation rate has been forecast as a declining trend over the next few years as the government has already taken some pragmatic measures on addressing rising commodity prices, excess liquidity, robust remittance inflow etc. Other economic factors like export, import and remittance have also been forecast as a higher trend in FY 11-15 MTBS than FY 10-12 MTBS.

Table 4.1
Economic Factors affecting the Fiscal Framework: A Comparison between the FY 10-12 and FY 11-15 Projections

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Billion Taka)						
FY 10-12 MTBS	6867.30	7681.1	8592.4	-		
FY 11-15 MTBS	6905.70	7802.88	8834.36	10029.65	11406.9	12941.61
Nominal GDP Growth (%)						
FY 10-12 MTBS	11.7	11.9	11.9	-		
FY 11-15 MTBS	12.3	13.0	13.2	13.5	13.7	13.5
Real GDP Growth (%)						
FY 10-12 MTBS	5.5	6.0	6.5	-		
FY 11-15 MTBS	6.0	6.7	7.2	7.6	8.0	8.0
Export Growth (%)						
FY 10-12 MTBS	12.5	17.5	18.5			
FY 11-15 MTBS	8.0	15.0	16.0	16.5	17.0	17.2
Import Growth (%)						
FY 09-11 MTBS	13.0	17.0	16.0	-		
FY 11-15 MTBS	6.0	16.0	17.5	18.0	18.5	18.7
Remittance Growth (%)						
FY 10-12 MTBS	12.5	10.0	10.0	-		
FY 11-15 MTBS	18.7	21.7	22.0	22.0	22.5	23.0
GDP Deflator (% change)						
FY 10-12 MTBS	5.8	5.5	5.0	-		
FY 11-15 MTBS	6.0	5.9	5.6	5.5	5.3	5.0

Source: Finance Division, Ministry of Finance.

Summary Statement of Budgetary Balance

4.5 Table 4.2 shows total revenues, expenditures and financing items of the Budget Balance. It can be seen from the table that in terms of GDP, both the revenue collection and expenditure have been forecast at higher levels for the outer years. Lower Tax-GDP ratio (about 10.4 percent) still remains a great concern for Bangladesh as it is one of the lowest even among the SAARC countries. The

government is well aware of the gravity of the revenue situation and plans to take all-out measures for improving revenue mobilization. To increase the Tax-GDP ratio, the government has already undertaken some pragmatic measures like reforms in VAT and Income Tax Law, establishment of a Dedicated Bench at the Supreme Court for quick disposal of revenue litigation, downsizing tax exemption lists, arrangements for alternative dispute resolution (ADR), widening tax net up to the Upazila level etc (details have been described in Chapter-3). It can be anticipated that these measures would increase the Tax-GDP ratio and for these reasons, total revenue has been projected at 14.1 percent of GDP for FY 2014-15.

Table 4.2
Summary Statement of Budget Balance

(In Billion Taka)	2009-10 Budget	2009-10 Revised	2010-11 Estimate	2011-12 Proj.	2012-13 Proj.	2013-14 Proj.	2014-15 Proj.
Budgetary Operations							
Total Revenue	794.6	794.8	928.5	1104.3	1313.9	1551.3	1824.8
Tax Revenue	639.6	639.6	757.9	901.1	1083.2	1239.0	1,271.1
Non-Tax Revenue	155.1	155.3	168.1	203.2	230.7	262.4	297.7
Total Revenue as % of GDP	11.6	11.5	11.9	12.5	13.1	13.6	14.1
Total Expenditure	1138.2	1105.2	1321.7	1519.5	1745.2	2030.4	2342.4
Program Expenditure	957.2	943.0	1138.5	1294.6	1499.6	1761.9	2037.2
Interest Payment	158.1	146.5	147.1	203.2	220.7	239.5	271.8
Other Expenditure	22.9	15.8	36.1	21.7	24.9	29.0	33.5
Total Expenditure as % of GDP	16.6	16.0	16.9	17.2	17.4	17.8	18.1
Primary Balance	-185.5	-163.9	-233.2	-212.0	-210.6	-239.5	-245.9
Budgetary Balance	-343.6	-310.4	-393.2	-415.2	-431.3	-479.1	-517.7
Budget Deficit as % of GDP	-5.0	-4.5	-5.0	-4.7	-4.3	-4.2	-4.0
Financing Operations	343.6	310.4	393.2	415.2	431.3	479.1	517.7
External Borrowing (Net)	138.0	137.1	156.4	186.4	201.6	229.3	247.2
Loans	132.2	144.9	159.7	185.5	200.6	228.1	245.9
Grants	51.3	37.4	48.1	58.3	66.2	75.3	85.4
Amortization	45.4	45.2	51.3	57.4	65.2	71.1	84.1
Domestic Borrowing	205.6	173.3	236.8	228.8	229.7	249.8	270.5
Bank Borrowing	167.6	86.6	156.8	115.9	170.5	193.9	220.1
Non Bank Borrowing	38.0	86.6	80.0	69.8	59.2	55.9	50.5

Source : Finance Division, Ministry of Finance.

4.6 Public expenditure as a percentage of GDP was a bit lower (14.3 percent) in FY09 due to a sharp decline in commodity prices and the price of fertilizers in the international markets. However, as the world is recovering from the financial crisis and recession and as the prices of some basic imported commodities for Bangladesh are increasing (for example, according to the World Bank commodity price indices for low and middle-income countries, the energy price index increased from 166.3 percent to 256.1 and agricultural products increased from 178.6 percent in the January-March, 2009 period to 212.6 percent in October-December, 2009), it can be expected that government expenditure level will increase in coming years. Moreover, the present government has declared a road map of economic development (Vision -

2021) with the aim of achieving higher economic growth. In this regard, the government has planned to increase the overall expenditure level with some special emphasis on ADP expenditure. These combined factors have been reflected in the expenditure projections in the form of gradual increase in total expenditure which have been projected at 16.9 percent of GDP in FY11 to 18.1 percent in FY15.

4.7 Prior to FY08, the budgetary deficit had for a number of years remained within the government's targeted level of 4.0 percent of GDP. In FY08, damages caused by two consecutive floods and the costs of recovery from Cyclone Sidr necessitated higher levels of spending which led to an increase of deficit to 5.1 percent of GDP. But it declined to 3.9 percent of GDP in FY09 because of declining commodity prices in the international markets, lower subsidy in the fuel and fertilizer sector etc. In the context of the global financial crisis, the government has decided to stimulate economic growth through a higher level of public expenditure and investment and for this reason, budget deficit has been fixed at 5.0 percent of GDP for FY10 which is 1.6 percent higher than that of FY09. In the meantime, the government has enacted the "Public Money and Budget Management Act – 2009" which aims to maintain the budget deficit within a tolerable limit. This has limited the projected budget deficit at a lower level (decreased from 5.0 percent of GDP in FY11 to 4.0 percent of GDP in FY15) for the outer years.

Public Expenditure

4.8 Sectoral public expenditure priorities and the allocation of resources among the sectors will be discussed elaborately in Chapter – 5. This section mainly looks at the distribution of public spending between major capital and current spending and between major economic categories of non-ADP spending (pay and allowances, goods and services, subsidies and transfers, interest payments etc). It also looks at the overall implementation performance of public expenditure over the last few years.

Composition of Public Expenditure

4.9 **Disaggregation by Sectors:** Sectoral composition of public expenditure is discussed in detail in Chapter 5. It is worth mentioning here that the sectors within the government activities are not well defined. The Planning Commission's classification of sectors is different from the Finance Division's classification. For the purpose of this report we have used the Finance Division's definition of sectors.

4.10 **Disaggregation by Major Economic Activities:** Due to problems with harmonizing externally financed ADP expenditure within the budget framework, a comprehensive breakdown of public spending by broad economic category is not available now. With significant recurrent spending occurring under the ADP, and development activities being financed under recurrent expenditure, it is currently almost impossible to get an accurate picture of the distribution of resources between recurrent and capital expenditures.

4.11 Composition of public spending as a percentage of GDP (Non-ADP and ADP) with major items of Non-ADP expenditure in recent times has been presented in Table-4.3. By analyzing the table, the following trends can be identified:

Table 4.3
Composition of Total Public Expenditure
(As a percent of GDP)

	2004-05 Actual	2005-06 Actual	2006-07 Actual	2007-08 Actual	2008-09 Actual
Total Expenditure	14.0	14.0	13.4	15.9	14.3
Non-ADP Expenditure	9.0	9.3	9.4	12.6	11.6
Current Expenditure	8.4	8.9	9.2	9.6	9.9
Pay and Allowances	2.3	2.4	2.7	2.3	2.2
Goods and Services	1.5	1.4	1.3	1.3	1.3
Interest Payment	1.7	2.0	2.0	2.5	2.5
Subsidies and Transfer	2.8	2.8	3.0	3.4	3.9
Block Allocations	0.2	0.3	0.1	0.0	0.1
Others	0.6	0.4	0.2	3.0	1.2
Annual Development Program (ADP)	5.0	4.7	4.0	3.3	3.1

Sources: Finance Division, Ministry of Finance.

4.12 Subsidies and transfers have recorded a substantial increase during the last few years. Current transfers have increased due to introduction of new safety net programs, gradual expansion of coverage and increased per person payment under the existing systems etc. Pension and retirement benefits are also a major component of current transfers, which has increased the transfer payments. On the other hand, subsidies have increased due to increase in agriculture subsidy (in diesel, electricity, fertilizer, seeds etc), export subsidies etc. Composition of subsidies for the last few years can be seen from table 4.4:

Table – 4.4
Composition of Subsidies (in Billion Taka)

Items for Subsidy	2005-06 Rev. Budget	2006-07 Rev. Budget	2007-08 Rev. Budget	2008-09 Rev. Budget	2009-10 Rev. Budget
Food	4.96	6.99	7.36	10.16	9.84
Agriculture	6.00	10.41	39.00	57.85	42.00
Export	5.02	7.00	11.70	12.00	17.00
Others	0.23	6.32	0.15	0.64	3.50
Fuel (BPC)	-	6.00	75.23	15.00	9.00
Electricity (PDB)	-	-	6.00	9.81	12.00
Total Subsidy	16.21	36.72	139.44	105.46	93.34

Items for Subsidy	2005-06 Rev. Budget	2006-07 Rev. Budget	2007-08 Rev. Budget	2008-09 Rev. Budget	2009-10 Rev. Budget
As % of Total Revenue Budget					
Food	1.33	1.57	1.28	1.51	1.29
Agriculture	1.62	2.34	6.80	8.62	5.50
Export	1.35	1.57	2.03	1.79	2.23
Others	0.06	1.42	0.03	0.10	0.46
Fuel (BPC)	-	1.35	13.10	2.23	1.18
Electricity (PDB)	-	-	1.04	1.46	1.57
Total Subsidy	4.36	8.25	24.28	15.71	12.23

Source: Ministry of Finance

4.13 From table-4.4, it is visible that subsidy is accounting for about 12.23 percent of total expenditure of the current fiscal year which is about 3.48 percent less than in the previous fiscal year. Due to the fall of oil price in the international market, fuel subsidy has declined in the last two fiscal years but subsidy has increased in sectors like food, agriculture, exports, electricity etc. Other than fuel subsidy, total subsidy in FY10 was about taka 84.34 billion, down from about taka 90.46 billion in FY-09. This means that excluding fuel, total subsidy has decreased by about 6.76 percent in FY10. One noticeable characteristic of the subsidy program of Bangladesh is that it is pro-poor. For example, agriculture (including fertilizer, seeds and other inputs), fuel and food subsidy is provided mainly targeting the poor people/farmers who are hardly affected with higher prices of these items.

Table - 4.5
Major Transfer Items (FY 2005-06 to 2010-11)
(As percentage of Total Transfer)

Item	2005-06 Revised	2006-07 Revised	2007-08 Revised	2008-09 Revised	2009-10 Revised	2010-11 Budget
Total Transfer (As % of GDP)	1.7	1.7	1.9	2.3	2.4	1.8
General Grants	3.8	3.6	3.3	1.5	25.6	22.9
MPO to Teachers	39.7	37.0	33.0	21.9	29.4	36.1
VGD	4.5	4.5	7.1	5.3	3.6	4.1
VGF	3.8	5.7	8.4	10.7	6.7	9.8
TR	5.6	5.1	6.1	9.0	6.5	7.5
GR	1.0	1.5	1.7	1.4	1.0	1.4

Source: Finance Division

4.14 From Table 4.5, it can be seen that current transfer as a percentage of GDP has increased over the years. The major component of transfer is salaries to teachers of non-government educational institutions, which are about 36.1 percent of total transfer in the FY 11 budget. However, total contributions of VGD, VGF, TR and GR are also noticeable (about 22.8 percent of total transfer amount). These programs are carried out by the government where the target groups are poor

communities of the society. So, it can be said that the government is committed to pro-poor spending, which is also a demand of the donor community.

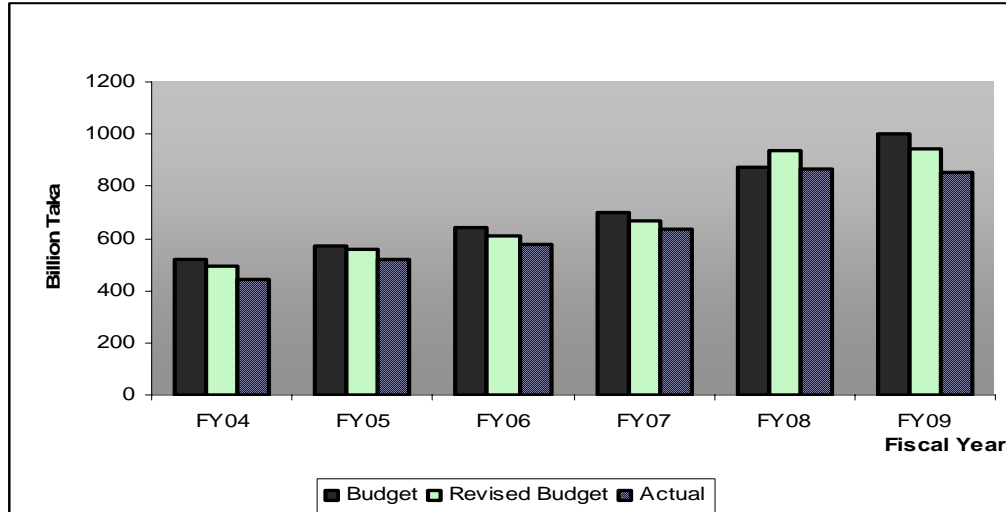
4.15 Expenditure on interest payment as a percentage of GDP has increased gradually during FY04 to FY09. In FY-98, expenditure on interest payment as a percentage of GDP was about 1.16. This has stood at 2.5 percent in 2008-09. One notable characteristic of interest payment expenditure is that the share of domestic interest payment expenditure is higher than the foreign interest payment expenditure.

4.16 With some exceptions, pay and allowances remained almost at the same level during FY04 to FY09 that reached its highest level of 2.72 percentage of GDP in FY07. One important reason behind this higher expenditure is absorption of project employees into the revenue set up. Expenditure on pay and allowance will increase in the next fiscal year as gradual implementation of the recommendations of the last pay commission will start in FY11. Although a better salary structure for the public servants is a key for efficient, service-oriented and pro-people public administration, compared to the public servants of other countries pay packages for the public servants of Bangladesh are not up to the mark. Less attractive pay packages are discouraging talented and skilled job aspirants from entering public service.

Performance of Public Expenditure

4.17 Higher and efficient public expenditure is conducive to the economic development of any country. While on an average, developed countries' share of public expenditure to GDP is over 20 percent, in terms of public expenditure in relation to its GDP, Bangladesh is lagging far behind as it moves around 15 percent of GDP. More interesting is that despite this low expenditure-GDP ratio, the country suffers from lack of implementation capacity which is an indication of higher estimates but lower achievement. It can easily be seen from Figure 4.1 that during FY04 to FY09, in comparison to original budgetary allocation, actual budget implementation rate for the same fiscal years was lower (around 90 percent) with an exception in FY08. And this implementation rate has been raised mainly by the higher rate of Non Development Budget implementation. Implementation rate for the ADP is much lower than the Non-Development Budget. However, the government is trying its best to increase the budget implementation rate. In this regard, immediately after the declaration of the last national budget (FY10), a budget implementation matrix covering all the ministries and divisions has been prepared by the Finance Division and on the basis of this matrix, close monitoring is taking place so that the budget implementation rate can be raised.

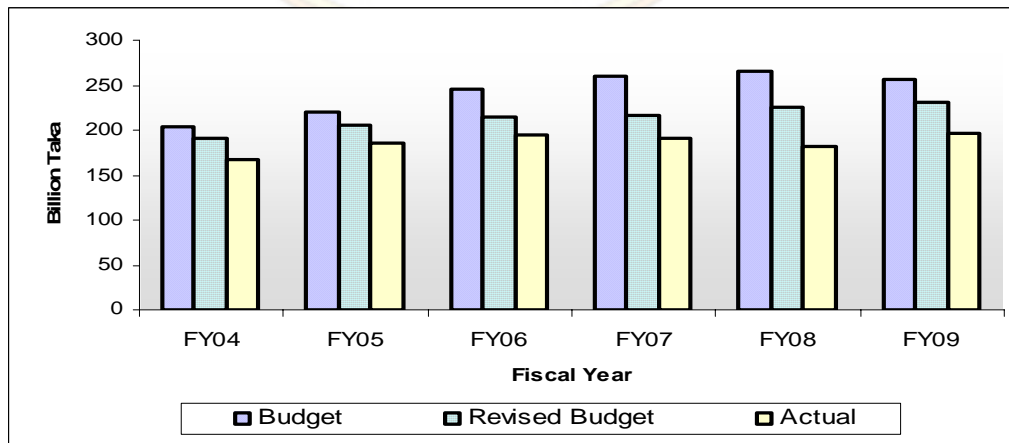
Figure: 4.1
Expenditure Performance (FY04 to FY09)



Expenditure Execution: Annual Development Program

4.18 Despite the fact that administrative ministries have sufficient administrative and financial authority, implementation performance of ADP was not satisfactory at all in the last few years (Figure 4.2, Table 4.5). While expenditure rate of non-development budget has recorded a gradual increasing trend during this period, ADP expenditure continued to decline. For this reason, ADP allocation declined in the revised budget in most of the cases.

Figure- 4.2
ADP Implementation (FY04 to FY09)



4.19 It can be seen from figure 4.2 that the actual implementation rate for ADP compared to original allocation has declined during FY04 to FY09. Table 4.6 also supports this as it can be seen from it that the highest level of implementation was achieved in FY05 (84.0 percent) while the lowest rate was in FY08 (68.9 percent). The present government has put greater emphasis on ADP implementation in fulfilling its election manifesto pledge of employment generation and infrastructure development including power generation and digitalizing governance. In this regard, the government has increased the current year's ADP allocation by Tk 75.00 billion from last year's revised allocation of Tk 23,0.00 billion.

4.20 Lack of **capacity to** implement ADP **negatively impacts** public investment. In order to achieve the anticipated growth and also to accelerate the poverty reduction program, full utilization of ADP allocation as well as quality of expenditure needs to be ensured. For expediting the ADP implementation some short and long-term measures can be taken. These include- prioritization as well as rationalization of development projects, preparation of an annual work plan at the beginning of each fiscal year, close monitoring and evaluation of the implementation of development projects by administrative ministries, ensuring the accountability in case of lower ADP implementation etc. In addition to these, the government has decided to review the implementation status of two big projects at each ECNEC meeting. It can be expected that all these steps would lead to ADP expenditure at a satisfactory level.

Table – 4.6

ADP Allocation and Implementation FY- 04 to FY– 09

Allocation (Billion Tk)	FY04	FY05	FY06	FY07	FY08	FY09
Budget	203.0	220.0	245.0	260.0	265.0	256.0
Revised Budget	190.0	205.0	215.0	216.0	225.0	230.0
Actual	167.9	184.9	194.6	191.1	182.7	193.5
Implementation Rate compared to Original Allocation (%)	82.7	84.0	79.4	73.5	68.9	76.5

Source: Finance Division, Ministry of Finance.

Expenditure Execution: Revenue Budget

4.21 The share of the non-development budget in total budgetary allocation has increased significantly in recent years. Against this higher allocation, non-development expenditure has also increased and after FY02, the interval between development and non-development expenditure relative to GDP reached 8 percent. Implementation performance of Non- Development Budget expenditure has also recorded an upward trend in recent times. It can be seen from Table 4.7 that in FY04, actual Non -development budget expenditure against the original budget was about 87.1 percent and reached its highest at 113.2 percent in FY08.

Table – 4.7**Non-Development Allocation and Implementation (FY04 to 09)**

Allocation (In billion Taka)	FY04	FY05	FY06	FY07	FY08	FY09
Budget	316.8	352.5	398.8	437.4	606.4	743.6
Revised Budget	303.7	351.3	395.6	452.4	711.1	711.4
Actual	276.0	333.4	386.1	442.0	686.3	655.1
Implementation against Budget (%)	87.1	94.6	96.8	101.0	113.2	88.1

Source : Finance Division, Ministry of Finance

4.22 Gradual increase of expenditure on pay and allowances, maintenance, interest payments, subsidy management, social safety nets including pensions, current transfers etc have increased the non-development budget expenditure substantially. Expenditure on pay and allowances has increased due to transfer of project personnel into the revenue setup as well as due to higher salaries paid to MPO listed teachers of various non-government educational institutions. Expenditure on maintenance has also increased significantly due to transfer of vehicles and structures procured and built under development projects into the revenue budget. Due to increase in number of beneficiaries and rate of allowances, expenditure on the social safety net has increased significantly. As full implementation of the last pay scale would be started in July, 2010, it is expected that public expenditure will continue to rise.

Public Revenue

4.23 The importance of domestic revenue and its current state has been discussed in detail in Chapter-3. The discussion in chapter 3 indicates the results of the government's revenue mobilization efforts. The difference between total government expenditure and domestic revenue mobilization creates a deficit, which needs to be financed.

Deficit Financing and Debt Management

4.24 The fiscal policy of the government continues to endeavor to narrow the gap between expenditure and income in order to offset the budget deficit or to maintain it at a tolerable level. The deficit on the budget balance (excluding grants) is financed through domestic and external borrowing, and external grants. Meanwhile, on July 9, 2009 the Parliament has enacted a new law THE PUBLIC MONEYS AND BUDGET MANAGEMENT ACT, 2009 (ACT NO. 40 of 2009) for the custody of public moneys, deposit and withdrawal of money from the Consolidated Fund or deposit and withdrawal of money from the Public Account of the Republic, maintenance of a sustainable budget deficit and public debt, ensuring inter-generational equity,

improvement of macroeconomic stability, establishment of accountability and transparency in budget preparation and for other related issues.

Under article 3 of Act 40 of 2009 the fiscal management activities of the government shall be guided as follows:

- a) The Government shall carry out all appropriate measures for the improvement of macro-economic stability and maintain the annual budget deficit at a sustainable limit.
- b) The Government shall follow specified procedure for sound fiscal and public debt management and shall carry out following actions to maintain affordable public debt:
 - Borrowings from domestic sources shall be reduced gradually and annual borrowings from these sources shall be within a reasonable limit;
 - Contingent liability due to sovereign guarantee of the government shall remain within a sustainable limit;
 - Public debt obtained from domestic and external sources shall be reduced gradually every year as a percentage of GDP.
- c) The Government may obtain Ways and Means advance from Bangladesh Bank to meet regular cash requirements within a specified limit and in case of exceeding such a limit the additional money may be obtained as overdraft; other than that the government shall not borrow from the Bangladesh Bank.
- d) Whatever is mentioned in sub-section (3), the Bangladesh Bank may continue to purchase primary securities like treasury bills, bonds etc issued by the government within a specified time limit.
- e) The government shall determine the annual limits of budget deficit, borrowings from domestic and external sources and contingent liabilities out of guarantees, size of public debt and time limit to purchase primary securities by the Bangladesh Bank through specified procedure.

Act 40 of 2009 outlined the avenues for government borrowing for the following purposes. For borrowings

- a) The government may borrow from domestic and external sources;
- b) No ministry, division, other institution, department or agency shall borrow any loan other than the ministries or division or other institutions that have been authorized to borrow on behalf of the Government;
- c) The government may borrow to achieve the following objectives:-
 - To finance budget deficit;

- To implement any project or program;
- On-lending to any agency;
- To pay back previous loans or financing any loans on their maturity;
- For any other purposes approved by the Parliament.

Guarantee: Act 40 of 2009 outlined the avenues for government guarantees for the following purposes. For guarantees no ministry or division other than the Finance Division shall issue any guarantee on behalf of the government.

4.25 In pursuant to Act 40 of 2009, currently the government is maintaining a prudent debt management policy, which guides the strategies towards maintaining a gradual declining trend of debt as a percentage of GDP. The main objectives of the debt management policy in Bangladesh are to (i) minimize cost; (ii) minimize implicit and explicit risks; (iii) diversify sources of borrowing on a competitive basis and (iv) strive to access more long-term than short-term borrowing.

4.26 Although there is no documented Debt Management Strategy, adoption of a formal Medium-Term Debt Strategy is under active consideration of the government. However, the country follows an implicit strategy that consists of maximizing external concessional official borrowing and financing the gap in the domestic market while maintaining a gradually reducing trend. The sequence of the implicit debt strategy is as follows:

- Continue and expand External Concessional Official Borrowing
- Borrowing from Retail Sources
- Borrowing from Market Sources

Reflecting these objectives, net new government borrowing will be such that total debt stock is expected to fall from 44.8 percent of GDP in FY10 to 42 percent in FY15

Box 4.1

Sovereign Credit Rating and Bangladesh

A credit rating estimates the credit worthiness of an individual, corporation, even a country. A sovereign credit rating is the credit rating of a sovereign entity, i.e. a national government. The sovereign credit rating indicates the risk level of the investing environment of a country and is used by investors looking to invest abroad. Credit ratings are forward looking options about credit risk. Absence of credit rating hindered countries and public and private institutions for getting access to credit from international financial systems. There was an urge from the private sector as well as from the development partner's side to assess the credit worthiness of Bangladesh through credit ratings. Accordingly, the government engaged two of the most

prominent credit ratings agencies, the Standard and Poor, and Moody's Investment Service to assess the credit worthiness of Bangladesh. In April 5, 2010 S & P announced its assessment and rated Bangladesh with a ranking of BB- and in April 12, 2010 MOODY'S released its assessment for Bangladesh with a rating of Ba3. Both the credit ratings gives Bangladesh a better positioning in its credit worthiness as well as a stable outlook reflecting the prospects for continuing economic stability alongside a steady increase in the growth rate. The possible impact of positive credit rating for Bangladesh would be as following

- Access to financing from international financial system
- Borrowing under relatively easy term and lower interest rate
- Low import bill for goods and services
- Long-term project financing

This very assessment has also paved the way for comparing Bangladesh's credit worthiness with other countries of the world. Moody's rating puts Bangladesh on a par with the Philippines, Vietnam and Turkey. In the South Asian context, Bangladesh's position is higher than Pakistan's and Sri-Lanka's in both S & P and MOODY'S rating.

Financing Forecast

4.27 The level of financing required to cover the fiscal deficit is forecast to increase from 4.5 percent of GDP in FY10 to below 5.0 percent in FY11 and then remain close this level during FY12. The scenario will start changing continuously with a declining trend and is projected to reach 4.0 percent in FY15 (Table 4.8). The increased forecast of budget deficit for FY11 is due to high investment in the power and energy sector, ground breaking of some of the flagship projects like construction of the Padma Bridge, four-lanes Dhaka-Chittagong highway, and construction of an elevated expressway in Dhaka, extension of safety net coverage and full implementation of the National Pay Scale 2009.

4.28 In order to reduce the costs of financing the fiscal deficit, the government's strategy has been to cover as much deficit as possible from external grants and concessional credits. The government is eyeing foreign financing on average 2 percent of GDP as its strategy to meet budget deficit and to keep buoyant liquidity for the private sector in the domestic market. With development partners' substantial emergency assistance in the aftermath of Cyclone Sidr and Aila, contributed external financing rose to 1.6 percent of GDP in FY08. It is forecast that external financing will increase further to 2.1 percent of GDP by FY12, as substantial new funding is made available to cover major investment projects in the power and transport sectors.

4.29 Domestic borrowing peaked at 3.5 percent of GDP in FY08, but is expected to fall back sharply to 2.5 percent in FY10 as the impacts of global economic recession

have lowered the general price level of imported goods that ultimately triggered the shortfall of revenues and expenditures.

Table 4.8
Budget Deficit and Financing

	2008-09 Actual	2009-10 Budget	2009-10 Revised	2010-11 Estimate	2011-12 Projection	2012-13 Projection	2013-14 Projection	2014-15 Projection
Total Financing Requirement	239.3	343.6	310.4	393.2	415.2	431.3	479.1	517.7
as % of GDP	3.9	5.0	4.5	5.0	4.7	4.3	4.2	4.0
External Financing (Net)	46.6	138.0	137.1	156.4	186.4	201.6	229.3	247.2
as % of GDP	0.8	2.0	2.0	2.0	2.1	2.0	2.0	1.9
Loans	72.1	132.2	144.9	159.7	185.5	200.6	228.1	245.9
Grants	21.1	51.3	37.4	48.1	58.3	66.2	75.3	85.4
Amortization	46.7	45.4	45.2	51.3	57.4	65.2	74.1	84.1
Domestic Financing	192.6	205.6	173.3	236.8	228.8	229.7	249.8	270.5
as % of GDP	3.1	3.0	2.5	3.0	2.6	2.3	2.2	2.1
Borrowing from the Banking System	137.9	167.6	86.6	156.8	159.0	170.5	193.9	220.0
Non-Bank Borrowing	54.7	38.0	86.6	80.0	69.8	59.2	55.9	50.5

Source: Finance Division, ERD and Bangladesh Bank

Cost of Borrowing

4.30 The rising cost of borrowing is a matter of concern to the government in formulating fiscal policy. Since, to date, the majority of outstanding debts are owed to external sources and are obtained on concessional terms, government borrowing in Bangladesh, both as a share of total debt and as a share of GDP is low compared to many other countries. But, the significance of borrowing costs does not give any complacency to the government as its share of the budget is much greater due to the relatively low levels of total revenue and spending as a share of GDP.

4.31 The emerging new political and economic changes have shrunken the portfolio in concessional external borrowing relative to GDP. Combined with an increase in the budget deficit this has meant that greater reliance has been placed on higher cost bearing domestic borrowing. As a result, the total cost of borrowing has increased significantly. During FY11-15 interest charge payments are projected to remain at around 2.2 percent of GDP (Table 4.9). Interest payments as a proportion of total expenditure are projected to increase from 12.1 percent in FY10 to 13.4 percent in FY11.

Table 4.9
Cost of Borrowing

	2008-09 Actual	2009-10 Revised	2010-11 Estimate	2011-12 Projection	2012-13 Projection	2013-14 Projection	2014-15 Projection
Total Interest Payment	151.8	146.5	147.1	203.2	220.7	239.5	271.8
Interest Payment on Domestic Borrowing	138.4	132.6	132.7	185.5	200.6	216.7	245.9
Interest Payment on External Borrowing	13.4	13.9	14.4	17.7	20.6	22.8	25.9
Total Interest Payment as % of GDP	2.5	2.1	1.9	2.3	2.2	2.1	2.1
Total Interest Payment as % of Total Revenue	23.7	18.4	15.8	18.4	16.8	15.4	14.9
Total Interest Payment as % of Total Expenditure	17.2	13.3	11.1	13.4	12.6	11.8	11.6

Source: Finance Division, ERD and Bangladesh Bank

Debt Stock and Sustainability

4.32 Total outstanding government debt reached to Taka 2769.3 billion at the end of June 2009. Of this total the share of domestic debt was Taka 1274.1 billion (46.0 percent) and that of external debt Taka 1495.2 billion (54.0 percent). The share of domestic debt has been showing an increasing trend over the recent years.

4.33 Debt sustainability is measured by debt as a share of GDP and also in the case of external debt by amortisation and interest payments as a percentage of the value of exports of goods and services. In recent years sustainability has strengthened with total debt as a percentage of GDP falling to 45.0 percent in FY09 compared with 49.6 percent in FY07. This trend is expected to be maintained throughout FY11-15 period. Although external debt accounts for the major share of total debt, it poses little pressure; because it has been secured on primarily concessional terms, its impact on debt sustainability is significantly reduced. Thus amortisation and interest payments on external debt would be at the level of 4.5 percent of export earnings on goods and services in FY10, and are expected to fall to 3.9 percent in FY15 (Table 4.10).

Table 4.10
Debt Sustainability

	2008-09 Actual	2009-10 Revised	2010-11 Estimates	2011-12 Projection	2012-13 Projection	2013-14 Projection	2014-15 Projection
Total Debt	2769	3042	3388	3744	4110	4513	4946
as % of GDP	45.0	44.1	43.4	42.4	41.0	39.6	38.2
Domestic Debt	1274	1447	1684	1913	2143	2393	2663
as % of GDP	20.7	21.0	21.6	21.7	21.4	21.0	20.6
External Debt	1495	1595	1703	1831	1967	2121	2283

	2008-09 Actual	2009-10 Revised	2010-11 Estimates	2011-12 Projection	2012-13 Projection	2013-14 Projection	2014-15 Projection
as % of GDP	24.3	23.1	21.8	20.7	19.6	18.6	17.6
Amortization Plus Interest Payment on External Borrowing	60.1	59.3	65.7	75.1	85.3	97	110
as % of Export of Goods and Services	5.0	4.5	4.3	4.2	4.1	4.0	3.9
Interest Payment on External Debt	13.4	13.9	14.4	17.7	20.1	22.8	25.9
as % of Export of Goods and Services	1.1	1.1	0.9	1.0	1.0	0.9	0.9

Source: Finance Division, ERD and Bangladesh Bank

Contingent Liabilities

4.34 Contingent liabilities reflect the level of potential fiscal risk originating from guarantees given by the government on borrowing by parastatal bodies, state-owned enterprises and in some cases to private organisations. Contingent liabilities carry significant risk since the government could face substantial financial demands if these guarantees were to be invoked. Steps have therefore been taken to make such liabilities explicit and subject to formal contracts. The government has also taken action to reduce fiscal risk by strengthening the management of contingent liabilities and building up a full inventory of outstanding liabilities.

4.35 Table 4.11 shows the estimated current stock of contingent liabilities for FY10. Total contingent liabilities for FY10 amounted to Tk. 154.11 billion which is around 2.23 percent of GDP. This contingent liability is about 55 percent higher than the government's contingent liability from last year, FY09. This is mainly because of the fact that during FY10 the government has given a guarantee in favor of Bangladesh Biman Ltd. for acquiring two new Boeing aeroplanes.

Table 4.11

Contingent Liability (Taka in Billion)

Organization	Up to June' 09	Up to June' 10
Bangladesh Jute Mills Corporation	7.43	6.37
Bangladesh Krishi Bank	40.98	0.00
Rajshahi Krishi Unnayan Bank	16.20	2.00
Bangladesh Sugar and Food Industries Corporation	3.95	3.46
Bangladesh Agriculture Development Corporation	11.12	34.35
Bangladesh Tele Communication Company Ltd	2.56	0.00
Bangladesh Submarine Company Ltd	0.00	0.00
Ministry of Food and Disaster management	0.12	0.00

Organization	Up to June' 09	Up to June' 10
House Building Finance Corporation	16.94	0.00
Bangladesh Chemical Industries Corporation	0.00	27.00
Trading Corporation of Bangladesh	0.00	1.73
Ansar and VDP	0.00	0.20
Biman Bangladesh Ltd	0.00	79.00
Total	99.30	154.11
Source: Finance Division		

