



CROWN AGENTS
ACCELERATING SELF-SUFFICIENCY & PROSPERITY

FINANCIAL MANAGEMENT OF DEVELOPMENT PROJECTS

13 – 24 May 2019



Programme Introduction

Course Aim

This course provides a detailed look at the financial management components within the project life cycle and provides an overview of the tools available for assessing financial management systems. It covers budgeting, accounting policies, financial management staffing considerations, procurement and contract management, audit and internal controls.

Objectives – by the end of this course, you will be able to:

- Adopt appropriate systems for managing projects and finances
- Assess weaknesses in your own financial systems
- Draw up and maintain financial plans and project financial accounts and reports
- Align financial management of procurement in accordance with international best practice
- Evaluate risks and establish an appropriate financial control environment

Course Time-table – see hand-out

Daily Agenda



Day 3

1. Financing the Budget
2. Public-Private Partnership
3. Visit
4. Visit



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Financial Management of Development Projects

15 May 2019

FINANCING THE BUDGET



Session Agenda

Our Learning Journey – how we will achieve our objectives:

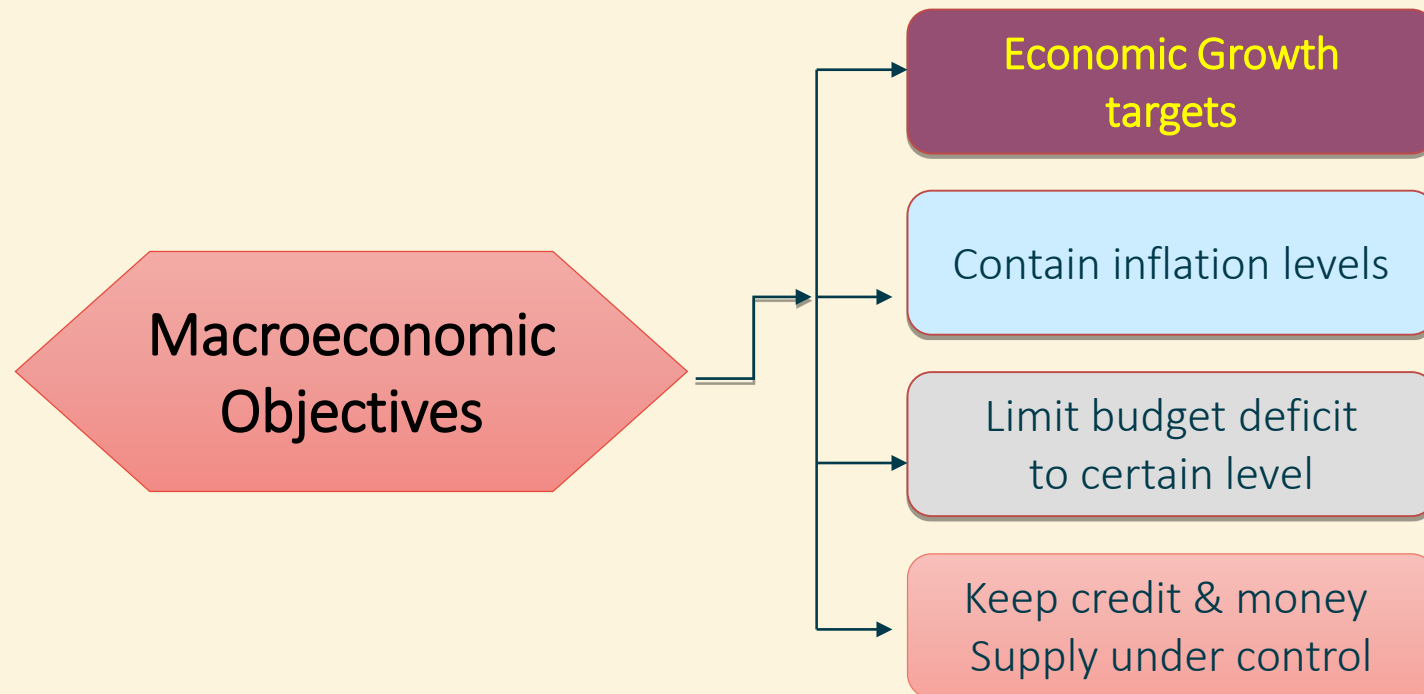
1. Look at options for financing the Government budget
2. External sources
3. Domestic sources
4. Define various sources of funds and their impact on project and budget funding
5. Session close



Budget & Borrowing influenced by wider Policies and Operations

Borrowing, DEBT MARKETS and macro objectives

A country's borrowing policy should be consistent with its macroeconomic objectives





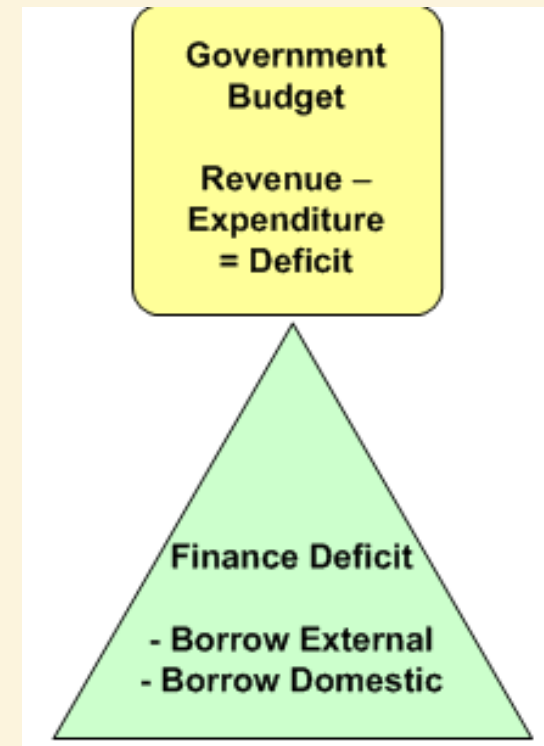
Just a quick reminder...of a bigger framework - **Public Financial Management**

PFM is about the effective management of the collection and expenditure of funds by governments

The budgetary process is central

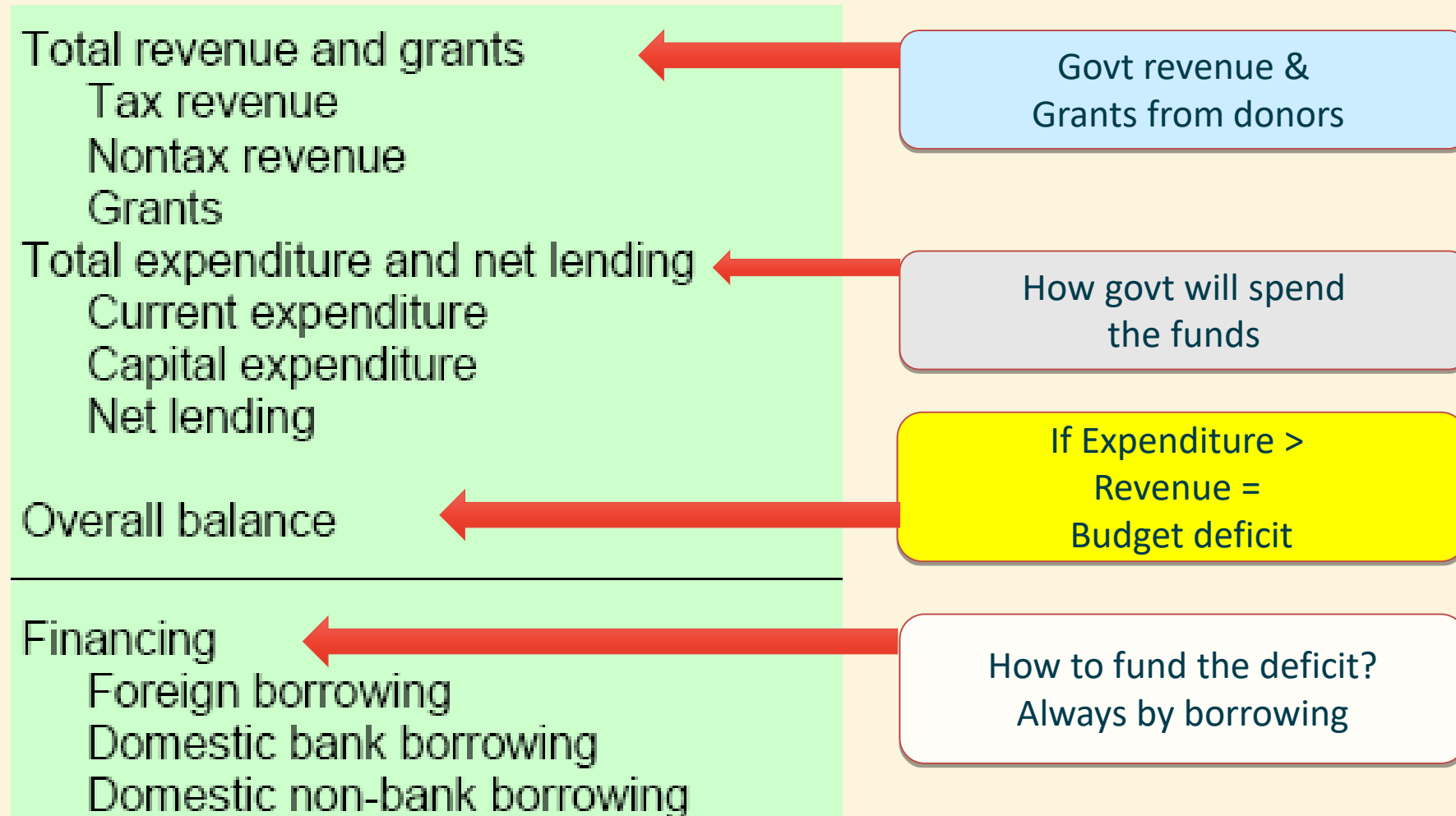


Source: IMF





Budget - Money you have (revenue) v/s How much you spend (expenditure)





Another quick reminder - Budget and Fiscal Policy



Total revenue & grants	200
Total expenditure & net lending	250
Interest payments	25
Overall balance	-50
Primary balance	-25

Fiscal Policy

About government
budget balance
(surplus/deficit)

-Government Expenditure

- Borrow from abroad: say UK or World Bank
- Local: Treasury bills, bonds

Budget deficit of 50: financed by

Financing it via

- Raising revenue (Tax)
- Aid Flows (revenue)
- Borrowing



Financing the budget

- When a budget deficit exists, means Government is spending more than the revenue in its possession
- This budget deficit must be financed
- Financing the deficit through borrowing
- It creates debt – a liability which has to be repaid in the future (principal)
- This is recorded below the line
- Interest payments also incur. Is recorded above the line under current expenditure
- Financing options:
 - Borrow abroad
 - Borrow domestically from Banks
 - Borrow domestically from non-bank sources

Total revenue and grants
Tax revenue
Nontax revenue
Grants
Total expenditure and net lending
Current expenditure
Capital expenditure
Net lending
Overall balance

Financing
Foreign borrowing
Domestic bank borrowing
Domestic non-bank borrowing

Total revenue & grants	200
Total expenditure & net lending	250
Interest payments	25
Overall balance	-50
Primary balance	-25



Financing the Budget

Borrowing from Abroad: External Debt

- From different sources – official agencies, capital market, from other governments
- Borrowing in foreign currency – has exchange rate implications

Borrow domestically from Banks

- Issue bonds which are taken by commercial banks
- Central Bank provides overdraft – dangers of overdoing this

Borrow domestically from non-bank sources

- Government issues bonds which are taken up by non-bank investors –private sector

Borrowing domestically requires the presence of active and liquid domestic securities market – discuss later

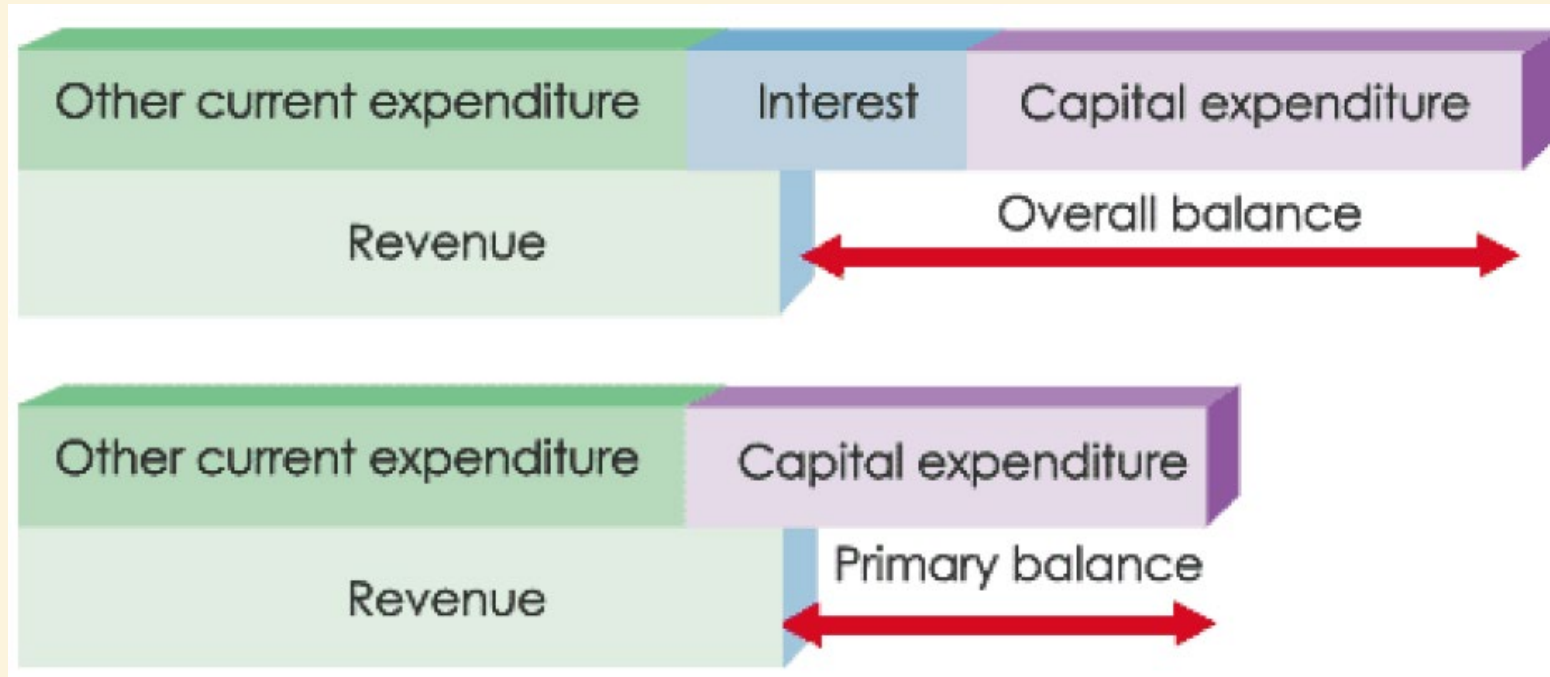


Implications of financing the budget and borrowing options

- Borrowing for financing budget can have implications for sustainability
- Cannot ignore the dangers of excessive borrowing and its adverse impact
- Too much borrowing can lead to the following problems:
 - Financing from Foreign borrowing: external debt problem
 - Financing from Bank sources: inflation
 - Financing from Non-bank sources:
 - rise in interest rate (sells too much bonds)
 - crowding out the private sector (leaves nothing for them)
- Fiscal policy becomes ineffective with high debt/GDP level (>50%)



Overall Fiscal Balance and Primary Balance



- Besides overall fiscal balance, we can look at Primary Balance
- One deducts from the overall fiscal balance the interest payments to be paid
- **Primary Balance = Overall fiscal balance – interest payments**
- Interest payments is usually fixed so the analysis on how to reduce the deficit will look at how much leeway the Government has - excluding interest

- This logically leads to understanding: What Debt Management is about
- What are the different sources of finance available to Governments



Debt, External Debt and Domestic Debt

Debt consists of all liabilities that require payment or payments of interest and /or principal by the debtor to the creditor at a date or dates in the future

External Debt

- Obligations that are owed to non-residents by residents of an economy

Gross debt, at any time, is

- the outstanding amount of those actual and current, not contingent liabilities
- that require payment of principal and/or interest by the debtor
- at some point in the future

Domestic Debt

- Domestic debt liabilities - obligations owed to residents by residents of an economy.
- Debt is classified on the basis of residency



A quick reminder... What Public Debt Management is about...

Definition

- “Process of establishing & executing a strategy for managing government’s debt ... to raise required amount of funding, achieve its risks and cost objectives and to meet any other sovereign debt management goals the government may have set...”

from *Guidelines for Public debt Management*

- E.g.: Concerned with
- determining debt level needed
- ensuring terms are compatible with debt service capacity
- related administrative, monitoring aspects of management of debt flows and stocks

Important policy

- DM - integral part of macroeconomic management
- Like monetary, fiscal, trade, exchange rate, BOP policy - PDM critical for promoting sound economic management
- Policies & measures it encompasses aimed at ensuring that
 - country's borrowing is properly managed and
 - borrowed funds are properly channelled to raise economic welfare to higher levels
- DM - not a once-for-all activity carried out only during a crisis but is a continuous operation



Borrowing ...(more later)

Sources

- External sources (e.g.)
 - Loans
 - Bonds
- Domestic sources (e.g.)
 - Treasury bills
 - Bonds

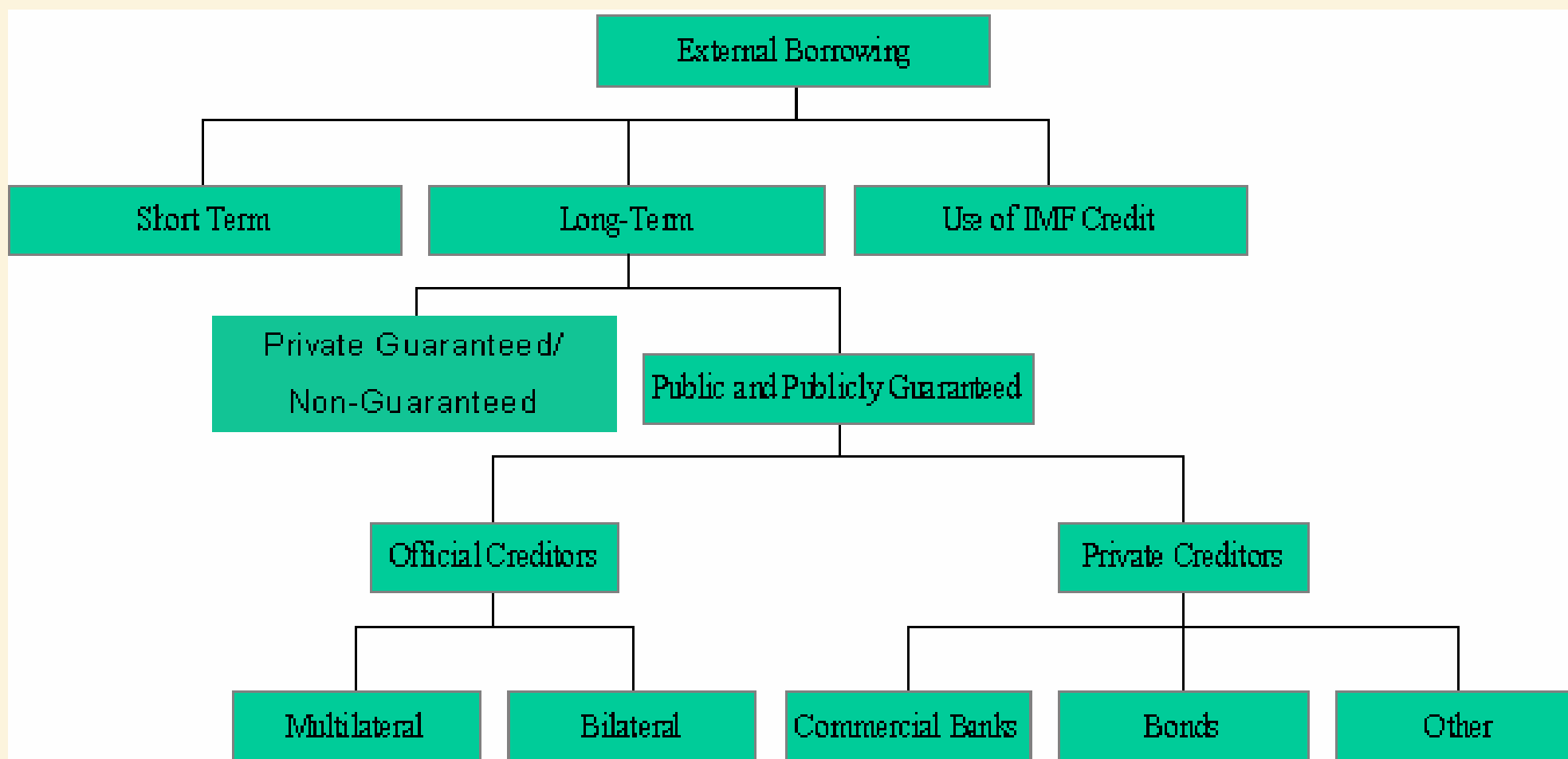
Borrowing Entities

- Central Government
- Parastatal
- Other tiers of government
 - States
 - Municipalities
 - local government
- Private Sector

External debt



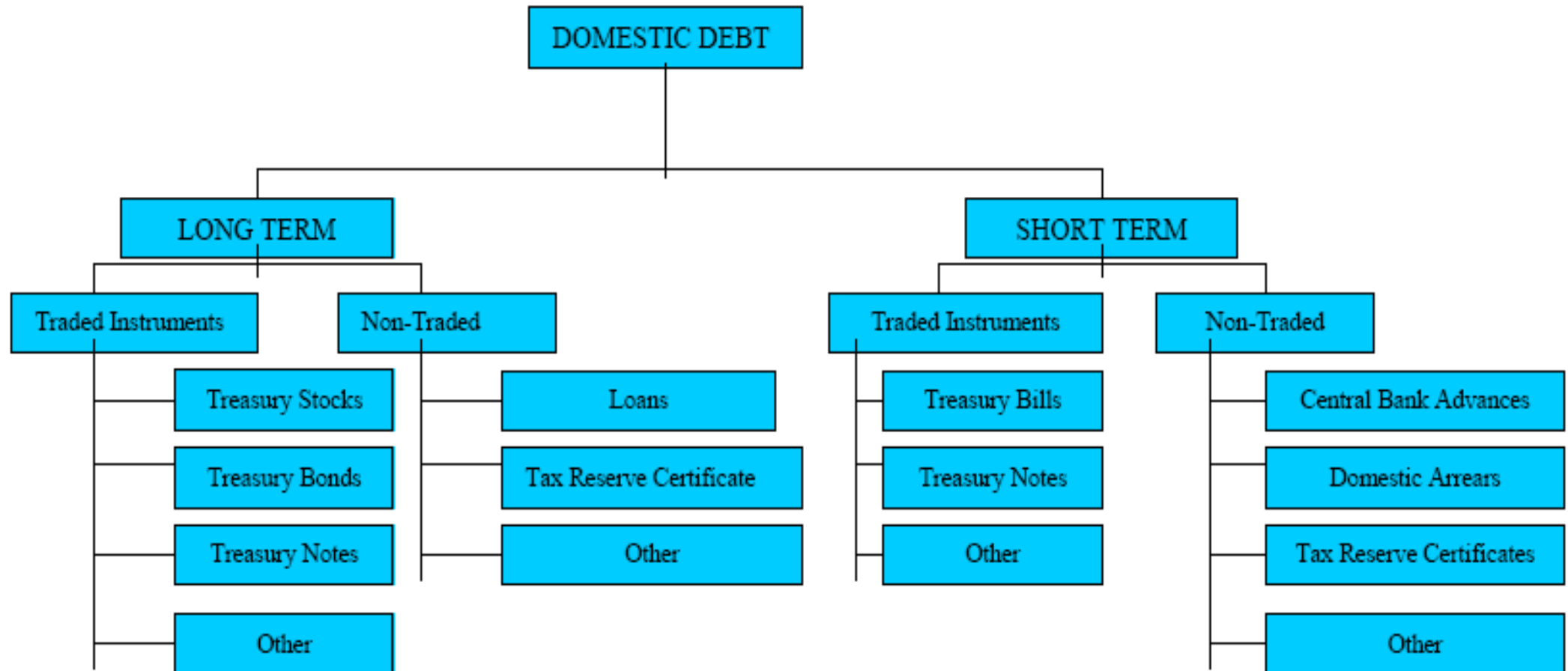
Obligations owed to non-resident creditors



Domestic debt



Obligations owed to residents creditors





Debt and Growth - Is Debt good or bad for the economy?

- Why should countries resort to borrowing?
- Seen how borrowing created havoc to economies of so many developing countries (and developed nations) during recent crisis)
 - Affecting lives, standard of living of population
 - Generations will bear the effect of the debt burden
 - Are we not better off not borrowing and living within our means?
- Does borrowing really help countries develop and grow?
- This is an over-simplistic argument...
 - Too narrow focus on the debt problems



Debt and Growth - Is Debt good or bad for the economy?

- This narrow focus on debt problems
 - should not overshadow a clear fact
- Rather than being detrimental, borrowing has important supportive role to play to foster economic growth
- Indeed debt problem is not directly related to borrowing per se
 - but with "over-borrowing" or the improper uses which borrowings are subjected to
- Borrowing widely recognised as a powerful development tool
 - Adds to total resources available to an economy
 - Supplements exports earnings and private foreign investment
 - Ensures that countries do not rely solely on domestic savings
 - Used to finance investment that contributes to raise the economic welfare of the country to levels that might not be attained
- If **properly managed**, Debt can be used to support growth, development
 - A genuine “Asset for Growth”



Debt: PFM context

- Budget Preparation and Execution
- Government's accounts - operational debt servicing
- Project finance management
- Macro-economic context: debt ratios/benchmarks
- Net financial exposures of government
 - Asset Liability Management
- Integral to treasury management



Main Types of External Finance

Grants

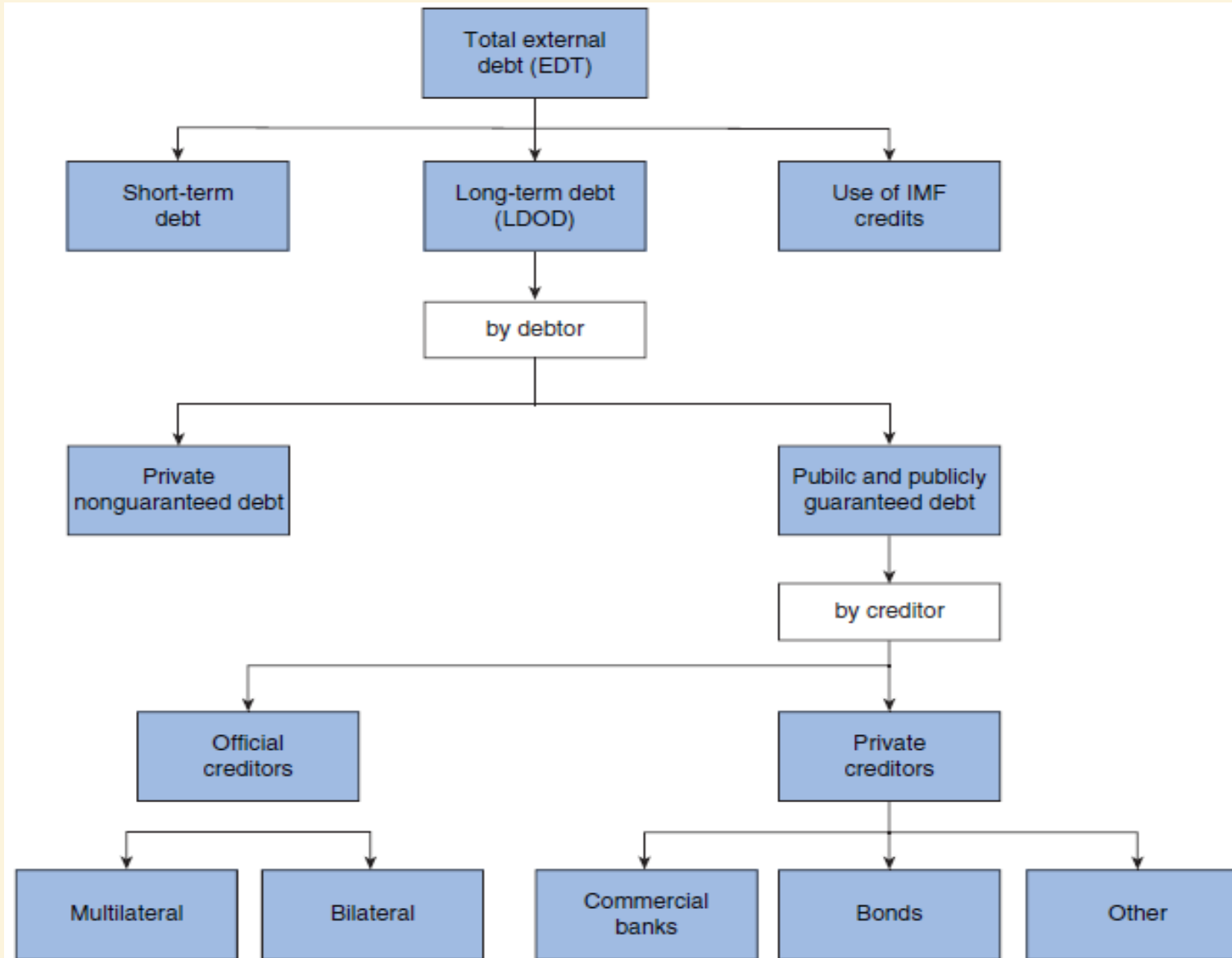
- Transfers that do not have to be repaid
- But only available to low income countries

External Loans, which can be classified in several ways

- Concessionality (measure by the Grant Element of a loan)
 - Concessional => 35%
 - Non-concessional < 35%
- Source of funds
 - Creditor category (e.g. bilateral, multilateral, commercial)
- Financial terms (e.g. fixed rate loans, variable rate loans)
- Use of funds (e.g. project loan, balance of payment support etc.)
- Maturity (e.g. short term, medium and long term)



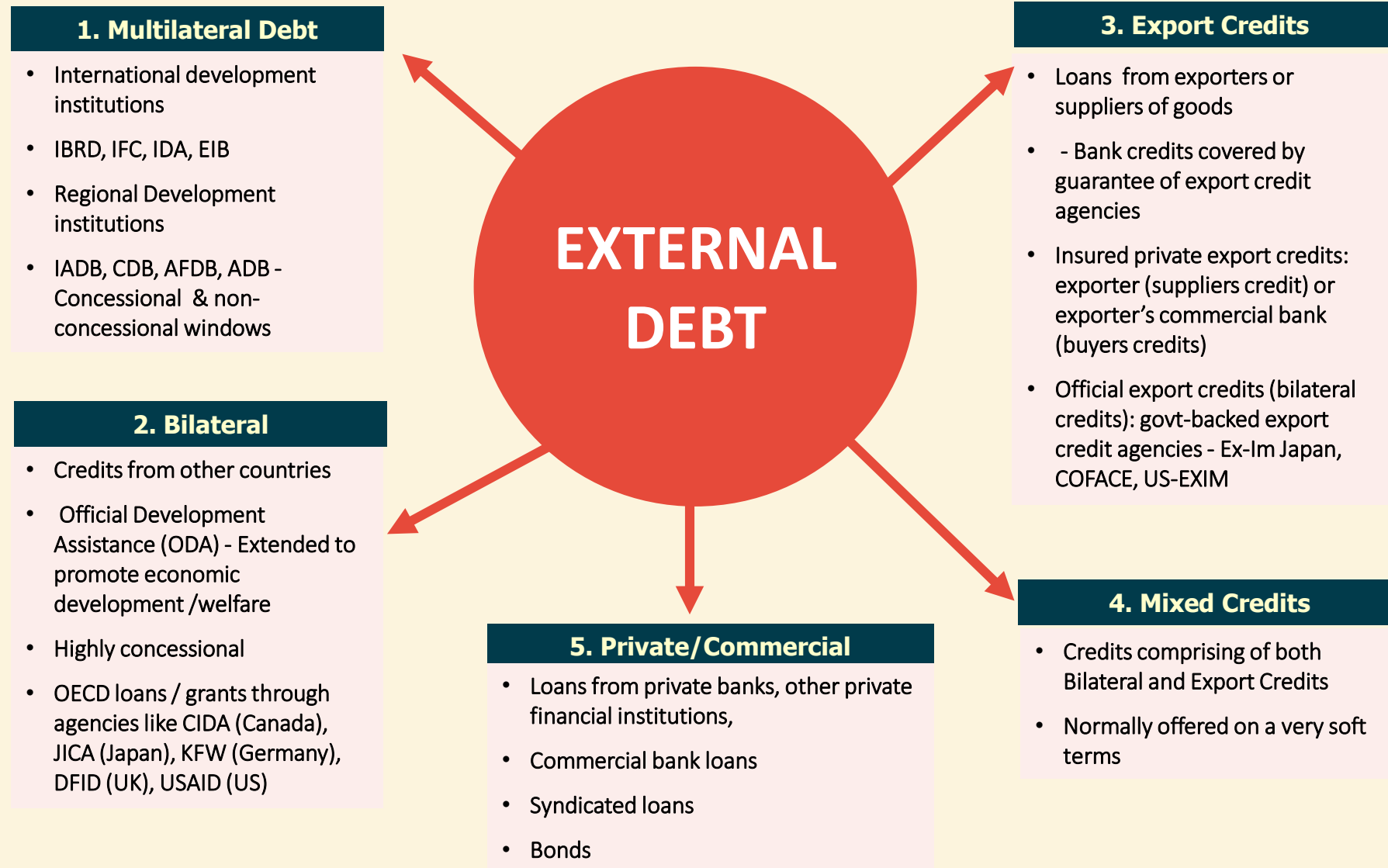
External Debt and its Components



Source: International Debt Statistics,
World Bank, 2014



Source of finance (1)



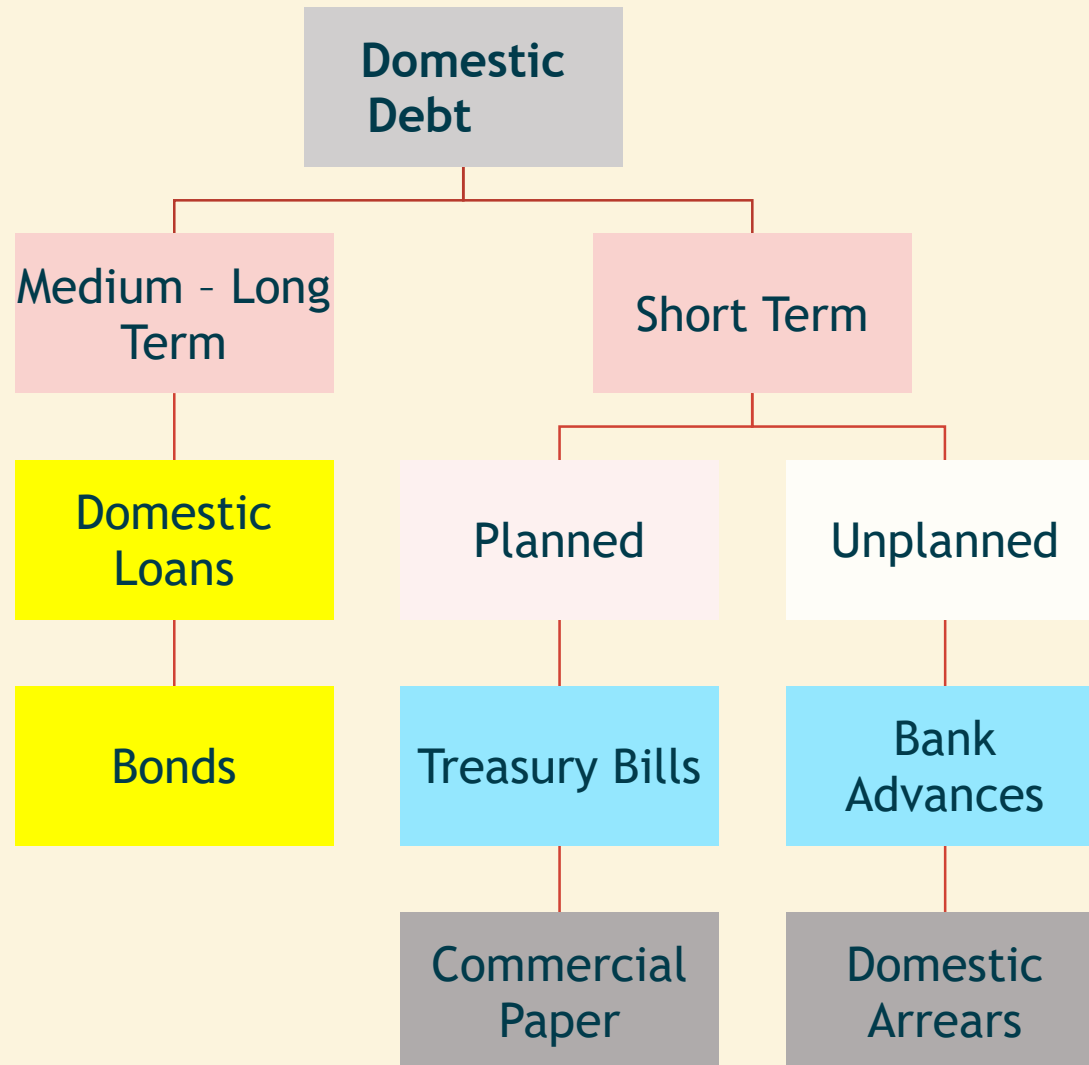


Sources of domestic borrowing

- Two main sources of domestic borrowing
 - Non-bank institutions and the public
 - Banking system
- Borrowing from the central bank results in money creation (inflationary)
- Borrowing from commercial banks can crowd out private sector
- Governing law

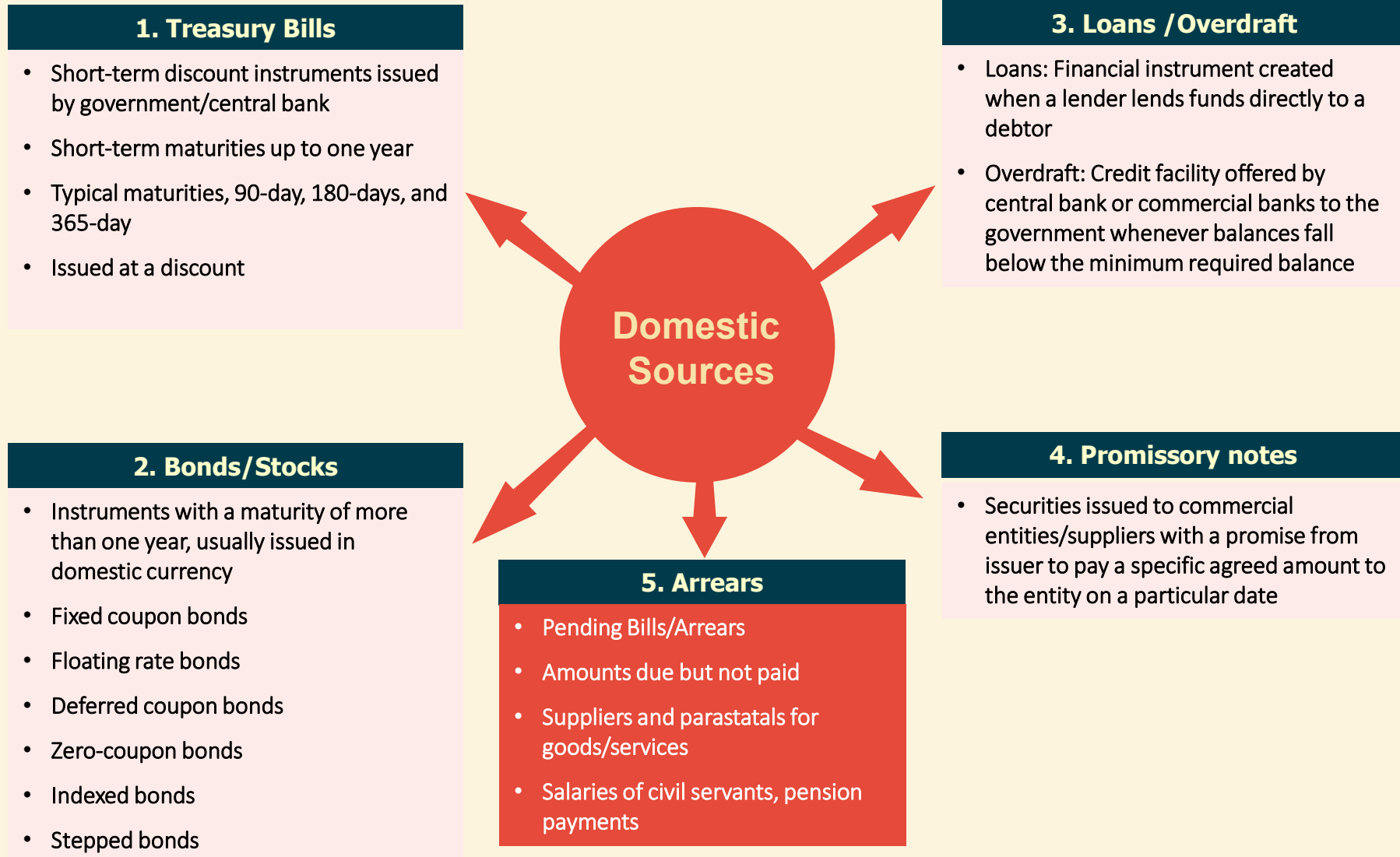


Categories of Domestic Debt Instruments



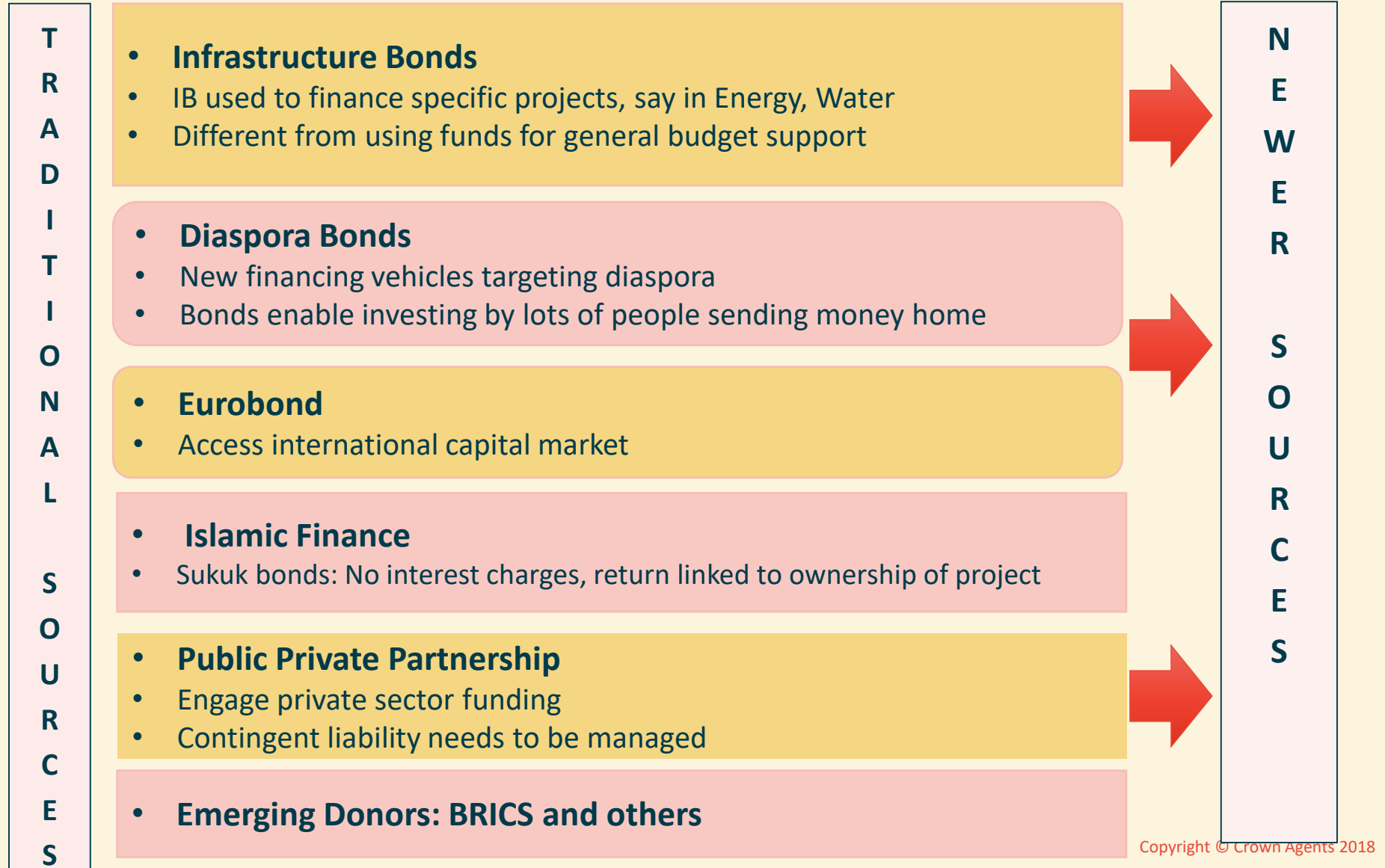


Sources of finance (2)





Other sources of funding





Session close

Let's wrap up the session:

- Recap of key learning
- Final questions?
- Revisit session objectives – achieved?
- Application of learning – update your action plans
- What's next?



THANK YOU /



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