

Demystifying domestic debt

In conclusion, it can be stated that the alleged ill effects of government borrowing from the banking system cannot be statistically substantiated in Bangladesh. That does not mean that the government should resort to unbridled borrowing. The trade-offs involved need to be closely monitored and carefully assessed.

MIRZA AZIZUL ISLAM

PARLIAMENT gave its final seal of approval on June 30, 2009 to FY10 budget with the underlying macro-economic framework unchanged from the proposals presented on June 11. An important element of this framework is the size of the budget deficit which is estimated at 5% of GDP. Domestic borrowing is estimated at 3.08% of GDP with borrowing from the banking system amounting to 2.51% of GDP.

Many businessmen and some economists have expressed concerns about the government's reliance on the banking system to finance budget deficit. These concerns are predicated on the following presumptions:

- Government borrowing fuels inflation.
- It raises interest rate and thus adds to the cost of business.
- It crowds out credit to the private sector.
- The interest payments pre-empt government's capacity to undertake development projects.

Let us now examine the validity of these presumptions in light of relevant data.

Inflation: It is observed from data for the period 1997-98 to 2007-08 that the link between government borrowing and inflation is at best tenuous. In

several years government borrowing from the banking system moved in the opposite direction of inflation i.e. lower level of borrowing as per cent of GDP was followed by higher level of inflation or vice-versa. Even where the changes were in the same direction, there was no proportionality. The causes of inflation in Bangladesh seem to lie elsewhere. Perhaps the two most important causes are domestic production of food-grains (with food price weight being well above 50% in consumer price inflation) and the international price level which influences consumer prices directly and also causes cost-push inflation through impact on the prices of raw materials and intermediate goods.

Interest rate: In this case, there have been even more cases of movements in the opposite direction. Of the ten year-to-year changes, there were five years in which government borrowing from the banking system fell, but interest rates rose. The financial market in Bangladesh is by no means competitive. The commercial banks, particularly the private banks, determine lending rate through a cartel type of arrangement, leading to considerable

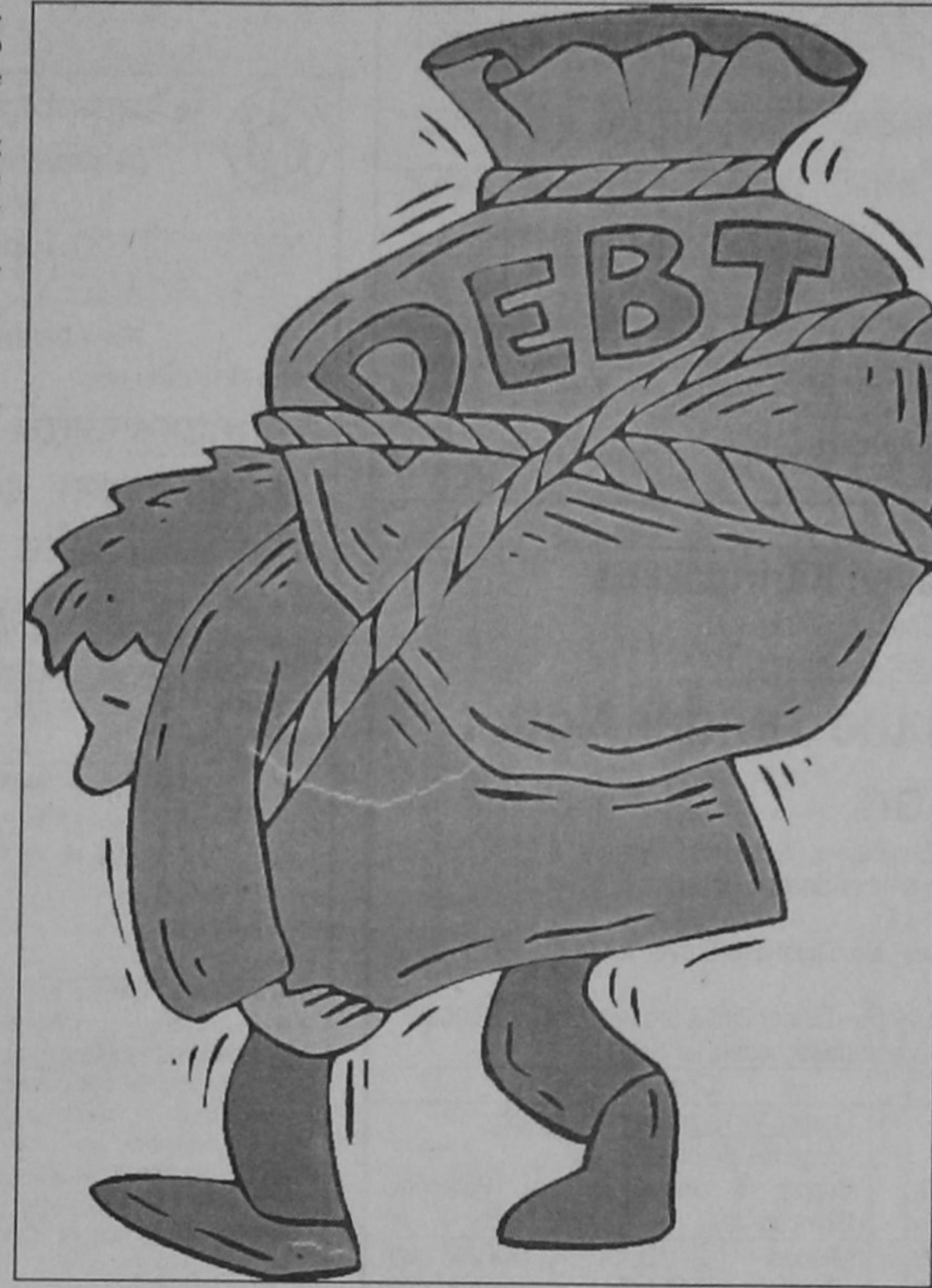
rigidity in the interest rate structure. Government borrowing appears to exert practically no influence on the determination of interest rates.

Crowding out: The issue of crowding out can be interpreted in two ways. One interpretation would be that higher growth of borrowing by the government would cause a fall in the growth of credit to the private sector. The implicit assumption is one of a zero sum game on the supply side and ignores demand side of the picture. Based on readily available data for the years 2002-2003 to 2007-08, it is observed that growth rate of credit to the private sector rose throughout this period excepting for the year 2006-07 when the growth rate of credit to both the government and the private sector fell. In fact, the fall in credit growth to the government was sharper (from 23.6% to 14%) whereas credit growth to the private sector declined from 18.1% to 15%. The crowding out hypothesis in the sense noted above, therefore, does not hold.

Another interpretation of crowding out could be that government borrowing prevents the banks from meeting the credit needs of the private sector.

The "need" is not easy to define. However, it is observed from the data for 2002-2003 to 2006-07 that in every single year credit growth to the private sector well exceeded the growth of GDP at current market prices. It can, therefore, be inferred that legitimate needs of the private sector were adequately met.

Interest payments and development project financing: Taking any single year, it is an arithmetic truth that higher



interest payments by the government limit its capacity to finance development projects. It should, however, be noted that single year statistics gives a

wrong impression. A lower level of interest payment today would be obviously the product of lower level of borrowing and hence lower level of expenditure on development projects in the past. Thus the issue is essentially one of sequencing of development project finance.

In this context, it may also be noted that interest payments by the government to the domestic private sector, including the banks, are transfer payments, and do not constitute a macro-economic burden. Such payments could, of course, inflict harm to the economy if the revenues required to finance these payments are raised in sub-optimal manner. One could then argue that the greater the interest payment, the greater would be the degree of sub-optimality. However, such costs would have to be traded off against the potential positive impact of foregone development projects, which lower levels of interest payments would imply. Furthermore, there is a positive externality of government borrowing; the bonds issued for this purpose provide an instrument for the central bank to undertake monetary policy operations more effectively.

In conclusion, it can be stated that the alleged ill effects of government borrowing from the banking system cannot be statistically substantiated in Bangladesh. That does not mean that the government should resort to unbridled borrowing. The trade-offs involved need to be closely monitored and carefully assessed.

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L'Aquila G8 Summit: What did it achieve?

In spite of the gaffes of playboy Silvio Berlusconi, the achievements of the L'Aquila Summit cannot be rubbed as worthless. The Declaration on Climate is indeed a step in the right direction. Such Summits do contribute some goods, though not all that are promised are always implemented to the expectations of many.

MAHMOOD HASAN

SINCE the last G8 Summit at Hokkaido, Japan in June 2008, the world economic and financial situation has grown from a "slowdown" into a full-blown crisis. The club of the eight major industrial countries met for its 35th Annual Summit in L'Aquila, Italy from 8-10 July 2009. It may be recalled

that in April this year an earthquake, which killed nearly 300 people, hit this small central Italian town. The venue for the Summit was apparently selected as a mark of solidarity with the people of L'Aquila.

Italy currently holds the G8 Presidency. Apart from the G8 members (Canada, France, Germany, Japan, Italy, UK, USA, Russia), the group known as G5 (China,

India, Brazil, Mexico, South Africa) was also invited to participate in some of the sessions. An assortment of 15 countries was specially invited, as were 9 International Organisations.

The Summit came at a time when the world is still smarting under the weight of severe economic and financial crisis, in which many financial institutions and big business firms in the developed world have collapsed. It also came in the backdrop of the G20 Summit in London in April last, held specifically to address global economic turmoil. The rich nations during that Summit committed \$1.1 trillion to save the world financial system.

Silvio Berlusconi, Italian Prime Minister and President of the Summit summed up the main issues of the meeting as: new ground rules to tackle economic crisis; boost international trade; restore confidence of people (to consume more); climate change; development of poor countries and Africa; food security; and international political issues.

After three days of negotiations the leaders produced seven declarations and statements on: Responsible leadership for a sustainable future; Political Issues; Promoting the Global agenda; Counter Terrorism; Energy and Climate; G8-Africa partnership on Water and Sanitation and Global Food Security.

Under the political issues the leaders have expressed dismay at the post-election violence in Iran. On its nuclear ambitions the Summit -- "strongly urged Iran to cooperate fully with IAEA and comply with the relevant UNSG Resolutions without further delay." The Summit condemned North Korea in the strongest terms for its nuclear test in

May and launching of ballistic missiles in April this year.

Referring to President Obama's speech in Cairo, the Summit reiterated its full support for the two-state solution of Palestinian-Israeli conflict and hoped that the process of negotiations would be quickened to establish peace in the entire region. The leaders agreed that stability in Afghanistan and Pakistan remains top priority for the G8. On Myanmar the leaders expressed their indignation that the military junta has failed to make any progress in their meeting with the UN Secretary General earlier this month. The leaders called for the release of all political prisoners including Aung San Suu Kyi and to make the 2010 elections credible.

Declarations and Statements are actually negotiated and decided upon at the series of Ministerial meetings held prior to Summits. The negotiation that actually took place during the Summit was on energy and climate -- an issue of grave importance for the planet. The crucial sentences of the statement read: "We recognise the scientific view that the increase in global average temperature above pre-industrial levels ought not to exceed 2 degrees C. In this regard and in the context of the ultimate objective of the (UN) Convention and the Bali Action Plan, we will work between now and Copenhagen ... for substantially reducing global emissions by 2050."

President Barack Obama, hoping to unite the G8 and G5, chaired the session of MEF, which is responsible for almost 80% of evil emissions globally. G8 for the first time agreed on specific emission reduction goals and agreed to finance and transfer green technologies to the developing countries.

The industrial nations also agreed to reduce their emissions by 80% by 2050. G5 wanted the developed countries to reduce their dreadful emissions by at least 40% by 2020. The argument was that without immediate restraints on emissions in the short-run, the world climate might drift towards irreversible damage. The effects of global warming are already being felt in many parts of the world. While some countries are experiencing shortages of water (e.g. Sub-Saharan), others are threatened with floods and sea level rise. (e.g. Bangladesh, Maldives).

The UN Secretary General criticised the Statement saying it ought to have fixed a short-term target for 2020. Others have welcomed the statement because the US, which was so far opposed to any climate deal, is now onboard. Also now that the G8 countries have made a commitment, it will probably make negotiations easier at the UN Framework Convention on Climate Change (UNFCCC) to be held in Copenhagen in December this year.

The G8 Leaders have also agreed to achieve sustainable global food security. It has committed \$20 billion over the next three years to help food-insecure countries grow more food. For the first time emphasis has been laid on growing more food than on emergency food supplies to distressed countries.

Future Summit Format

Even with stiff economic competition the continued growth of G5 and other developing countries over the decades, have made them into a force to be reckoned with. It is evident now that it is becoming increasingly difficult for G8 leaders to resolve common global challenges, such

as -- economic crisis, climate change, ensuring free trade, food security etc, all by themselves. The G8 indeed needs the support and assistance of the developing countries to achieve progress.

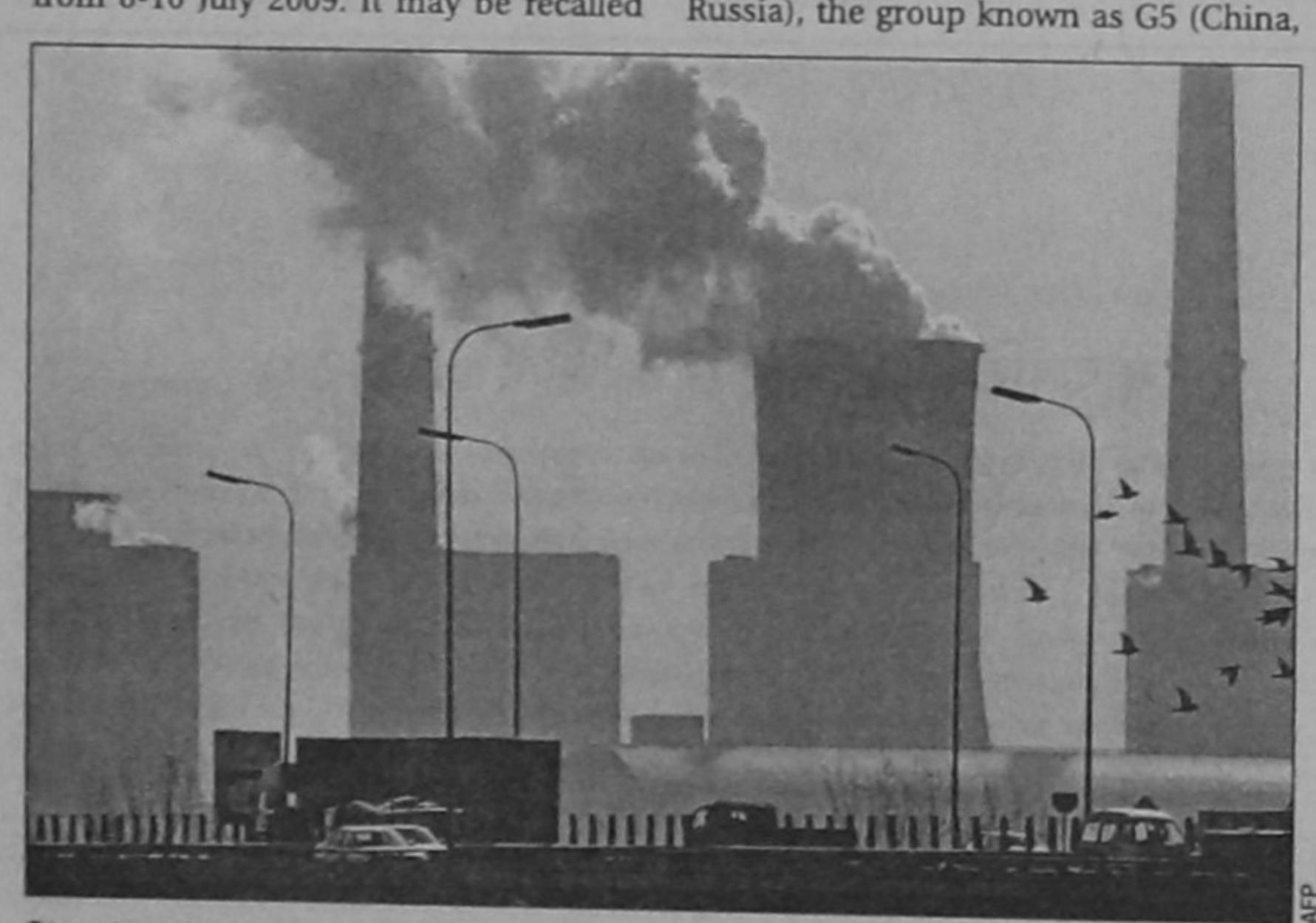
The G5 leaders were invited by G8 leaders not as full members, but as leaders on the sidelines, which the G5 represented. They want to be treated as full partners. There was a time when the G8 countries had set the agenda for the rest of the world. With the emergence of economically and militarily strong nations -- the G8 is now obliged to open its door to new entrants.

The first instance of the G8 enlarging into G14 (G8 plus G5 plus Egypt) came when the declaration for "Promoting the Global Agenda" was signed on 9 July. A new acronym was used MEF (Major Economies Forum).

With the waning of influence of the United Nations over world affairs -- Groups such as G8, G14, G15, G20 will probably become more and more relevant. It would however be wrong to presume that G8 will fade away. What is more likely to happen is that we shall probably see more "G" summits in the days to come. But we have to remember that larger the format becomes the more arguments it will stir up and more important it would tend to become.

In spite of the gaffes of playboy Silvio Berlusconi, the achievements of the L'Aquila Summit cannot be rubbed as worthless. The Declaration on Climate is indeed a step in the right direction. Such Summits do contribute some goods, though not all that are promised are always implemented to the expectations of many.

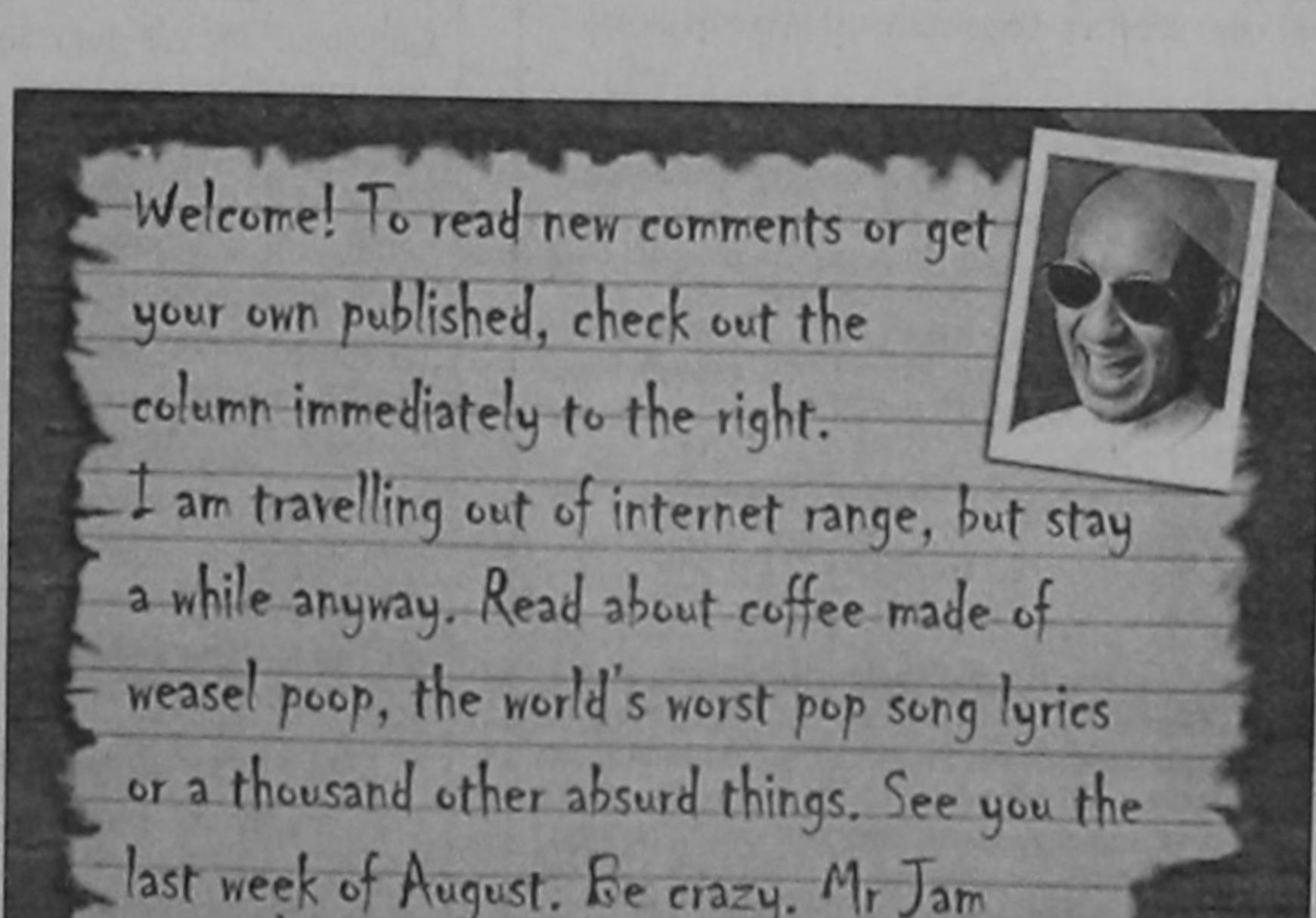
Mahmood Hasan is a former Ambassador and Secretary.



Opinions creep into news



- Terri Seymour, ex-girlfriend of super-grumpy American Idol judge Simon Cowell, was attacked and choked by an assailant recently, but recovered quickly. Let's face it, could it be that different from going on a date with Simon?
- Paris Hilton has said she is eager to work with top movie director Quentin Tarantino. Considering her track record in feature films, I would advise Mr. Tarantino to make a five-minute home-made movie to circulate via the internet, as those are the only Paris Hilton videos people watch.
- A French company has invented a car powered by air. The smog-filled cities of Hong Kong, Bangkok and Beijing will probably order 1,000 vehicles each. Now all they need is some air.
- A gaming company has given Britain's Queen Elizabeth II a gold-plated Nintendo Wii. Just a note of warning, Liz: you'll love Guitar Hero, but remember to take off your crown before the head-spin on Dance Dance Revolution.
- A Japanese company is issuing a horror story printed on toilet paper for bathroom reading. Why don't American car companies copy this? Their annual reports are already horror stories and toilet paper would be fitting.
- Evil empire North Korea is planning to become a world power by building plutonium plants, intercontinental missiles, and a nuclear bomb factory. However, I can't get worried since they have several steps to go before reaching the age of technology, including the discovery of fire, the wheel and opposable thumbs.
- Richard Branson's Virgin Media is said to be interested in buying Playboy magazine. Is it me, or does anyone else think there's a branding mismatch in the names of the two companies? Will the magazine henceforth be circulated in a padlocked cover?
- The White House in Washington DC announced that from now on, all US cars are going to be equipped under standards created for cars in Los Angeles. This should be interesting. The



- A new study says that smokers are not a financial burden to public welfare budgets since they don't live long enough. Given the present economic downturn, it's only a matter of time before governments re-word the cigarette carton warning to say: "Relax, have another. Why not finish the pack?"
- After NASA's recent repair job, the Hubble Telescope has resumed its work of scanning the galaxies for any signs of intelligent life. At the moment, it is sweeping North Korea without success. With those final thoughts, I hit the road and head to Europe. I've left a few extra columns for newspapers, so my printed ramblings will still be visible for a while. But I'll be visiting rural parts of Italy and France, and passing through UK, so I don't expect to have much internet access. Feel free to leave comments or tips, and I'll check in when I can.

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