“The role of Public Debt Management Strategy in Public Debt Sustainability”

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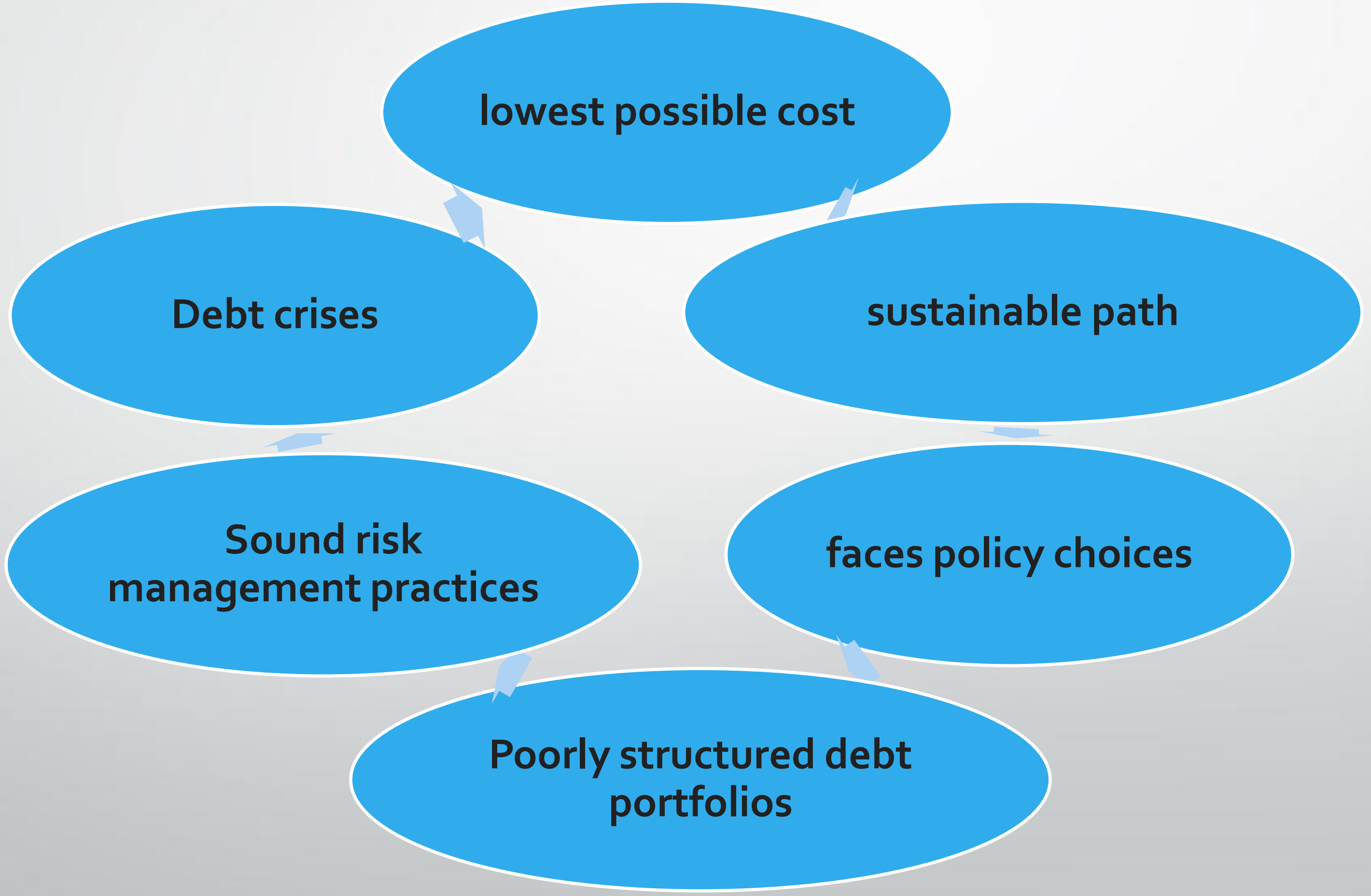
1 – Importance of Public Debt Management

According to "Revised Guidelines for Public Debt Management" (IMF and WB, 2014) paper the importance of Public Debt Management is summarized as follow:



- 1) 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 at the lowest possible cost** over the medium to long run.
- 2) Governments should ensure that both the level and rate of **growth in their public debt are on a sustainable path.** The debt can be serviced under a wide range of circumstances, including economic and financial market stress, while meeting cost and risk objectives.
- 3) Every government **faces policy choices concerning debt management objectives,** in particular its preferred risk tolerance, the parts of the government balance sheet, the management of contingent liabilities, and the establishment of sound governance for public debt management.

- 4) **Poorly structured debt portfolios,** in terms of maturity, currency, or interest rate composition and large contingent liabilities, have been important factors in inducing or propagating economic crises in many countries.
- 5) **Sound risk management practices** are essential given that a government's debt portfolio is usually the largest financial portfolio in the country and can contain complex and risky financial structures.
- 6) **Debt crises** have highlighted the importance of sound debt management practices and the need for an efficient and liquid domestic capital market.

2 – Public Debt Management Strategy

- **1) A debt management strategy is a plan that operationalizes the debt management objectives.** A debt management strategy should strongly focus on:

✓ managing the risk exposure

✓ potential variations in the cost of debt servicing

✓ impact of the cost of debt servicing on the budget

✓ impact of the cost of debt servicing on level of public debt

✓ New debt issuance

✓ Liability management operations

- **2) The risks inherent in the government's debt structure should be carefully monitored and evaluated.** Some Pitfalls in Debt Management which should be taken account:

❖ *Increasing the vulnerability of the government's financial position by increasing risk.*

❖ *Distorting private vs. government decisions, as well as understating the true interest cost.*

❖ *Misreporting contingent or guaranteed debt liabilities.*

❖ *Using non-market financing channels.*

❖ *Conducting improper oversight and/or recording of debt contracting and payment, and/or of debt holders.*

- 3) In order to help guide borrowing decisions and reduce the government's risk, debt managers should consider the financial and other risk characteristics of the government's cash flows.
- 4) Some countries have extended this approach to Include other government assets and liabilities.
- 5) Debt managers should carefully assess and manage the risks associated with foreign currency, short-term and floating rate debt.
- 6) Short-term or floating rate debt can create a substantial refinancing risk for the government.

- 7) If a country lacks a well-developed market for domestic currency debt, a government may be unable to issue long-term domestic currency debt at a reasonable cost, and consequently must choose between short-term domestic currency debt and longer-term foreign currency debt.
- 8) Some governments would be well served to accept higher funding costs to keep refinancing risks under control, as concentrating the debt in benchmark issues at key points along the yield curve to reduce the liquidity premia required by investors may increase refinancing risk.
- 9) There should be cost-effective cash management policies in place to enable the authorities to meet their financial and budgetary obligations as they fall due.

- 10) Sound cash management facilitates debt management and monetary operations.
- 11) Appropriate policies related to the management of external debt vulnerabilities can also play a valuable role in meeting a government's financial obligations in the face of economic and financial shocks.
- 12) Hedging instruments, when available, can be used to move the cost and risk profile of the debt portfolio closer to the preferred portfolio composition.

3 - Examples of Public Debt Management Strategy (Croatia, Romania, Jordan, Latvia)

- ***The main objectives of public debt management strategy of Croatia (2011 – 2013) are followings:***

1) Contribution to the stabilization of the public-debt-to-GDP ratio

2) Extension of the average deadline maturity and reducing the share of short-term debt in the total amount of public debt

3) Establishment of mechanisms of protection against currency risk

4) Development of the yield curve on domestic and foreign markets

5) Continues development and improvement of the domestic securities market

6) Legalization of the time limit and manner of drafting of public debt management strategy through law on the fiscal responsibility

7) Development of the project for decrease of unemployment, demographic renewal and mitigation of emigration of young and educated people from Republic of Croatia

- ***Strategic guidelines for 2017-2019 (Romania)***
- The indicative target ranges for key risk indicators as follows:

To manage foreign currency risk:

1. keep the share of local currency denominated debt in total government public debt between 45% (minimum) and 60%.

2. keep the share of debt denominated in EUR in total foreign currency debt between 80%(minimum) and 95%.

To manage refinancing risk:

1. keep the share of debt maturing in the next year between 20% and 30% (maximum) for the local currency debt and between 10% and 20% (maximum) for total debt.

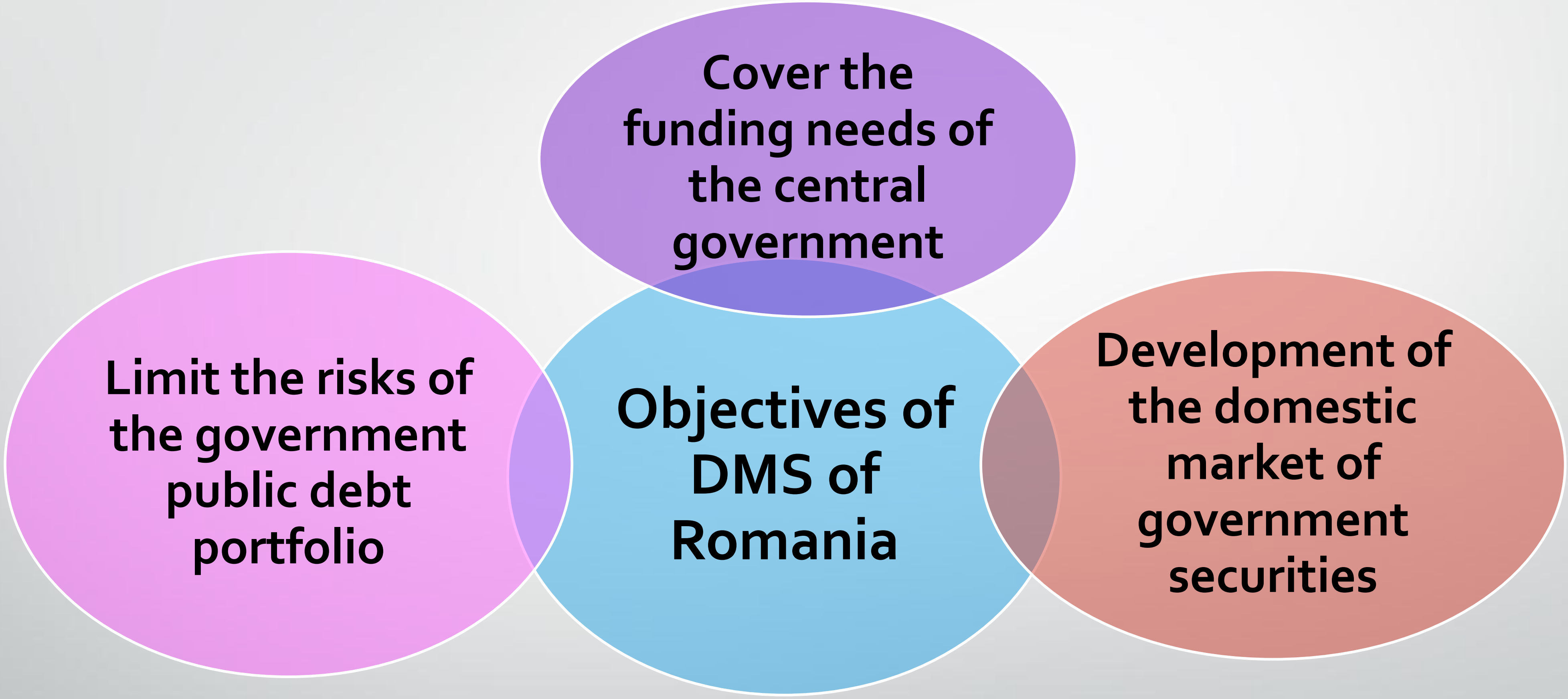
2. the average maturity remaining should be maintained between 3.5 years (minimum) and 5.0 years for local currency denominated debt and between 5.5 years (minimum) and 7.0 years for total debt.

3. keep a foreign currency buffer at a comfortable level, in order to mitigate the risks corresponding to high volatility times on the financial markets.

To manage interest rate risk:

1. debt re-fixing its interest rate in the next year should stay between 20% and 30% (maximum) for local currency debt and between 10% and 20% (maximum) for total debt.

2. keep the average maturity remaining until the next refixing between 3.5 years (minimum) and 5 years for local currency debt and between 5.5 years (minimum) and 7.0 years for total debt.


Cover the funding needs of the central government
Limit the risks of the government public debt portfolio
Objectives of DMS of Romania
Development of the domestic market of government securities

- **Medium Term Debt Management Strategy of Jordan (2017-2021) can be summarized as follows:**

- Continue reliance on external debt sources especially borrowing in USD to cover the portion of the borrowing needs with target to increase the FX as % of total debt to reach 45.5% of total debt in 2021.
- Extend the average maturity of domestic debt by issuing debt instrument with long term maturity (3, 5, 7, 10 and 15 years) taking market conditions into consideration.
- Decrease the share of debt maturing within one year.
- Issue Islamic Sukuk to diversify the financing sources and expand the investor base in government debt securities.

- **Central Government Debt and Cash Management Strategy of Latvia (2018)**
- The central government debt portfolio is managed in accordance with the following **basic principles:**

a) the optimum central government debt portfolio structure shall be defined taking into account the financial risks (liquidity risk, debt refinancing risk, interest rate risk, foreign exchange risk) and the situation in financial markets;

b) the costs of funding and financial risk hedging shall be balanced over the long term, setting as a priority risk hedging and prevention by not allowing uncontrollable increases in debt service costs;

c) only such transactions are acceptable for debt portfolio management, which are at the same time based on known or forecasted cash flows and assumptions on interest rate trends;

d) methods and technologies recognised by international financial practice, and, where applicable, legal advice shall be used for debt portfolio management.

- **Mostly following issues should be stated in Debt Management Strategy:**

1. Legal and Institutional Framework of a country
2. Macroeconomic situation of a country
3. The objectives and scope of Strategy
4. General information about government's debt portfolio
5. Current debt portfolio risks
6. Sources of financing
7. Pricing assumptions and description of shock scenarios
8. Debt management guidelines and annual borrowing plan
9. Reporting and follow-up

4 - The role of Public Debt Management Strategy for Debt Sustainability

- According to Carlos, **Debt sustainability** - is considered deterministic, where all uncertainty regarding future behavior of relevant variables is disregarded. In this setting, a debt is sustainable when the present value of future revenue flows minus debtor expenses can pay for all that has been contractually agreed.
- However, even with this simplistic concept, **some issues** need to be clarified.
- **First,** the emphasis on values specified in the contract (or securities) is fundamental to avoid the circularity associated with the use of market value.
- **Second,** debt will be considered in real terms, since the price level can be seen as a variable to adjust the debt value.

According to **Addis Ababa Action Agenda (UN, 2015)** in order to achieve the long-term debt sustainability in developing countries following issues should be taken account:

1) Stimulate debt financing from different sources
2) Regulation of public debt
3) Public Debt Restructurings
4) Improvement of debt management

5) Assets and liabilities should be used economically
6) Good mechanism for monitoring of debt
7) Improvement of assessment tools of public debt
8) Clearly determination liabilities of debtors and creditors
9) Usage of innovation tools for debt management
10) Improvement of reporting

All of these issues should be included to Public Debt Management Strategy.

We can also state "Principles on promoting responsible Sovereign lending and borrowing" (UN, 2012) which is useful for Public Debt Managementand Debt Sustainability:

	Responsibilities of Lenders	**Responsibilities of Sovereign Borrowers**
1	Agency	Agency
2	Informed Decisions	Binding Agreements
3	Due Authorization	Transparency
4	Responsible credit decisions	Disclosure and publication
5	Project financing	Project Financing
6	International Cooperation	Adequate Management and Monitoring
7	Debt Restructurings	Avoiding Incidences of Over-Borrowing
8		Restructuring

- **Responsibilities of Sovereign Borrowers**
- **1) Agency**
- Governments are agents of the State and, as such, when they contract debt obligations, they have a responsibility to protect the interests of their citizens.
- **2) Binding Agreements**
- A sovereign debt contract is a binding obligation and should be honored. Exceptional cases nonetheless can arise. A state of economic necessity can prevent the borrower’s full and/or timely repayment
- **3) Transparency**
- The process for obtaining financing and assuming sovereign debt obligations and liabilities should be transparent. Governments have a responsibility to put in place and implement a comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities.

- **4) Disclosure and publication**
- Sovereign debtors have a responsibility to disclose complete and accurate information on their economic and financial situation that conforms to standardized reporting requirements and is relevant to their debt situation.
- **5) Project Financing**
- In the context of project financing, sovereign borrowers have a responsibility to conduct a thorough ex ante investigation into the financial, operational, civil, social, cultural and environmental implications of the project and its funding. Borrowers should make public the results of the project evaluation studies.

- **6) Adequate Management and Monitoring**
- Debtors should design and implement a debt sustainability and management strategy and to ensure that their debt management is adequate. An audit institution should conduct independent, objective, professional, timely and periodic audits of their debt portfolios to assess quantitatively and qualitatively the recently incurred obligations.
- **7) Avoiding Incidences of Over-Borrowing**
- Governments have a responsibility to weigh costs and benefits when seeking sovereign loans. They should seek a sovereign loan if it would permit additional public or private investment, with a prospective social return at least equal to the likely interest rate.
- **8) Restructuring**
- If a restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken promptly, efficiently and fairly.

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