Identifying the Objectives and Scope for Debt Management

MTDS: Step 1
Step 1

• Objective
  – Identify main objectives for public debt management and define the scope of the MTDS

• Outcome
  – Description of the overall objectives for public debt management
  – Definition of the scope of the MTDS (i.e. what types of debt are to be covered)
Agenda

• What is public debt management?
• Governance issues – why do we need clear definitions of objectives and scope?
• What are the objectives for debt management? Where do we find them?
• What is the scope for debt management?
• Summary
What is public debt management?

• Sovereign debt management is distinct from fiscal policy
  – Fiscal policy determines the level of public debt;
  – Public debt management involves its composition, i.e. exposure to market risks

• DSA versus debt management
  – DSA:
    • Projections of debt-to-GDP ratios over time
    • Primary balance required to achieve sustainable debt levels
  – Analysis of debt composition:
    • Objective is to identify a debt composition that efficiently trades off cost against risk
    • Provides useful input to DSA, as changes in financial variables may have an impact on debt sustainability
Why is effective governance important?

• To ensure that a prudent debt management strategy is developed and adhered to: this is the most important element of public debt management

• Public debt managers manage significant risks and strong accountability arrangements are required. The public and investors require assurance about this

• Disclosure of the borrowing program increases certainty for investors … and lowers the borrowing cost to the Government in the long-run
The main players

Legislature ← Overall objectives

Central Bank

Monetary Policy ↓

Executive ← Strategy decision

Advisory Board

Debt Management Unit ← Proposals/Implementation
Objectives – ideally set by the legislature

• Debt management may have significant repercussions for future tax and spending levels, extending beyond the term of the current Government

• Gives the objectives particular prominence and avoids ad hoc and frequent change

• The objectives form a natural base for regular reporting to the Parliament on the costs/risks of the debt - hold the Government accountable for its strategy

• Is consistent with other macro framework legislation – e.g. monetary policy objectives, fiscal sustainability/debt ceilings
Objectives are distinct from a strategy

• Debt management objectives determine the **long-term** aims of debt management, e.g.:
  – To minimize borrowing costs subject to keeping risks at an acceptable level
  – To support the development and functioning of the domestic financial markets

• Strategy is the plan on how to achieve these objectives

• Strategy and objectives should not be mixed
  – Different purposes, time horizons, evaluation processes
  – Separate decision-making
A stylized process for strategy development

- **Delegation**
  - Power to borrow, transact
- **Accountability**
  - Reporting and oversight, external audit
Laws can support a formal strategy

• Legislation relating to debt management should at a minimum
  – Clearly define the Government’s power to borrow, invest and enter into other financial obligations
  – Define the roles of the various institutions and the power to delegate

• Legislation may be used to strengthen the framework for public debt management
  – Include objectives in laws
  – Require the Government to produce a formal strategy, perhaps as part of the Budget process
  – Require the Government to publish its strategy and report frequently on public debt
Objectives for debt management

• Common objectives for government debt management are
  – To ensure the government’s financing need is met in a timely and cost effective manner
  – To minimize borrowing costs subject to keeping risks at an acceptable level
  – To support the development and functioning of the domestic financial markets

• Clear definition of scope is important, e.g. including guarantees, on-lending portfolio etc.
Examples of debt management objectives

• Brazil: The management of the Federal Public Debt is aimed at minimizing long-term financing costs, while maintaining risks at prudent levels and contributing to the favorable performance of the public securities market.

• Finland: To fulfill the State’s financial requirements and to keep long-term costs incurred by debt as low as possible in relation to risks.

• Mexico: Obtain the financial resources to cover the amortization of its outstanding debt and its net financing needs under the most favorable cost conditions in the medium and long term subject to a prudent level of risk.
Typical debt management objectives

• Most basic: finance the government and meet debt servicing obligations

• Minimize cost but subject to containing risks and/or over a medium to long time-frame

• May include promoting the development of the domestic debt markets

• Will change infrequently – reflecting significant changes in a country’s situation
What if no law or no formal objectives exist?

• As the MTDS is a translation of the long term objectives, we need agreement on the latter
  – Important for the MTDS that the objectives are clearly documented

• Several options exist
  – Introduce debt law, including objectives – may take time
  – Use general objectives – ensure timely funding, ensure low cost in the medium term taking into account risk – and include in strategy document
Moving from objectives to a strategy

• Objectives typically refer to “costs and risks” – how should these be defined for a government debt portfolio?
  – “Cost” – interest payments on debt? May not be a sufficient measure
  – “Risk” – the negative effects that could arise from an undesirable outcome
  – For a government debt manager an undesirable outcome is an increase in the cost of debt servicing; the impact is more severe if this occurs when revenue is low, i.e. to assess risk arising from government debt, need an understanding of the assets and revenue

➡ Topic for Step 2
Scope for debt management (1)

• Debt management should cover all central government liabilities, including contingent liabilities
  – Explicit contingent liabilities, such as guaranteed debt, are the same as direct government borrowing which funds on-lending operations
  – Some debt offices are responsible for credit analysis and/or pricing of guarantees and some control their granting
  – Implicit contingent liabilities, such as debt issued by the banks or state and local governments, also pose a risk and at least should be monitored

• The exact definition of the scope will depend on the degree to which the DM can influence the risk exposure of specific portfolios
Scope for debt management (2)

• A good/practical starting point is the direct domestic and external debt
  – The scope can then gradually be expanded

• If the scope exclude guaranteed and/or on-lent debt, do we ignore these portfolios?
  – No, use information on risks to the overall government balance sheet, i.e. main assets and liabilities helps inform the MTDS

• For sound governance, a clear definition of the scope for debt management is essential
  – If no clear definition, the debt manager may be held accountable for things that are outside his control
Summary

• The debt management objectives provides the basis for the MTDS

• The first step in developing an MTDS is defining
  – Objectives
  – Scope

• This will not only facilitate the development of the MTDS, but also support clear governance arrangements

• The output from Step 1
  – Description of the overall objectives for public debt management
  – Definition of the scope of the MTDS (i.e. what types of debt are covered)