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Strengthening Debt Management Practices: Lessons from Country Experiences and Issues Going Forward

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Acronyms

AAA	Analytical and Advisory Activities
ALM	Asset and Liability Management
CAS	Country Assistance Strategy
CB	Central bank
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ECCB	Eastern Caribbean Central Bank
FSAP	Financial Sector Assessment Program
GDDS	General Data Dissemination System
HIPC	Highly Indebted Poor Country
IDA	International Development Association
IFIs	International Financial Institutions
LIC	Low-Income Country
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-Income Country
MoF	Ministry of Finance
MTDS	Medium-term Debt Management Strategy
MTFF	Medium-term Fiscal Framework
ODA	Official development assistance
OECD	Organization for Economic Cooperation and Development
PDM	Public Debt Management
PEFA	Public Expenditure and Financial Accountability
PMU	Program Management Unit
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	Public-Private Partnership
PRGF	Poverty Reduction and Growth Facility
ROSC	Report on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard
TA	Technical Assistance
TAC	Technical Assistance Center
TSA	Treasury Single Account

EXECUTIVE SUMMARY

This paper reviews Bank-Fund staff experience with strengthening public debt management (PDM) frameworks and capacity in developing countries. In 2001, the IMF and the World Bank developed sound practice guidelines in this area, followed by a pilot program to assist 12 countries develop and implement reforms. In addition, an assessment of PDM has been incorporated into surveillance work, where relevant, and included in other Bank and Fund advisory and technical assistance work. Based on these, the paper draws key lessons, identifies the continuing challenges facing debt managers, and proposes further capacity building and advisory work in PDM.

Financial crises of the 1990's highlighted the need for effective PDM, including well functioning domestic public debt markets, to help reduce financial vulnerabilities. Experience suggests that many countries, particularly the middle-income countries (MICs), have made progress in strengthening their PDM frameworks and reducing debt-related vulnerabilities. In parallel, some MICs have made impressive progress in deepening domestic public debt markets, which is contributing to strengthening monetary and financial stability more generally.

Nevertheless, many countries continue to face a range of policy, institutional and operational challenges. Several MICs, and most low-income countries (LICs), remain at an early stage in defining comprehensive medium-term debt management strategies (MTDS). Experience also highlights the challenges in establishing an effective governance framework and in building capacity. In many LICs, such challenges are acute. As recognized in the November 2006 review of the debt sustainability framework (DSF), LICs—especially those that received significant HIPC and MDRI debt relief—face a further challenge in managing their increased borrowing space and maintaining debt sustainability.[1] Finally, many MICs and LICs require substantial public debt market reforms.

The Bank and Fund staff will continue their support for programs to strengthen PDM in developing countries, and efforts will be intensified in the case of LICs. Guided by the experience of work to date, the Bank and Fund will continue to respond to demand by individual countries, undertake capacity building and knowledge dissemination, and monitor and analyze financial risks in debt structures. A special effort will be made to support development and implementation of effective MTDS in LICs. This will comprise joint Bank-Fund capacity building work, over an initial 4-year period (2008–2011). Consultation on the methodology will be carried out as needed with other institutions, including the private sector. To track progress, this joint work will be complemented by periodic measurement of debt management performance. These initiatives will be tailored for individual countries, complement existing programs, and be undertaken in close consultation with country authorities, other providers of technical cooperation, and bilateral donors.

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[1] See "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," November 2006.

I. BACKGROUND

1. **In 2001, the World Bank and the IMF developed and disseminated sound practices in the areas of public debt management** (PDM) (Box 1).[2] PDM is the framework, system or process, within which the required amount of government funding is raised, in a manner that is consistent with the authorities' risk and cost objectives, and which meets any other debt management goals set by the government. This is usually supported by a formal debt management strategy. But the process of moving from a set of general principles, to concrete programs and capacity building, is not straightforward. Recognizing this, a joint Bank-Fund pilot program covering 12 countries was initiated in 2002, with the objective of assisting authorities design and implement a reform program in PDM.[3]

Box 1. Six Principles of Sound Practice in Public Debt Management

1 **Debt management objectives and coordination**
- ensure that the government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk.
- develop a common understanding of debt management, monetary and fiscal policy objectives.

2 **Transparency and accountability**
- publicly disclose the objectives of PDM, the relevant measures of cost and risk, and the allocation of responsibilities.

3 **Institutional framework**
- clarify the legal authority to borrow and issue new debt, invest, and undertake other transactions on the government's behalf.
- ensure clear roles and responsibilities.
- develop accurate and comprehensive debt data.

4 **Debt management strategy**
- monitor, evaluate, and manage the risk structure of public debt.
- implement cost effective cash management policies that minimize government liquidity and repayment risk.

5 **Risk management framework**
- manage the tradeoffs between cost and risk of government debt.
- consider the impact of contingent liabilities on the government's financial position.

6 **Development and maintenance of an efficient market for government securities**
- ensure that policies and operations are consistent with the development of an efficient government securities market.

[2] The *Guidelines for Public Debt Management* (the *Guidelines*), published in March 2001, and subsequently revised in December 2003, and the Handbook, published in July 2001, were followed by the *Accompanying Document to Guidelines for Public Debt Management* (2003), which contained 18 case studies written by country authorities on how they implemented public debt management based on sound principles.

[3] The 12 countries in the pilot program were Bulgaria, Colombia, Costa Rica, Croatia, Indonesia, Kenya, Lebanon, Nicaragua, Pakistan, Sri Lanka, Tunisia, and Zambia. The Bank led this work and insights from the pilot program are published as *Managing Public Debt: From Diagnostics to Reform Implementation* and *Developing the Domestic Government Debt Market: From Diagnostics to Reform Implementation,* World Bank, 2007.

2. **Both institutions have also provided technical support to countries outside that pilot program.** The Bank has helped several countries complete diagnostics and implement reforms. Similarly, the Fund has provided technical assistance (TA), arising out of surveillance, where relevant, or other direct requests from member countries. In addition, the PDM framework has been explicitly reviewed in several Financial Sector Assessment Programs (FSAP).[4]

3. **The objectives of this paper are to review country experience in strengthening PDM practices, identify continuing challenges, and discuss how the Bank and Fund should continue to support reform in this area.** It draws specifically on the experiences of developing countries reviewed in the joint Bank-Fund pilot program, and the FSAP. It is also informed by staff experiences from other capacity building work, surveillance, TA and outreach.[5, 6] The paper identifies the key policy, operational and institutional challenges countries continue to face; discusses the specific challenges faced by LICs, specifically in countries post the Multilateral Debt Relief Initiative (MDRI); and outlines how the Bank and the Fund plan to work with developing countries going forward, providing advisory services and other capacity building support, collaborating where relevant with other providers of capacity building support, donors, and the private sector. The paper concludes with a number of specific issues for discussion.

II. Emerging Trends[7]

4. **In recent years, the structure of debt has significantly improved in several developing countries.**[8,9] The maturity profile has lengthened, both in the case of domestic debt (Colombia, Costa Rica, Czech Republic, and Peru) and of international bond issues.[10] Also, several countries have reduced their reliance on foreign currency debt (e.g., Brazil, Colombia, Mexico, Peru, and Thailand), and countries are issuing more fixed rate debt (e.g., Brazil, Indonesia, Peru, and Mexico). Countries such as Colombia, Mexico, Tunisia, and Uruguay have also made use of debt exchanges or swap transactions to transform the profile of their debt portfolio. As a result, vulnerabilities to sharp changes in the exchange rate, interest rates, or market access appear to have been reduced relative to the situation of

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[4] The FSAP assessments of the PDM framework and practices based on the Bank-Fund *Guidelines* have included Albania, Cote d'Ivoire, Ecuador, Jamaica, Mozambique, Peru, and Turkey.

[5] Such as the occasional World Bank Sovereign Debt Management Forum and the semi-annual IMF Debt Managers' Forum.

[6] Within the Fund, the paper has been prepared by staff in the Monetary and Capital Markets Department, with inputs from the Fiscal Affairs Department and the Statistics Department, and in close collaboration with the Policy Development and Review Department.

[7] For the purposes of this chapter, the country references are only illustrative, and not exhaustive.

[8] For fuller details see Chapter III of the April 2006 *Global Financial Stability Report*.

[9] It is likely that countries would not have been able to achieve the same degree of improvement if global liquidity conditions had been different.

[10] For example, over 2001-05, the average maturity of international issues for a sample of 18 important emerging market countries increased from 8 to 13 years. Note that this sample excludes Argentina.

the mid-1990s (Table 1 and Figure 1). However, in general, levels of debt remain high (see Table 1) and continue to represent a significant risk to sovereign balance sheets. Consequently, a strong focus on maintaining debt at sustainable levels remains necessary.

Table 1. Level and Structure of Public Debt in Selected Countries

	General Govt. Debt / GDP[1]		FX Debt Share[2]		ST Debt Share[3]	
	1996	2005	1996	2005	1996	2005
Brazil	33	71	48	14	57	22
Colombia	28	46	30	25	0	6
Czech Republic	n.a.	26	13	13	56	16
Hungary	72	61	30	26	15	22
India	69	83	0	0	19	3
Indonesia	n.a.	47	n.a.	6	0	0
Malaysia	36	44	5	7	5	2
Mexico	35	36	67	29	29	23
Philippines	n.a.	63	16	34	55	29
Poland	42	48	27	22	42	8
South Africa	44	34	3	10	6	6
Thailand	14	46	49	7	0	24
Turkey	n.a.	69	31	37	60	7

Sources: BIS; Jeanne and Guscina (2006), "Government Debt in Emerging Market Countries: A New Data Set", IMF Working Paper WP/06/98, April 2006; IMF staff estimates; IMF World Economic Outlook; Mexican authorities; South African Reserve Bank; and Turkish authorities.

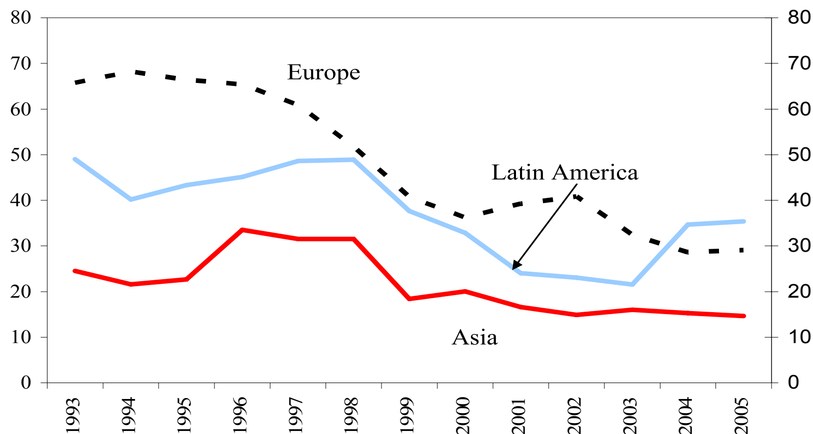
[1] Gross general government debt, except for Hungary, which is net and Mexico, which is net augmented debt. Note coverage may vary across countries.

[2] Foreign-currency-denominated debt (issued both domestically and abroad) in percent of total marketable debt

[3] Short-term domestic debt in percent of total domestic marketable debt.

Figure 1. Proportion of Emerging Market Domestic Public Debt Maturing in Less than a Year

(in percent of total sovereign debt)



Source: Global Financial Stability Report, IMF, April 2006

5. **Several MICs have made progress in developing and publishing a debt management strategy** (e.g., Brazil, Bulgaria, Colombia, Costa Rica, Czech Republic, Hungary, Indonesia, Peru, Poland, Mexico, and Turkey). Few LICs, however, publish such a strategy. Those that do (e.g., Tanzania and Papua New Guinea) often lack a systematic analysis of the cost and risk of the debt portfolio, and the strategies are limited to external debt.

6. **Some countries have strengthened the governance framework supporting PDM** (e.g., Bulgaria, Croatia, and Nicaragua).[11] Colombia, Indonesia, and Uruguay consolidated PDM responsibilities in one unit, while Nigeria and Hungary have formed semi-autonomous debt management agencies. Other countries, such as Costa Rica, have formed coordination committees.

7. **However, fragmentation of debt management responsibilities remains a problem.** Some countries with centralized debt management responsibilities continue to manage domestic and foreign debt separately. Quasi-fiscal debt is often managed separately by central banks (e.g., Chile, Costa Rica, Guatemala, and Nicaragua). But even with fragmentation, close coordination can still permit the production of a consolidated public debt database (e.g., Nicaragua).

8. **Some countries have made considerable progress in improving transparency and strengthening communication with market participants.** This can include disseminating information on the composition and risk profile of the public debt portfolio to supplement data appearing in financial statements (e.g., Colombia, Indonesia, Jamaica, Lebanon, Tunisia, Turkey, Sri Lanka, and Zambia).

9. **Debt managers have also become more active in developing their domestic public debt markets.** Brazil, Chile, Colombia, Mexico, and Turkey, have increased liquidity, and reduced interest rate volatility, by introducing benchmark bonds and improving the transparency and predictability of debt operations, for example, by publishing annual or monthly auction schedules (e.g., Brazil and Turkey). Some have introduced primary dealer systems (e.g., Colombia and Turkey) to support the functioning of their primary and secondary markets. Efforts to strengthen regulatory and legal environments have also helped (e.g., Kenya and Nicaragua).

III. Debt Management: Key Policy, Institutional and Operational Challenges

10. **Notwithstanding recent progress in PDM, the reform agenda remains significant.** This is particularly true for the LICs as a group, where the quality of debt management may have deteriorated as indicated in the latest Bank Independent Evaluation Groups' review of the HIPC Initiative.[12] In particular, in the absence of a strong debt

[11] See Chapter I of the accompanying background volume for more detail.

[12] World Bank World Bank Independent Evaluation Group, 2006, "*Debt Relief for the Poorest: An Evaluation Update of the HIPC Initiative,*" http://www.worldbank.org/ieg.

management framework, the new borrowing space created by HIPC and MDRI debt relief aggravates the risk that imprudent borrowing will lead to a re-accumulation of unsustainable debt.[13]

11. **The remainder of this section points to three priority areas for strengthening developing countries' PDM practices**: (i) developing a comprehensive and effective debt management strategy; (ii) improving governance and capacity; and (iii) strengthening the relationship between debt management operations and financial market development.

A. Developing a Medium-Term Debt Management Strategy

12. **A debt management strategy offers a framework to guide new financing decisions, in terms of the preferred choice of instrument, and other portfolio operations, so that the debt management objective is met.** It should identify the authorities' desired debt portfolio composition, taking account of the cost-risk trade-off and other policy settings, such as exchange rate or monetary policy. Almost all OECD countries have a published debt management strategy**.** But only half the sample developing countries have a debt management strategy and even fewer publish it.[14]

13. **Most developing countries follow implicit or *de facto* strategies** (e.g., Colombia, Kenya, Lebanon, Nicaragua, and Tunisia). In addition, fragmentation of responsibilities, and the lack of adequate information and analytical capacity in debt units has hindered the progress from *de facto* to formal debt strategies.

14. **Where *de facto* strategies have been followed, there were some shortcomings.** For example, in countries with access to concessional loans, such as Kenya, Pakistan, Sri Lanka and Zambia, the trade-off between foreign currency debt (with very low interest rates and long maturities) and domestic debt (typically with shorter maturities and higher interest rates) were often not adequately taken into account. Second, actions to reduce risk or cost in one sub-portfolio have conflicted with another (e.g., Pakistan).[15] Third, short-term expediency (to reduce budgetary costs) has sometimes outweighed prudent risk management (e.g., Sri Lanka).[16]

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[13] See "*Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief*", November 2006, which highlights how new lending opportunities, if taken in excessive volumes or on unfavorable terms could contribute to the re-emergence of debt vulnerabilities.

[14] According to a survey conducted in 2006 by the Banking and Debt Management Department (BDM) of the World Bank. The sample of 71 countries consisted of 30 OECD countries, the 12 countries of the pilot program, 10 countries where the Bank is conducting follow-up work and other IBRD countries that responded to a questionnaire. Moreover, 61 percent of OECD countries express their strategies as targets or benchmarks compared to 38 percent in the case of the non OECD countries surveyed.

[15] For fuller details, see Chapter I of the accompanying background volume.

[16] For example, this could lead to an excessive use of short-term financing instruments, that are cheaper given the existence of a term premium, but which carry more rollover and interest rate risk than longer-dated debt. See Annex II for a fuller discussion of the key elements of a MTDS.

15. **Developing a medium-term debt management strategy (MTDS) is a significant analytical exercise that requires incorporation of a number of key elements.** A natural first step is to formalize existing practices, which often highlights specific constraints such as the lack of monetary or fiscal policy credibility, market development, or institutional shortcomings.[17] The strategy should identify any plans to relax these constraints, such as regular issuance of benchmark securities, or formalizing information sharing procedures.

16. **Evaluating the relevant costs and risks is not straightforward.** While some countries have developed sophisticated financial models for this, many countries lack a systematic framework, including a clear definition of cost and risk. In LICs, an explicit recognition of key exogenous risks such as terms of trade shocks and aid volatility must support the development of a MTDS.

17. **Developing MTDS that effectively balance cost against *fiscal* risk can prove challenging**. This should be accomplished within a rigorous and fully operational medium-term fiscal framework (MTFF). But many countries have not linked a theoretical MTFF with the annual budget process.[18] Integrating the debt strategy analysis within a debt sustainability framework (DSF) can provide a suitable alternative.[19] This will enable the impact of variations in key variables on long-term macro-fiscal projections, and their corresponding consequences for debt, to be modeled (Box 2). More generally, a framework that captures the evolution of the government's revenues and expenditures, under different scenarios, can offer valuable insights into how the budgetary impact of volatility in debt servicing might be reduced.

18. **Fiscal policy, however, remains the principal tool for achieving and maintaining debt sustainability.** Although, poor debt management can add to the debt burden, fiscal policy is the main determinant of the debt level. Effective debt management can, however, help mitigate the likelihood of a liquidity crisis, and reduce costs and risks; but solvency is not assured without an appropriate fiscal, and broader macroeconomic, policy stance.

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[17] In industrialized countries, sound macroeconomic fundamentals and deep, and liquid, domestic public debt markets, allows the debt management strategy to be principally driven by cost-risk analysis.

[18] See for example World Bank (2002), "*Medium-term Expenditure Frameworks: From Concept to Practice. Preliminary Lessons from Africa,*" World Bank Africa Region Working Paper Series No. 28.

[19] See PIN 06/136, December 2006, "*IMF Executive Board Discusses the Application of the Debt Sustainability Framework for Low-Income Countries Post Debt Relief.*"

Box 2. Inter-Relationship Between Debt Sustainability Analysis (DSA) and Debt Strategy Analysis

The Debt Sustainability Framework (DSF) provides an objective assessment of debt sustainability given a macroeconomic framework that outlines a country's fiscal and balance of payments stance under certain assumptions and conditions.1/ A Debt Sustainability Analysis (DSA) applies the DSF and considers a number of stress tests to evaluate the robustness of debt burden indicator profiles—usually the ratio of the NPV of debt to GDP, exports or tax revenue—to various macro-economic shocks, such as to GDP, the exchange rate, revenues, etc., Often, simplifying assumptions about the level and shape of the yield curves facing the country are made, i.e., the term structure is not explicitly modeled, either as a function of policies or the debt structure, but rather taken as given; nor is the impact of debt composition on the exchange rate modeled.

Conversely, debt strategy analysis generally evaluates the performance of various financing strategies under a given path for the primary balance and other macro-economic variables. Here, variables that capture market risk, such as the interest rate sensitivity of cash flows, other determinants of the term structure, the exchange rate, etc, may be explicitly modeled. Again, the robustness of the various strategies is evaluated against a variety of outcomes for these variables. Generally, the output is presented in terms of the impact on nominal debt servicing costs, which can be set within the overall context of the budget or presented as an absolute level. Presenting it within the budgetary context, for example, by expressing it as a proportion of tax revenues, allows the real economic burden to be captured.

Clearly, the two approaches share many common assumptions, including the future path of the primary balance. A key element of the debt strategy analysis is its consideration of how the primary balance is financed. The analyses of both approaches are complementary and may suggest efficiency gains if the same agent carries out both sets of analysis, especially in the LIC context. However, it must be recognized that the DSA is focused on evaluating certain fiscal policies and is rightly within the purview of the fiscal policy maker; the debt manager is focused less on whether fiscal policy is sustainable, which is outside their remit, but rather, given a preferred stance for fiscal policy, how that should be financed.

There is, however, scope to bridge the gap and develop approaches to debt strategy analysis that are more closely related to a DSA, while also allowing for an analysis of the potential impact of the debt structure on key macroeconomic risks (e.g., assessing the implications of extensive foreign currency financing on the risk of a sharp depreciation of the exchange rate). In particular, debt managers could augment the traditional DSA, both through inclusion of details on the term structure of debt and through the use of more tailored risk assessment techniques to better analyze the portfolio risks, to improve its effectiveness as a tool for debt strategy analysis.

1/ See, for example, Abiad and Ostry (2005), "*Primary Surpluses and Sustainable Debt Levels in Emerging Market Countries*", IMF Working Paper WP 05/6, October 2005, or Celasun, Debrun and Ostry, (2006), "*Primary Surplus Behavior and Risks to Fiscal Sustainability in Emerging Market Countries: A 'Fan Chart' Approach*", IMF Working Paper WP 06/67, March 2006, for a broader discussion on debt sustainability issues.

19. **Improving the effectiveness of *cash management* reduces cost and helps mitigate liquidity and rollover risk.** This helps ensure that financial obligations are met without incurring high costs or compromising the debt issuance program. Conversely, weak cash management can impede the achievement of debt management objectives. For example, in Croatia, Indonesia, and Tunisia the timing of bond sales was driven by cash management needs, whereas domestic public debt market development would have benefited from a more regular and predictable issuance program.[20] The proliferation of government bank accounts in

[20] Although Indonesia is taking steps to address this.

many LICs has been a major factor in the inefficient use of cash across the government. Also, where markets are underdeveloped, a tendency to use large cash balances, cash rationing or resort to borrowing from the central bank not only unduly increases costs, but also hinders liquidity forecasting, and otherwise impedes the effective implementation of monetary policy.[21] However, many MICs and LICs struggle to improve the quality of their cash flow forecasting, with LICs facing particular challenges in implementing a treasury single account (TSA).

20. **To minimize potential conflicts, it is desirable to set the objectives of debt management and *monetary policy* independently**. In several developing countries this independence is often not feasible for two reasons: (i) weak institutional structures and lack of technical capacity in the MoF, and (ii) underdeveloped domestic financial markets. For example, in Kenya, Pakistan, Sri Lanka, and Zambia the lack of technical capacity of the MoF made it difficult to shift responsibility for debt management away from the central bank (CB). Where the CB has issued significant quantities of its own securities to control excess liquidity or to finance quasi-fiscal deficits, the CB's willingness to raise interest rates, and consequently, the credibility of monetary policy (e.g., Costa Rica, Indonesia, and Nicaragua), may be called into question. Independent debt management and monetary policy is very important where fiscal dominance has, in the past, thwarted the achievement of monetary objectives. This is often the case in LICs that have experienced high inflation, resulting from monetization of fiscal deficits.

21. **Few countries incorporate *contingent liabilities*—both explicit and implicit—into their debt strategies.** Explicit contingent liabilities, such as government guarantees, can represent a significant fiscal risk, and are a particular issue in LICs, where guarantees are often required to finance projects. The increasing reliance on public-private partnerships (PPPs) adds to this risk. Managing these risks effectively requires countries to record and monitor such guarantees on a regular basis, which is increasingly a role for the debt manager. However, evaluation of the fiscal risks involved in guarantee portfolios, and other contingent liabilities, is problematic. While these issues have been widely discussed, and some valuation techniques have been developed, no common methodology is available on how to reflect such risks in a MTDS.[22] This is equally true for implicit contingent liabilities—for example, those that arise from the vulnerability of the banking system.

[21] At an operational level it is important for the central bank to be aware of the government's financing plans and cash flows so that they can be properly incorporated into the central bank's liquidity management operations.

[22] See, for example, OECD (2005), "*Advances in Risk Management of Government Debt*", OECD, March 2005, IMF (2005), "*Government Guarantees and Fiscal Risk*", April 2005, (www.imf.org), or World Bank (2002) "*Government at Risk: Contingent Liabilities and Fiscal Risk*" for a discussion of some of these issues.

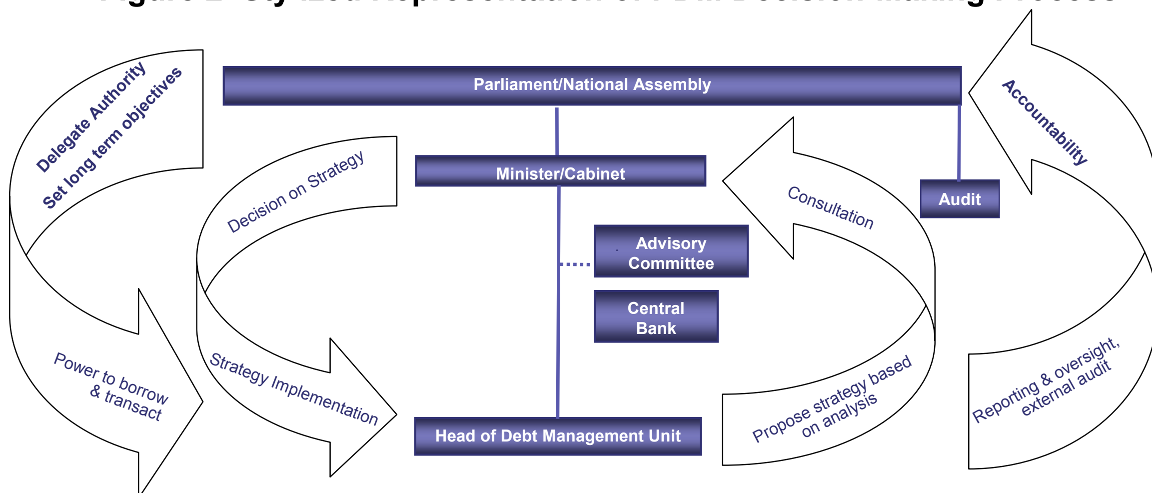
B. Governance Arrangements and Capacity

22. **Impediments to effective PDM also result from poor governance and capacity constraints.** This section focuses on some of these issues, as well as the approaches countries are adopting for reform in this area.[23]

Accountability and Legal Framework for Public Debt Management

23. **The governance structure supporting PDM should delineate clear roles and responsibilities for all the relevant institutions.**[24] Appropriate checks and balances should be in place, along with clear reporting lines. Accountability and transparency should be ensured through the disclosure of activities and outcomes (Figure 2).

Figure 2. Stylized Representation of PDM Decision-Making Process



Source: World Bank staff

24. **Very often, this is not fully supported by the underlying public debt legal frameworks, affecting the efficacy of PDM in various ways:**[25]

- Many laws enacted at different times often specify different levels of oversight for borrowing (e.g., Colombia, Costa Rica, Kenya, Lebanon, Mongolia, Panama, and Tunisia), or multiple authorities to borrow (e.g., Lebanon and Sri Lanka).

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[23] The section draws on information gathered over the period 2002–2006, based on the assessment reports prepared under the joint Bank-Fund 12-country pilot program and other work, which has been discussed with the relevant country authorities.

[24] In line with similar provisions in the IMF (2001), "*Code of Good Practices on Fiscal Transparency*", (www.imf.org), and IMF (2000) "*Code of Good Practices in Monetary and Financial Policies,*" (www.imf.org).

[25] Other problems include the absence of a clear legal framework governing borrowing at the sub-national level, and its relationship to borrowing at the central level, and insufficient provisions governing the recording of public debt.

- Budget laws generally focus on aggregate borrowing requirements, but often set sub-limits that impede decisions on instrument choice and risk management (e.g., Indonesia, Lebanon, and Sri Lanka).

- Minimal disclosure and reporting requirements affect transparency and market efficiency (e.g., Côte d'Ivoire and Dominican Republic).

25. **Countries have adopted various approaches toward reforming the legal framework, but the institutional and political realities often impede reform**. In some cases, an amendment to the constitution would be required (e.g., Tunisia). Nevertheless, some countries have succeeded in consolidating legislation in new budget systems laws or debt management laws (e.g., Bulgaria, Nicaragua, and Serbia). A medium-term focus has also been supported by the introduction of legislation requiring the introduction of multi-annual budgeting frameworks (e.g., Colombia, Croatia, and Pakistan). Some countries have sidestepped legislative change in the early stages and have used secondary regulation (decrees, regulations, and ministerial authority) to implement urgent reform. But such partial solutions have their risks, for example, by adding to the already complicated and fragmented legal frameworks in some countries (e.g., Colombia and Indonesia).

26. **Organizational arrangements in countries also hampered effective debt management.** Fragmentation of responsibilities across different ministries and departments increases the coordination and informational requirements and hinders the development of a strategy for the aggregate debt portfolio (e.g., Costa Rica, Croatia, El Salvador, Indonesia, Kenya, Kazakhstan, Lebanon, Pakistan, Romania, and Zambia). Often, the CB's role as an agent in the management of domestic or external public debt is not clearly defined. Where the CB is (*de facto*) involved as the principal, this can contribute to policy conflicts (e.g., Zambia).

27. **Consolidation of debt management responsibilities in one unit has been a difficult reform to implement.** While some countries have taken actions to consolidate within the ministry of finance (e.g., Brazil and Uruguay) or established separate public debt management offices (e.g., Hungary and Nigeria), in countries where the CB was responsible for domestic debt, attempts to transfer this from the CB have proven difficult to implement (e.g., Costa Rica, Nicaragua, and Sri Lanka). Others have created a coordination office (e.g., Pakistan), or a coordination committee (e.g., Costa Rica). Experience with these approaches has been mixed, as it can add a further layer to an already complex set of arrangements.

28. **The systematic management of operational risk must be improved in most countries,** for example:

- In a few countries, debt transactions were entered into and verified by the same unit and individuals, which can reduce the integrity of the data and, at one extreme, increase the risk of fraud.

- Where debt management involves regular interface with the market, a code of conduct is necessary but rarely implemented.

- Most countries do not have adequate, written, and well understood procedures governing their debt management operations.

29. **In this context, Bank-Fund initiatives on the collection, availability, and quality of debt statistics have played an important role.** The availability of timely and good quality statistics can mitigate some of the impediments to debt strategy formulation that arise from organizational fragmentation. These efforts are being carried out in partnership with other agencies, including those responsible for debt data recording systems, and include the dissemination of methodologies and frameworks corresponding to international accounting standards (see Box 3). Training in debt statistics compilation has also been delivered.

30. **This underscores the long recognized need for sound debt recording systems, which has been the focus of considerable development assistance by many donors.** Despite this, some countries still do not have well functioning debt recording and reporting systems in place (e.g., Kenya and Zambia).

Box 3. Current Multilateral Initiatives for Improving Availability and Quality of Debt Statistics

In response to growing demands for data, an Inter-agency Task Force on Finance Statistics (TFFS) 1/ has undertaken an initiative aimed at improving the availability and quality of debt statistics. Significant advances have been made in recent years in improving availability of external debt statistics and in related capacity building. 2/ These include:

- production of the *External Debt Statistics: Guide for Compilers and Users (External Debt Guide) (2003*), providing an internationally recognized methodology for compiling and presenting external debt statistics;
- creation of the World Bank Quarterly External Debt Statistics (2004) (QEDS), a joint initiative of the Fund and the Bank to bring together external debt statistics produced by SDDS subscribing countries in one central location, on a comparable basis;
- production of the External Debt Statistics Data Quality Assessment Framework (ED DQAF) in June 2005, a tool produced by the Fund for improving and assessing the quality of external debt statistics;
- launch of the Fund public sector debt statistics initiative in 2005, with the aim of assembling existing statistical series on public sector debt (domestic and external) in a single electronic source that could be accessed easily for balance sheet analysis;
- launch of the Joint External Debt Hub (JEDH) website in March 2006, a joint initiative of the BIS, IMF, OECD, and the World Bank aimed at facilitating availability of external debt statistics produced both from creditor/market sources and national sources;
- deepening capacity building in the area of debt statistics through collaborative training activities with the members of the TFFS—since May 2002, over 500 government officials from about 140 emerging markets and the low income countries were trained in external debt statistics compilation methodologies.

1/ The TFFS was established in 1992 under the aegis of the United Nations Statistical Commission and the Administrative Committee on Coordination-Sub-Committee on Statistical Activities. The TFFS is chaired by the IMF and meets annually. It comprises BIS, Commonwealth Secretariat (ComSec), Eurostat, European Central Bank, IMF, OECD, Paris Club Secretariat, World Bank and UNCTAD.
2/ See Annex I for further detail.

Capacity

31. **The ability of countries to manage public debt effectively is often hampered by staff and information technology (IT) systems capacity.** One short-run response to fill skill gaps has been for special advisors and ministers to do the job themselves, but this practice has heightened key person risk, and parallel efforts to build staff capacity are still necessary.

32. **Some countries have opted for "islands of excellence", insulating the debt management function from the resource constraints faced elsewhere in government**. This approach brings its own disadvantages in that it can impede coordination of debt management with other core policy functions and the challenge of ensuring effective oversight arrangements.

33. **To address staff capacity issues, countries are using a variety of measures to improve skills, including:**

- Providing training opportunities (e.g., Brazil and Colombia).
- Providing better incentives, including accelerated promotion, bonuses, occupational pay scales, as well as exempting staff from ministry rotation policies (e.g., Indonesia).
- Hiring staff on fixed-term assignments, particularly when a new organization is being established (e.g., Uruguay).

34. **Ideally, the development of the IT systems infrastructure should be adapted to specific institutional arrangements and functions of debt management units.** Major IT development that does not give sufficient attention to business processes is unlikely to succeed (e.g., Croatia and Lithuania). Some countries have improved IT systems by taking smaller steps, such as recording domestic debt data in the external debt system (e.g., Nicaragua).

C. Debt Management, Market Development and Financial Stability

Developing domestic public debt markets

35. **Some MICs have included the development of the domestic public debt market as an explicit part of their debt management strategy (e.g., Brazil).** More generally, well-functioning markets help reduce asset-liability mismatches on the country's balance sheet and facilitate the better distribution of risks, increasing the resilience to shocks and enhancing financial stability. However, in many developing countries, a number of broader impediments exist. In particular, a robust and stable macroeconomic framework, with

sufficient credibility of fiscal and monetary policy, is often lacking.[26] In some countries, weaknesses in the legal framework, the payment and settlement system, and the regulatory framework persist; the investor base remains concentrated; and the authorities' commitment to accept market determined prices is weak. Box 4 highlights other issues. Consequently, a coordinated approach across all relevant agents, including debt managers, central banks, securities market regulators, and private sector participants will increase the likelihood of success in developing the market.

36. **Debt managers can facilitate market development through supply side measures**. Several countries have introduced benchmark bonds (e.g., Brazil, Costa Rica, Mexico, and Tunisia). Such large, standardized issues facilitate the development of the yield curve, bringing wider benefits with respect to the pricing of other securities, and supporting the development of repo and other derivatives markets. Similarly, replacing non-marketable bonds with marketable instruments, has enhanced market functioning (e.g., Brazil, Bulgaria, Croatia, Indonesia, and Tunisia). Following a predictable and regular pattern of issuance also deepens the market, and supports the development of complementary markets. A clear and publicly disseminated financing plan, within the framework of a MTDS, plays an important role in this regard (e.g., Brazil, Bulgaria, Colombia, Mexico, and Turkey). Finally, the introduction of primary dealer systems has been beneficial in several MICs (e.g., Brazil, Mexico, and Turkey).

37. **In LICs, the efficiency of public debt markets can be improved** through steps such as (i) agreeing market standards, such as codes of conduct or other trading conventions; (ii) improving the issuance mechanisms; and (iii) developing a clear communications strategy (e.g., Kenya, Nicaragua, and Zambia).

38. **On the demand side, steps are needed to diversify the investor base.** For example, demand from foreign institutional investors has facilitated the introduction of longer-term fixed-rate debt in local currency (e.g., Mexico and Turkey). Developing a specific retail debt program might also be beneficial (e.g., Indonesia). Establishing strong relationships with the investor base—built on a foundation of transparency—is an important aspect of investor diversification. This has been achieved in a number of countries through explicit investor relations programs (e.g., Brazil, Mexico, and Turkey).[27]

[26] As illustrated by "original sin", where countries have struggled to issue long-term fixed rate bonds in their own currency.

[27] See, IMF (2004), "*Investor Relations Programs: Recent Developments and Issues*", October 2004, (www.imf.org) for more details on these programs.

Box 4. Impediments to Improving the Functioning of Domestic Public Debt Markets in Developing Countries

Progress has been made in developing domestic public debt markets; however, some continued shortcomings require further work: 1/

Money markets remain underdeveloped. Many developing countries are now transitioning to inflation targeting, and moving to indirect market-based instruments to implement monetary policy. However, underdeveloped money markets have aggravated volatility at the short end of the yield curve, impeding the policy transmission mechanism, particularly in the context of excess domestic liquidity. Further, the lack of marketable government debt in CB portfolios means many CBs issue their own debt to sterilize structural excess liquidity. This weakens the CB's balance sheet, reducing the credibility of monetary policy. In addition, where marketable government debt exists, the issuance of CB debt contributes to market fragmentation. This can be alleviated once open market operations can be implemented using repos or where an agreement is reached allowing Treasury bills to be used for monetary policy purposes (e.g., Colombia, Croatia, and Macedonia).

Incentives to trade remain poor. Banks and other institutional investors often have limited incentives to trade. This impedes liquidity in the market. While important developments have been made in broadening the investor base, including pension funds, insurance companies, and mutual funds, in many instances these investors have largely followed buy-and-hold strategies, using new inflows of funds to rebalance their portfolios. In some instances, although prudential requirements should not be compromised, where institutional investors have developed, investment guidelines have inadvertently hindered secondary market liquidity (e.g., Chile). Similarly, where the banking system has experienced sustained periods of excess liquidity, this has reduced their incentive to trade in the money or public debt markets. In such circumstances, banks have followed buy-and-hold strategies, often increasing their purchases of longer dated debt. The consequent asset-liability mismatch increases their own vulnerability, aggravating the risks to financial stability.

Asset valuation remains difficult. Illiquid markets have reduced the efficiency of prices and led to difficulties in asset valuation—for the corporate sector to price their securities, for mutual funds to price the net present value of its assets, and for the government to price new issues in the primary market. This has also reduced investors' incentives to trade.

1/ See World Bank (2007), "*Developing the Domestic Government Debt Market: From Diagnostics to Reform Implementation*" for a detailed account of issues in the 12 pilot countries.

Financial stability

39. **Where the domestic financial sector is the dominant holder of sovereign debt—often the case for developing countries—then a well developed PDM framework helps safeguard financial sector stability by assuring the credit quality of those assets**. For example, in 2004, banks constituted the largest group of investors for public debt and provided above one third of domestic financing for a sample of 18 large EM countries.[28] As noted above, this is particularly true for LICs, where the availability of alternative assets is limited. Correspondingly, under-developed public debt markets reduce the ability of banks

[28] See Chapter III of the April 2006 Global Financial Stability Report. Also see "*Remarks by IMF Deputy Managing Director, Murilo Portugal At a Debt Managers Conference,*" February 2007, (www.imf.org) for a broader discussion of this topic.

to liquidate their positions if required, reducing the quality of these assets, and accentuating risk to the banking sector. In addition, the lack of well-functioning primary and secondary government debt markets, or the design of specific investment regulations, can also contribute to pricing distortions and misallocation of capital, which are not conducive to financial stability.

IV. The Special Case of Debt Management in the Low-Income Countries (LICs)

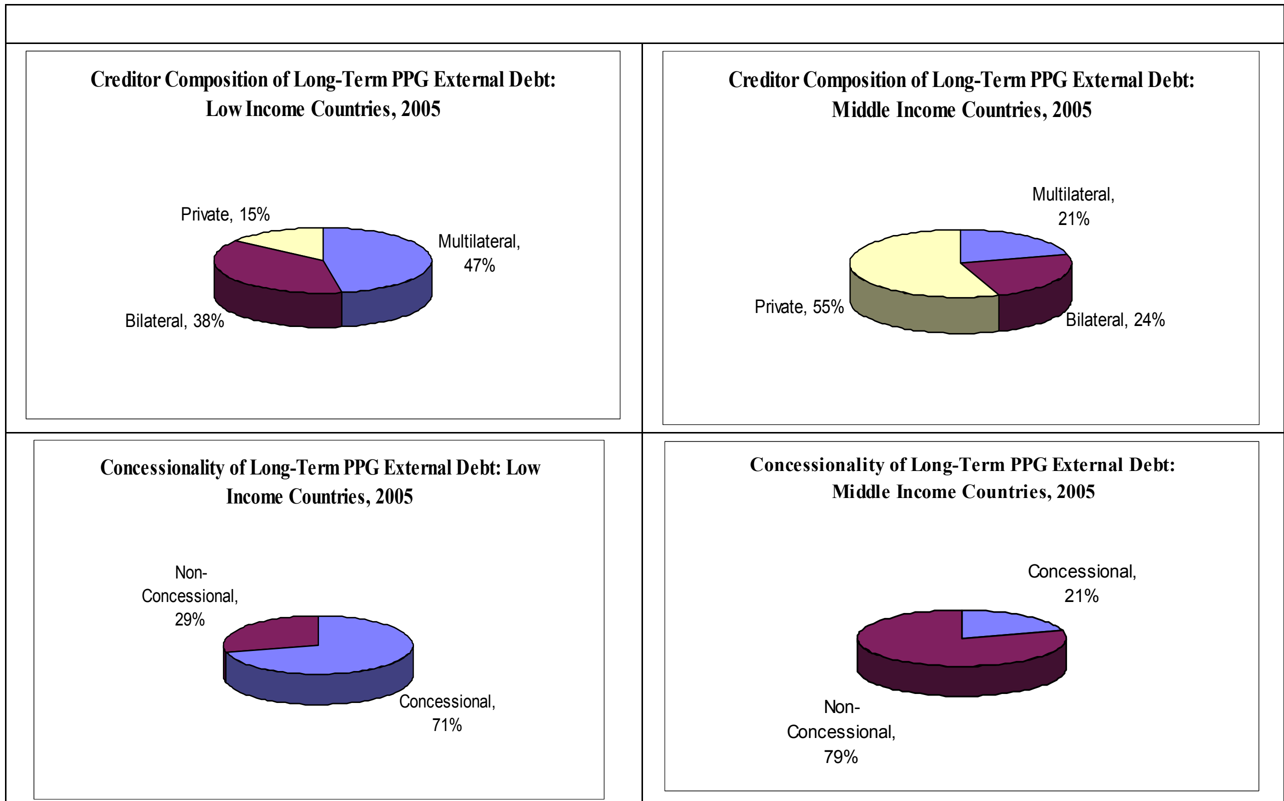
40. **The LICs face all the issues discussed above, but to differing degrees.** From one perspective, their challenges tend to be more acute—capacity, institutional arrangements, governance, all need considerable strengthening—but from another perspective, simpler—their choice set is significantly more limited with respect to the instruments they can use for meeting their financing gap.

41. **The past reliance on concessional flows has added a different dimension to traditional cost and risk considerations in managing the debt portfolio**. As of 2005, multilateral and official bilateral creditors made up over 80 percent of the public and publicly guaranteed external debt of LICs. Over 70 percent of this debt was contracted on concessional terms with below-market interest rates and long maturity periods, including grace periods.[29] In contrast, 55 percent of the external debt stock in MICs was made up of credits from the private sector and was predominantly on non-concessional terms (Figure 3). While the past reliance on concessional sources of funding may have limited exposure to interest rate risk, the consequent exposure to currency risk has been significant.[30]

[29] A loan is considered concessional if its grant element, i.e., the difference between the nominal value of the loan and its NPV, is equal to or exceeds 35 percent. Moreover, the concessionality of a loan, i.e., its grant element, increases respectively with lower interest rate, longer grace and maturity periods, and a more back-loaded repayment profile.

[30] While limited, some choices exist for actively managing this currency risk. For example, it may be possible to choose amongst IFIs to achieve a more diversified and balanced currency composition. Risk could also be partially mitigated by taking into account the debt structure when determining the currency composition of the foreign exchange reserves.

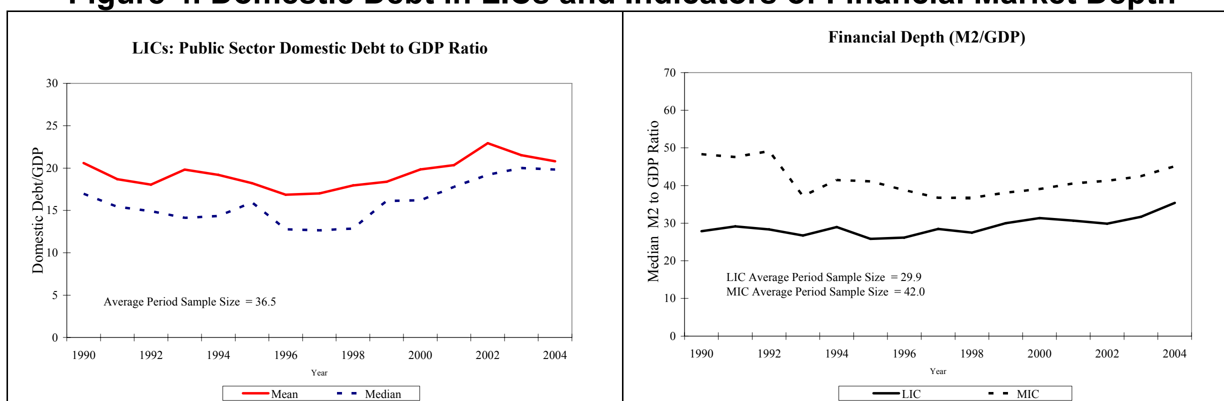
Figure 3. Characteristics of Long-Term Public and Publicly Guaranteed External Debt in MICs and LICs



Source: World Development Indicators, World Bank 2006.

42. **It will limit the scope to take a systematic approach to public debt market development.** In practice, decisions to access domestic financing have generally been passive—domestic debt is generally the residual once external financing sources have been exhausted. In some instances, high external financing in LICs with low absorptive capacity might also have required additional domestic debt issuance to sterilize the in-flows. In each case, domestic debt might have been accumulated in a manner that is not conducive to domestic market development, and again limiting the scope for mitigating currency risk (Figure 4).

Figure 4. Domestic Debt in LICs and Indicators of Financial Market Depth



Sources: Bank and Fund staff; International Financial Statistics, IMF 2005.

43. **Debt managers in LICs face a number of particular risks, with only limited tools to manage them.** The structure of LIC economies and their public debt portfolios render them particularly vulnerable to exogenous shocks that imply significant risk to the debt portfolio. Along with the issues discussed above, LICs are particularly vulnerable to:

- *Operational risks.* These arise from the typically weak organizational arrangements, systems and procedures, and are compounded by vulnerability to natural disasters, loss of institutional memory or key persons.
- *Terms of trade trends and shocks.* These arise from the typically narrow and volatile production and export bases. LICs are more vulnerable to commodity price shocks than other developing countries, and such shocks occur more frequently and can persist for many years.[31]
- *Aid volatility*. LICs are significantly exposed to fluctuations in aid flows, due to external factors (e.g., shifts in donor sentiment) or in response to perceived domestic changes (e.g., in governance and economic management). Moreover, aid commitments, which are an important input into most LIC budget forecasts, often vary significantly from the level of actual aid disbursements. This increases the need for effective cash management to cushion the impact of aid disbursement shocks on the implementation of fiscal policy.

44. **Capacity constraints continue to impede the development and implementation of an effective MTDS.** A survey of 24 HIPC decision and completion-point documents shows significant gaps in basic debt management capacity.[32] For example, debt units in these countries lack adequate capacity to monitor and record debt information and new resource

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[31] Please see, "*Fund Assistance for Countries Facing Exogenous Shocks*," IMF 2003. Also, "*IDA Countries and Exogenous Shocks*," October 2006.

[32] See Chapter III of the background volume.

flows accurately. These constraints have remained during the successive rounds of debt relief under HIPC and MDRI.

45. **The new borrowing space created by HIPC and MDRI debt relief has radically altered the financial landscape facing beneficiaries, creating both opportunities and risks.**[33] For some, this provides the opportunity to access non-concessional sources of financing, from new creditors, through new instruments, and is reflected in increased foreign investor interest. For example, recent data from the Emerging Markets Traders Association indicate that the volume of sub-Saharan African debt traded in 2006 more than doubled that in 2005.[34] Given the large social and infrastructure needs in many of these countries, additional inflows can be a welcome development, particularly where domestic resources are insufficient.[35] However, the management of non-concessional debt poses new challenges and these developments aggravate the risk that post-MDRI LICs will re-accumulate unsustainable debt. Indeed, the availability of non-concessional financing has increased the urgency of building capacity to develop and implement an MTDS, so that governments can take informed borrowing decisions to manage their debt portfolio.

46. **Access to new sources of non-concessional financing changes the scope for actively managing risk in the public debt portfolio.** New borrowing opportunities may offer greater scope to change the currency exposure of the portfolio, so that, for example, it is more tailored to the country's export revenue streams. However, that is likely to be achieved at the expense of higher debt servicing costs, and potentially increased rollover and interest rate risks. Similarly, greater foreign investor interest increases the scope for domestic debt to play a more active role in the portfolio. This is likely to increase the availability of financing resources in domestic currency, and the scope to extend the tenor of domestic debt.

47. **These new opportunities might also provide the opportunity to refinance some existing debt to secure cost savings or risk reductions.** For example, it may be possible for countries to retire some short-term, high cost domestic debt, and refinance at longer tenors in the international capital markets. However, the scope for actual cost savings must be carefully assessed.[36] Again, this calls for an effective MTDS to assess the relevant trade-offs.

48. **Operational risk also becomes more acute as the diversity of instruments and creditors increases.** For example, where LICs are contemplating a move into international capital markets, and consequently obtaining a credit rating, the quality of PDM, and the

[33] For example, the median NPV of external debt-to-exports ratio is estimated to have fallen from 153 percent prior to MDRI debt relief to 55 percent post-MDRI.

[34] See www.emta.org for more detail.

[35] Note that in many instances IFIs are providing grants in addition to lending.

[36] For example, recent movements in the Tanzanian Shilling suggest that there would be little cost savings to be secured by switching from domestic to external debt in this manner.

effectiveness with which the authorities communicate their MTDS, can directly influence debt servicing costs by influencing the credit rating.[37]

49. **Developing a MTDS, that is consistent with maintaining debt sustainability, will be a challenge.** In addition to strong fiscal control, a comprehensive MTDS, that takes account of both domestic and external debt considerations, will be required to ensure that these new opportunities, and challenges, do not lead to a re-accumulation of unsustainable debt. This adds to the need to provide capacity-building support for these efforts.

V. Bank and Fund Support for Public Debt Management

50. **Recognizing the continued challenges, and the growing demand and need for capacity building, TA and advisory services from developing countries, the Bank and the Fund staff intend to intensify their efforts in a coordinated manner in this area.** Both will build on the insights gained from the pilot program, and other country work, to deepen support for the implementation of debt management reforms in line with their respective focus. Emphasis will be given to help identify and manage sovereign balance sheet risks, improve the functioning of the domestic public debt markets, and develop a diversified investor base, with due consideration for the macroeconomic policy linkages. In particular, staff will help countries develop and strengthen a MTDS that is consistent with the analysis of debt sustainability, integrating it into the policy dialogue with country authorities. In addition, both institutions will continue to attach high priority to making progress in the area of debt statistics and legal and institutional reform.

A. Current Capacity Building Activities

51. **Both the Bank and the Fund have been active in providing capacity building assistance in PDM.**

- The Bank is collaborating extensively with finance ministries and public debt offices to help them build capacity to frame appropriate public debt management and market development strategies, identify and evaluate funding and risk management tools available in the markets and from official institutions, and develop the front-, middle-, and back-office staff and infrastructure to execute transactions utilizing those tools. Often, this collaboration is associated with Bank financing delivered through project, development program or TA loans. In other instances it can be incorporated in other vehicles, such as policy notes, public expenditure reviews or delivered in connection with countries' use of Bank hedging products. These activities have been developed in close association with the practical experience of the Bank Treasury as regular issuer and manager of its own ALM strategy.

[37] Ratings agencies will often cite improvements in debt management capacity as a factor supporting rating upgrades.

- The Fund's work with countries emanates from follow-up to its surveillance, where relevant, with a focus on ensuring proper management of sovereign balance sheet risks and vulnerabilities in debt structures, debt restructuring work, and the development and implementation of debt strategies consistent with other macroeconomic and financial sector policies. The Fund's involvement may also be linked to program design in the context of use of Fund resources, or come through direct advisory and TA activities, with country coverage ranging from LICs to emerging and mature markets.

52. **Both institutions have also been active in knowledge building and dissemination.** This is typically carried out through research and publications, presentations in conferences and seminars, training courses, and collection and dissemination of external debt statistics. Increasingly, PDM issues are being covered through the joint Bank-Fund FSAP program, with specific follow-up exercises often funded out of the FIRST Initiative.[38] On the related issue of debt sustainability, there is joint outreach on the development and implementation of the DSF and DSAs being prepared for LICs. More information on the work of the two institutions is summarized in Box 5.

Box 5. Bank and Fund Capacity Building Activities in PDM

World Bank activities

The World Bank supports developing countries at two levels; first, through collaboration with individual countries on a demand basis and second, through training, research and outreach.

Country work
Advisory work for individual countries is based on a comprehensive needs assessment of the public debt management process, and is typically done in conjunction with domestic public debt market development. This serves as a platform for the authorities to specify a program to improve public debt management. Follow-up is provided, on a demand basis, in the following areas: governance, including the legal framework, institutional arrangements and transparency; debt strategy and risk management; capacity building and management of internal operations; coordination with cash management, macroeconomic policies, and debt market development; and debt strategy implementation, including capital and derivatives markets access. It also provides support in designing and structuring risk management products for IBRD borrowers.1/

Insights from the pilot program have shaped the approach to diagnostics and ensuing reform and capacity-building programs. This has been mainstreamed since early 2005 on the basis of demand from countries, in conjunction with the Regions. In addition to the 12 pilot countries discussed in this report, needs assessments and/or advisory assignments have taken place in sixteen countries including Peru, Philippines, El Salvador, Ukraine, Romania, Guatemala, Panama, Mongolia, Kazakhstan, Serbia, Mauritius, Lao PDR, Ecuador, Morocco, Mexico and Armenia. In recent years, Bank lending operation have supported debt management capacity-building in Brazil, Kenya, Lao Republic, Mongolia, Serbia, Slovak Republic, and Zambia. 2/

[38] The Financial Sector Reform and Strengthening (FIRST) Initiative, a US$53 million multi-donor program supports capacity building and policy development projects in financial sectors, including debt management, in developing countries.

Box 5. Bank and Fund Capacity Building Activities in PDM (cont'd)

Training, Research, and Outreach

Based on experience gained from the pilot program, an intensive one-week training workshop, "Designing Government Debt Management Strategies", is offered twice per year. Since it was introduced in 2005, 38 countries have participated. The Bank will also offer a workshop on "Implementing a Debt Management Strategy" from May 2007. Research on various themes for effective public debt management, including process for developing a debt management strategy, organizational arrangements, legal framework, and macroeconomic coordination are being conducted and are published as policy working papers, technical notes, articles, as well as books, such as *Sound Practice in Government Debt Management(2004)* and *Managing Public Debt: From Diagnostics to Reform Implementation (2007)*. It also periodically organizes the Sovereign Debt Management Forum, which brings together debt managers from around the world to share experiences and new developments in public debt management.

Fund activities in Public Debt Management

The Fund provides support for its members' reforms on public debt management and debt market development through the following routes:

Surveillance and Use of Fund Resources

Where relevant, greater focus is being placed on debt structures, debt strategies and debt market development issues to inform Article IV surveillance. In addition, institutional developments in public debt management are also carefully monitored under Fund programs in some cases. The Fund also encourages members to pursue orderly debt restructurings and has been active in promoting the use of collective action clauses. In terms of multilateral surveillance, public debt management operations and other developments in debt markets are regularly reported on in the *Global Financial Stability Report.* In addition, the semi-annual *Public Debt Managers' Forum* forms part of ongoing monitoring of developments in public debt management and local market development in emerging markets.

Technical Assistance

The Fund delivers technical assistance both at an individual and a regional level. At the individual level, technical assistance can involve a comprehensive and in-depth assessment of the entire framework for public debt management and debt market development; be incorporated in a broader public financial management reform program; address weaknesses in specific areas (e.g., institutional arrangements for debt management, public debt legislation, investor relations, debt strategy development, etc.); or comprise advice on specific debt portfolio operations. Debt management advisors have also been placed in two regional Technical Assistance Centers (TACs) in Africa.

Training and Outreach

Training and workshops are offered on a select basis covering institutional arrangements for debt management, debt portfolio risk management, debt strategy development and implementation, and debt market development through the IMF Institute, and associated regional training centers, the Center for Excellence in Finance (in Slovenia), and in partnership with regional TACs, and other multilateral agencies. Periodic outreach activities are also undertaken, for example, in partnership with the World Bank and the OECD, on a range of debt management issues. Staff research and analysis on topics ranging from debt restructuring, risk measures, contingent claims analysis for sovereign balance sheet risks, and sovereign asset and liability management are disseminated through IMF Working Papers and selected issues in country papers.

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1/ Related programs in the WB-Treasury build capacity in the management of foreign exchange reserves, pension funds and other pools of national wealth.
2/ For further details of these loans, see Table 5 in Strengthening Debt Management Practices – Lessons from Country Experiences and Issues Going Forward: Background Papers.

B. Insights from the Pilot Program and Other Country Work

53. **Bank and Fund country work has provided considerable insight into the elements that can help sustain the implementation of reform**. A number of broad observations can be made. First, capacity building is a long-term endeavor requiring sustained technical, financial and political support. Second, programs to improve debt management must be tailored to a country's unique economic and institutional circumstances. Third, identifying a clear project management focus for the reform program, with key responsibilities allocated, increases the durability of reform. Such a systematic framework can only be developed with country ownership and political commitment, and also allows for follow-up through regular surveillance and other country work. Finally, the demand, and need for, improving debt management capacity in developing countries requires a multi-agency effort.

54. **The work done in the pilot countries indicates that a comprehensive diagnostic is necessary before a substantive program of reform can be undertaken**. Not only does such a diagnostic capture the main building blocks of debt management, it also identifies the interrelationships with macroeconomic policies, the overall governance environment, and the level of development of the domestic government debt market. An analysis of these interactions helps identify the trade-offs across different policies, and the possible consequences of reform.[39]

55. **A thorough understanding of the macroeconomic situation and the relationship with PDM remains crucial.** Debt management reforms tend to be more effective where a credible macroeconomic framework is in place. A diagnostic narrowly focused on debt management, which does not take into account or is inconsistent with the overall macroeconomic framework, might lead to unrealistic recommendations. In addition, a broader policy context provides for a realistic assessment of what can be achieved through public debt management reform. Owing to the high degree of complementarity, developing a reform plan that simultaneously addresses weaknesses in public debt management and debt market development will be more effective.

56. **Experiences to date suggest that, in cases where extensive reforms are required, embedding public debt management reform in broader projects, supported by multiple donors, can increase the chances of successful implementation**. For example, in Kenya the work was integrated into the World Bank Financial and Legal Sector Technical Assistance Project; in Zambia, it is part of the (multi-donor) Public Expenditure Management and Financial Accountability (PEMFA) Reform program; in Lebanon, the work is integrated within the UNDP-funded project "Capacity Development for Fiscal Reform and Management;" and in Croatia, implementation is supported by the European Union under its program for accession countries.

[39] For example, until the late 1990s, public debt management assistance was often limited to establishing centralized inventories of foreign borrowing agreements, a focus which did not support the development of analytical capacity.

57. **Coordination with other organizations and governments has improved the quality of PDM guidance and technical assistance.** The development of the *Guidelines for Public Debt Management* included extensive consultation with public debt managers, and have provided a framework for debt management that has been universally accepted. Experience in the pilot program also suggests that comprehensive needs assessments can serve to establish a broad understanding of the main issues across donors, and facilitates coordination among them. This allows synergies to be exploited, improves sequencing, precludes any conflicting messages, and reduces any scope for overlap. In addition, there is coordination among the main providers of TA, including the Bank and the Fund, through shared resources or co-hosted conferences, workshops and other outreach events. Some of the main partners are the OECD Working Party on Public Debt Management, DMFAS Program of the United Nations Conference on Trade and Development (UNCTAD), the Commonwealth Secretariat (COMSEC), and Debt Relief International (DRI).[40]

C. Going Forward—Strengthening the Process

58. Building on the above, and in light of the issues identified in Section IV, the Bank and Fund propose to continue to work with developing countries in building their debt management capacity and accelerating the reform process as below:

Support for middle-income countries

59. **Generally, MICs possess greater debt management capacity and stronger institutions than LICs.** Yet, the demand for TA and advisory services continues to rise for three reasons. First, despite improved fiscal performance, many such countries still experience significant debt-related vulnerabilities (see Section II). Second, as outlined in Section III, many countries have yet to develop explicit debt management strategies, coordinate these effectively with macroeconomic policies, improve their governance arrangements and strengthen their domestic public debt markets. Finally, many have embarked on programs to enhance their analytical capacity or take advantage of current market opportunities to restructure their debt portfolios. As such, they are seeking more customized financial and advisory services.[41]

60. **The Bank and the Fund expect to continue to provide cutting-edge technical support to this group of countries, building on insights gained from the pilot program and other country work.** The Fund's interest stems from its role in helping countries

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[40] In addition a number of regional bodies are active in the area: Macroeconomic & Financial Management Institute of Eastern & Southern Africa (MEFMI); Pôle-Dette (Regional Debt Management Training Center of Central and Western Africa); West African Institute for Financial and Economic Management (WAIFEM); and the Center for Latin American Monetary Studies (CEMLA), the Eastern Caribbean Central Bank (ECCB), the Central American Monetary Council (CAMC) and the Technical Assistance Centers (TACs). Details on some of the main providers/regional partners are provided in Annex IV.

[41] This was discussed in "*Strengthening the World Bank's Engagement with IBRD Partner Countries*" SecM2006-0354, presented to the Development Committee. In addition to supporting countries through capacity building, the Bank is developing and expanding the range of banking products offered to IBRD countries.

prevent fiscal and financial crises, and its focus on the macroeconomic links between debt, monetary, fiscal, and capital markets. The Bank's mandate arises from its role as a long-term development partner, with its strengths lying in long-term institutional development, capacity building, and knowledge transfer based on the technical expertise anchored in its own Treasury operations.[42]

Support for low-income countries

61. **Building debt management capacity in LICs, however, is more complex, not least because of institutional weaknesses, and scarcity of skills.** But, as discussed in Section IV, the urgency for improving debt management capacity in countries that have benefited from debt relief is acute. For LICs that have not benefited from debt relief, the focus remains on managing new borrowing prudently. More broadly, the challenges LICs face in terms of their macroeconomic vulnerability and the limited development of their domestic financial systems, suggests a need for a carefully crafted MTDS, which in turn will require a significant strengthening of capacity.[43]

MTDS capacity building missions

62. **One focus of the Bank and the Fund, therefore, will be to assist these countries build the capacity to develop and implement an effective MTDS.** The MTDS will identify the authorities' preferred composition of debt and guide new financing decisions, and should lead to borrowing which (i) is consistent with the country's development plans and macroeconomic program; (ii) is sustainable; and (iii) minimizes borrowing costs over the medium to long term, consistent with a prudent degree of risk.[44]

63. **The proposed capacity building work in LICs will initially cover a four year period (2008-2011).** It will be demand-driven, with preference given to post-MDRI countries. To begin, staff will target 4–6 countries a year. The impact of these efforts will be reviewed every two years before considering scaling up the effort across other LICs or developing countries. The initial group of countries will be chosen carefully, based on

[42] The research and training programs and knowledge of the latest financial products and risk-hedging techniques have proved to be of lasting value to clients.

[43] For the Bank, this will be consistent with ongoing work in public expenditure management and financial sector development. For the Fund, this will be consistent with its 2006 Medium-Term Strategy (MTS), which calls for a more focused engagement with LICs on macro-critical and financial stability issues, and specifically to help them build capacity to prepare and implement medium-term debt management strategies.

[44] See Annex II for a fuller discussion of the key elements of a MTDS. This work does not preclude capacity building work on other elements of PDM reform also being undertaken in these countries.

expressed demand for such support by the authorities as well as an assessment of where the pressures for better debt management are considered most acute.[45]

64. **The first phase of mission work will be to prepare a comprehensive diagnostic of a country's debt management capacity, in collaboration with the authorities, and after consultation with other stakeholders.** This will form the basis of the reform plan for developing and implementing a MTDS that is tailored to the circumstances of a country and supported by the donor community. Where possible, staff will draw on existing assessments to help progress the reform plan more rapidly.

65. **Follow-up work, including missions and HQ-based support, is likely to be required to help countries implement elements of the reform plan.** This is likely to involve other providers.[46] Training, and other outreach, will also play an important part in helping countries embed reforms;[47] this is where regional partners can be particularly effective. In addition, in some cases where initial capacity is very weak, countries might benefit from the use of resident or short-term advisors.[48]

66. **In addition, Bank-Fund staff will mount missions periodically to monitor the implementation of the agreed reform plans, and assist the authorities deal with new challenges as they arise.** Also, as countries prepare and implement their initial MTDS, this will highlight any continued weaknesses in the PDM framework and help re-evaluate the priorities for reform.

Performance indicators

67. **To complement this effort, the Bank, in collaboration with other stakeholders (including the Fund), is developing a set of indicators to periodically measure debt management performance.** Like the PEFA indicators for public financial management, these indicators will provide an international standard for evaluating performance, and will enable harmonization of support.[49] The indicators will, among others, assess (i) governance

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[45] In the Bank, demand will be channeled through country teams and will be an integral part of the Country Assistance Strategy; in the Fund, the determination will normally be made by the Area Departments, based on their regular dialogue with member countries.

[46] Such as those described in Annex IV.

[47] This outreach might include the private sector where appropriate.

[48] For example, Albania and Nicaragua are benefiting from the presence of resident debt management advisors provided by the U.S. Treasury OTA. Similarly, IMF resident debt management advisors have been posted to the Central Asian region and 2 of the AFRITACs.

[49] The indicators build from, and deepen, the *Public Expenditure and Financial Accountability (PEFA)* indicators for overall public financial management, which already include high-level indicators for debt management. They draw upon existing resources, such as the IMF-World Bank's *Guidelines on Public Debt Management* (2001), the IMF-World Bank's *Developing Government Bond Markets – A Handbook* (2001), the IMF's *Data Quality Assessment Framework for External Debt Statistics* (2003), which covers various quality

(continued…)

(including the legal and institutional framework for debt management); (ii) the internal organization across debt management functions; (iii) staff capacity; (iv) policies and procedures for borrowings and loan guarantees; (v) loan administration and secure payment operations; and (vi) the transparent reporting of accurate and comprehensive debt data. The indicators will be assessed in close consultation with the authorities, but central quality control and a common methodology will be employed to ensure cross-country comparability.[50] This would help provide an objective measure of debt management capacity in relation to country peers, as well as to monitor country progress over time. Most importantly, the indicators will give the authorities, as well as the international donor and creditor community, a common platform to see which approaches are working and which are not. In addition, donors that are financing capacity building initiatives will be able to use this as a yardstick to determine whether their financial support is yielding results. This initiative could add to the existing store of knowledge on PDM and could also support a debt management practitioner's program that builds communities of practitioners, facilitating the sharing of experiences and other peer learning techniques.

68. **The governance and financing arrangements for applying these indicators are still being explored**, but initial discussions with a range of stakeholders have helped clarify key issues. First, the effort must be actively supported by a broad range of stakeholders—country authorities, technical assistance providers, donors, debt management specialists. Second, as in the arrangements for implementing the Public-Private Infrastructure Advisory Facility (PPIAF), the initiative could be managed by the Bank, drawing on its convening power and expertise.[51] Third, given the long-term nature of the work, commitments of financial support from donors will be needed for a long period, subject to periodic impact evaluations.

Consultation and coordination with other agencies

69. **The activities proposed above will require intensive consultation, collaboration and coordination with donors and other TA providers.** In the implementation of reform

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aspects of data collection, processing and dissemination, and the IMF's *Standards and Codes on Fiscal Transparency*, the PEFA Performance Measurement Framework, as well as other relevant sources/material including the capacity building indicators developed by DRI for HIPCs.

[50] The Bank is already in the process of testing a preliminary set of indicators in 6 countries; based on these tests the indicators will be refined and improved. Beginning in FY08, the intention is to assess all low-income countries against these indicators over three years, and subsequently refresh the indicators for a third of the countries each year, synchronized with the CAS or AAA cycle.

[51] The Public-Private Infrastructure Advisory Facility (PPIAF) provides a useful model for how funding might be structured. The PPIAF is a multi-donor technical assistance facility that is managed by the World Bank on behalf of participating donors. The PPIAF is owned and directed by participating donors, governed by a Program Council comprising representatives of participating donors, and managed by a small Program Management Unit (PMU). Thirty percent of the PPIAF's donor financing is allocated to the operation of the PMU (which is housed in the World Bank and comprises seven full-time professional staff) and the supervision of PPIAF tasks undertaken by Bank teams. PMU staff members are internationally recruited and serve on coterminous appointments.

plans to facilitate the development of a MTDS, the bulk of the coordination will need to be done at the country level. But there are several activities that would need to be coordinated at the international level.

70. **Several bilateral and multilateral agencies, debt management specialists, and technical assistance providers have been consulted on the broad initiatives suggested in this paper.** Staff will continue to promote the flow of information across key partners, prior, during and after any MTDS capacity building mission.[52] Further efforts will be made to strengthen the mechanisms for the ongoing collaboration with bilateral agencies, debt management specialists, and other TA providers. Consultation with the private sector on specific issues, such as the development of the operational framework for MTDS, may also be considered.

Country ownership

71. **Demand from the authorities for this capacity building, ownership of the diagnostics and reform plan, and accountability for the implementation will be key ingredients for the success of the program.** The proposed design has taken this into account by: (a) ensuring that activities supporting the preparation of an MTDS have a strong, upfront country interest and ownership; (b) participation by the country authorities in the diagnostics and preparation of the reform plans; and (c) accountability on the part of country authorities for the implementation of the MTDS and associated reforms. Where progress does not take place, and the performance indicators show no improvement or deterioration, the Bank and Fund would reconsider their continued engagement in that program.

Costing and financing

72. **The program described above will entail significant resource costs** (see Annex III). For the Bank, the assistance to support MICs will continue to operate on a fee basis, but the costs for initiating work in LICs will require incremental Bank budget for staffing. These resources will be used to initiate and support the work on developing capacity for PDM in the selected countries and launching the performance indicator work; all subsequent support will need to be allocated from existing country budgets. Long-term funding from donors will be critical for applying the performance indicators in 60 LICs, while the Bank can be expected to assume the cost of managerial oversight. As far as the Fund is concerned, the support to the MICs will continue to be charged to its current technical assistance budget. However, as in the case of the Bank, the capacity building work on the MTDS, in LICs and other developing countries, will entail a resource cost. This includes the original resource requirement identified in *Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief,* November 2006.[53] These costs will also be borne under the existing budget.

[52] Subject to country consent.

[53] That paper identified a resource cost of 1–1.5 Fund staff years to cover: (i) the cost of developing the required MTDS templates and capacity building frameworks; (ii) outreach activities and collaboration with other agencies and internal

(continued…)

VI. Conclusions and Issues for Discussion

73. This paper has reviewed country experiences with strengthening PDM frameworks, including the functioning of domestic public debt markets. It makes three points:

- Many countries have made some progress in strengthening their PDM frameworks and reducing debt-related vulnerabilities.

- Nevertheless, countries still confront many policy, institutional and operational challenges. In particular, most countries are at an early stage of developing MTDS. Establishing effective governance and organizational arrangements for PDM has proved challenging as has the development of domestic debt markets.

- For LICs, these challenges are even greater, not least because of institutional weaknesses and scarcity of skills. In addition, conditions in global markets, and the new borrowing space created by HIPC and MDRI, have attracted new creditors, who increasingly view these countries as attractive borrowers. This adds new urgency to the need to strengthen PDM frameworks, including debt market development, to ensure debt sustainability.

Consequently, the Bank and Fund are proposing to intensify their efforts to support capacity building in these areas across developing countries.

  - For MICs, the Bank and the Fund will continue to provide specialized financial and advisory services.

  - For LICs, the Bank and the Fund will undertake joint work to help build capacity to develop and implement an effective MTDS. This will be complemented by the development and application of indicators of debt management performance.

74. Staffs would welcome the Boards' views on the following issues:

- Do Boards agree with staffs' assessment of the challenges that developing countries face in improving public debt management?

- Do Boards agree that, when relevant, PDM issues should be incorporated to a greater extent in Fund surveillance, and in Bank country programs (e.g., CASs) when requested by country authorities?

- Do Boards believe that the Bank and Fund are responding adequately to demand from MICs for advice and capacity building in public debt management?

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staff dissemination; and (iii) backstopping including review work. However, that estimate excluded costs associated with direct delivery of capacity building activities.

- Do Boards endorse the proposed joint Bank-Fund approach, and resourcing, for building capacity to develop MTDS in LICs, to be rolled out in FY08?
- Do Boards endorse the complementary work to periodically measure debt management performance in LICs, which would help provide a basis to assess progress and a common platform for donor support for PDM.

Annex I. Multilateral Initiatives to Improve Debt Statistics

QEDS and JEDH

75. In parallel with the joint work in promulgating internationally recognized methodologies and standards for compiling and presenting external debt statistics, the TFFS agencies have accorded high priority to the availability of these data to market participants and policy makers. Following the launch of the QEDS in 2004, the TFFS agencies have embarked on joint actions to encourage all SDDS subscribers (64), as well as countries that are not SDDS subscribers but who compile external debt statistics that are compliant with SDDS requirements, to provide these data to the QEDS database. As result of these concerted efforts, the countries reporting to the QEDS continues to increase.

76. The launch of JEDH was a significant milestone not only in bringing together national data published in the QEDS and creditor/market data published in the former Joint BIS-IMF-OECD-WB Statistics on External Debt (JDS), but it also provided a basis for comparison and improvement of these datasets. Recognizing that the success of the JEDH going forward will depend on the coverage, national capacity to produce, and the quality of the data available on the new website, the TFFS is now focusing efforts on finding ways and means of increasing national source debt data, creditor/market source debt data, and improving data quality.

77. In tandem with efforts being made to improve national data sources, the TFFS agencies are working together to improve creditor data series, in particular bilateral loans and export credits, to assist in monitoring the borrowing and lending operations of emerging and low income countries. These data series are critical inputs in revealing possible “free-rider” problems associated with the HIPC debt relief.

Public sector debt statistics

78. The IMF in collaboration with the TFFS is implementing a new initiative to assemble existing statistical series on public sector debt (domestic and external) in a single electronic source that could be accessed easily for balance sheet analysis. More specifically, the initiative aims at (i) developing a uniform presentation of public sector statistics based on recognized methodologies such as the Government Finance Statistics Manual (*GFSM 2001*) and the *External Debt Guide*, and (ii) promoting public debt statistics through international cooperation in debt reporting, technical assistance, and IMF surveillance work.

Data quality

79. In addition to improving the availability of external debt statistics produced by national authorities, the Fund, in collaboration with TFFS agencies, is addressing debt data quality issues on two fronts—promoting good practices of data quality based on the IMF’s ED DQAF; and confirming the quality of data supplied by national authorities through consistency checks. The ED DQAF has many uses including identifying and promoting “good practices” in compilation and dissemination of external debt statistics; designing and monitoring technical assistance programs; assessing the quality of external debt statistics produced by national authorities; and, importantly, for use by country authorities as a self-

assessment tool in seeking donor support for capacity building. Indeed, the ED DQAF has become a useful tool in external debt training activities conducted by the Fund and other agencies, as participants use the ED DQAF in workshops to self assess.

80. In parallel with the work on the ED DQAF the Fund has started a new initiative to assess the consistency of external debt data reported by SDDS countries to the QEDS and corresponding data series produced by countries and reported in the international investment position (IIP). This initiative is geared towards improving countries' external debt and IIP data for effective use in economic surveillance work.

Capacity building

81. The TFFS agencies have made a significant contribution in disseminating international best practices in the compilation of external debt statistics through joint capacity building training activities. Since May 2002, there has been a major effort, with 18 such activities involving over 500 compilers of debt statistics drawn from about 140 countries in various regions. In addition, both COMSEC and UNCTAD have each developed their own capacity building modules on debt statistics and debt data validation, which are currently being implemented in their client countries. The objectives of these modules are to promote continuously validated debt databases and the production of comprehensive debt statistics consistent with the internationally accepted methodologies and standards articulated in the *External Debt Guide*.

Annex II. Medium-Term Debt Strategy in Low Income Countries

82. **The importance of developing a medium-term debt management strategy (MTDS) was discussed in the November 2006 review of the joint Bank-Fund DSF.**[54] As outlined in that paper, an MTDS should lead to borrowing which (i) is consistent with the country's development plans and macroeconomic program; (ii) is sustainable; and (iii) minimizes borrowing costs over the medium to long term, consistent with a prudent degree of risk. The MTDS should be linked to the public debt sustainability analysis (DSA) and contribute to mitigating any vulnerabilities identified in the DSA. This annex describes the key elements of a comprehensive MTDS for a low-income country.

83. **Any debt management strategy will describe the authorities' preferences as to their preferred composition of the debt stock.** Consequently, it will indicate how the government will meet its future financing requirements, and will address issues such as the composition of debt in terms of various choices such as: (i) concessional or non-concessional; (ii) external or domestic; (iii) foreign or domestic currency; (iv) fixed or variable rate; (v) marketable or non-marketable securities; and (vi) long- or short-term.

84. **In LICs, an MTDS must be specifically tailored to** the availability of concessional flows, macroeconomic volatility, and institutional weaknesses. These three features distinguish LICs from other countries. First, the availability of aid and low-cost, long-term development assistance lending, renders a different tradeoff between cost and risk that generally underpins the analysis of debt strategy in MICs. Second, LICs are exposed to a greater degree of macroeconomic vulnerability relative to other countries; in particular, the impact of terms of trade shocks and aid volatility are far greater in proportion to the size of their economies. Third, LICs have lower institutional capacity to develop or execute complex debt strategies, including the capacity to use even basic techniques to model cost and risk. LICs sometimes even lack a comprehensive and sound debt database, a prerequisite for any strategic analysis.

85. **A well-formulated MTDS should set clear priorities among competing goals, analyze risks concretely, be flexible in anticipation of economic shocks, and support institutional objectives.** To do this, an MTDS should typically contain the following seven elements, discussed in greater detail below: (*i*) strategic objectives; (*ii*) macroeconomic context; (*iii*) assessment of the current public debt position; (*iv*) an indication of desired portfolio composition with supporting analysis; (*v*) the financing plan for the immediate fiscal period under baseline assumptions; (*vi*) the scope for flexibility in implementation; and (*vii*) a discussion of institutional and market-development factors conditioning the success of the strategy in the medium term.

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[54] "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief", November 2006.

Objectives

86. **Before any strategy can be developed effectively, its purpose and objectives must be clear**. In particular, priorities between competing strategic objectives need to be addressed and clarified. The strategy will guide decisions about borrowing, the need for which arises through four principal imperatives: (i) to cover a fiscal deficit; (ii) to fill balance of payments needs (i.e., finance reserves accumulation/maintain reserves at a given level or limit depreciation of the domestic currency); (iii) to sterilize foreign currency inflows; and (iv) to develop domestic capital markets. In LICs, several of these objectives may be in play at once and this may create hard choices. For example, the need to sterilize inflows may conflict with the desire to limit the cost of domestic issuance. Or the need to develop the domestic public debt market may suggest issuance of instruments that are more costly, such as long-term instruments, conflicting with purely fiscal considerations. Where such conflicts arise, the strategy ought to recognize them and set clear priorities, stating under which circumstances each objective would dominate.

Macroeconomic context

87. **The MTDS is intrinsically linked to the macro-economic framework (see Figure 5).** Coordination of the MTDS with other areas of macroeconomic policy will be particularly important for LICs, given the macro-vulnerabilities they often face. Ideally the MTDS would be formulated within a rigorous and fully operational medium-term fiscal framework (MTFF), as it will require some estimate of the government's financing requirements over the relevant time horizon.[55] Correspondingly, the chosen strategy will affect the debt servicing costs, and the potential volatility of those costs, and should be reflected in the relevant medium-term fiscal projections. However, the implementation of multi-annual fiscal frameworks remains a challenge for LICs, as well as in many MICs. Grounding the MTDS within the DSA will help achieve the required integration. In addition, the strategy may also have to take account of, and be consistent with, any formal borrowing limits or debt ceilings set out in the legislative framework.

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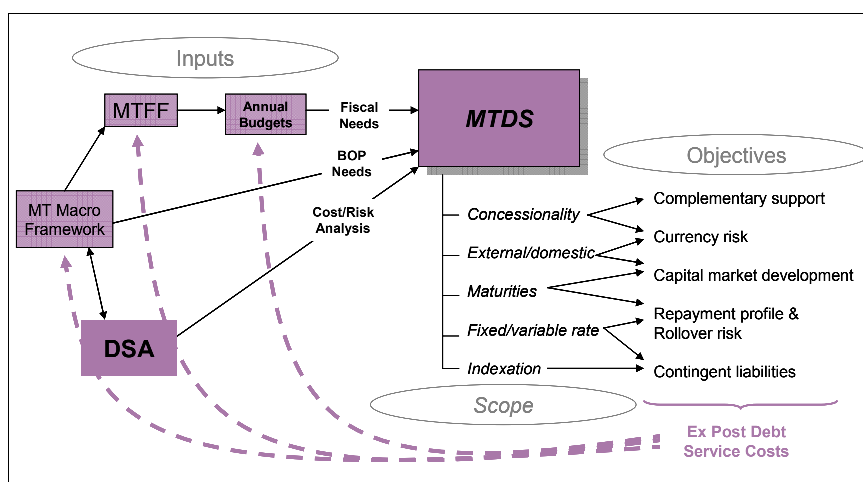
[55] In particular, macro-economic and fiscal policy indicators used in developing a MTFF should be used as key inputs to the MTDS, providing the medium-term context for the MTDS. The objective of the MTDS is not, however, to shape fiscal policy but to identify how to finance and manage liabilities incurred through implementation of fiscal policy.

Figure 5. Schematic Representation of a MTDS



88. **In addition, close coordination between debt and cash management will be important.** Development of cash management capacity in conjunction with debt management will facilitate avoidance of arrears and effective management of the liquidity risk associated with, for example, volatile aid disbursement. In addition, it will also allow relevant information on the government's impact on domestic liquidity conditions to be shared with the central bank, supporting effective implementation of monetary policy.

Assessment of the current position

89. **A basic requirement for any debt strategy analysis is accurate and comprehensive information on the current composition of the debt portfolio**. This requires the capacity to record and monitor existing debt; track the quantity, currency, maturity, instrument mix, and interest rate profile of all debt in the portfolio; and accurately forecast future debt servicing obligations, also necessary for fiscal planning. It also helps identify the risks that are embedded in the existing portfolio, and suggest the desired directions of change. The joint Bank-Fund *Guidelines* discuss a number of risks relevant to debt management, including exchange rate, interest rate, liquidity or rollover, and refinancing risks.

Indication of the desired composition of the portfolio

90. **Evaluating the costs and risks of alternative debt strategies requires some analysis.** Alternative paths for aid and access to concessional finance, and the consequent impact on access to other financing sources, must be assessed. Similarly, assumptions will be required about the likely evolution of exchange rates, and domestic and foreign interest rates. Given the underlying volatility of revenue flows that LICs face, it is particularly important to consider the affordability of debt strategies by expressing costs as a ratio of GDP and of fiscal revenues, drawing on the baseline assumptions embedded in the DSA. The risk associated with any given strategy may then be assessed using suitably designed stress tests,

incorporating the key macroeconomic shocks the economy is likely to face. In this way, analysis using the debt sustainability framework underlying the LIC DSA would inform the choice of debt portfolio.

91. **In the near term, rather than setting precise quantitative targets, the MTDS can be expressed in terms of directional goals** that express how certain key indicators should move. Where foreign currency risk has been identified as a key risk, for example, the short-term strategy could be to increase the share of local currency debt. Similarly, where the amortization profile indicates a concentration of rollover risk, the immediate strategy could be expressed in terms of smoothing this amortization profile.

The short-term financing plan

92. **Once the desired portfolio composition has been determined, the MTDS should be accompanied by an associated financing plan.** This plan should indicate the debt manager's intentions to meet the financing requirement for the coming fiscal period, consistent with the agreed strategy. An assessment of market constraints and immediate access to grants and concessional debt will be necessary. Publicizing information on the financing plan may also support market development and help strengthen relationships with creditors.

Flexibility in implementation of the MTDS

93. **It will be necessary to allow flexibility in the implementation of the strategy.** Such contingency arrangements allow the debt manager to respond to unexpected developments without requiring a full review of the MTDS. This is particularly pertinent for LICs given their exposure to fiscal shocks, such as volatility in growth or aid flows. Often, strategies are expressed as ranges for risk indicators, giving debt managers discretion to adapt to prevailing conditions within the strategy. A similar approach is the setting of confidence intervals for a small number of macroeconomic variables (e.g., growth, aid, current account deficit, budget deficit, etc.), with an indication of how these variables will affect public borrowing at the margin.

Institutional and market development factors

94. **The MTDS must be consistent with the institutional setting in which it is executed, including plans to strengthen capacity.** There are institutional requirements for an MTDS to be effective. These include record keeping, debt monitoring and reporting, the technical capacity of staff, and the legal framework. While strengthening the institutional framework does not fall directly within the ambit of an MTDS, the strategy must take these capacity constraints into account, and could include a component outlining the authorities' plans to alleviate these constraints. For example, outlining the intention to formalize procedures for sharing information across different units so that debt reporting and analysis can be undertaken on the total public debt portfolio at regular intervals. Similarly, any plans to enter the international capital markets should be accompanied by plans to establish the

necessary analytical and investor-relations functions within the debt management unit, as well as to manage additional operational risk arising from such transactions.

95. **Similarly, the MTDS must reflect market constraints, and other access to financing, including from the international financial institutions (IFIs).** Market demand, and availability of other financing sources, will affect the debt manager's ability to implement the desired strategy, the costs incurred, and the risk assessment. For example the assessment of the intensity of rollover risk will reflect market depth. Correspondingly, the strategy might outline the steps to be taken to relax some of these market constraints. All these factors need to be weighed by the debt manager before the strategy is agreed (see Figure 5).

96. **The debt manager should be active in trying to relax some of the constraints on MTDS implementation.** Debt managers in LICs should take an active role in developing the domestic government securities market, in cooperation with other important agents such as the central bank. Improving cash management and budget planning should also be a priority to mitigate liquidity risk.

97. **The MTDS must be subject to regular review.** It may need to be adjusted according to financing availability, market development, or eligibility for grants and concessional debt. Similarly, evolving macroeconomic conditions will have knock-on effects on risk analysis. A further important feature is the retrospective analysis of successes, failures, and departures from previous strategy and their causes, which should reinforce realism going forward.

Annex III. Resource Costs for the Bank-Fund Capacity Building Proposal for the Low Income Countries

98. This annex provides *preliminary* incremental resource requirements for the proposed intensification of work on debt management by the Bank and Fund. The work will be carried out in two phases: (i) the initial phase of work will develop the methodological framework and operational tools for the MTDS, builds on the existing DSA templates, thereby ensuring consistency with the debt sustainability framework; and (ii) the next phase of MTDS capacity building will be country work, to identify reform plans to develop the MTDS in 4–6 LICs per year, and to assist with its implementation.[56] This country work will be complemented by the performance indicator program, which will apply to about 20 LICs per year. All of these tasks will be carried out in close collaboration with country authorities, country teams and area departments.

Bank

99. The total cost associated with the Bank's proposed work on debt management in low income countries will amount to about $10.8 million over four years, reflecting additional staffing costs of $0.9 million per year, and other costs ($1.6 million per year) expected to be financed through donor resources that are yet to be committed. The following activities would be undertaken in close collaboration with regional colleagues: (i) developing methodological and operational tools for an effective MTDS, and country work required to strengthen capacity in 4–6 LICs (est. $1.2 million/year); (ii) assessing, applying, and disseminating performance indicators for debt management, and providing training on them, as well as reviewing and disseminating lessons learned from the MTDS capacity building program (est. $1.1 million/year); and (iii) establishing a Debt Management Practitioners Program ($300,000/year), where practitioners can share and learn from other peer experiences.

Fund

100. At a minimum, up to 5.5 staff years ($1.25 million) of resources will be required over the 4-year period (See Table below). In FY 2008, 1.2 staff years of resources would be needed for (i) developing the analytical and operational tools needed for the MTDS; (ii) delivery of capacity building missions in 4 select countries; and (iii) coordination, backstopping, review, and follow-up work. With the planned increase in the MTDS capacity building mission work from FY 2009 onwards (six countries a year), an additional 1.45 staff years will be required in each year. These costs also cover the resources that will be required for the training, dissemination, and analytical work associated with the MTDS work and

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[56] Preference will be given to the post-MDRI countries, based on expressed demand, for such support by country authorities. This project will initially cover a 4-year period (2008–2011), and its coverage could be expanded, as needed, based on the impact of the capacity building effort and country demands.

possible methodological refinements. In addition to these direct staff costs, mission travel over the four year period is estimated at $1.2 million, bringing total costs for the capacity building proposal for low-income countries to an estimated $2.45 million. These costs are provisional and may need an upward revision as the MTDS capacity building work progresses.

Capacity Building Proposal for Low Income Countries
(in staff years, except where indicated)

	FY2008	FY2009	FY2010	FY2011	Total
Development of MTDS framework	0.3				0.3
Field time 1/	0.8	1.2	1.2	1.2	4.4
number of countries	4	6	6	6	22
number of missions	8	12	12	12	44
time/mission	0.1	0.1	0.1	0.1	
Mission follow up 2/	0.2	0.2	0.2	0.2	0.8
Total resource costs (years)	1.2	1.4	1.4	1.4	5.5
Total resource costs (US$) 3/	265,605	317,488	328,505	339,092	1,250,690
Mission travel (US$) 4/	208,000	321,360	331,001	340,931	1,201,292
Total Costs (US$)	473,605	638,848	659,505	680,023	2,451,982

1/ Two IMF staff will participate per mission (13 day visits, 2 missions/country).
2/ One week per mission.
3/ Based on standard costs for an A9-A15.
4/ Based on two 13 day missions per country and cost inflation of 3 percent per annum.

Annex IV. Description of Debt Management Technical Assistance Agencies

The Commonwealth Secretariat (COMSEC)

101. In 1985, the COMSEC established an integrated program of assistance in various areas of debt management, beginning with the development of debt management software for use by its member states. The Debt Management Section (DMS) is responsible for further developing the system and providing public debt management TA. The system allows countries to record, report, analyze and manage various types of debt flows (external and domestic; medium/long-term and short-term; public and private). The DMS provides a range of TA support, from data recording and reporting with the use of the CS-DRMS, to advising on necessary institutional and administrative arrangements for sound debt management. In 2005, a Regional Adviser's project was launched for the four regions of Western Africa, Eastern and Southern Africa, Caribbean region and Pacific islands in collaboration with WAIFEM, MEFMI, ECCB and the Government of Fiji, respectively. As of January 2006, 53 countries (including non-members) have adopted the CS-DRMS, of which 24 are LICs.

United Nations Conference on Trade and Development (UNCTAD)

102. In 1982, UNCTAD designed a computer-based Debt Management and Financial Analysis System (DMFAS) to help countries manage their external debt. The current version of the software system facilitates the recording and analyzing of various types of debt (external and domestic; medium/long-term and short-term; public and private). Through its Geneva-based DMFAS Program, UNCTAD has established itself as one of the leading providers of debt management TA. It currently works directly with 65 low and middle-income countries, 34 of which are LICs, and typically provides services to governments through technical cooperation projects. The Program provides assistance in the installation or upgrading of the DMFAS software and related software training. Technical assistance also covers maintenance and system support, procurement of appropriate equipment, participation of government officials in DMFAS training seminars, study tours for government officials to other DMFAS user countries, and assistance in debt analysis and development of debt management strategies.

Debt Relief International (DRI)

103. DRI is a London-based non-profit organization that was established in 1997 to implement a Capacity Building Program (CBP), the overriding objective of which is to build the capacity of HIPC governments to manage their debt strategy and analysis independently. The Program, which is implemented in close collaboration with four regional providers of debt management TA, covers 36 HIPC-eligible countries. DRI's scope of advisory services covers institutional reform, external and domestic debt management, debt re-negotiations, macro-economic forecasting, and poverty reduction programming. It also co-ordinates regional and national workshops. CBP also finances (i) short-term capacity-building advisors; (ii) activities related to the HIPC Ministerial Network, which convenes biannual meetings of HIPC Ministers of Finance and their senior officials; (iii) the HIPC Technical

Network, comprising middle-level management; and (iv) newsletters, publications and a website that facilitate communication among HIPCs.

Macroeconomic & Financial Management Institute of Eastern & Southern Africa (MEFMI)

104. MEFMI was established in 1997 and is owned by its 13 regional member countries: Angola, Botswana, Kenya, Lesotho, Malawi, Mozambique, Namibia, Rwanda, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. It manages a training program focusing on macro-economic and financial sector management, including debt sustainability analysis, cash management and domestic public debt market development, which are offered through workshops and seminars. MEFMI works with DRI's CBP to assist HIPC members build capacity in carrying out debt sustainability analysis and strategy formulation.

Pôle-Dette (Regional Debt Management Training Center of Central and Western Africa)

105. Pôle-Dette is based in Yaoundé and responsible for managing the Debt Management Capacity Building Project established jointly by the Training Centers of the Central Bank of Western African States (BCEAO) and the Bank of Central African States (BEAC) in 1999. The organization's membership encompasses 14 countries (Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Congo Republic, Cote d'Ivoire, Equatorial Guinea, Gabon, Guinea-Bissau, Mali, Niger, Senegal and Togo). In addition, assistance is provided to Guinea and Mauritania. The majority of its seminars and workshops are organized jointly with DRI. In addition to training workshops in debt sustainability analysis and other areas covered by the CBP, Pôle-Dette and DRI organize joint missions to countries to evaluate capacity building requirements and to assist with urgent debt strategy support.

West African Institute for Financial and Economic Management (WAIFEM)

106. WAIFEM was established in 1996 by the Central Banks in Gambia, Ghana, Liberia, Nigeria, and Sierra Leone, the member countries, with the primary objective of building capacity for debt, macroeconomic and financial management. A key part of its mission is to help strengthen the capacity of its member countries to develop, present, and negotiate a case for debt relief through the HIPC Initiative. Training subjects include debt management, financial sector management and macro-economic management. Under the CBP, WAIFEM has extended its activities to institutional and governance dimensions of human resource development and management in debt management, and it has expanded its audience to include legislators and the mass media with a view to improving their capacity to assess economic and financial policy issues and performance.

Center for Latin American Monetary Studies (CEMLA)

107. The Center for Latin American Monetary Studies (CEMLA) was established in 1952, and is based in Mexico City. Its objective is to promote a better understanding among central bank and other financial agency personnel of monetary and banking matters, pertinent

aspects of fiscal policy, and their relation with the economies of Latin America and the Caribbean. CEMLA organizes seminars and special training courses, and publishes surveys and research studies. After the launch of HIPC, in collaboration with DRI, CEMLA began assisting its HIPC members to develop their debt management capacity to benefit from the HIPC Initiative and avoid future over indebtedness.

Crown Agents

108. Crown Agents is a limited company that delivers capacity building and institutional development services in public sector transformation, particularly in revenue enhancement and expenditure management, banking, public finance, training and procurement. The company has provided debt management services to developing countries throughout the world. The company has a technical partnership with ComSec to install and service the CS-DRMS. It also has links with debt management offices in a number of OECD countries who collaborate with them by providing technical advice, delivering training sessions on their courses and by receiving study tours.

United Nations Institute for Training and Research (UNITAR)

109. UNITAR has developed the 'legal aspects' for training and capacity building of debt managers in Africa. Training has been conducted since 1987; partnerships with regional organizations like MEFMI, WAIFEM and Pôle-Dette have started as early as 1998; and since 2001 UNITAR has been offering six-week e-Learning courses for capacity building and training of debt managers using new information and communication technologies. UNITAR's training in the legal aspects focuses on skill building of lawyers and non-lawyers in negotiating, drafting and structuring international financial transactions. UNITAR has also developed a diagnostic tool to develop national profiles of the existing legal infrastructure of developing nations with a view to providing guidance and inputs in improving financial governance and transparency.