

**Public Debt Management and Fiscal Vulnerability:
Potential Roles of Supreme Audit Institution
In Bangladesh**

**A Dissertation by
Tanveer Akhter Hossain Khan
I.D. # 07272006**

**Submitted to
Institute of Governance Studies
BRAC University, Dhaka, Bangladesh**

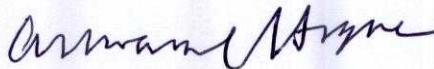
**In partial fulfilment of the requirement for the degree of MA in
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**Institute of Governance Studies
BRAC University
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BRAC University,
Mohakhali, Dhaka.**

June, 2008. *5th, 2009*

Public Debt Management and Fiscal Vulnerability:

Potential Roles of Supreme Audit Institution

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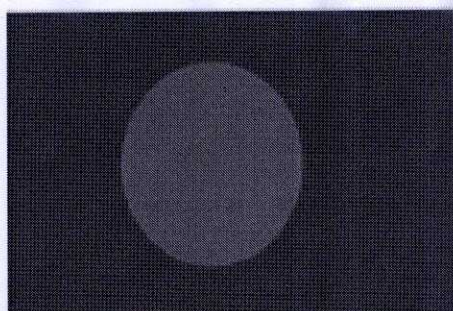
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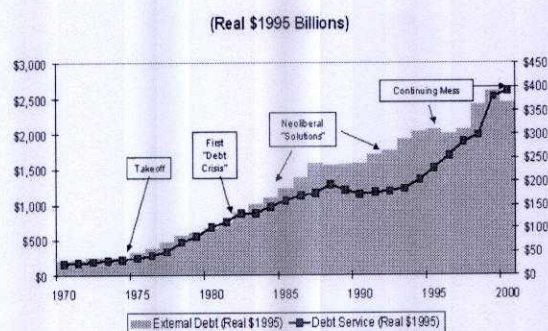
Journey to Justice : 18 May 2008

Drop the Debt first : April-May 2008



Bangladesh is the focus of the **Drop the Debt Fast** on Monday 14 April, when it is also Bengali New Year.

Chart 1.1. Third World Foreign Debt and Debt Service, 1970-2000



Source: World Bank (2002) data, JSH analysis

© JSH 2003

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List of Abbreviations

ADB	Asian Development Bank
ADP	Annual Development Program
BB	Bangladesh Bank
BOP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BPDB	Bangladesh Power Development Board
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
LIC	Low-Income Countries
MDGs	Millennium Development Goals
MFA	Multi-fiber Agreement
NCB	Nationalized Commercial Banks
ODA	Official Development Assistance
PRSP	Poverty Reduction Strategy Paper
WB	World Bank

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“As we express our gratitude, we must never forget that the highest appreciation is not to utter words, but to live by them.” - John Fitzgerald Kennedy quotes (American 35th US President (1961-63).

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ID# 07272006
MAGD 2nd Batch

Preface

This is a report on the debt management of Bangladesh. This paper examines past aid allocations to Bangladesh as well as Bangladesh's debt sustainability, and present debt management capacity of the country in compare to Standard/ Idle Practices. The issue of public debt and debt sustainability has long been a concern for policy makers of both fiscal and monetary authority in Bangladesh.

Some 30 years ago, Bangladesh was one of the poorest countries of the world. Henry Kissinger famously prophesied Bangladesh's Economic future as an "International basket case". Extremely weak initial conditions and various vulnerabilities offered plenty to worry about. Summing up the conditions then, a World Bank Report in 1972 noted: Even under the best of circumstances, Bangladesh constitutes a critical and complex development problem. The population is poor (per capita income of \$50 to \$70- a figure which has not risen over the past 20 years), overcrowded and becoming more so (population is growing at 3% per annum), short-lived (life expectancy at birth is well under 50 years), In many cases unemployed (perhaps 25%-30%), and largely illiterate (under 20% literacy rate). Furthermore, most of the population (90% rural) lived below subsistence, with the poverty rate estimated at over 70%, and regarding schooling gender discrimination was prevalent: there were only 658 females for every 1000 males in 1970, which then was lower than in India, Pakistan, Nepal and Sri Lanka in the region (World Bank Report, 1972). But Bangladesh's development record has been a remarkably positive one, especially when viewed through the prism of the weak initial conditions and surrounding pessimism. Thirty some years later life expectancy has risen to 64 years (comparable to neighbouring India's), Population growth has dropped 1.5%, literacy has more than doubled, child mortality has been cut by 7%, unemployment has down to 4%, poverty incidence has fallen to 40%, and about a quarter of the population lives in urban areas. Bangladesh in on track in meeting its Millennium Development Goal (MDG) on gender parity, having already achieved goal in primary and secondary schooling. There were an estimated 978 females for every 1000 males in 2005- more than in India and Pakistan. So to achieve those and also to reduce the gap between expenditure and income, development partner's grant and debt play a vital role. Though living conditions have improved considerably and poverty declined drastically, especially in the last

few years, there are still about 40 million people living below \$1-a-day in Bangladesh. Hence, Bangladesh has ample needs for more aid.

Presently, the per capita debt obligation of Bangladesh has increased from US\$6.59 in 1973/74 to US\$147.32 in 2006/07. In the year 2006-07 debt stock was 46.5% of GDP. So the dilemma is that for development we need aid, debt but we have to consider that do the country have debt sustainability and have the capacity to face the challenges if any financial recession would occur i.e. need to ensured the existence of sound debt management.

But since the early 1980s, poor countries have been facing unsustainable debt levels which mean they are paying more to service their debts than in efforts to tackle poverty and provide essential services for their citizens. High public debt stems from persistent fiscal deficit and leads to high taxes and puts upward pressure on real interest rates, which may crowd out private investment. When a government is no longer able to finance its deficit, it is forced to cut spending or raise revenues, often at times when fiscal policy is needed to help stabilize the economy. It is important for overall macroeconomic policy to manage the debt and it needs to be coordinated closely with fiscal, monetary and other macroeconomic and financial policies. For this reason, debt manager, fiscal and monetary authorities should share an understanding of the objectives of debt, fiscal and monetary policies, given the interdependence among the policy instruments. Close coordination is needed to choose an appropriate mix of financing and policy adjustment to facilitate economic recovery while preventing the build-up of an unsustainable debt burden. Moreover strong oversight function is needed. Supreme Audit Institutions (SAI) shouldn't simply point out what's wrong in government. It's also important to highlight policies and practices that are working well. A balanced and constructive approach to oversight is also more likely to build public trust and confidence in government.

The main objective of fiscal policy in Bangladesh is to enhance the effectiveness of public expenditure by channeling resources to the appropriate direction and attain faster growth and poverty reduction by mobilizing larger amount of revenue than done presently. With a view to fostering economic growth and accelerating poverty reduction, Bangladesh has been pursuing expansionary fiscal policy since its

independence. As a result, total expenditure very often exceeds total revenue which generates fiscal deficit. In the wake of persistent saving-investment gap, export-import gap, and fiscal deficit, a prudent public debt management is an essential issue for sustained macro stability of Bangladesh. Considering the trend of present interest rate, GDP growth rate, exchange rate, inflation, burden of debt services, and debt dynamics, the present level of debt/GDP, as well as present debt management situation, this report's findings are: *Bangladesh should be considered at low risk of debt distress based on external indicators, but the risk of debt distress is moderate once domestic obligations are included in the analysis.* Debt maturity structure shows an improvement, on the other hand, the currency denomination reflects that foreign currency especially Yen denominated debt are too high which exposes the of exchange rate risk. In addition, Bangladesh could not achieve the CPI indexed bonds which could protect investors against inflation and also secondary market of Government bonds/securities is not properly operated yet. The composition of domestic and external debt shows the over dependency on domestic borrowing and consequently crowding out private sector investment. Again in many cases where Government invest the borrowed money, most of the cases there is no return rather loss and increasing the debt burden. It is due to absence of professionalism in public sector enterprise, corruption, Trade union's negative role of and also for rigid and traditional Bureaucracy. So it is needed to make the Public enterprise profitable and to do that above mentioned hurdles need to eliminate.

Bangladesh has already initiated institutional reforms in debt management under a project named "Financial Sector Reform Program" mainly institutional reforms. But still it is suffered by lack of coordination, debt strategy, absence of professional risk and portfolio analysis and proper accounting practices. Actually there is no written debt strategy, debt policy and also there is no laws limiting aggregate borrowing. Moreover in present system there is no provision for reporting to the legislature about the debt flows and stocks- certainly it affects the transparency and accountability issue of debt management. Contingent liabilities also are not considered in our country for ascertained future borrowing demand and also Contingent liabilities are not properly disclosed in financial statement of the government and last but not the least, absence of oversight functions on debt management by the SAI.

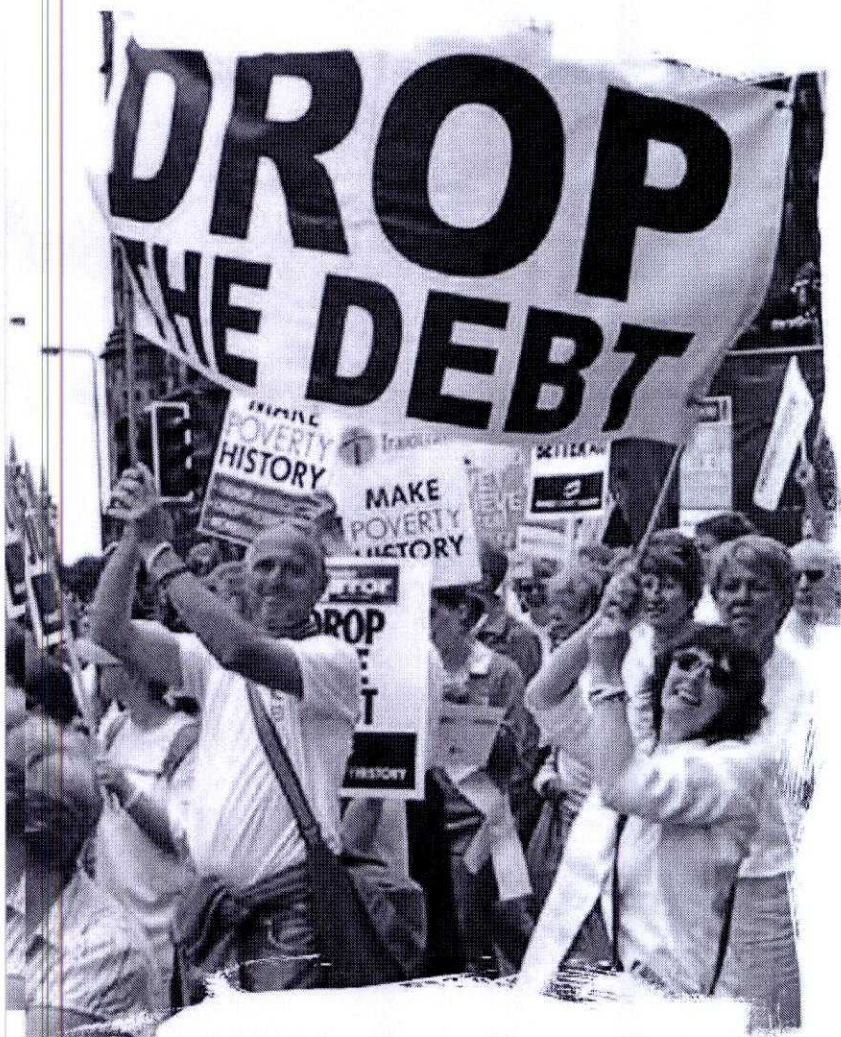
Moreover aid flow is decreasing and on the other hand reverse trend is observed in case of debt servicing in every year. Over the last few years, annual external debt service of Bangladesh averaged \$ 710 million which surpasses yearly health budget. Health budget of FY 2007-08 is less than \$ 600 million. Actually, for every dollar in grant aid Bangladesh received, the government paid back over US \$ 1.50 in debt repayments and every dollar paid in debt service is a dollar lost for the Millennium Development Goals. Keeping in mind that Bangladesh is a highly disaster-prone country, and that disasters are likely to increase due to climate change. Scientists predict that by 2050, 17% of Bangladesh will be submerged under water; and the intensity of cyclones and floods will have increased, as was experienced in 2007. Bangladeshis themselves are largely not responsible for this climate change. While an average Bangladeshi emits 0.02 tons of carbon a year, an average American emits 20 tons of carbon. So, the cancellation of Bangladesh's external public debt would not only serve as a shock absorber but also allow Bangladesh to use its scarce resources to achieve the MDGs.

Finally, Present financial crisis shown that Joint efforts are must in the edge of globalization to tackle any crisis, single effort is not enough even it is taken by the super power and the world never tackled such financial crisis in an integrated way like now. Joint approach already improves inter bank lending and downwards LIBOR interest rate. So, a financial crash is more than an economic glitch. It leads into dangerous political territory. It can trigger revolutions. Financial distress in the 1780s led to the French Revolution. Financial distress brought the Nazis and Japanese militarists to power before World War II. A financial earthquake may cause a political earthquake. A political earthquake, in turn, can set off a revolution, civil war, or even a world war. So to avoid that situation, First world and third world have to work together to make the poverty history and it is possible when first world cancelled all the debts they have paid to the third world. We have to remember, that-

"Only when the last tree has died, and the last river has been poisoned, and the last fish has been caught, will we realize that we cannot eat money."
—19th Century Cree Indian proverb

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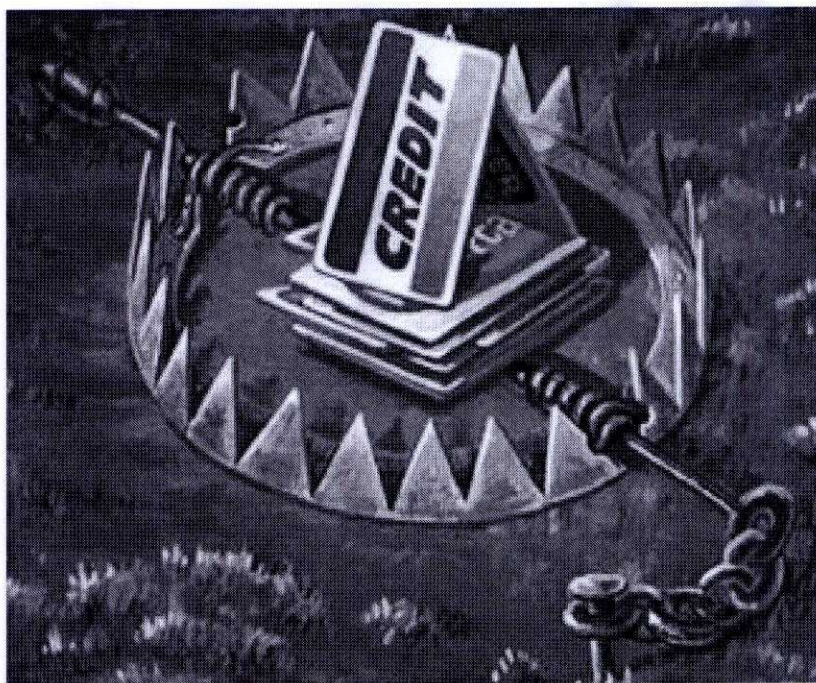
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Chapter One: Introduction

"There will be another global economic crisis. The trigger will be different, the country will be different, but we will see a repeat."

- George Muñoz,

Overseas Private Investment Corporation



Chapter one

Introduction

Bangladesh, a relatively young country in the South Asian subcontinent, emerged with high expectations of establishing an effective system of government by resolving the problems that had been hindering its development. However at the end of thirty-seven years of independence, Bangladesh is still facing many challenges that impede it from realizing its full economic potential. Among other things, strengthening the Debt management system and effective role of Supreme Audit Institution (SAI) to aware the government about overall debt situation of the country is crucial component to mitigate the problem.

1.1 Motivation for the Study:

Public debt is one of the strategies to finance budget deficits that governments follow around the world. If unattended, the debt can grow very fast and can constrain fiscal (and monetary) policy in ways that cannot be totally anticipated. Growing budget deficits and increasing debt servicing costs are inducing many governments to form more efficient public debt management strategies. The public debt management not only concentrates on minimising cost but also on the sustainability of debt. Public debt management can be defined as managing levels of public borrowings, decisions regarding the sources of government borrowing and type of tools used.

Public debt management became a key policy issue for a number of highly indebted industrialized countries in the late 1970s and early 1980s, when public debt accumulation accelerated significantly following the emergence of primary fiscal imbalances, the large increase in real interest rates and the concurrent slowdown in economic growth. Although some of the high debt countries, such as Ireland and Denmark, have succeeded in reversing the increasing trend of the debt-to-GDP ratio, the burden of public debt remains

significant today in several economies. In 1993, for example, debt-to-GDP ratios exceeded 100 percent in Belgium, Greece and Italy; in the same countries, interest payments on public debt exceeded 10% of GDP. On the other hand a number of countries in the Asian and Pacific region have nevertheless avoided defaults, although debt situations are critical in some low income countries, such as Indonesia, Kazakhstan, Kyrgyzstan, the Lao People's Democratic Republic, Myanmar, Pakistan, Papua New Guinea, the Philippines and Tajikistan. These countries are in various stages of debt restructuring and are undertaking macroeconomic adjustments, but the outcome has not been very significant. Aid flows to some of these countries have declined as donors have placed increasing emphasis on economic reforms and structural adjustments. The climate of concessional development assistance has not shown any noticeable improvement in recent years. In fact, the official net resource flows have fallen and now stand at 0.17 per cent of the GDP of the advanced economies. Multilateral aid has remained small in relative size and more constrained than in the past. Moreover, aid flows have become less responsive to short-term or cyclical phenomena.

In case of Bangladesh External assistance is considered a significant factor in the economic development in order to bridge the gap between savings and investment and balance of payment. The per capita debt obligation of the country has increased from US\$6.59 in 1973/74 to US\$147.32 in 2006/07 and external debt service payments on total public sector debt rose from US\$ 100.9 million in 1974/75 to about US\$ 1.55 billion in 2006/2007. Domestic borrowing also rose from TK. 640.22 Crore in 1990/91 to TK. 9098.20 crore in 2006/07. In the year 2006-07 debt stock was 46.5% of GDP. So taking debt has shown increasing trends. On the other hand the price of food grains, oil is also shown increasing trends in world market that leads high inflation in our country that may threaten the debt sustainability situation in our country. If we are not conscious about the debt management, debt sustainability now then it may cause the financial crisis in our country. Moreover Supreme Audit Institutions (SAI) through it's

oversight functions could play a vital role to improve debt management situation of the country and being an officer of BCS Audit and Accounts Cadre, it is also an inspiration for me to choose this area for dissertation.

1.2 Aim and objective of the study

The main concentration of the study will be on debt management in Bangladesh during the period 1996-2007. The main reason behind this is that in the beginning of late nineties the country initiated a lot of financial reform programmes to strengthening debt management system along with other financial area. But debt situation of the country is not improving much. It's not only shown increasing trends in domestic borrowing but also suffered with hard supplier's credit and donor's strong conditionality.

The main focus of this study will be to examine whether Bangladesh debt management system is working efficiently. To reveal this, debt structure, debt sustainability and macroeconomic situation, existing regulations, oversight mechanisms/ practices, control and also performance of debt management systems will be examined. The Bangladesh debt structure will then be compared with some of the developing countries and with the successful debt management countries around the world as per literatures. It is also mentioned that available Public Debt management Information/Reports published by Finance Ministry , External Resource Division (ERD) and Bangladesh Bank (Central Bank) and other literature available regarding debt management will be reviewed in the study.

1.3 Justification of the study:

Economic catastrophes have affected Bangladesh economy throughout the period of 1990s. The country suffered from deteriorating debt stock, high inflationary problem, weak public finances along with other structural problems over the decade. Not only is that Bangladesh also one of the countries at the frontline of the impact of *climate change*. The rich world

owes a huge carbon debt to countries like Bangladesh, which suffer most in terms of cyclones, flooding, and other environmental disasters, while at the same time repaying hundreds of millions of dollars of debt each year. So, Bangladesh's public debt management could be an interesting area to explore as debt burden of Bangladesh economy constitutes fundamental causes of many of the problems that the Bangladesh economy is dealing with. In recent years, rising debt burden has become a very important issue that is reflected through the new establishment of a **Resource and Debt Management Division** in Ministry of Finance. It is very relevant to see how does the "Resource and Debt Management Division" is monitoring debt financing closely with joint collaboration of Bangladesh Bank and External Resource Division.

1.4 Analytical procedure of the study

This section of the chapter express the research questions that the study is going to address, data and methodology, limitation and organization of the study.

1.4.1 The key research question of this study is:

Is public debt management in Bangladesh improving?

In order to analyse this research question, the study further divided into four sub-questions. The sub-questions are:

Research Question - **1:** Is the current public debt level in Bangladesh sustainable?

Research Question - **2:** How Bangladesh is applying the debt management mechanisms or tools?

Research Question - **3:** What are the institutional effects of Bangladesh's debt management?

Research Question - **4:** What are the existing regulations to control and oversight mechanism (SAI role) to monitor or evaluate the debt management of the country?

1.4.2 Data and Methodology

This study is totally based on the secondary data available. This would include secondary data published by government and published and unpublished research done earlier on different aspects of debt regime in the country. Bangladesh economic review, 2007 of finance division, Flow of external resources into Bangladesh, 2007 of Economic Relation Division and Bangladesh Banks publications are the main sources of data. Published reports and Guidelines of World Bank, IMF and ADB are also widely used throughout the process of completing this study. For the interest of discussion some data are recalculated from the original source. Further, the internet sources and websites of World Bank, IMF, ADB and Bangladesh Bank are also consulted in this study.

Direct interview method is also adopted to get a view of Officer's who really involved in debt management in order to understand the present governance issues of debt management.

1.4.3 Limitations of data

This study was based on secondary data disseminated by other authors, Central bank website and Ministry of Finance website. In some cases there are some mismatches in data. In those cases effort has been made to follow Ministry data as to keep consistency. However, primary data provided by Ministry and central bank data could be biased. Yet it is expected that due to limited time in making in-depth research, these sources and data will provide sufficient information to support analysis.

1.4.4 Structure of the paper:

Chapter 2 is about, the debt economy of Bangladesh. In this chapter actually provides the information about debt trends in Bangladesh, debt portfolio, debt management structure i.e. some background information

about debt management of Bangladesh. This information play as a motive to look for real debt situation in Bangladesh and what are the sound practice needs to be practices to ensured debt sustainability. **Chapter 3** is all about the theoretical framework of the study focusing on the different debt management objectives, debt sustainability, debt management mechanism and institutional framework and debt regarding control and oversight function. **Chapter 4** is regarding analysis of the information regarding debt on the basis of literature review and also the summery findings that need to be addressed immediately. **Chapter 5** is the final chapter draws some matters that need to consider for ensuring efficient and sound debt management and draws conclusion.

Chapter Two:

Overview of Bangladesh Debt Economy

Currently, debt obligation of the government is at a tolerable level. For financing budget deficit the government has preferred concessional foreign borrowing to domestic borrowing because the lower cost of foreign borrowing.

- Bangladesh Economic Review 2007



Chapter two: Overview of Bangladesh Debt Economy

2.1 Why does Debt become crucial in the economy of Bangladesh :

The main objective of fiscal policy in Bangladesh is to enhance the effectiveness of public expenditure by channelling resources to the appropriate direction and attain faster growth and poverty reduction by mobilizing larger amount of revenue than done presently. With a view to fostering economic growth and accelerating poverty reduction, Bangladesh has been pursuing expansionary fiscal policy since its independence. As a result, total expenditure very often exceeds total revenue which generates fiscal deficit. In the wake of persistent saving-investment gap, export-import gap, and fiscal deficit, a prudent public debt management is an essential issue for sustained macro stability of Bangladesh. (Ezazul & Bishnu, 2006)

Increasing trend of deficit and to fill that gap how did the government responded (deficit financing) is shown in following table-

Table 1: Year wise borrowing position (in crore Taka)

Year	Deficit	External Borrowing	Internal Borrowing
1995-96	10447	6033	4414
1996-97	11700	5975	5725
1997-98	12200	6679	5521
1998-1999	14000	8188	5812
1999-2000	16500	8274	8226
2000-2001	18200	8670	9530
2001-02	16000	8215	7785
2002-03	17100	8241	8859
2003-04	19000	9410	9590
2004-05	20500	10430	10070
2005-06	21500	10700	10800
2006-07	21600	10194	11406

Source: Bangladesh Economic Review 2007

Budget deficit and its financing in Bangladesh, like in many other developing countries, are very important parameters for analyzing monetary

effect as well as the fiscal effects in the country's overall economic development. Many industrialized countries face similar long-term budgetary challenges like Bangladesh and have run persistently large budget deficits in recent decades. These large and persistent budget deficits have generated considerable concern. There is a widespread perception that they reduce growth, and could lead to a crisis if they continue for long or become too large. Thus it is important to examine the sources and effects of budget deficits. (Romer, 2006)

Repayment scenario of debts of our country gives clear idea how far debt burden could hamper the growth of the country when it is on average 50% of total borrowing is shown in following table:

Table 2: Year wise Debt repayment (amount in Crore Tk.)

Year	Interest amount (1)	Principle amount (2)	Total repayment (1+2)	% of total borrowing
1995-96	1740	2576	4316	41.31
1996-97	1756	4524	6280	53.68
1997-98	2319	3986	6305	51.68
1998-1999	2946	2692	5638	40.27
1999-2000	3554	3512	7066	42.82
2000-2001	4126	4682	8808	48.40
2001-02	4520	3199	7719	48.24
2002-03	5574	7820	13394	78.33
2003-04	5842	4828	10670	56.16
2004-05	6503	6229	12732	62.11
2005-06	7545	5360	12905	60.02
2006-07	9154	6165	15319	70.92

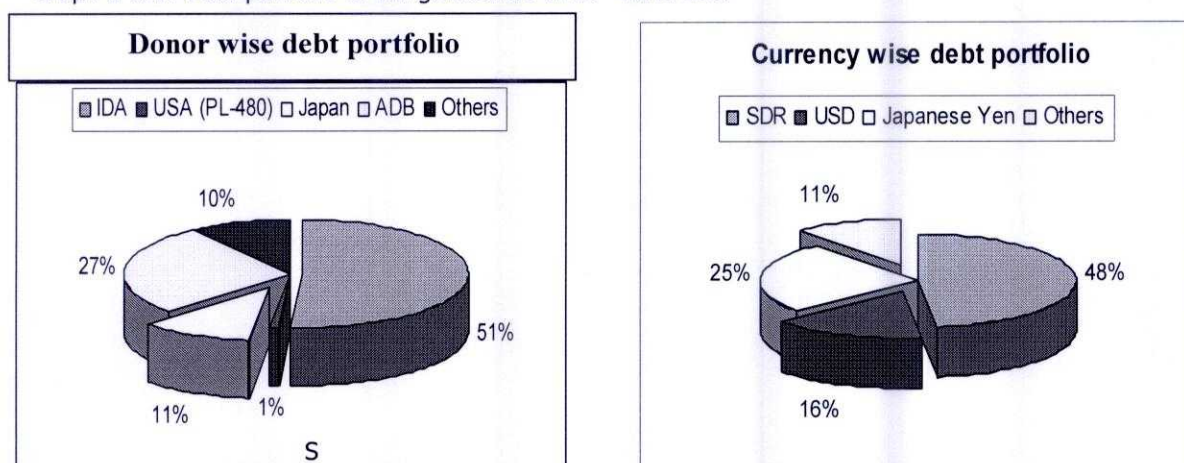
Source: i. Bangladesh Economic Review 2007, ii. External Resource Flow 2007 (ERD), iii. Own Calculation

So if we consider the net borrowing (Borrowing – repayment) is gradually decreasing in every year. In the year 06-07 repayment is 71% of borrowing. Over the years significant changes have been taken place in the total aid package to the country. The share of grants is declining gradually. Bilateral aid which was 75.4% in total aid in 1973-78, has decreased to 24.3% in 2006-07. Multilateral aid, on the other hand, has grown from 24.6% to

almost 75.7% over the same period. The decreasing volume of grants has resulted in a larger proportion of loans in the total aid package. The share of grants which was 88.2% in 1972-73 declined to 36.2% in 2006-07. Furthermore, the flow of food aid and commodity aid has drastically declined. Food aid has declined consistently from 47.9% of total aid in 1971-72 to 3.7% in 2006-07. Commodity aid has similarly fallen from 50.8% to nil during the same period; project aid has increased sharply from 1.3% to 96.3% over the same period. By seeing those trends Dr Debapriya Bhattacharya, former Executive Director for Policy Dialogue, correctly said, *"Bangladesh has regularly paid its debts, expanded exports and are now being punished for its success"*. (Drop the debt fast campaign on 14th April, 2008). Actually, for every dollar in grant aid Bangladesh received, the government paid back over US \$ 1.50 in debt repayments and every dollar paid in debt service is a dollar lost for the Millennium Development Goals.

In case of external borrowing, most of the borrowings were received from IDA and ADB and those are multilateral. If we consider currency wise debt then SDR and USD are dominant. Debt portfolio is shown in the following graph.

Graph 1 & 2: Debt portfolio of Bangladesh as of 30th June 2007

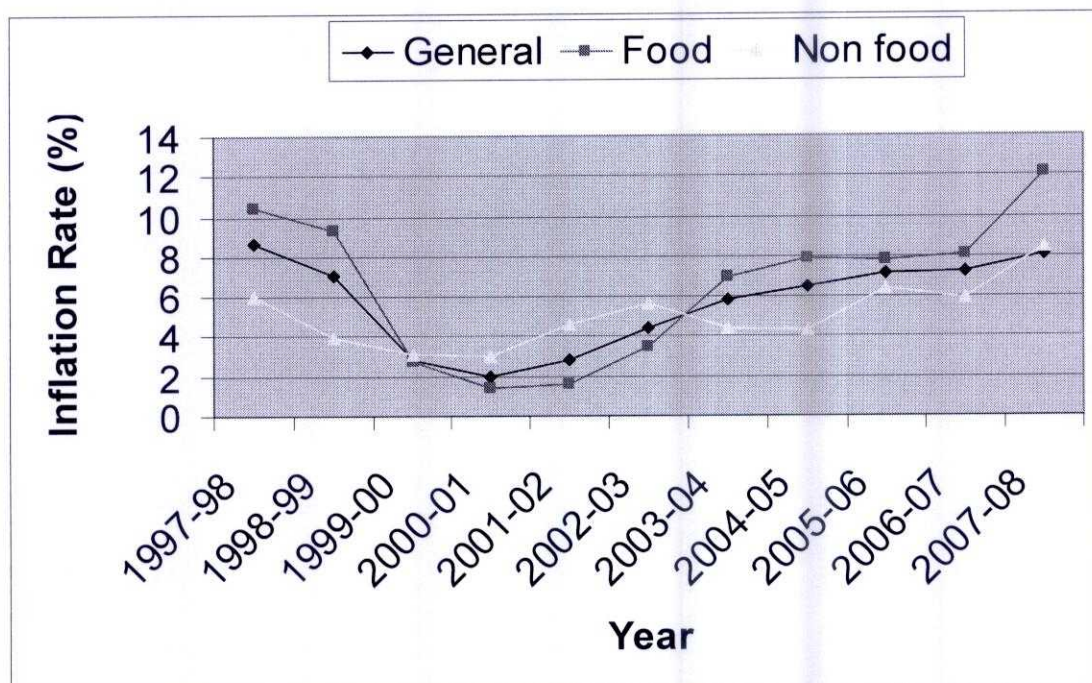


Source: Bangladesh Economic Review 2007

In case of domestic borrowing Bangladesh government usually emphasise on non bank sources and domestic borrowing remains on average 2% of GDP.

On the other hand recent shock in food production boosts up the price of food grains. This situation becomes more complex for particularly for a country like Bangladesh due to price hiking of oil. To meet the domestic demand Government has to take suppliers credit to import oil that worsens the debt situation of the country.

Graph 3: National Inflation Rate



Source: Bangladesh Economic Review 2007

2.2 Debt management Structure of Bangladesh:

Ministry of Finance, Bangladesh Bank (Central Bank) and External Resource Division are the main organ related to Debt Management. Initially Central Bank performs the monetary and as well as debt management functions. Presently Resource and Debt Management Division under Finance Division actually responsible for debt planning, co-ordination,

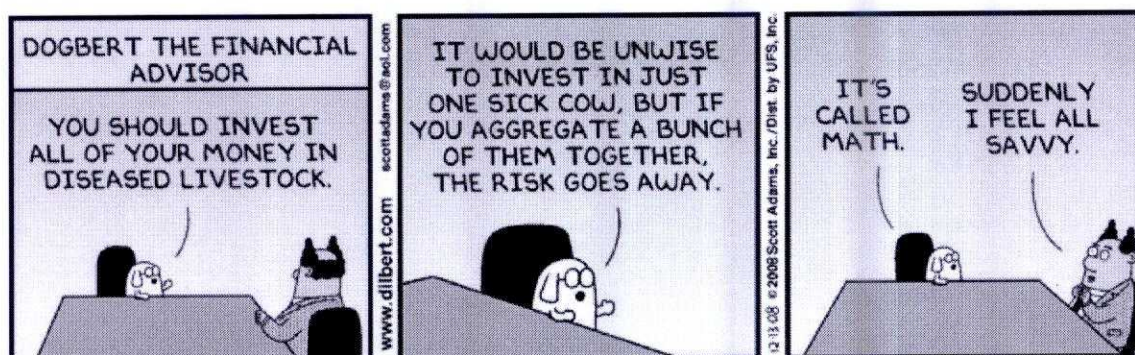
demand placing and also some other related jobs. External Resource Division responsible for external debts and related contract, documentation and reporting and Bangladesh Bank now only perform the monetary management like conducting auction of different treasury bonds for raising domestic debt independently as well as treasury functions. There is a formal provision of oversight function by the Office of the Comptroller and Auditor General (SAI) but still no such oversight report regarding debt management was submitted by the Auditor General Office to the Parliament. Moreover coordination, monitoring activity regarding debt management became difficult due absence of Debt Management Office.

In next chapter, theoretical framework is developed to understand the different debt management concept like debt sustainability, factors that influence debts, and also about best practices- institutional support, policy, regulation, oversight functions. On the basis of that theoretical framework, chapter four is focusing on the present debt management practices of our country. Trend and Ratio analysis of debt related different data would be done in order to know the debt sustainability of the country and also comparing the real situation of different debt management area with and standards that describe in theoretical framework in order to know that does the present situation of debt and institutional arrangement is acceptable or not for sound debt management and explore the area where concentrate/development is needed.

Chapter Three: Theoretical Framework

Debt sustainability can be assessed on the basis of indicators of the debt stock or debt service relative to various measures of repayment capacity (typically GDP, exports, or government revenues). Each of these indicators has its merits and its limitations, suggesting that they should be used in combination.

- (IMF, 2003)



Chapter three: Theoretical Framework

In this chapter, a theoretical framework of public debt management would be drawn based on the literature. This chapter starts with defining the public debt and public debt management. The second section describes the objectives of debt management as described in the literature. The third section provides the issues regarding the use of debt management tools – key decisions to be taken in managing public debt. The next section focuses on managing debt sustainability. The final section of this chapter is concerned about the institution framework of debt management and its oversight function.

3.0 Definition of Key Concepts

Public Debt:

Public Debt arises when government expenditure exceeds government revenue. The expenditure-revenue gap can be financed through government borrowing (public debt). As the government represents the people, government debt can be seen as an indirect debt of the taxpayers.

Usually Governments borrow through using a number of instruments such as Treasury bills, Government notes and bonds, promissory notes, overdrafts or advances from the central bank and savings certificates. Less credit worthy countries sometime borrows directly from commercial banks or Multilateral Agencies. Government can also borrow from external sources.

Public debt is the concern of fiscal management of the country that include only public sector Internal and External debt whereas External debts not only consider the external public debt but also private external debt. (IMF, 2003a) So the diagram of following page shows a considerable overlap, both public and external debts include public external debt.

Figure 1: Composition of Public debt

	EXTERNAL DEBT Concern of foreign exchange management	
PUBLIC DEBT Concern of fiscal management	A. Public sector external debt	B. Public sector domestic debt
	C. Private external debt	D. Private domestic debt

(Source: UNCTAD Debt Management and Financial Analysis System (DMFAS))

3.1 Public Debt Management

Public debt management, narrowly defined, is about decisions on the type of stocks used and the sources of government borrowing. More broadly, it is also about maintaining a level of public debt which is conducive to macroeconomic stability. The former may be referred as the debt management tools, while the latter is primarily about debt management over time.

A joint publication of IMF and World Bank (2001) states:

“Public debt management is the process of establishing and executing a strategy for managing the government’s debt in order to raise the required amount of funding, pursue its cost and risk objectives, and to meet any other public debt management goals the government may have set, such as developing and maintaining an efficient and liquid market for government securities.”

The above definition of public debt management leads a number of questions that are usually addressed when dealing with it. The questions are:

- **How to borrow (maturity structure)?**
- **From where to borrow (domestic or foreign)?**
- **How much to borrow (debt sustainability)?**

3.2 Does Public Debt Matter?

Governments spending requirements can be fulfilled through debt or increasing taxes. The Ricardian equivalence hypothesis (Barth and Hemphill, 2000) states that borrowing is no more than deferred taxation as government's debt-financed tax cut will lead to higher taxes in future. The decision regarding whether to finance government expenditure through taxes has no economic consequence. Barro (1999 cited in IDB, 2006) presented a formal framework of Ricardian equivalence and recognised that debt management matters when taxes are distortionary. The literatures in public finance show that tax smoothing policies minimises distortions. As a result, any change in the tax-debt policy would have real effects and contravene Ricardian equivalence.

Most economists agree that Ricardian equivalence is dubious to hold in practice (IDB, 2006), also known as the 'conventional view'. This view states that debt management has important effects both in the short and the long run. The conventional view holds the notion that a debt-financed tax cut has a positive effect on output in the short run and thus can be used to speed improvement from a downturn. Two conditions are required for such positive effects. **The first one** reveals that the Ricardian equivalence has no existence. It points out that financing through debt and cutting taxes would lead increase in aggregate demand through increased consumptions of households. **The second point** is that there might be increase in aggregate demand in the short run but the price does not vary as it takes time to change. However, in the long-run the debt financing may result in lower output due to increased consumption and reduced saving which would in turn, results crowding out private investment.

Empirical evidence is very limited which supports the debt neutrality hypothesis. Though in industrial countries this is partially true through decreases in government savings, in developing countries the hypotheses find no support (Barth and Hemphill, 2000). Rather, research focusing on developing and emerging market countries has shown that an independent

monetary policy is affected by higher levels of public debt which becomes more evident when share of foreign currency denominated debt is higher (Calvo and Reinhart, 2002 cited in IDB, 2006).

Finally, in many cases like developing countries a rising share of revenues devoted to debt service payments—even if financed by new aid flows—weakens a government's ability to implement its own policies, particularly as aid flows are often earmarked. The result can be a severe loss of ownership that undermines public support for policy reforms and brings governments under pressure to renege on their debt-service obligations. (Allen, 2004)

3.3 Purposes of Debt Management

According to Graham Wafa a sound public debt management is necessary-

- To finance approved projects/programs and overall budget deficits
- To do so at a minimum overall cost (interest and transaction charges)
- To promote capital market development
- To support monetary policy
- To encourage saving (Wafa 2007)

3.4 Objectives of Public debt management

Every country should have clear debt management objectives that may vary from other countries. Explicit debt management objectives clarify the aims of debt management activities which is also a precondition for formulating a debt management strategy and for evaluating its implementation (World Bank, 2007). The starting point for the discussion of objectives of public debt management is found in the seminal paper of Tobin (1963 cited in Montiel, 2005; Abedian and Abraham 1998 and Wolswijk and Haan, 2005). Tobin regarded public debt management primarily as a tool of macroeconomic stabilisation and minimisation of interest as the secondary role.

A key objective of public debt management may be the creation of certainty in the fiscal-resource stream (IMF and World Bank, 2007; Abedian and Abraham 1998). The financial certainty indicates both the financial inflows (borrowings) and the outflows (cost of borrowing or debt service). Governments need to ensure that they can borrow whenever they need and at the same time it needs to ensure *available liquidity position to service debt*. This would in turn help the governments to achieve creditworthiness.

The next important goal of public debt management is to select a debt structure at minimum possible debt servicing cost (IMF, 2001; Abedian and Abraham 1998, Wolswijk and Haan, 2005). This objective is justified on welfare grounds (Montiel, 2005). To see how, the rise in the debt service cost has to be financed by additional taxes or by issuing new debt. Taxes might be distortionary or costly to collect which might impose 'excess burden' on the economy. On the other hand, issuing additional debt has implications for government solvency at the margin. Both of these options hence entail macroeconomic implications.

There are differences in setting debt management objectives in developed and developing countries. It is perhaps possible to set simple objectives in developed countries which focus on covering government borrowing need at minimum cost. (Commonwealth Secretariat, 1999). There is less concern regarding other objectives like price stability. However, debt managers in developing countries cannot do so as most developing countries differ from advanced countries. The latter have developed security market. Moreover in those countries fiscal deficits and inflation are not so overwhelming. In developing countries, on the other hand, almost the opposite scenario prevails.

So, if Debt is poorly managed, it would have excessively negative effects on the economy. This reason behind this is that two chief macroeconomic prices, the interest rate and exchange rate, could be affected by the poor public debt management. It becomes more obvious especially when

Debt/GDP ratio is high and when the Public Sector Borrowing Requirement (PSBR) are relatively high in the domestic capital market, (Abedian and Abraham 1998).

3.5 Debt Sustainability

The concept of debt sustainability in low-income countries is different from that in middle-income countries that rely primarily on private financing. While low income countries are a diverse group—ranging from poor countries with weak policy records and histories of war and civil strife to relatively advanced economies that have some access to private capital inflows and are on the verge of becoming emerging markets—most countries in this group rely predominantly on official financing. As a result, the sustainability of their debt—i.e., the condition that this debt can be serviced without resort to exceptional financing or a major future correction in the balance of income and expenditure—is largely de-linked from the sentiments of the market, as embodied in spreads on market interest rates. Indeed, to the extent that donors and creditors base the allocation of new aid flows on the implied *net* transfers to recipient countries—effectively providing more gross transfers to those countries with higher debt-service payments—debt sustainability is a particularly blurred concept in these countries. Debt can be serviced for long periods, or suddenly become unsustainable, depending on the willingness of official creditors' and donors to provide positive net transfers through concessional loans and grants. Even though the risks are different, excessive debt in low-income countries is a serious problem, and debt sustainability remains an essential condition for economic stability. (Allen,2004)

The sustainability of public debt is a function of key variables; among others, the real growth rate and the real interest rate. A fiscal stance is ultimately not sustainable if it leads to an ever-increasing ratio of debt to income. To assess fiscal sustainability, it is necessary to estimate whether this ratio will rise, fall, or remain stable in the immediate period ahead. Since the primary budget balance (the conventional fiscal balance less interest payments)

determines the rate at which new debt accumulates or old debt can be retired, it plays the central role in assessing fiscal sustainability (Makin, 2005). Bohn's (1998) method tests the relationship between public debt and primary balance. Bohn's basic notion is that if a government improves its primary balance when it sees an increasing public-debt/output ratio, then its public debts are sustainable in the long-run. If not, public debts are not sustainable.

In literature, different equations were developed to test debt sustainability. Here **Ley's (2003)** debt dynamics equation is chosen to explain the debt sustainability.

Total Debt Dynamics:

$$1. \text{ Change of Total Debt: } \Delta d_t = \frac{r_t - \Pi_t (1+g_t) - g_t + \varepsilon_t \alpha^f (1+r_t)}{(1+\Pi_t)(1+g_t)} * d_{t-1} - (pd_t + \gamma_t)$$

Where,

Δd_t = Change of debt/GDP ratio at t time

d_{t-1} = Stock of debt/GDP ratio

g = real GDP growth

r_t = Nominal interest rates of government treasury bill and savings certificates

ε_t = Exchange rate appreciation/ depreciation

α^f = Share of foreign debt

Π_t = Rate of inflation

pd_t = Primary budget balance

γ_t = Stock change of high powered money to GDP ($\Delta M/GDP$)

2. Stress tests for shocks in different components:

a. Contribution of real interest rate: $r_t - \Pi_t (1+g_t) / (1+\Pi_t)(1+g_t) * d_{t-1}$

b. Contribution of the real growth rate: $g_t / (1+\Pi_t)(1+g_t) * d_{t-1}$

c. Contribution of the exchange rate depreciation/ appreciation:

$$\varepsilon_t \alpha^f (1+r_t) / (1+\Pi_t)(1+g_t) * d_{t-1}$$

3. Stability of debt/GDP ratio: $[\Delta d_t = i_t - g_t / 1+g * d_{t-1}] - (pd_t + \gamma_t)$

if want $\Delta d_t = 0$ then $i_t - g_t / 1+g * d_{t-1} = (pd_t + \gamma_t)$, where i_t = Real interest rate. It is implied that it required government primary surplus (including seignorage). The larger the real interest-growth

differential, $i_t - g_t$, the larger the required surplus. If the interest-growth differential is zero, $i_t - g_t = 0$, then $\Delta d_t = p d_t + \gamma_t$

4. Explosive debt-dynamics (EDDs): The EDDs are underpinned by the following equation:

- i. If $(1+i)/(1+g) < 1$, then debt-dynamics convergent and
- ii. If $(1+i)/(1+g) > 1$, debt-dynamics is explosive and adjustment gets larger and larger over time.

Above equation consider the combined effects of certain macro variables namely the interest rate, the exchange rate, budgets deficit and GDP growth on changes in debt/GDP ratio.

It is important for developing countries because *Debt service* is the most obvious measure of the immediate burden that debt imposes on a country by crowding out other important uses of scarce resources by the borrower. **Debt service ratios** provide the best indication of this claim on resources and the associated risk of payment difficulties and distress. In the same vein, low and stable debt-service ratios are the clearest indication that debt is likely to be sustainable. However, in light of the back-loaded repayment profiles typical of concessional debt, current debt-service ratios may understate the burden inherent in the existing debt stock. Debt stocks provides a useful shorthand measure of the future debt service burden inherent in *existing* debt and the choice of the most relevant *denominator* depends on the constraints that are most binding in an individual country, with GDP capturing overall resource constraints, exports those on foreign exchange, and revenues those on the government's ability to generate fiscal resources. In general, it is useful to monitor external debt in relation to GDP and export earnings and public debt in relation to GDP and fiscal revenues. Similarly, external and public debt services are usefully expressed relative to exports and revenues, respectively. (IMF, 2003b)

For these reasons, it is best to base debt sustainability analyses on a variety of indicators, acknowledging that each is important in signalling current or

prospective constraints that a country may face in meeting its debt-service obligations. (IMF, 2003a)

Table 3: Debt ratios -Indicators of debt sustainability

Debt indicators	Interpretations
	<u>Solvency:</u>
Interest service ratio	Ratio of interest payments to earnings from exports of goods and services indicates the terms of external debt burden. It also indicates the level of current earnings needed for the debtor in servicing the debt.
Debt Service ratio	The ratio of debt service payment to exports of goods and services indicates how much of a country's export revenue will be used up in servicing its debt.
External debt to export ration	The debt to exports ration provides an indicator of solvency, since an increasing debt to exports ration indicates that the country may have problems meeting its debt obligations in future.

	<u>Liquidity</u>
Reserve to imports ratio	An important indicator of reserve adequacy
Reserve to short term debt ratio	This ratio can indicate vulnerability to a liquidity crisis in the event of capital flight on account of short term debt.
Interest payment to reserve ratio	Measures the internet payment of all debt which could be covered by usable reserves.
Short term debt to total debt ratio	Measures the relative importance of short term debts (all debt with residual maturity of less than one year) in total external financing measures the extent of vulnerability in the event of the liquidity crisis.

Source: International Monetary Fund (2003), " Guidelines for Public Debt management", prepared by the Policy Development and Review Department

3.6 Public debt management Tools (Decision mechanism)

Level of Government borrowing is determined according to the fiscal policy. Public debt management has to accept these policies given. The management decisions are then about choices over the types of bond issued, the maturity structure of government stocks (short term vs. long term, and

domestic vs. foreign borrowing, nominal vs. indexed debt and currency denomination of debt.

Figure 2: Debt management decision mechanism

Short term borrowing Vs. Long term borrowing	Domestic borrowing Vs. Foreign Borrowing	Currency Denomination: Domestic Vs. Foreign
	Nominal bond Vs. Indexed Bond	

Source: Own

Theoretically, all options are available to the government, each option having its own advantages and disadvantages. Government has to choose the best option keeping its own debt management objective in mind. In practice, this need to be achieved according to prevailing circumstances in the capital markets, the existing debt and its term structure, and its composition with respect to domestic and foreign debt.

3.6.1 Long term vs. short term debt:

Maturity of government debt is a key consideration in debt management, as reflected both in academic literature and in practice (Wolswijk and Haan, 2005). Theoretically, issuance of short term debt is cheaper than issuing long term debt if the normal term structure exists. As a result, the objective of minimising borrowing cost tempts the governments to go for short term financing. However, refinancing risk is higher for short term debt as frequent refinancing risk of having to refinance debt at higher interest rate. Financing at short term rates adds to the volatility of budget balances and of household disposable income.

A large stock of Short term debt can create vulnerability to self fulfilling confidence crises (Alesina et al. 1990). On the other hand, A confidence

crisis in public debt management is less likely if the average maturity of debt is longer, if the rollover of the outstanding stock of debt is more evenly smoothed out over time, and if the government has better access to foreign credit lines in the event of a debt panic (Giavazzi and Pagano 1990 cited in Montiel, 2005). Political instability may affect the debt maturity as considered by Miller (1997, cited in Wolswijk and Haan, 2005). Inflation uncertainty can be caused by political unrest, which might push the interest rate in the long-term. Governments as result might be induced to issue debt with short term maturity which could be a large proportion of total debt.

3.6.2 Currency Denomination of Debt:

Currency denomination of debt instruments is less debated in the literature than the choice between nominal and indexed bonds, although there are similarities between indexed bonds and foreign currency bonds (Gilson and Gerard, 2002 cited in Wolswijk and Haan, 2005). Both types of security can be seen as commitment devices, protecting bondholders against domestic inflation and thus weakening incentives for government to push for high inflation.

Focusing on the debt variables Falcetti and Missale (1999) found a strong and significant effect on the growth rate of foreign currency debt: an increase of such debt significantly reduces the probability of devaluation. The impact of the debt to GDP ratio and of the share of foreign currency debt is also as expected, though not significant; a higher debt ratio increases the likelihood of devaluation while a higher share of foreign currency debt reduces it.

On the other hand, a real exchange rate depreciation triggered by independent events will increase the Governments debt servicing costs and the consequence would be distortionary taxation or a government default as in Argentina in 2002 (Montiel, 2005). Furthermore, issuing non-domestic debt is sometimes avoided for reasons of prestige, as recourse to foreign

currency debt may be regarded as a sign of financial weakness (Wolswijk and Haan, 2005).

3.6. 3 Nominal vs. Indexed debt

Research findings has emphasized that the existence of a large share of long term nominal debt might have important consequences in macroeconomic performance (Montiel, 2005). The optimality of inflation indexed debt as the share of government debt is determined through these consequences. With an indexed bond, the interest and maturity value are adjusted by the rate of inflation over the life of the bond. Shen (1995) argues that the cash flow of an indexed bond is adjusted for inflation so that, the bond's real value does not vary with inflation and which would be able to protect investors and issuers from inflation risk. Moreover, combined with nominal bonds, indexed bonds would provide policymakers with additional information on real interest rates and inflation expectations. She concludes that inflation indexed Treasury bonds are likely to be beneficial if carefully designed.

However, for governments the potential disadvantages of issuing inflation indexed bonds include reduced predictability of nominal interest payments, resulting in larger sensitivity of budgets to inflation, and greater volatility, unless revenues are also inflation sensitive.

3.6. 4 Domestic vs. Foreign (external) debt:

The balance between the domestic and foreign components of the public debt is a central policy issue (Abedian and Abraham 1998). In the 1980s the major problem facing many developing countries was how to deal with external debt. Domestic debt was relatively insignificant and little discussed. Domestic debt levels have risen, often in very same countries which faced acute external debt problems (Commonwealth secretariat, 1999). Theoretically, domestic borrowing may lead to higher interest rates and crowding out of private investments and may be inflationary. On the other

hand, foreign borrowing has to be repaid in foreign currency, putting strain on the exchange rate and the country's capacity to export.

In theory, there is no optimal ratio for domestic and foreign debt that should be maintained by a country. The level of foreign borrowing and its possible limit will be determined by the extent of net financial gap of the public sector, the amount of amortization falling due, and the balance between domestic and foreign borrowing (Loser, no date). However, the balance between domestic and foreign financing goes to the core of macroeconomic management.

3.7 Institutional Framework

Sound public debt management requires an institutional structure that clearly delineates roles, responsibilities, and reporting channels for the relevant institutions (World Bank, 2007). The organisational structure of debt management is linked to prevailing views on the goals that debt management should aim at. Putting the emphasis on macroeconomic stability naturally leads to the debt management task being entrusted to the Ministry of Finance. Fear of interference to the monetary policy, on the other hand, may lead to operational responsibilities being assigned to the central bank (Wolswijk and Haan, 2005).

The precise organisation of debt management differs from country to country (Currie et al, 2003). Countries considering the reduced role for macroeconomic considerations in determining debt management objectives allowed debt management units more independence in 1990s. Recently, in an endeavour to increase the efficiency of debt management, some governments delegated the operational dimensions of debt management to separate debt management offices (SDMOs).

Currie et al. (2003) identified characteristics of emerging countries which includes the characteristics of developing domestic markets such as lack of

co-ordination between debt management and monetary policy, problem of controlling impact of debt servicing on budget the problem of controlling contingent liabilities, lack of accountability mechanisms and significant interdependence between debt management and macroeconomic policies. He suggested modernisation of DMO within the MoF model would be suitable for such countries however also pointing that low salaries of the staffs in the ministries are the barrier of this model which fails to attract competent staffs.

According to United Nations Institute for Training and Research (UNITAR), the change in the international economic environment and the new requirements for debt management are leading countries to review the institutional arrangements for public sector borrowings and their management. They believe this institutional arrangement should be in three types- Front, Middle, and Back. The **Front Office** will be responsible for Resource Mobilization and make the major decision on foreign and domestic borrowings based on the approved borrowing plan. It will also take responsibility for on-lending and guarantee operations and hedging and derivative transactions of the government. The **Middle Office** will be responsible for debt and risk analysis. It should undertake portfolio analysis, develop a risk management strategy and develop borrowing scenarios and compare the emerging debt indicators with agreed benchmarks. This would enable sustainable levels of public sector borrowings to be estimated and a borrowing policy and plan for public sector borrowing to be prepared. The front office should formulate a strategy for implementing the borrowing plan by mobilizing resources from domestic and foreign sources with the assistance of middle office and the Back Office will be responsible for the Management Information System (MIS) and settlements. It will make debt service payments based on creditor invoices that are crosschecked with its own database and also be responsible for monitoring loan utilization and the preparation of accounting and other reports required by creditors and the government. Straddling all three offices will be a legal group whose principal function will be to support the activities of the Front and Back offices. The three offices will be interdependent and exercise checks and balances over each other in the interests of transparency and accountability. (UNITAR, 2002)

Kraay and Nehru (2004).believes among the factors that influence the debt levels countries can sustain, the quality of policies and institutions turns out to be a key

determinant. Countries operating in a weaker institutional and policy environment are likely to experience debt distress at significantly lower debt ratios, as such countries tend to be more prone to misuse and mismanagement of funds and less capable of using their resources productively.

So, an important empirical finding is that there is significant *dispersion* in the debt ratios that countries can sustain, and that the quality of a country's macroeconomic policies and institutions has a crucial bearing on the levels associated with distress.

3.8 Accountability and oversight function of debt management:

3.8.1 Legal Framework

Laws should assign the responsibility for managing the public debt to a single authority, here called the Debt Management Office. Normally, public debt comes within the mandate of the ministry of finance. There may be laws limiting aggregate borrowing, e.g. to a percentage of the GDP or to absolute limits revised from time to time by the legislature. Laws may also prescribe the methods of raising debt and reporting debt flows and stocks.

3.8.2 Transparency

Financial crises in Russia, Southeast Asia and Brazil have shown how poorly risks had been assessed, monitored and controlled. Unreliable financial and economic data is partly to blame. Market participants and policy makers had difficulty assessing the financial vulnerability of the economies and of their government because of the limited set of data.

To ensure transparency, annual budget and accounts should show the amount of borrowing and repayments each year, and the aggregate debt at the end of each year. It is also noted that a significant proportion of government debts are often held by the government itself, e.g. in sinking funds for the redemption of debt, and in social security funds. Contingent

liabilities (which materialize only on the occurrence of a specific event) are not included as liabilities (even under an accrual system of accounting), but their nature and fiscal significance should be described in notes to the government accounts. Examples are guarantees on the debts of public enterprises. In the revised IMF system of Government Finance Statistics (GFS: 2nd draft Dec. 2000), which closely follows the definitions and classifications in the UN System of National Accounts (1993), liabilities are classified according to the residence (domestic or foreign) of the debt holder (person or organizational unit to whom the liability is owed). Liabilities are then further broken down according to "the liquidity and legal characteristics of the instrument that describes the underlying creditor-debtor relationship. The liquidity of a financial instrument embraces characteristics such as negotiability, transferability, marketability, and convertibility" (IMF, 2003a).

The IMF Code of Fiscal Transparency and the OECD Fiscal Transparency Guidelines also require that liabilities be classified by their currency denomination, by whether debt carries a fixed or variable rate of interest, and whether it is callable. In the budget, a sensitivity analysis should show the impact that changes in interest rates and foreign exchange rates would have on financing costs. (Barrow 1999)

3.8.3 Oversight role

Supreme Audit Institutions have no direct role to play in the establishment of public debt management, data disclosure policies and regulatory regimes for the financial services sector. A SAI's ability to influence and persuade public debt managers will depend on its powers, responsibilities and credibility. However, SAIs within the limits of their legal authority could have a role in promoting and encouraging policy makers to adopt debt and risk management practices that will be sound and robust.

So, Supreme Audit Institutions (SAI) in addition to their normal oversight and insight functions, like the GAO in the United States and the Board of Audit in Japan, can and should educate government leaders about emerging trends and challenges. As independent, professional, fact-based, and non-partisan organizations, SAIs are uniquely positioned to speak truth to power and help policymakers address key current and emerging challenges in a timely and informed manner. SAIs have credibility, in part, because of their independence. In addition, SAIs should have only one agenda: the public good. Comptroller General of the United States has made the remarks in his speech before 20th public audit forum-

"Many government leaders in Washington, D.C., have decided to live for today rather than prepare for tomorrow. We've heard few calls for meaningful reforms or shared sacrifice as the wave builds silently but surely offshore. In fact, just the opposite has been happening. Despite our long-range fiscal imbalance, in recent years the U.S. federal government has pursued an unsustainable policy of promoting additional spending increases while expanding tax cuts. Among other things, the United States should impose budget controls and take steps to increase transparency and accountability relating to fiscal responsibility and inter-generational equity issues. We are working with a number of elected officials on a bi-partisan basis in supporting such an effort." (David, 2007)

It clearly indicates that audit should suggest government on policy. Here GAO did the foresight audit on debt policy of the U.S. government and warned government about the deficit practice. So oversight role obviously ensured effective monitor of the indicators and help policy makers to formulate sound policy and also help legislature to enact effective rules regarding debt management.

To do that SAI should not only concentrate on post audit, as well as need to concentrate on Performance (Value for money), preemptive/ foresight audit. 20th Public Audit Forum believes that every SAI should follow the psychologist Dr. Abraham Maslow's hierarchy of needs. Maslow believed that people first must meet their "self-preservation" need for things like food, shelter, employment, and personal safety. Once these basic needs are met, individuals then want to satisfy higher needs. At the top of Maslow's hierarchy is self-actualization. Those individuals reaching this stage have made the most of their God-given abilities. These individuals have become the best they can be.

When it comes to supreme audit institutions, there's a similar hierarchy and it is shown in the following figure.

Figure 3 : Supreme Audit Institutions Maturity Model



Source: GAO

Envision a pyramid with six levels, each describing a mission. At the bottom is the most basic mission every government SAI should hope to achieve—fighting corruption. It's essential that civil servants are honest and committed to the public good. After all, any government run by corrupt officials isn't going to accomplish much, other than picking the pockets of its own people. The next level in the SAI pyramid is enhancing transparency, which helps to facilitate progress on all fronts. The third level is accountability. The idea is that all aspects of government should be accountable to the taxpayer for the results they achieve with the resources and authorities they have been given. At a minimum, every SAI, whatever its budget, whatever its expertise, should be fighting corruption, ensuring transparency, and pursuing accountability. The fourth level is enhancing government economy, efficiency, ethics, equity, and effectiveness. The fifth level is providing policymakers with insight and options to make government work better by refining programs, consolidating redundant efforts, or adopting best practices.

The sixth and final level in the pyramid is foresight, a function that more mature and experienced SAIs should consider undertaking and helping policymakers focus on the future. Government decision makers need to develop a long-term perspective,

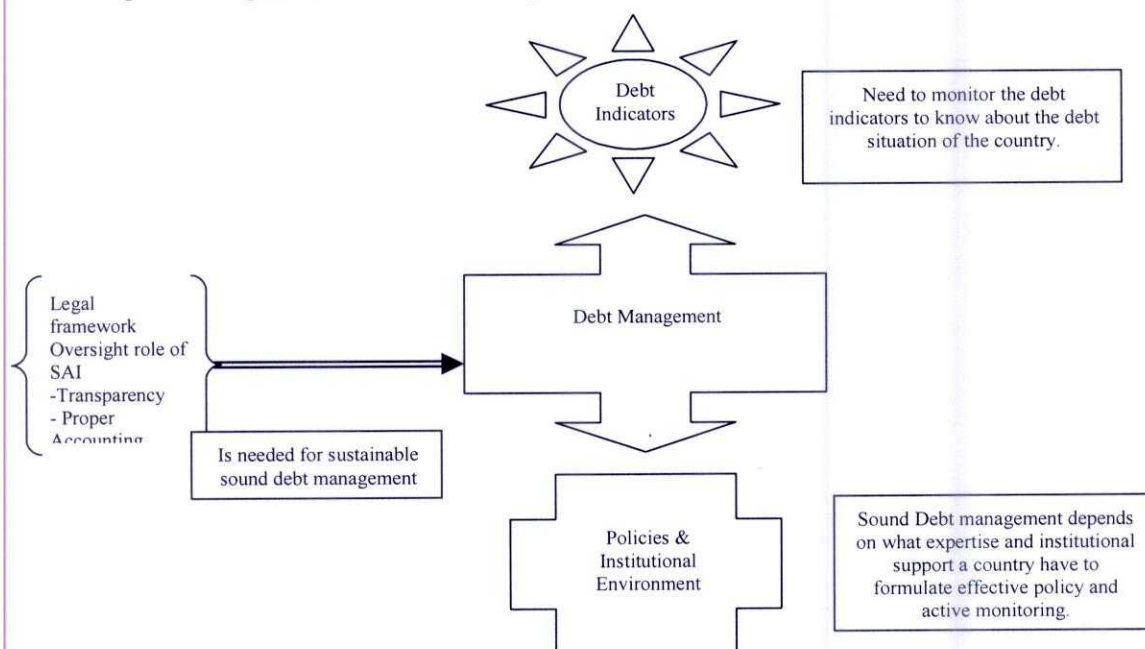
understand the big picture, and appreciate the collateral implications of their actions.

At every level of the pyramid, SAI work needs to be balanced, constructive, and non political in its approach. SAIs shouldn't simply point out what's wrong in government. It's also important to highlight policies and practices that are working well. By sharing success stories and describing best practices, SAIs are more likely to get their governments to transform how they do business. A balanced and constructive approach to oversight is also more likely to build public trust and confidence in government. (David,2007)

In sum, debt sustainability analyses for low-income countries should consist of three elements: (i) indicative country-specific debt-burden thresholds that depend on the quality of individual country's policies and institutional environment; and (ii) an analysis and careful interpretation of actual and projected debt-burden indicators under the baseline and in the face of plausible shocks (iii) Oversight function is also needed not only to ensure best practices through accountability and transparency but also for ensuring sound debt management.

Lastly if I depict the idea what have I learned from the literature review about “ what are the information needed to know about the debt situation of the country and what institutional support is needed for ensuring sound debt management” is shown below-

Figure 4: Organization of debt management

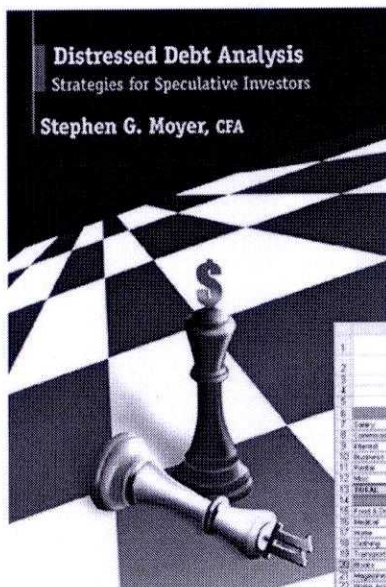


Chapter- Four

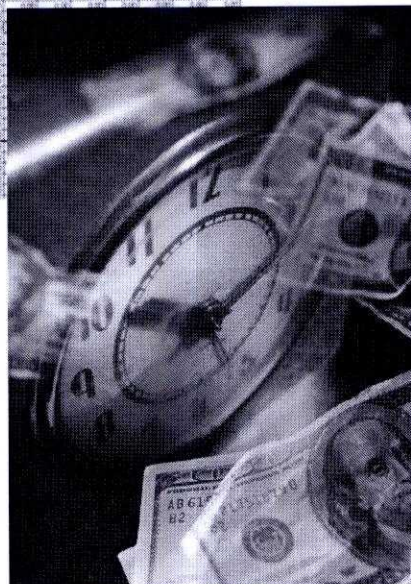
Analysis & Findings

Nearly a century ago, one of my favourite U.S. Presidents, Theodore Roosevelt, said, "We have to, as a nation, exercise foresight.....and if we do not exercise that foresight, dark will be the future." My talk today is about the foresight role that the more Supreme Audit Institutions (SAI) and other key accountability organizations should be undertaking.

- Honorable David M. Walker, Comptroller General of the United States before the 20th Public Audit Forum on 3rd January, 2007, Board of Audit and Inspection, Seoul, Korea



	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
1	Daily Cash Flow Statement																	
2	For The Month of _____																	
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CHAPTER 4: Analysis & Findings

This chapter analyses public debt management in Bangladesh focusing on sustainability of public debt, application of different debt mechanism and institutional effects on the basis of theoretical knowledge that explore in chapter Three. The debt sustainability of Bangladesh is tested from different aspects – broad consensus, standard approach and a resource gap point of view. Second, application of debt mechanism tools in Bangladesh are analysed based on maturity structure of debt, debt denomination, debt indexation and sources of debt (external and domestic). The third part of this chapter focuses on institutional effects of Bangladesh's debt and its oversight functions and obviously analysis has done in a way that it is able to address the research questions properly.

4.1 Research Question One: Is the current public debt level sustainable?

Different approaches (mentioned in Third chapter) like debt Ratios, Leys equation, are used to determine the debt sustainability situation of Bangladesh.

4.1.1 Debt indicators:

We already have learned that Debt sustainability analysis considers the indicators of "solvency" as well as "liquidity" together. This way of analyzing debt sustainability resolves the issue whether a country needs to reduce its debt, as in the case of solvency, or to reschedule and restructure debt to make it sustainable. The common set of solvency indicators has been the ratio of external debt to exports, external debt to national income, debt service ratio and interest service ratio. The level of short-term debt has also been considered an important liquidity risk factor that can precipitate a foreign exchange crisis, especially when coupled with high or unsustainable current account deficits. Recent debt sustainability analysis takes into account the ratio of short-term debt to total outstanding debt and the ratio

of international reserves to short term debt as common indicators of liquidity. So following table gives us the idea why does Bangladesh consider as less indebted country-

Table 4- Solvency debt indicators of Bangladesh

Debt indicators	Interpretations											
	<u>Solvency:</u>	<u>Y E A R</u>										
	Year	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07
Interest service ratio	Total Interest/ Total earnings	1.41	1.38	1.37	1.34	1.35	1.36	1.36	1.35	1.34	1.30	1.28
	Foreign debt interest/foreign earnings	2.4	2.0	2.4	2.2	2.0	1.9	1.9	1.6	1.4	1.2	1.1
Debt Service ratio	The ratio of debt service payment to exports of goods and services	9.2	7.7	10.0	9.0	9.8	9.8	8.8	8.8	8.3	8.7	7.9
External debt to export ratio	The debt to exports ration	226.0	187.2	191.8	189.4	165.3	175.1	165.9	155.6	141.0	116.5	105.5

Source: i. Bangladesh Economic Review 2007, ii. External Resource Flow 2007 (ERD), iii. Own Calculation

Above different solvency debt indicators of last 11 years was never and even in present is not in alarming condition rather it is improving in every year.

Following graph gives us the clear idea in this respect.

Graph 4: Solvency indicators (External debt/export ratio)

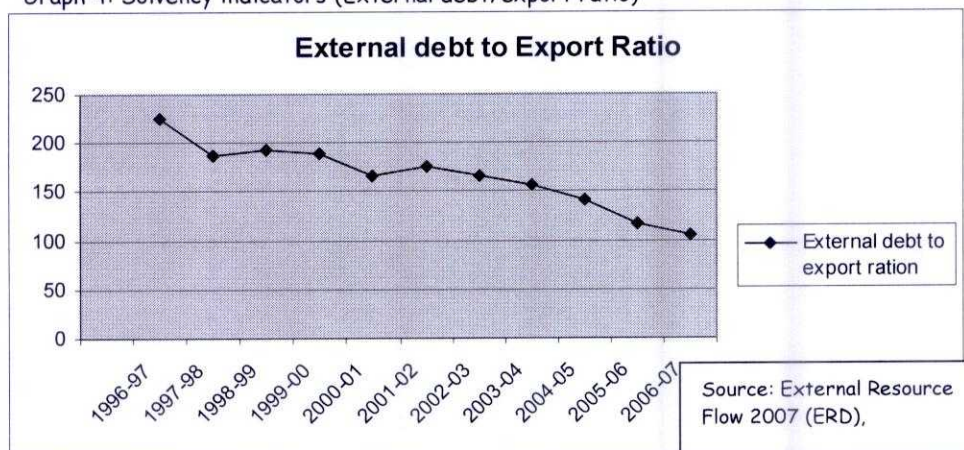


Table 5: Liquidity Debt indicators of Bangladesh:

Liquidity indicators	YEAR										
	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07
Reserve to imports ratio	2.88	2.77	2.28	2.30	1.68	2.22	3.07	2.98	2.67	2.83	3.55
Reserve to short term debt ratio	11.65	13	6.41	10.82	4.41	4.81	7.77	5.99	6.05	4.47	6.12
Interest payment to reserve ratio	0.68	0.72	0.83	0.81	1.11	0.96	0.69	0.71	0.72	0.68	0.53
Short term debt to total debt ratio	0.04	0.04	0.03	0.03	0.03	0.02	0.03	0.03	0.04	0.04	0.07

Source: i. Bangladesh Economic Review 2007, ii. External Resource Flow 2007 (ERD), iii. Own Calculation

So, it is observed that position of different liquidity ratio is also improving. Reserve/Import ratio indicates that on average reserve kept in a way to meet the 2-3 months import demand. Reserve to short term debt is also satisfactory, reserve is on average 7-8 times of short term debt. Interest payment to reserve ratio is also insignificant, on average monthly interest payment is 70% of the reserve. Short term debt is also insignificant; it is only on average 3% of the total debt.

4.1.2 Assessment of Public Debt Sustainability (As per Ley's equation):

As per Ley's equation to assess the debt dynamics in Bangladesh, data on

- real GDP growth rate,
- GDP deflator inflation,
- interest rate (treasury bills and NSD certificates),
- exchange rate,
- reserve money, and
- primary deficit

are used for the sample period of FY 81-06. The estimated results of debt dynamics equations are given in following table:

Table 6: Trends in Change of Debt-GDP ratio and contribution of different component from FY 81-06

Year	Change of ratio of debt (Δd_0)	Interest rate contribution	Growth rate contribution	Exchange rate contribution	Primary budget balance -pd+u	Explosive debt dynamics (EDD)
1981-82	0.025	0.050	0.010	-0.034	-0.072	0.973
1982-83	-0.030	0.047	0.021	-0.074	-0.028	0.969
1983-84	-0.033	0.015	0.029	-0.020	-0.035	0.909
1984-85	0.059	0.039	0.017	-0.016	-0.093	0.957
1985-86	0.030	0.057	0.022	-0.066	-0.079	0.979
1986-87	0.022	0.031	0.021	-0.012	-0.061	0.951
1987-88	0.041	0.052	0.012	-0.010	-0.049	0.998
1988-89	0.045	0.048	0.015	-0.014	-0.062	0.987
1989-90	0.067	0.067	0.035	-0.012	-0.086	0.985
1990-91	0.026	0.067	0.019	-0.034	-0.044	1.006
Average (FY81-90)	0.025	0.045	0.020	-0.029	-0.063	0.967
1991-92	-0.002	0.080	0.031	-0.031	-0.012	1.006
1992-93	0.025	0.081	0.025	-0.012	-0.013	1.033
1993-94	0.027	0.062	0.022	-0.011	-0.030	1.007
1994-95	0.015	0.037	0.027	-0.002	-0.043	0.957
1995-96	0.036	0.073	0.026	-0.006	-0.035	1.000
1996-97	0.020	0.085	0.027	-0.017	-0.021	1.016
1997-98	0.003	0.074	0.025	-0.021	-0.018	0.993
1998-99	0.023	0.083	0.022	-0.020	-0.028	1.010
1999-00	0.038	0.087	0.029	-0.018	-0.037	1.018
Average (FY91-00)	0.021	0.073	0.025	-0.017	-0.028	1.005
2000-01	0.027	0.082	0.028	-0.024	-0.028	1.020
2001-02	0.009	0.070	0.023	-0.023	-0.014	1.013
2002-03	0.018	0.075	0.028	-0.003	-0.021	1.001
2003-04	0.002	0.058	0.034	-0.006	-0.019	0.980
2004-05	-0.001	0.064	0.031	-0.014	-0.018	0.982
2005-06	-0.017	0.070	0.035	-0.026	-0.008	0.982
Average (FY01-06)	0.006	0.070	0.030	-0.016	-0.018	0.996

Source: Public debt management and debt sustainability, by Md. Ezazul Islam & Bishnu Pada Biswas published by Bangladesh Bank, 2006 and own calculation

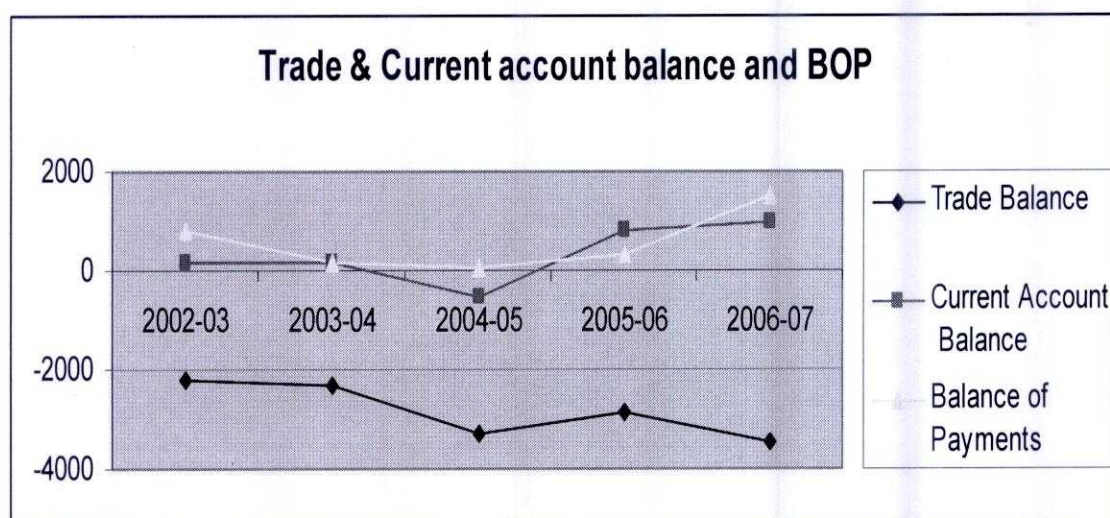
From above table, it is clearly evident that changes in debt-GDP ratio showed mixed trend during FY1981-2006. Change of debt-GDP ratio, on average grew by 2.5% in 1980s, 2.11% in the 1990s and 0.63% during

FY2001-06. Stress test for the different components indicates that the interest component contributed more to changes in the stock of debt-GDP ratio during the whole sample period compared to the growth component's contribution. Net effect of the interest component stood at 6.21% on average during the whole period while growth effects average at 2.46%. Exchange rate component also contributed to about 2.11% during FY81-06 period. The combined effect of primary budget deficit and changes in high powered money to debt-GDP ratio was strong in the 1980s, which gradually eased during the 1990s and FY01-06 due to improvement in primary balances. Estimated results of EDD indicate that some coefficient values of EDD are less than one for some years. Though the values are lower than 1 but close to 1, which indicates debt-GDP ratio to be explosive. (Chapter three: 3.6 bullet point 4, page 23) It needs larger adjustment to become convergent. It is worth mentioning here that during the last three years coefficient of EDD remained below one.

4.1.3 Current Account Balance and Balance of Payments:

More over, Current account balance and overall balance of payments are also improving in every year. All those things have positive impacts on solvency and liquidity position of the country. Following graph shows year wise trend of above mentioned balances.

Graph 5: Trend of Trade and Current account balance



Source: Bangladesh Economic Review, 2007

But the contingent liabilities associated with quasi-fiscal activities of public enterprises are significant and, if combined with the risk Under pricing of energy products by Bangladesh Petroleum Corporation (BPC) and Bangladesh Power Development Board (BPDB), and operating losses by Biman Airlines are creating contingent liabilities that will need to be borne by the government. These contingent liabilities are presently growing by 1–1.5 percent of GDP per annum, and in the absence of an effective strategy to address this problem, the risks of large debt-creating flows in the future are elevated.

In comparison with South Asian countries, debt-GDP ratio of Bangladesh is lower than that of India, Pakistan and Sri Lanka. Debt-GDP ratio for Bangladesh was 50.43% in 2001 while it was 55.92% for India and 148% for Sri Lanka. The ratio for Pakistan stood at 67.9% in 2004.

Table 7 : Trend in Debt-GDP ratio for some selected Asian Countries, %

Year	Bangladesh	India	Pakistan	Sri Lanka
1993	54.23	53.71	79.43	96.80
1994	57.37	55.63	-	94.86
1995	55.68	53.18	-	94.65
1996	49.68	51.03	-	92.34
1997	48.67	49.38	-	85.82
1998	45.66	51.12	79.08	90.84
1999	46.68	51.22	-	95.06
2000	50.51	52.72	74.67	96.90
2001	50.43	55.92	-	148.16
2002	53.85	60.14	-	105.54
2003	52.47	63.30	59.88	105.86
2004	52.26	62.92	67.9	98.82
2005	50.88	64.22	-	-
2006	50.86	62.17	-	-

Source: IFS, IMF and own calculation, hand book of Statistics, RBI

Note: Data for Bangladesh indicate end June.

So the findings of research question one:

Considering the trend of present interest rate, GDP growth rate, exchange rate, inflation, burden of debt services, and debt dynamics, the present level of debt/GDP, ***Bangladesh should be considered at low risk of debt distress based on external indicators, but the risk of debt distress is moderate once domestic obligations are included in the analysis.***

4.2 Research Question Two: How Bangladesh is applying the debt management tools?

4.2.1 Trends in Debt:

Analysing the sources of borrowing - domestic vs. foreign and Short Term vs. Long Term:

In the wake of persistent high fiscal deficit in the 1970s and 1980s, total debt-GDP ratio in Bangladesh, on average, rose sharply from 33.65% during the 1970s to 56.95% during the 1980s. During the period, high levels of public debt triggered growth of monetization and financial repression, including forced absorption of Government bonds by banks and financial institutions ², leading to underdevelopment of financial markets. The fiscal adjustment measures initiated in the early 1990s have brought down the debt-GDP ratio to 51.05% during the 1990s. With 4.53% fiscal deficit, the ratio slightly increased to 51.98%, on average, during 2001-2006.

On the other hand, Total outstanding domestic debt as percent of GDP increased to 19.24%, on average, during 2001-2006 from 12.96% during 1973-1980. Over the period FY 74-06, the nominal value of domestic debt grew at the rate of 13.41% per year. The growth rate was higher during FY90-FY06 as compared to growth registered during FY74-FY90.

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² Banks are allowed to hold Government bonds and securities in maintaining Statutory Liquidity ratio (SLR). During 1970s and 1980s, SLR was about 25% for banks. As a result, the government has raised large amount by selling bonds and securities to banks as well as Central Bank.

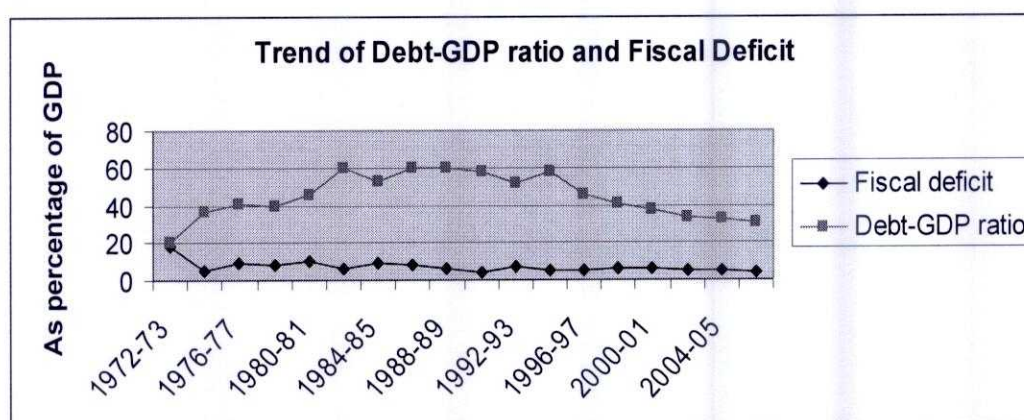
In case of External debt-GDP ratio, it is declined to 32.74% during 2001-2006 from 43.57% in 1980s; the growth of external debt came to 6.65% per year on average over the period 1990-2006 as compared to the year growth of 25.54% during 1974-1990.

Table8 : Average Trend in Fiscal Deficit and Nominal Debt-GDP ratio (As percentage of GDP)

Year	Fiscal deficit	Total debt	Domestic debt	External debt
1970s	7.60	33.65	12.96	20.69
1980s	6.96	56.95	13.38	43.57
1990s	4.70	51.05	12.33	38.72
2000-06	4.53	51.98	19.24	32.74

Source: i. Bangladesh Economic Review 2007, ii. External Resource Flow 2007 (ERD), iii. Own Calculation

Graph 6: Trend of Debt/GDP ratio and Fiscal deficit



Source: i. Bangladesh Economic Review 2007, ii. External Resource Flow 2007 (ERD),

4.2.2 Tools using in domestic debt:

Regarding domestic debt, the accumulation is domestic debt was from mainly three sources:

- Bangladesh Bank,
- Deposit Money Banks (DMBs), and
- Non-banks (including National Savings Directorate; NSD).

Bangladesh Bank and DMBs purchases government securities/treasury bills to finance budget deficit. When Bangladesh Bank purchases

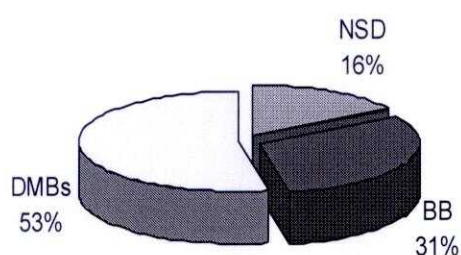
government treasury bills to finance the deficit, it engages in money creation. The interest rates of these instruments are determined on ad-hoc basis and the rates are relatively lower as compared to NSD certificates or fixed deposit rates offered by the commercial banks. Interest rates on different instruments are mentioned in Annex-A.

During the 1970s and 1980s, BB followed administered interest rate policy. In the early 1990s, a market oriented interest rate policy was introduced under Financial Sector Reform Program (FSRP). Subsequently, auction of Government treasury bills system was introduced. As a result, interest rates on treasury bills have been determined through auction since 1995.

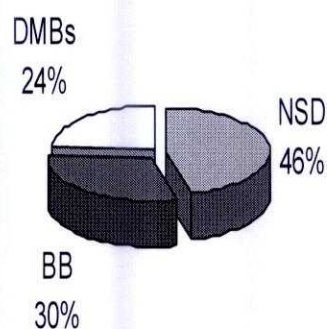
The share of outstanding debt financing from BB in total domestic public debt remained within 30-31% during 1990-2006. In view of growing need of private sector credit, the Government shifted debt financing operation to non-bank sources. The share of outstanding debt financing from commercial banks (DMBs) decreased from, 53% in 1990 to 24% in 2006. Conversely, the share of non bank financing increased to 46% in 2006 from 16% in 1990.

Graph 7 & 8: Composition of domestic debt in different period

Composition of Domestic Debt as of 1990



Composition of Domestic Debt as of June 2006



Source: (Bangladesh Economic Review, 2007)

But growing level of Government borrowing from BB, which increases the level of high- Powered money, grew by 19.76%, on average, during 1990-2006 as compared to 11.30%, during the whole period of FY74-FY06. As a result, the amount of outstanding debt from BB stood at Taka 246.62 billion at the end of FY06 from Taka 16.78 billion at the end of FY91. High powered money (Reserve money) and Broad Money increased by 12.46%, on average and 14.23% respectively during FY90-FY06. Beside this, Government borrowing from commercial banks, which generally affects private credit subject to liquidity position, grew by 16.32% during 1990-2006 compared to 13-70% during 1974-1990.

On the other hand, in absence of a broad-based capital market, private sector relies heavily on commercial banks for both term loan and working capital. Market capitalization-GDP ratio for Bangladesh, a good indicator for capital market base, stood at 6% of GDP in FY05 (DSE, 2006) as compared to 3% in FY01. Thus the credit demand was met by banks and financial institutions which disbursed industrial term loan of Taka 87 billion during FY05 (Annual Report 2006, BB). In this perspective, it may be noted that excessive government borrowing from commercial banks may increase lending rate which may partially crowd out private sector credit.

The growth rate of outstanding debt on NSD certificates averaged at a rate of 25.25% per year during a 16-year span of 1974-1990 as compared to a 20.32% growth rate in 1990-2006. This method of borrowing is expensive. The interest rate is close to market rates but higher than that of the banking system and external financing (Annex-A). However, despite the high interest rate, it is non-inflationary. It dampens inflation and encourages household savings. The outstanding stock of NSD certificates was sky-rocketed to Taka 394.64 billion at the end of FY06 from Taka 93 billion in FY91. Lending and deposits rate of commercial banks are also affected by the high interest rates of NSD certificates (Ahmed and Islam, 2006b). Thus interest rate of NSD certificates is of much significance in maintaining the balance between this form of savings and the Banking system.

The trend in external debt-GDP ratio during the 1990-2006 periods indicates (Table 7: Page 39) that the external debt-GDP ratio declined over time. It came down to 30.25% of GDP at the end of FY06, from 49.56% of GDP at the end of FY88 was the highest during the entire FY74-FY06 period. It may be noted that Bangladesh's external Debt obligation comprises mainly of *public sector debt*. The share of private sector borrowing is negligible; it is less than 4% of the total external debt. The total public sector debt increased from USD 0.501 million in FY 1973-74 to about USD 18.90 billion in FY06. (External Resource Flow 2007 (ERD)),

However, the increasing external debt, together with the expiry of grace periods and unfavorable exchange rate movements has resulted in increased external debt service. External debt service payments on total public sector debt rose from USD 302 million in FY90 to about 644 million in FY06 which represents 6.18% of the country's merchandise exports and 4.23% of total foreign exchange earnings. Despite relatively low cost of external debt services, total interest payment burden in Taka is increasing over time. Total payments went up to Taka 56 billion during FY01-06 from Taka 17.57 billion in 1990s. Out of total interest payments, domestic interest payments stood at BDT 45.67 billion during FY01-06, reflecting higher interest rate of NSD certificates. The ratio of interest outlay to revenue budget reached 20.14% during FY01-06 from 14.27% in 1990s. This trend is shown in following table-

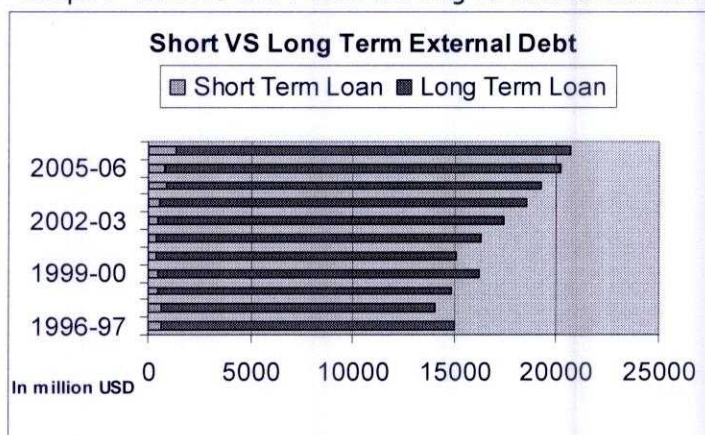
Table 9: Trend in Interest Payment on Total Debt in Bangladesh (Taka in billion)

Year	Domestic	Foreign	Total	Budget Revenue	Ratio of interest outlay/Budget Revenue, %	Ratio of interest to GDP, %
1980s	1.79	2.21	4.01	35.92	10.98	0.84
1990s	11.43	6.14	17.57	117.22	14.27	1.01
2001-2006	45.67	10.34	56.02	279.51	20.14	1.72

Source: Economic Review, 2007 and own calculation.

The ratio of short term and long term domestic debt is 54:46. Following graph shows the ratio of short term and long term debt in regards to external debt -

Graph 9: Ratio of short term and long term external debt.



Source: (Bangladesh Economic Review, 2007)

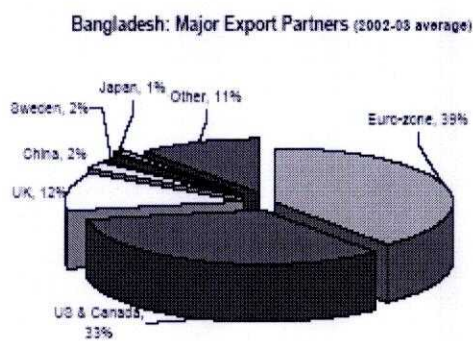
4.2.3 Analysing currency denomination of Debt:

Information about currency wise debt composition of our country is already mentioned in chapter-2 of this report. Our debt is SDR and Yen dominated. But on the other hand our export to Japan is on average 2% and remittance from Japan is also not significant.

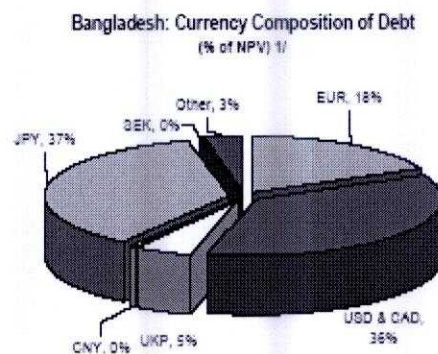
IMF June report, 2006 mentioned by using present value of future flow of debt and export of Bangladesh that mismatch **in the currency composition of Bangladesh's external debt and its exports may deteriorate the liquidity ratio.**

Following graph shows, a large part (37 percent in NPV terms) of Bangladesh's liabilities is yen-denominated. However, since only 1 percent of Bangladesh's exports go to Japan, this analysis cautions that an appreciation of the Japanese yen vis-à-vis other currencies could lead to a substantial deterioration of Bangladesh's external debt ratios. (Steven, IMF 2006)

Graph 10 & 11: Currency composition of debt



Source: IMF DOTS.



1/ SDR allocated to basket currencies using 2005 weights.

4.2.4 Analysing debt indexation

Bangladesh government still not takes any step to indexation of its bond. But Notable progress in the financial sector about nominal debt in Bangladesh in recent years is evident in the separation of debt management from monetary management. Auction is now performed only for the purpose of government financing. This separation enables the central bank to conduct open market operations purely to manage monetary conditions and not for government financing needs. The introduction of an auction calendar and a primary dealer system are also important steps toward development of an active secondary market for government securities. This will help establish benchmark yields and promote the development of a corporate bond market. But further facilitation is needed by allowing greater flexibility of interest rates across all maturities in the primary auctions and developing the new primary dealer system for government securities. So presently Bangladesh Government giving importance towards domestic debts to meet the expenditure of the governments.

So the findings of research question two:

In sum, the analysis regarding the application of debt management tools in Bangladesh shows different results. While the maturity structure shows an

improvement, on the other hand, the currency denomination reflects that foreign currency specially Yen denominated debt are too high which exposes the of exchange rate risk. In addition, Bangladesh could not achieve the CPI indexed bonds which could protect investors against inflation and also secondary market of Government bonds/securities is not properly operated yet. Lastly, the composition of domestic and external debt shows the over dependency on domestic borrowing and consequently crowding out private sector investment.

4.3 Research Question Three: What are the institutional effects in Bangladesh's debt management?

In chapter two it is already mentioned about the Institutional arrangement of debt management in our country and in chapter three we get an idea about what actually institutional support mean.

Already different initiatives have taken to increase the institutional capacity of debt management under financial reforms program that had started in early nineties in our country. United Nations Institute for Training and Research (UNITAR) believe three type of institutional arrangement needed for effective debt management. Front Office is responsible for operation, Middle office is responsible for strategy and policy formulation and back office is responsible for transparency, accountability and oversight issue.

In case of Bangladesh operation side is now doing much better than middle and front office. **Front office** actually consists of Ministry of Finance, Resource and Credit Management Department of Finance Division (for DSL), External Resource Division (for external debt), and Central Bank for Monetary management. So Front offices are more and less organized.

But In case of **middle office** actually there is no formal institution; it is seemed that Resource and Credit Management Department of Finance

Division do some job of middle office. They are now preparing Bond auction calendar (previously it was done by BB), Cash and Debt Management Committee has been established to monitor and project the government's financing requirements. But to do the job efficiently need to do portfolio analysis, need to develop a risk management strategy and compare the emerging debt indicators with agreed benchmarks but those are not still practices properly. It is because of *absence of agreed benchmarks, borrowing policy, Debt strategy and methodical practices of risk analysis*. For those reasons different equipped office set up is needed for middle office in our country immediately.

Back Offices job to ensure transparency, accountability and oversight issue. Actually Office of the Comptroller and Auditor General of Bangladesh (by doing oversight function), Ministry of Finance, Controller General of Accounts, Bureau of Statistics and Bangladesh Bank are responsible for this issue (by doing proper reporting, disclosure). But the fact is that till today SAI, Bangladesh did not perform any policy related audit and also did not do any debt management related audit. Our present accounts disclosure system (Annual and Appropriation accounts) of Controller General of Accounts (CGA), there is no provision to show/understand/ or mention the debt situation of the country. Again different offices published different debt related reports, (Resource and Credit Management Department of Finance Division published reports on public sectors borrowing on the other hand External Resource Division published report on external borrowing) so it become impossible to get a full picture of debt situation of the country in one frame.

It is reality to enhance the capability of the "Debt Management Office" needed proper logistics and human resources. Need to develop a Network among the different debt offices for information sharing that leads towards **e-debt management**. It is also mentioned that present salary structure has no scope to attract the professionals who are expert in this field. But it is highly technical are where experts service is needed.

I also gathered primary information through questionnaire method (Annex-B) from two key Officials of Ministry of Finance and the related findings are shown in following table-

Table 10: Summery information of institutional capacity of debt management that has been gathered by Questionnaire method.

Sub set of Core Indicators	Governance		Coordination		Data	Skills and resources	
	Legal framework and institutional arrangements	Transparency and public availability of information	Inter agency level	Policy level cash, budget and macro policies	Recording, reporting & monitoring of debt data	Human Resources capacity	Computers and debt software
Bangladesh debt management	P	P	✓	✓	✓	P	x

✓ = Represents meeting adequate levels for efficient debt management; x = Represents otherwise and P is partial.

So the findings of research question three:

In summery, Bangladesh has already initiated institutional reforms in debt management. But still it is suffered by lack of coordination, debt strategy, absence of professional risk and portfolio analysis and proper accounting practices.

4.4 Research Question Four: What are the existing regulations to control and oversight mechanism (SAI role) to monitor or evaluate the debt management of the country?

4.4.1 Legislation and Regulatory framework:

In our country the borrowing authority is vested in the Ministry of Finance but there is no **Debt Management Law** in our country. So that, in most

cases ambiguity arises regarding some basic provision of debt management, like: regarding limit of government and government guaranteed borrowing, about a separate ceiling for unguaranteed borrowings of state enterprises, etc. It is also mentioned that there is an absence of practice to place a formal report regarding debt and its related contract before Parliament and also absence of necessary regulations and procedures which set out the explicit roles of the Ministry of Finance, Central Bank, ERD and other agencies involved in loan operations at all stages of the loan cycle.

4.4.2 Transparency:

All countries need to disclose materially important aspects of their debt management operations and information on the government's financial condition and its financial assets and liabilities. The Italian Treasury, for example, maintain an extensive web site that includes information on the government's annual auction calendar, the quarterly issuing program; tender announcements; auction results; and information on government securities and the primary dealers in Italian government securities market. (IMF, 2003)

Regarding Transparency issue- few works already have been done like maintain a Website though it is not extensive, three different reports are published on debt: ERD published "Flow of External Resources into Bangladesh, Assets and Debt Management Department of Finance Division published "Guidelines and Financial Statement of DSL" and Bangladesh Bank published Bangladesh Bank Annual Report. Those three reports actually covered three aspects of Debt management and present reporting system not able to give full picture of debt management in one frame. So it is strongly needed a consolidated extensive debt management report and certainly it would become easier for people/academician to understand the performance of debt management.

As per UN System of National Accounts (1993) financial statement of a country should properly disclose the liabilities i.e. should include contingent liabilities, and liabilities should disclose as currency denomination wise etc. But in case of our accounts actually did not reflect such.

4.4.3 Oversight:

Government auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and in still confidence among citizens and stakeholders. The government auditor's role supports the governance responsibilities of oversight, insight, and foresight. *Oversight* addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. *Insight* assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. *Foresight* identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, and investigation and advisory services to fulfil each of these roles. So, the accountability framework for debt management can be strengthened by public disclosure of audit reviews of debt management operations (MFP, 2003). In some countries like Bulgaria, Croatia, Sri Lanka, and other develop country like UK, Ireland, Denmark etc, the external auditor (usually the "Supreme Auditor"), has publicly called for improvements to the management of public debt, including institutional arrangements, the need for strategy, and better accounting. (IMF & WB, 2007).

But, in our country there is no practice regarding reporting on debt incurred to the Parliament. That's caused too broad an authority to incur debt. This can be due to the absence of parliamentary reporting requirements on debt incurred, or the absence of a borrowing limit or debt ceiling. However, the authority must ensure that existing debt service obligations are met. But

separate financial accounts for the debt management operations at the central bank are not prepared, and thus cannot be subjected to a formal audit.

It is also mentioned that present practice of auditing it was not done to aware the executive about the policy level difficulties, system fault and recommendation for further development. SAI has failed to do so because of the limited scope of traditional regularity and financial audits, the audit office with their traditional tools could hardly make any marked impact in the minds of the legislators and executives about their role in the improvement of management of public resources

So that SAI image to the executive as a “Fault finder” not as a “solution finder”- not play the role of “Aid to the management” rather only focus on rules but not considering the outcomes. The role of audit has to change to respond to what our main clients, Parliament and the public, want. They want to know how public resources are being spent and what they are achieving. They are asking for more accountability and transparency in government operations, achieving of results and realization of objectives.

4.4.4 $g > i$

As per financial management principle borrowing is profitable when Rate of Return (g) is greater than Borrowing rate (i) . In that case borrowing money help to increase the capital base and ensured growth. In our case where Government invest the borrowed money, most of the cases there is no return rather loss and increasing the debt burden. It is due to absence of professionalism in public sector enterprise, corruption, Negative role of Trade union and also for rigid and traditional Bureaucracy. So it is needed to make the Public enterprise profitable and to do that above mentioned hurdles need to be eliminate.

So the findings of research question four :

Actually there is no written debt strategy, debt policy and also there is no laws limiting aggregate borrowing. But those are essential for sound debt management. Moreover in present system there is no provision for reporting to the legislature about the debt flows and stocks- certainly it affects the transparency and accountability issue of debt management. **Contingent liabilities** also are not considered in our country for ascertained future borrowing demand and also Contingent liabilities are not properly disclosed in financial statement of the government and last but not the least, absence of oversight functions on debt management by the SAI.

So Bangladesh is a moderate debt sustainable country and moreover different reforms programs have initiated under a project named "Financial Sector Reform Program" mainly institutional reforms. But there are other area mainly legal issues, transparency issues, using debt tools, and also oversight issues demand effective and more work for ensuring efficient, sound debt management. In the next chapter some recommendation has made to overcome the weaknesses lies in the present debt management and also ensuring a sound, efficient debt management who are able to face the challenges of tomorrow's world.

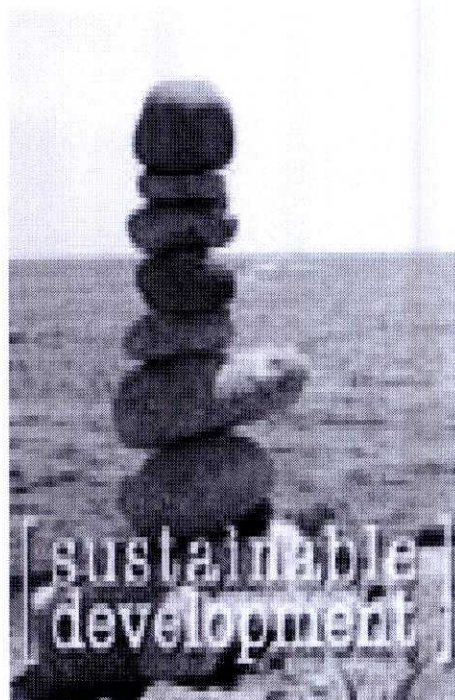
Chapter Five

Recommendation & Conclusion

"Some people see change as bad thing. Yet change is essential for progress and innovation.

Entities that fail to successfully adapt to changing circumstances can see their value diminish and even their very existence threatened over time."

- David M. Walker, Comptroller General of United States



Chapter Five: Recommendation & Conclusion

Poorly structured debt in terms of maturity, currency, or interest rate composition and large and unfunded contingent liabilities have been important factors in inducing or propagating economic crises in many countries throughout history. We have already learned in the preceding chapter that our country is a moderate indebted country and where the pitfalls lie in the present debt management of our country. It is also mentioned that different initiatives have been taken to ensure sound debt management but so far reforms programs have initiated that mainly focused on building institutional capacity but there are some other major area which demand immediate concentration for prudent government debt management, along with sound policies for managing contingent liabilities, can make countries less susceptible to contagion and financial risk and the areas are-

5.1. Innovative in Using debt tools:

Presently the government mostly depends on short term floating interest bearing bond for domestic borrowing and on the other hand in case of external borrowing conditionality is increasing day by day. To overcome this situation Debt Managers need to be innovative to improve its debt portfolio packages. So that it can overcome not only the roll over risk but also currency risk.

In this case we may quote an example of Mexican Debt Management Department- they introduce a new debt tools - debt exchange Warrants. Details of its reinventing thought is describe in following box-

On November 18, 2005, Mexican authorities for the first time successfully sold exchange warrants that gave to investors the right to swap up to US\$ 2.5 billion of bonds for longer maturity, peso denominated bonds (Mbonos). The transaction was a part of the authorities' strategy to shift currency composition of public debt towards the peso and to lengthen its average maturity. By November 2006, buyers had exercised all warrants and exchanged

the total of US\$ 2.5 billion of bonds. As a result of the exchange, the average maturity of the public debt was significantly extended (from 6.4 to 7.8 years to maturity), but while the debt service costs increased to a small degree. Here value of the warrants depended only on the relative price movements of US\$-and peso-denominated Mexican debt, and was immune to exchange rate risk. The latter was borne completely by the issuer. On the day the warrants expired, investors were able to exchange US\$ debt for peso denominated debt at a predetermined ratio, set on the day the warrants were issued, and equal to the ratio of forward prices of both types of debt on the day of the issue. To obtain the face value of the peso debt, the exchange rate from the day of the exchange was applied. Consequently, warrants had positive value (were in the money), if by the expiration day prices of the peso denominated (domestic) debt had increased more than of the US\$ denominated (external) debt, or prices of the US\$ denominated debt had fallen more than the prices of the domestic debt. The entire exchange rate risk was borne by the Mexican authorities. In case the peso had depreciated, investors would have been entitled to exchange their US\$ bonds for peso bonds with a higher face value in case the peso had appreciate, holders of external debt would have received peso debt with lower peso face value, and the issuer-Mexican authorities- would have benefited from a reduction in the domestic debt, while still benefiting from the exchange. (Source: International Monetary Fund (2003), "Guidelines for Public Debt management", prepared by the Policy Development and Review Department)

So like Mexico in order to tackle currency risk we may introduce the above debt tools.

5.2 Development of debt Market:

Need to take proper initiatives for development and maintenance of an efficient market for government securities in order to minimize cost and risk over the medium to long run, and also need to develop proper policies and

operations that would be consistent with the development of an efficient government securities market.

5.3 Proper disclosure of the debt burden:

To ensure that Debt managers should consider the impact that contingent liabilities have on the government's financial position, including its overall liquidity, when making borrowing decisions and also need to proper discloser in financial statement of the country. In that case Debt manager could apply Balance Sheet Approach (BSA). ⁵

5.4 Governance Issue:

Need to enact a debt Act to ensure authority, role, to set limits on government and government guaranteed borrowings, and also about borrowing methods.

- ⊕ Need to establish a strong Mid Office, not only to strengthen the coordination but also for development of sound debt strategy.
- ⊕ Need to develop sound and robust debt strategies, the IMF and the World Bank have developed guidelines for sound practices in sovereign debt and liquidity management. The two organizations have co-operated in the development of broad principles to help governments to improve the quality of their debt management policy and to reduce their financial vulnerability (IMF, 2001). The proposal is not a one-size-fits-all approach. It is a compendium of agreed-upon public debt management practices for which there is convergence of

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⁵"The Balance Sheet Approach to Financial Crisis" (WP/02/210) provided a comprehensive review of the analytical literature on the role that balance sheet weaknesses can play in the genesis and evolution of financial crises. The BSA can be best understood as a comprehensive framework for looking at vulnerabilities that may arise as a result of (i) interactions between debt levels, debt structure (in particular with respect to maturity and currency), and the relevant assets for servicing these debts, and (ii) linkages between sectoral balance sheets.

what is considered prudent and desirable debt practices such as the setting of clear debt management objectives; the separation and co-ordination of debt and monetary management; limited debt expansion; clear delegation, transparency and accountability; and the establishment of benchmarks relating to currency composition, duration and maturity, etc.

- ❖ what is considered prudent and desirable debt practices such as the setting of clear debt management objectives; the separation and co-ordination of debt and monetary management; limited debt expansion; clear delegation, transparency and accountability; and the establishment of benchmarks relating to currency composition, duration and maturity, etc.
- ❖ Need to develop Sound Risk management strategies for protecting a government's fiscal position. Weakening market conditions that are not apparent today may erode the sovereignty of a government and limit its ability to respond to future policy challenge. Sound strategies and risk management should ensure that debt obligations are managed properly and orderly without too much fiscal stress on the budgetary position of the government.
- ❖ Government debt management requires staff with a combination of financial market skills (such as portfolio management and risk analysis) and public policy skills. Regardless of the institutional structure, the ability to attract and retain skilled debt management staff is crucial for mitigating operational risk. This can be a major challenge for Bangladesh, especially where there is a high demand for such staff in private sector, or an overall shortage of such skill generally. Investment in training can help alleviate these problems, but where large salary differentials persists between the public and private sector for such staff, government debt managers often find it difficult to retain those skills.

- ⊕ Need to introduce Information Technology (IT) system to overcome the coordination problems and also for accurate and timely forecasting. E-debt management is important to minimize the rollover risk and market risk.
- ⊕ Need to take the initiatives to increase the rate of return of the public sector enterprise instead of liquidation, so called privatization process. It could be done by appointment of Professional expertise from private sector, by exploration of new market, by product diversification, or contracting out of few jobs and building partnership with private sectors, etc.

5.5 Potential Roles for SAIs: Promoting Good Principles and Practices

Recent events and the globalization of capital markets have heightened the need for sound public debt and risk management practices to better protect the governments' budgetary positions. SAI need to play an active role in protecting the financial condition of governments by promoting the need for sound public debt strategies and risk management practices, data disclosure policies and effective supervisory-regulatory regime for the banking sector so that the risks associated with future obligations and claims of the public sector as well as possible contingent obligations arising from the private sector can be minimized. SAIs should act within their legal authority when adopting these roles. Furthermore, providing guidance is distinct from the auditor's traditional financial attest work, therefore SAIs will not be able to provide the same level of assurance.

i. Promoting Sound Public Debt and Risk Management Practices

Through financial and performance audits, SAI should encourage the adoption of sound and robust public debt strategies and proper risk management practices. The debt strategy recommended to senior officials for approval should be based on a delicate trade-off between costs and benefits

and must have been reached by using forward-looking tools and risks analysis. Not only can sound debt strategies and practices contribute to reduce fiscal vulnerability but also lower interest charges in the long term, which can have a positive impact on debt sustainability.

SAIs could also encourage debt management authorities to give a high priority to sound risk management practices. A government's debt portfolio is often the largest financial portfolio in the country and can generate substantial risk to an economy's balance sheet and to a country's financial stability. Public debt managers should be expected to identify, monitor and control risks. Debt managers should watch for deteriorating economic fundamentals and review the debt strategies accordingly.

ii. To Encourage Improved Data Disclosure and Best Practices Approaches

Good public financial reporting practices will improve the accountability regime of governments and reduce their fiscal vulnerability. More specifically, SAIs may wish to encourage governments to publish leading indicators on the size of the external debt, public debt structure (maturity, duration, fixed-floating ratio and currency composition) and detailed reporting on reserve assets (including liquidity level and foreign exchange position) and capital movements. SAIs could assess how well governments perform in the release of data disclosure.

iii. Promoting the Need for a Proper Regulatory and Supervisory Framework

Through performance audits, SAIs may wish to encourage governments to introduce better supervisory and regulatory functions in the financial sector. It is believed that the widespread adoption of internationally accepted standards and practices dealing for example, with risk management, disclosure and transparency requirements governance, business ethics, and accounting standards could contribute to the well-functioning of financial markets, and could lead to stronger international financial systems. SAI

could highlight the gap between present practices of debt management and International Standard and recommended what need to do to minimize the gap.

iv) Network building:

In many countries Civil society organizations utilize innovative methodologies to complement and strengthen the role that external auditors play in enforcing government accountability. In following diagram it is illustrate how SAIs and civil society organizations can partner each other to improve good governance. When a government is accountable, it means that it is answerable to its citizens and is therefore also responding to their needs. Audits (in their expanded modern versions, which include performance audits) provide citizens with concrete measures of how governments have performed against accepted standards. Civil society organizations can use the information gathered through audits to pressure governments to respond to audit recommendations and improve governance. As such, each institution can complement the other's work in promoting good governance.

Figure 5: Network building



Idea: Own

- SAIs also strengthens their capacity through cooperation with different International agency. INTOSAI and the United Nations are staunch advocates of a closer exchange of experience and best

practice when it comes to innovation in the public administration and strengthening government audit as a contribution to social and economic development.

INTOSAI is therefore convinced that good governance, today and tomorrow, can be promoted in a joint effort by the following:

- Enhanced reporting on public finance and national budgets, and stronger accountability of governments and administrations vis-à-vis parliaments, citizens and the international community, including promoting the adoption of international financial reporting standards;
- More transparency of government action, and active endorsement of the essential role of parliamentary scrutiny, deepening public understanding and media perception of the functions and tasks of government audit, as well as raising awareness with the law-making bodies and the people at large;
- Improving public administration and better public service delivery at greater economy, efficiency, effectiveness, fairness and integrity;
- Preventing and fighting fraud and corruption in the public administration in cooperation with anti-corruption agencies.

Which would ultimately ensure sound practices of debt management in our country.

So, Bangladesh may consider as moderate risk associated country in the field of debt sustainability. It is because of low growth of public enterprise, more dependency on short term domestic borrowing, and one currency dominated external debt. Moreover in Governance area there is an absence of Mid Office, absence of debt strategy, debt Act, reporting mechanism to the Parliament on debt issues and also weak oversight functions. All those

limitations make Bangladesh Moderate risk associated country. After nineties some initiatives have taken under Financial Sector Reforms Program like separation of debt management from monetary management, reforms of banking sector, some steps to strengthening the capital market, etc. But we need to concentrate on above mentioned area immediately in order to ensured sound debt management, so that recommendation that have made may consider to eradicate vulnerability of debt and make Bangladesh “leading by example” in the field of debt management like Micro credit.

5.6 Implications for Further Research

This study focuses on debt sustainability, application of debt management tools and institutional effects while exploring the improvement in Bangladesh’s debt management. Due to time constraints this study did not considers other issues regarding debt management in Bangladesh such as application of debt reduction techniques (for example, privatisation, debt reduction through controlling public expenditure and enhancing revenue). Inclusion of these areas in Bangladesh’s debt management analysis could be more useful.

Epilogue



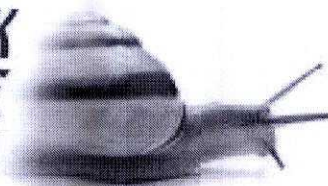
DROP THE DEBT FAST

A 36-DAY ROLLING FAST WILL DEMAND DEBT CANCELLATION FOR 36 POOR COUNTRIES. The rich world needs to *pick up the pace* as these countries are still suffering under a huge debt burden, while millions of their people live in extreme poverty.

The fast will begin as the World Bank and International Monetary Fund hold their Spring Meetings, and end on Sunday 18 May when we mark the **10th anniversary of the Birmingham G8 human chain**. Each day we will focus on one country that urgently needs the chains of unpayable and unjust debts to be broken.

Join the fast for a day or more in your community.
Find out more and register at:
www.jubileedebtcampaign.org.uk/fast

**PICK
UP THE
PACE!**



EPILOGUE:

Economic crisis will bring new world order, global governance and ultimate ensured sound debt management.

- Baron David de Rothschild, Spanish economist



Epilogue

Economy: The Ship of State

Let Picture the economy as a ship loaded with goods absolutely vital to the health of the world, running along in an open, free-market ocean. The ship is buoyed by natural forces of competition and personal incentive, and steered by a series of captains.

The engine has chugged along with little inspection for years, but recently shuddered uncontrollably, belched toxic smoke and froze solid. The mechanics say that engine lubrication has run dry, that the ship is taking on water and is in danger of sinking completely. A consensus of mechanics say the ship must immediately return to shore for repairs. Once problems are fixed, the ship again can sail in free open water.

So, the Present financial crisis of the world is the example of how does a strong economy fall trapped in recession due to absence of proper monitoring, lack of coordination and control over debt, and overall credit management. The **global financial crisis of 2008** is an ongoing major financial crisis, It became prominently visible in September 2008 with the failure, merger or conservatorship of several large United States-based financial firms.

Present financial crisis has undermined consumer and business confidence, triggering a sharp decline in domestic demand. Momentum continues to drop, with activity cooling further in the third quarter and confidence indicators for October falling to levels not seen in decades. Currently in financial markets, funding markets remain strained, reflecting the deep shock to confidence in counterparties, De leveraging and forced asset sales continue unabated. These difficult financial conditions coupled with the slump in economic activity portend sharp increases in corporate defaults in advanced economies. Emerging economies have also come under severe strain, as seen in rising spreads on sovereign and corporate debt and serious pressures on exchange rates. For this reason Markets all over the

world are engulfed in a global economic crisis, with stock markets sharply down and volatile, almost all currencies having depreciated substantially against the dollar, and risk premiums on a wide range of debt having increased by 600 or more basis points. Commodity markets too have turned a corner. According to economists at the World Bank due to this crisis GDP growth in developing countries—only recently expected to increase by 6.4 percent in 2009—is now likely to be only 4.5 percent, And rich countries are now expected to contract by 0.1 percent next year. (Dirk Willem te Velde, Overseas Development Institute, 2008)

Table11: **Real GDP growth forecast for developing regions**
(percentage change from previous year)

Region	2008	2009
East Asia and the Pacific	8.8	6.7
Europe and Central Asia	6	3.5
Latin America & Caribbean	4.5	2.1
Middle East & North Africa	5.7	3.5
South Asia	6.3	5.4
Sub-Saharan Africa	5.4	4.6

Source: ODI Report, 2008

Due to high food and fuel prices, it is estimated that 100 million people have already been driven into extreme poverty. With every one percent decline in developing country growth rates, approximately 20 million more people are added to this rapidly swelling number.

Actually the Financial crisis of 2007-2008 cast doubt on the free market consensus. In March, free market guru Martin Wolf, chief economics commentator at the *Financial Times*, announced the death of the dream of global free-market capitalism, and quoted Josef Ackermann, chief executive of Deutsche Bank, as saying "I no longer believe in the market's self-healing power." Shortly afterward influential Economist Robert Shiller began advocating robust government intervention to tackle the financial crises, specifically citing Keynes. Prominent Keynesian economists included Paul Krugman, Greg Mankiw, Robert Reich and Joseph Stiglitz advocacy for

international coordination of fiscal or monetary stimulus, and of international economic institutions such as the International Monetary Fund and World Bank. This was evident at the G20 and APEC meetings in Washington, D.C., and Lima, Peru, in November 2008, and in coordinated reductions of interest rates by many countries in November and December 2008. (IDS,2008)

The basic principle of free market economy is that the government should keep its nose out of people's businesses. However, the recent financial catastrophe has shaken this ideology as several unregulated US investment banks are failing to its worst since the Great Crash of 1929. As a result, the US government has got approved from its parliament a \$ 700 billion plan which in effect is nationalizing the big investment banks and financial institutions. Again, *Nationalization of these big financial houses has raised some doubts over capitalism with few even joking how the USA is morphing into the USSA: The United Socialist State of America.* That may be too far-fetched, but the free-market principle may now need to be modified to accept more market regulation. The European countries are also following the footsteps of the US as more troubled banks are being bought by the governments.

The recent financial crisis has taught a lesson that in a modern economy, financial sector especially debt management is too important to be left entirely on the vagaries of market turmoil. It is well accepted fact that the financial system of a country should be stable and sound because activities in this sector have a huge impact on the broader economy. Thus the government has a role in it.

So, which countries are at risk and how does risk volatile it's public debt management?

The following types of countries are most likely to be at risk:

• **Countries with significant exports to crisis affected countries such as the USA and EU countries (either directly or indirectly).** In case of Bangladesh Its already threatened it's biggest export sector: ready-made garments which employs nearly 2.5 million people, mostly women, and critically dependent on Western markets. Ready-made garments including knit and woven fabrics earned Bangladesh US\$ 10.7 billion in the 2007-08 fiscal year i.e. two thirds of the country's annual export income. Buying orders from Europe and the United States dropped 7% in September even before the crisis struck heavily, and buyers would likely to shy away in the coming months as well. If more than 700 chain stores of major U.S apparels bond that outsource to Bangladesh have either wound up or are planning to do so with the financial crisis spreading fast across the continents, then any setback in the single biggest export market (the United States) will push the sector in danger.

• **Countries dependent on remittances.** With fewer bonuses, Bangladeshi workers in the city of London, for example, will have less to remit. There will be fewer migrants coming into the UK and other developed countries, where attitudes might harden and job opportunities become more scarce; But the experts felt that our workers actually remit less from west but majority of our workers more than 5 million expatriate workers are employed in the Middle East which are away from the crux of the crisis – and their remittances almost the same amount that textiles earn annually- were safe. According to the Central Bank Officials, the experts sent home a record US\$ 7.91 billion in the 2007-08 fiscal year, and were likely to remit more in the current year to take the total to nearly US\$ 10 billion.

But according to Economist Dr. Atiur Rahman, downward trend of oil price actually reducing the income of Middle East countries and which ultimate effects the investment in real sector. Naturally it's shrinking the employment opportunity for others country's worker. Bangladesh may be the victim of that situation. (TV talk show organized by NTV, Bangladesh on 12th December, 2008 regarding present global financial crisis)

- **Countries heavily dependent on FDI**, but Bangladesh's capital market will not be hurt as we have only 2.5% foreign investment in the stock market; moreover our economy is agro based, most of the people directly or indirectly related to agro production and agro business. So, the stock market may not impact on our economy.

- **Countries with sophisticated stock markets and banking sectors with weakly regulated markets for securities;** According to Ahmed Rashid Dhali, former President of Dhaka Stock Exchange- in present situation there is no reasons for panic because 55% share of our capital market is control by banking sector and our banking sector is well regulated. (TV talk show organized by Ntv, Bangladesh on 12th December, 2008 regarding present global financial crisis)

- **Countries with a high current account deficit**

- **Countries with high government deficits.**

- **Countries dependent on aid.**

Last three points are also true for Bangladesh and it is already clearly mentioned in Chapter two and four of the main reports.

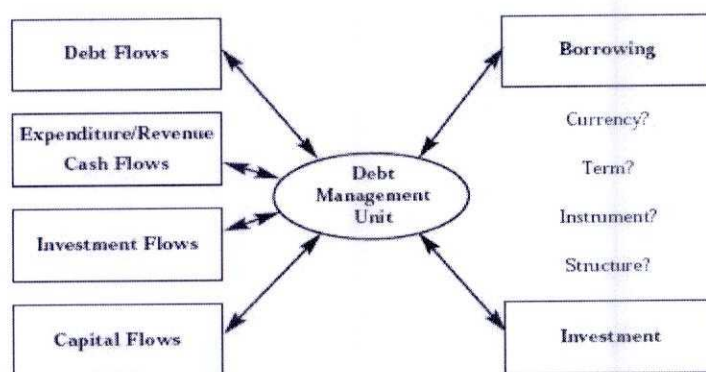
At present, Bangladesh's financial sector looks stable, but this doesn't imply that it is sound. There is a difference between stability and soundness, though both look similar. Soundness in the long run determines stability. Relatively small deteriorations in the macroeconomic scenario can easily threaten Bangladesh's fiscal sustainability. Relatively small deteriorations in the macroeconomic scenario can easily threaten Bangladesh's fiscal sustainability.

So if there is no compromise would met in case of expenditure and if on the other hand export earning, remittance and aid or FDI would fall due to global crisis then certainly deficit would increase and due to this domestic borrowing by the

government would increase which raised interest rate, caused high inflation and crowding out private sectors. On the other hand if expenditure would reduce then it's actually would shrink different safety net programmes and ultimate poverty rate would increase and volatile the sound macro economic situation.

To meet the challenges of financial crisis urgently need an integrated effort (Among responsible offices and oversight offices) and an office who would deal with different relevant information like export trend, remittance trend, Aid and FDI trend (opportunity, currency denomination etc), investment pattern, return on investment etc only for ensuring perfect decision regarding debt that ultimate ensured sound debt management. A financial Stability oversight board need to establish with a group of expert and experienced people and sovereign debt office may work under this board. But still those efforts are missing. (It is already elaborately discussed in chapter four of the main reports).

Figure 6: A Sovereign debt office



Idea: own, A Sovereign debt Office

It is also agreed by the global leaders that in terms of improving the global financial architecture, the crisis has made clear that new thinking and action are needed in at least four areas:

- (i) the design of financial regulation;
- (ii) a better way of assessing systemic risk; and
- (iii) Mechanisms for more effective, coordinated actions, both to reduce the risk of crises, and to address them when they occur.
- (iv) Parliamentary oversight panel and Comptroller General Oversight are needed for ensuring sound debt management.

Point that is not highlighted in the main reports:

Campaign for cancellation of debt:

Keeping in mind that Bangladesh is a highly disaster-prone country, and that disasters are likely to increase due to climate change. Scientists predict that by 2050, 17% of Bangladesh will be submerged under water; crop production will fall to 30% of current levels; and the intensity of cyclones and floods will have increased, as was experienced in 2007. Bangladeshis themselves are largely not responsible for this climate change. While an average Bangladeshi emits 0.02 tons of carbon a year, an average American emits 20 tons of carbon. So, the cancellation of Bangladesh's external public debt would not only serve as a shock absorber but also allow Bangladesh to use its scarce resources to achieve the MDGs. It is mentioned that the Bangladeshi government pays currently more than \$1.5 billion a year in external debt service to rich countries and multilateral institutions like the World Bank, and is expected to pay this amount for the next two decades, the Bangladeshi government should push the donor community to get at least all its debt to the World Bank and the IMF cancelled (as many other LDCs already got such debt relief) and as Bangladesh has far more urgent needs to use these resources for poverty reduction. The Bangladeshi government also should avoid further substitution of external borrowing with domestic borrowing as domestic borrowing has far higher fiscal implications than external concessional borrowing.

Finally, the world never tackled such financial crisis in an integrated way like now. Joint approach already improves inter bank lending and downwards LIBOR interest rate. German Chancellor Angela Merkel and French President Nicolas Sarkozy said "Bretton Woods II" should bring about "genuine, all-encompassing reform of the international financial system, mainly on-transparency, global standards of regulation, cross-border supervision and crisis management, to avoid conflicts of interest and

to create an early warning system, so as to engender confidence among savers and investors in every country.”

So, a financial crash is more than an economic glitch. It leads into dangerous political territory. It can trigger revolutions. Financial distress in the 1780s led to the French Revolution. Financial distress brought the Nazis and Japanese militarists to power before World War II. A financial earthquake may cause a political earthquake. A political earthquake, in turn, can set off a revolution, civil war, or even a world war. This is what history teaches. In that way a financial crisis quickly becomes a political crisis and a political crisis calls the existing order into question. This leaves the door open to a new order, based on fanaticism and hatred. This, in turn, leads to a shift in the global balance of power.

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Annex A

Average Interest Rates :

Table 3: Trend in Interest Rates of Treasury Bills and NSD Certificates					
Year	Treasury Bills			NSD Certificates	
	Treasury Bills	Treasury Bills on Tap**	Ways and Means Advances	5-year	3-year
1981-82	6.00	7.00	7.00	12.20	-
1982-83	6.00	9.50	9.50	12.20	-
1983-84	6.00	9.50	10.00	12.20	-
1984-85	8.50	9.50	10.50	18.00	-
1985-86	9.00	9.00	10.75	18.00	19.55
1986-87	8.00	9.00	10.25	18.00	19.55
1987-88	8.00	9.00	10.25	18.00	19.55
1988-89	8.00	9.00	10.25	18.00	19.55
1989-90	7.50	11.50	9.25	18.00	19.55
1990-91	7.00	11.00	9.25	16.00	15.00
1991-92	7.00	11.00	6.50	16.00	15.00
1992-93	4.75	8.50	6.00	15.00	15.00
1993-94	4.00	8.00	5.00	15.00	15.00
1994-95	4.00	8.00	5.00	15.00	15.00
1995-96	3.50	7.00	5.50	15.00	15.00
1996-97*	6.75	-	6.50	14.00	15.00
1997-98	8.32	-	6.50	14.50	13.50
1998-99	7.51	-	7.50	15.50	13.50
1999-00	6.05	-	6.50	14.50	13.50
2000-01	6.33	-	6.50	12.50	12.00
2001-02	4.81	-	5.50	12.50	12.00
2002-03	7.00	-	5.50	12.50	12.00
2003-04	3.99	-	4.50	11.00	10.50
2004-05	6.60	-	4.50	10.50	10.00
2005-06	7.10	-	4.50	12.00	11.50

Source: Economic Trend, Bangladesh Bank (various Issues) , Bangladesh Bank Quarterly (Various Issues), and Ahmed and Islam (2006a)

*= Treasury Bills rates from 1996/97 to 2005/2006 are 28-day Treasury Bills rate.

**=Treasury bills on Tap were abolished from 1995.

Annex B

Questionnaire for DEBT MANAGEMENT

OBJECTIVE

- ☐ ☐ **To ascertain the legal framework, organizational roles and responsibilities, and procedures for managing public debt**
- ☐ ☐ **To identify weaknesses in public debt management**

LEGAL FRAMEWORK

- 1.** Is there any law limiting the amount of public debt? What does it say? What categories of debt are covered?
- 2.** Who is responsible for enforcing the law? Any issues arising in its application?
- 3.** Are there any legal requirements or regulations prescribing how debt is to be raised? Are the laws and regulations followed?
- 4.** What reporting and disclosure rules apply to public debt stocks and flows? Are they observed?

ORGANIZATION AND MANAGEMENT

- 5.** Is a single agency responsible for controlling aggregate public debt and its mix? Which agency and how does it control?
- 6.** Is a single agency responsible for maintaining the debt management system and database? Which agency, and what relationships does it have with providers of data and users of the database?

DEBT ISSUES

- 7.** Are future auctions of government debt announced in advance?
- 8.** Are amounts issued and prices disclosed shortly after auctions?
- 9.** Are any debt issues index-linked?
- 10.** Are forward contracts, swaps or other derivatives used?
- 11.** Are sources and currencies diversified (to take advantage of incomplete arbitrage between the major world currencies)?