Timor-Leste: Debt Financing: What factors should Parliamentarians consider?

Presentation by Vivek Suri
World Bank
To Parliament Committee C Workshop
16 November 2011
Financing to meet infrastructure needs

• Funds to finance pressing Infrastructure needs – A priority in the SDP

• Infrastructure: Roads, water and sanitation, electricity, port, airports

• Infrastructure: Schools, medical centers, hospitals

• Such projects normally have large economic returns
Project selection is critical

• Before even considering financing: ‘high quality’ projects need to be identified
• High quality = High economic and social returns
• Economic return should be greater than cost of financing
• Economic return difficult to measure compared with financial return for a project
• Economic return includes benefits and costs that extend beyond a project
• Implementation capacity also needs to be assessed
  – Promising moves in this area recently
PF Drawdown versus Borrowing

- PF investments provide return
- 4.2 percent since inception
- Drawdown from PF means loss of return
- ESI will be lower
- The loss in return is the “cost” of financing from the PF
- Cost for a loan is the interest plus any fees
Does borrowing make financial sense?

- Under current market conditions and assuming that PF does as well as in the past
- Borrowing from IDA makes financial sense by a big margin
- Borrowing from IBRD makes financial sense
- IDA and IBRD also bring non-financial benefits in terms of technical assistance
- Assist with project selection, design, implementation and supervision
- Diversification of financing sources
Debt-service to revenue likely to remain manageable
IDA borrowing versus PF drawdown

Amount borrowed or drawn down: US$ 30 million

IDA: 25 year loan with 5 year grace period

IDA interest rate: 1.25 percent

PF return: 4.2 percent (historical average)
IBRD borrowing versus PF drawdown - II

Amount borrowed or drawn down: US$ 30 million

IBRD: 25 year loan with 5 year grace period

IBRD interest rate: 5 percent (only for example)

PF return: 3.75 percent

"Cost" of Financing $30m from IBRD: 53.3

"Cost" of Financing $30m from PF: 74.2
IBRD borrowing versus PF drawdown - I

Amount borrowed or drawn down: US$ 30 million

IBRD: 25 year loan with 5 year grace period

IBRD interest rate: 4 percent (only for example)

PF return: 4.2 percent (historical average)

"Cost" of Financing $30m from IBRD

"Cost" of Financing $30m from PF
Several Middle Income Countries borrow from IBRD

- China: A country with high level of reserves and access to international financial markets
Several Middle Income Countries borrow from IBRD

Brazil: A resource rich country with access to international financial markets
How much to borrow?

• Conduct “Debt Sustainability Analysis”
• How much is loan repayment plus interest in comparison with projected government revenue (importantly ESI)
• How much is debt in relation to GDP
• Does debt servicing prevent other key expenditures
• What are the risks – “stress tests”
What types of borrowing?

- Concessional versus commercial
- Short-term versus long-term
- Currency of borrowing
- Are public enterprises borrowing as well?
- Are there any guarantees being given by government?
Assessing risks is very important

- At present, Timor-Leste is at a low risk of debt distress
- Risk must be continually assessed
- Macro variables change (e.g. growth prospects, oil prices)
- Quality of Fiscal Policy may improve or deteriorate
- Types of risk
  - Interest rate risk (if borrow at variable rate)
  - Exchange rate risk (if borrow in ‘foreign’ currency)
  - Rollover risk (esp. if borrow short-term)
Parliament must scrutinize borrowing

- Parliament must be informed of all borrowing
- Borrow only against expenditure (projects) that are in the budget or otherwise approved by Parliament
- All forms of liabilities should be reported
- Contingent liabilities (explicit or implicit)
- Look at public and publicly guaranteed debt
- PF is a “good practice” example of transparent reporting
Parliament must scrutinize borrowing

- Is government borrowing consistent with the country’s development ambitions?
- Is borrowing consistent with the objectives stated in the law or debt policy statement?
- Is the government minimizing its financing costs with an acceptable level of risk?
Debt-service to exports likely to remain manageable
Debt-service to revenue likely to remain manageable