External Debt Management

World Bank presentation to the
Comissão de Economia, Finanças e Anti-Corrupção, Parlamento Nacional,
The Democratic Republic of Timor-Leste

Wednesday 21 October, 2009
Overview

- External loans to finance the budget deficit
  - Government operations
  - Economics of external borrowing
- Managing external debt
  - Governance and strategy
  - Coordination with macroeconomic policies
  - Operational risk management
  - Debt records and reporting
- Experience from other countries
  - Borrowing for public investment
  - Debt relief
  - Small states
Government operations

Total government expenditure

- Other recurrent expenditure
- Interest payments
- Capital expenditure

Revenue: Tax, Non-Tax

Financing: PF, Debt, Seignorage

Budget deficit/Non-oil balance
Government operations

Rapid rise in the non-oil fiscal deficit in Timor-Leste...

Fiscal trends (% of non-oil GDP)

- Non-oil revenues
- WoG expenditures
- Non-oil balance

2004 2005 2006 2007 2008
Government operations

Petroleum Fund → PF Law → Petroleum wealth, intergenerational equity

Seignorage → Printing money → Inflation

Domestic borrowing → Monetary markets → Interest rates, crowding out

External borrowing → Concessional and commercial credit → Balance of payments, exchange rate, external sust.
Economics of external borrowing

- **Different options for creating fiscal space:**
  - Increase in grant aid
  - Improved expenditure efficiency
  - Improved revenue effort
  - New borrowing.

- **Borrowing for what purpose:**
  - Scaling up public investment.
  - General government expenditure.

- **Terms and conditions of external loan:**
  - Cost characteristics: concessional or market rate?
  - Risk characteristics: grace, maturity period, fixed vs. variable rate, currency denomination?
  - Benefits and restrictions: tied vs. untied, technical assistance?
Economics of external borrowing

- **Trade-offs:**
  - Cost of borrowing vs. returns on the Petroleum Fund.
  - Wider macroeconomic impact.

- **Debt sustainability:**
  - Debt thresholds and quality of policies and institutions.

<table>
<thead>
<tr>
<th>Institutional strength and quality of policies</th>
<th>Weak (CPIA&lt;3.25)</th>
<th>Medium (3.25&lt;CPIA&lt;3.75)</th>
<th>Strong (CPIA&gt;3.75)</th>
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</thead>
<tbody>
<tr>
<td>NPV of debt-to-GDP</td>
<td>30</td>
<td>40</td>
<td>50</td>
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<tr>
<td>NPV of debt-to-exports</td>
<td>100</td>
<td>150</td>
<td>200</td>
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<tr>
<td>NPV of debt-to-revenue</td>
<td>200</td>
<td>250</td>
<td>300</td>
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<tr>
<td>Debt service-to-exports</td>
<td>15</td>
<td>20</td>
<td>25</td>
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<tr>
<td>Debt service-to-revenue</td>
<td>25</td>
<td>30</td>
<td>35</td>
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</tbody>
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Economics of external borrowing

Timor-Leste has a strong external position ...
Managing external debt

- Governance and Debt Management Strategy:
Managing external debt

- Coordination with macroeconomic policies:
  - Fiscal.
  - Monetary.
  - Exchange rate policies.

- Operational risk management:
  - Debt administration and data security.
  - Segregation of duties, staff capacity, and business continuity.

- Debt records and reporting:
  - Debt records.
  - Debt reporting.
Borrowing for public investment

- Impact of debt-financed investment on economic growth is a function of several factors including:
  - Quality of public investment.
  - Composition of public expenditure.
  - Crowding-in effect of public investment.
  - Existing stock of physical capital.
  - Effectiveness of public administration.
Debt relief

Dramatic rise in the debt burdens in some Low Income Countries from 1973 to 1993 (% of external debt/GDP in NPV terms)...

Source: World Bank
Small states

- High government expenditure in small states
  - Remoteness and limited economies of scale.
  - Lack of diversification and vulnerability to shocks.
  - Open economy and exposure to changes in international prices.
  - Volatility in government revenue and expenditure.

- Increased recourse to external debt:
  - Rise in external debt for small states.
Conclusion

• Assess options for creating fiscal space and financing the budget deficit, ensuring quality of expenditure.

• Develop governance and strategic framework for debt management including coordination with macro policies, operational risk management, and transparency.

• Regular monitor evolution of external debt burden to ensure sustainability.