

EXECUTIVE SUMMARY

1. Recognizing the important role that public debt management can play in helping countries cope with economic and financial shocks, the International Monetary and Financial Committee (IMFC) requested that staff from the IMF and World Bank work together in cooperation with national debt management experts to develop a set of guidelines for public debt management to assist countries in their efforts to reduce financial vulnerability. When the Executive Boards of the IMF and the World Bank endorsed the Guidelines in the Spring of 2001, they requested that the staffs of the two institutions also prepare an accompanying document to the Guidelines containing sample case studies to illustrate how a range of countries from around the world and at different stages of economic and financial development are developing their debt management capacity in a manner consistent with the Guidelines. The experiences of these countries should offer some useful practical suggestions of the kinds of steps that other countries could take as they strive to build their capacity in public debt management.
2. The eighteen case studies presented in this report clearly illustrate the rapid evolution that is taking place in the field of public debt management. In contrast to 15 or 20 years ago, countries are much more focused on managing the financial and operational risks inherent in the debt portfolio than was the case in the past. And the way in which the stock of debt is managed is becoming increasingly sophisticated, especially in those countries that have had histories of excessive debt levels or have experienced shocks associated with the reversal of capital flows. These points are embodied in several over-arching themes that emerge from the country case studies. These themes are highlighted below.
3. The first key theme is that the objectives for managing debt and the institutional framework for meeting these objectives are becoming more formalized. All of the countries surveyed have explicit objectives for managing their debt, which focus on managing the need to borrow at the lowest possible cost over a medium- to long-term time frame. While most countries' statements of objectives also make explicit reference to the need to manage risks prudently, this is not universal. Even so, the reference to managing costs over the medium- to long-term can be seen as an awareness of the need to avoid taking on dangerous debt structures that might have lower costs in the short-run but could trigger much higher debt service costs in the future. They clearly do not strive to minimize costs in the short-run without regard to risk. Avoiding dangerous debt structures is, of course, easier said than done. In some countries, the costs of borrowing domestically by issuing long-term fixed-rate instruments may simply be too prohibitive in the short run due to weak macroeconomic conditions or because this segment of the market is not functioning well. As a result, many countries are dedicating significant effort and resources towards developing the domestic market for government debt so that down the road they can reduce rollover risk and other market risks in the debt stock, even though the benefits of doing so may only emerge over time, and entail higher debt service costs in the short run.

4. Another aspect of the more formal institutional framework can be seen in the organizational structure underpinning debt management. There is a clear trend towards providing a proper legal framework to support debt management, and centralizing debt management activities as much as possible in one entity, even though the preferred entity varies depending on country circumstances. As circumstances permitted, the countries surveyed took steps to separate the conduct of monetary policy from debt management, while ensuring that there continues to be adequate coordination at the operational level, so that there is appropriate sharing of information on the government's liquidity flows between debt managers, fiscal, and monetary policy authorities, and so the two activities do not operate at cross-purposes in financial markets. They have also taken a number of steps to clearly specify the roles and responsibilities of those involved in debt management, and subject the conduct of debt management activities to appropriate financial and management controls. This has helped to ensure that appropriate safeguards are in place to manage the operational risks associated with debt management.

5. The more formal institutional framework has also been accompanied by transparency in debt management activities and appropriate accountability mechanisms. Debt managers in all of the case study countries emphasized the need to ensure that the public is fully informed on the government's financial condition, the objectives governing debt management, and the strategies and modalities employed by debt managers to pursue these objectives. They also make use of a variety of communication vehicles, such as regular formal reports and media announcements, to report on their performance in meeting the objectives laid out for them, and to outline in general terms their plans and priorities for the year ahead. In some countries, their performance in both a financial and broader stewardship sense is also subject to regular external review. This reflects a general consensus among the countries that markets work best, and debt service costs are minimized, when uncertainty regarding the objectives and conduct of debt management and the state of government finances is kept to a minimum.

6. A second key theme relates to the high level of awareness of the importance of risk management of public debt and of a growing consensus for the appropriate techniques for managing risk. Many of the countries surveyed use cash flow modeling for analyzing the costs and risks of different debt strategies, where cost is measured as the expected, or most likely, cost of debt service over the medium- to long-term, while risk is the potential increase or volatility in cost over the same period. One rationale for this is that the cost of debt is best considered in terms of its impact on the government's budget, and that cash flow measures are a natural way of quantifying this impact. A few countries are beginning to experiment with modeling debt service and macro-variables jointly in order to more directly measure cost and risk of debt relative to the government's revenues and other expenditures—that is to model the government's assets and liabilities jointly. In a number of other cases, this asset-liability management or ALM approach has been used in a more limited way by analyzing the risk characteristics of government financial assets (such as foreign exchange reserves) and debt jointly in order to determine the appropriate structure of debt and assets.

7. The management of operational risk is also receiving increased attention. In large part this is addressed by having institutional structures that permit clear assignment of authority and responsibility, operations manuals detailing all important procedures, conflict of interest rules, clear reporting lines, and formal audits. But many debt offices now also have separate middle offices with responsibility for analyzing risk and designing and implementing risk control procedures (some of these same offices also have responsibility for analyzing strategies for managing the costs and risks of debt, although in others, the responsibility for strategic analysis is separate from the risk control unit).

8. Those debt offices, which trade their debt or take tactical risk positions, have particularly strong middle office control structures. The focus on formal risk analysis and control structures is not universal, however, as it depends largely on country circumstances. In the past, the industrial countries seen as leaders in this field also had large and risky debt structures, including a substantial share of foreign currency debt. Consequently, the benefits of taking a more systematic approach to the financial and risk management of the government's debt were substantial. While others, which have deep and liquid domestic debt markets and consequently little or no foreign currency debt, have a much less risky debt structure and less of a need for a formal strategy for managing debt based on cost/risk tradeoffs. On the other hand, emerging market and developing countries, many of which also have had risky debt structures, had a later start in building the capacity for managing this risk. While some of these countries are now using models and systems which are similar to the industrialized countries, others are still in the process of building this capacity, and while good progress has been made, the experience of the leading practitioners demonstrate that this process can take several years. That said, some countries may not need to build models and systems as sophisticated as those found in the industrial countries because their debt issuance options are narrower and their markets less amenable to statistical analysis. Instead, they should strive to set achievable goals for their models that are limited to the genuinely useful aspects.

9. It also is clear that a lot of financial resources and management time is being devoted to developing the technology and systems needed to perform these tasks. This speaks to the need to ensure that the systems acquired are appropriate to the government's needs given a country's stage of development. The systems acquired do not necessarily have to include all of the latest and most sophisticated features—many of the cash flow simulation models used for cost/risk analysis are spreadsheet based. Countries also have pursued the acquisition of technology in different ways, depending on country-specific circumstances. Some have opted to acquire these systems by purchasing commercially available systems that were designed for private sector financial institutions and customizing them to suit their own needs, while others have opted instead to develop their own systems in-house. Some systems are very basic, focusing on the primary needs of debt recording, reporting and analysis, while others are integrated with other cash management, accounting, and budget systems. This highlights the fact that the appropriate technology varies considerably depending on country-specific circumstances, and that many countries are still experimenting to find out which systems work best.

10. A third key theme that emerged from the case studies is the striking convergence in approaches taken by countries to issue debt and promote a well-functioning domestic financial market. Auctions of standardized market instruments are commonly used to issue debt in domestic markets, and debt managers are cognizant of the need to avoid excessive fragmentation of the debt stock if they are to encourage deep and liquid markets for government securities. Where differences exist, they tend to be at the level of execution, such as in terms of the features of instruments issued and the extent to which debt managers are prepared to rely on primary dealers to market their debt to end-investors. Nonetheless, it is important to note that all of the countries surveyed made reference to the advantages of working with market participants in a collaborative fashion to develop their domestic government securities markets and minimize the amount of uncertainty in the market regarding government financing activities. Over time, this appears to be paying off in the form of more efficient domestic financial markets, and ultimately lower borrowing costs for the government, in that the presence of a thriving domestic market makes it easier for debt managers to achieve a debt stock structure that embodies the government's preferred risk-cost tradeoff.

11. Fourth, it is important to highlight what sound debt management in and of itself cannot deliver. It is no substitute for sound macroeconomic and fiscal policies, and on its own will not be enough to ensure that a country is well insulated from economic and financial shocks. Developing public debt management in a manner consistent with the Guidelines clearly has an important role to play in fostering prudent debt management practices and contributing to the development of a well-functioning market for government securities. However, many countries also stressed the need for a sound macroeconomic policy framework, characterized by an appropriate exchange rate regime, a monetary policy framework that is credibly focused on the pursuit of price stability, sustainable levels of public debt, a sound external position, and a well-supervised financial system. Such a framework is an important underpinning to instilling confidence among financial market participants that they can invest in government securities with a minimum of uncertainty. It is thus an important precondition if debt managers are to succeed in achieving a debt structure that reflects the government's preferred risk-cost trade-off, and helping the country at large to minimize its vulnerability to economic and financial shocks. Indeed, through their links to financial markets and their risk management activities, government debt managers are well-positioned to gauge the effects of government financing requirements and debt levels on borrowing costs, and to communicate this information to fiscal policy advisors.

12. Finally, while the examples of debt management practices presented in the case studies and the lessons drawn here offer some practical guidance for policymakers in all countries that are striving to strengthen the quality of their public debt management and reduce their country's vulnerability to economic and financial shocks, they are especially relevant for the HIPC's and less developed transition economies. These are at an earlier stage of developing their capacity in public debt management. For them, in addition to continuing to strengthen their budget and cash management functions, an important priority will be to draw from the experiences outlined in the case studies to build a proper foundation for

conducting debt management. In this regard, some important first steps for many of these countries are the need to introduce appropriate governance and institutional structures so that the operational and financial risks associated with debt management are properly managed, to develop information systems that fully capture the financial characteristics of all of the government's financial obligations and contingent liabilities, and the need to develop a debt strategy that encompasses both domestic and external debt. The latter is especially important, and the experiences of the countries covered by the case studies suggests that the development of a domestic debt market can play an important role over time in helping to broaden the range of borrowing opportunities for a country, and making it easier for it to achieve its desired cost-risk trade-off.