PUBLIC DEBT MANAGEMENT – PUBLIC POLICY COMPONENT

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Abstract:
The public loans sector in a certain country requires a transparent, efficient legal and regulation framework as well as an organization structure. The debt management operations should be supported by an accurate information management system, which would allow the analysis activity to be taken responsibility for, while the loans portfolio becomes complex and governments want to take on risk analyses and debt analyses. The government debt managers have the same concern as the monetary and fiscal policy advisors regarding the public sector indebtedness, which remains on a sustainable path and they consider that a credible strategy may lower the excessive debt levels.

Key words: *public debt management, fiscal and monetary policies, public debt service costs*

JEL classifications: *H6, H63, O1, O11, E6, E62*

Introduction

Public debt management is the process of establishing and performing a government debt management strategy, raising the necessary funds, regulating the risk cost/objectives, achieving any other public debt management objectives set by the government, such as the development and maintenance of an efficient and liquid state bonds market[1].

The debt management operations should be supported by an accurate information management system, which would allow the analysis activity to be taken responsibility for, while the loans portfolio becomes complex and governments want to take on risk analyses and debt analyses.

The public debt management issues often start from the decision makers' lack of attention to the benefits of a cautious debt management strategy and to the costs of a poor macroeconomic management and the excessive debt level. In the first case, the authorities should pay attention to the benefits deriving from the use of a cautious debt management strategy, but also to the policies that are coordinated by a complete macroeconomic framework. In the second case, unsuitable fiscal, monetary or exchange rate policies generate uncertainty on the financial markets regarding the future return on the investments in the local currency, thus making the investors ask for higher risk premiums. Especially on emerging or developed markets, the debtors and creditors alike, resorting to long-term commitments, may suffocate the development of financial markets and severely hinder the managers' efforts to protect the government from he refunding and excessive foreign currency exchange risks.

1. Approaching the public debt management concept. The legal and institutional framework

Public debt management became a priority for many countries with emerging and transition economies, which represents a change beginning with the 1980s. When the debt crisis occurred in 1982, the governments that took charge of managing the debt focused their attention on controlling and recording the medium and long term external public debt. Less attention was paid to controlling and monitoring non-guaranteed

private debts and short term debts. Various institutions within the government were faced with domestic and external debts. The domestic debt management was handled separately and it was not considered a priority at the time.

This approach was changed in the 1990s, especially in the second half of the decade as a result of the factors which interfered with the international financial environment. The amount and terms of the debt in the private sector were subjected to the regulations within a control regime. Loans were recorded and registered after the credits were taken out upon the approval. This was changed at the same time with the capital accounts liberalization in many emerging countries, when the public debt control and approvals were removed. In certain countries, a record-keeping system was used for monitoring reasons. In many cases, even this was removed due to the belief that the external loans of the companies in the private sector were their responsibility.

The crisis in Asia in 1997 demonstrated that this approach could not be argued. Governments should have known the whole extent of the obligations in the public and private sector, especially those of the large debtors, for an efficient public debt management. Thus governments took the responsibility for a series of loans in the private sector which would have had an impact on the country rating and, consequently, on the amount and terms of the future external loans. In this context, governments needed to estimate the overall non-guaranteed external private debt. Therefore, governments should eliminate as much as possible the policies that encourage the private sector to take excessive risks.

Moreover, a combination of surveys, voluntary reports from the debtors and the reports from the commercial banks through which the loan transactions are performed are necessary in order to obtain these estimates. At the same time, the conditioned liabilities level has become a concern for most governments after the crisis period was over. These liabilities could appear due to the predefined evens or circumstances, such as pre-established guarantees. In addition, the public sector obligations as a whole became those of the government, implicitly the included loans guaranteed by them. The public sector loans, as a result of the government policies which encouraged them, added another dimension to the conditioned liabilities level. The payments which could appear due to refunding the pension commitments, medical assistance and other public sector benefits, the governmental insurance and re-insurance programmes, indemnities and other forms of insurance which are not compulsory form a legal point of view, could be a burden during crises. These obligations must be identified, registered and quantified for a stable macroeconomic management.

A clear legal framework[2] is necessary in order to make adequate institutional arrangements for the public loans sector. This should cover the loan legislation of the government, state institutions and central bank and the legislation regulating and/or monitoring the private sector external loans. The legislation must be supported by regulations and procedures which clearly establish the roles played by different agencies involved in the crediting operation, at all the stages in the credit line, for each debtor category. The legislation covering the issue of government loans guarantees (usually by the Ministry of Finances) in the name of the government, as well as the criteria and procedures for approving and monitoring them are also necessary.

In this context, we mention several government agencies which were in charge of a part of or all the credit line regarding domestic and external loans, as well as of the debt management functions, such as: the Ministry of Finances, the Central Bank, the Ministry of Planning (where the planning function was not integrated in the Ministry of Finances, for example in the countries with transition economies) and the Treasury. In some cases, an autonomous Public Debt Management Office can be set up with the special responsibility for the public debt, by means of an administrative or legislative order. There are also agencies which implement projects and programmes for which the

funds were borrowed. The well-defined organizational regulations and the transparent coordination mechanisms between various agencies are necessary for an efficient public debt management. The institutional framework adopted by a country must facilitate the crediting process and the efficient use of borrowed funds.

The changes in the international economic environment and the new requirements for debt management make the countries revise their institutional regulations for the public loans sector and its management.

2. Debt management. Selecting the instruments used in minimizing the debt service costs

The debt managers, the fiscal policies advisors and the central bankers should have the same viewpoint on understanding the debt management objectives, the fiscal and monetary policies, taking into account the interdependence between he various instruments of their policy. The debt managers should communicate to the fiscal authorities their vision on the costs and risks associated with the government funding and debt level requirements. The decision makers should understand the ways in which the various political instruments operate their potential to support one another, and how political tension may occur. The cautious debt management, the fiscal and monetary policies can support one another in order to decrease the risk premiums in the long-term structure of interest rates. Therefore, the monetary authorities should inform the fiscal authorities of the government debt level effect on the achievement of monetary objectives. The loan limits and the risk management practices can help to hedge the state patrimony against the debt service shocks. In some cases, conflicts may occur between debt management and monetary policies as a result of the different objectives – debt management focuses on cost/risk exchanges, while the monetary policy aims at achieving inflation stability. Conflicts may also occur between debt managers and fiscal authorities, for example, over the cash flows which are inherent to a given debt structure (issuing a zero coupon in order to transfer the debt to the future generations). For this reason, it is important that this coordination should occur in the context of a clear macroeconomic framework.

Where the financial development level allows for a separation between debt management responsibilities and objectives and the monetary policies, its existence is important[3]. The clarity of the debt management and monetary policies roles and objectives minimizes the possible conflicts. In countries with well-developed financial markets, the loan programme is based on the economic and fiscal forecasts included in the state budget, and the monetary policy is performed independently form debt management. This helps guarantee that the debt management decisions are not perceived as being influenced by confidential information on the interest rate and avoids the perception of conflicts of interests between the operations on the market. A goal to minimize the government debt cost in time, subjected to a cautious risk level, must not be seen as a duty to decrease the interest rates. No cost/risk objectives should be seen as a justification for extending "cheap" central bank credits to the government and neither should the monetary policies decisions be triggered by debt management arguments.

While the monetary policy arguments and actions are relatively isolated from the debt management ones, it is well-known that the monetary transmission mechanism can be affected by the debt structure impact on the market expectations. Similarly, a high debt level could create time expectations that are inconsistent with the monetary policies (Sargent and Wallace, 1981).

In the industrialized countries' recent history, however, the high debt levels rarely resulted in an increase in inflation, which reduced the government's role regarding the debt, to the detriment of private creditors, the so-called "unpleasant monetarist arithmetic". This can be expressed partially in the existence of liberalized

treasury flows, which are a disciplinary force over the authorities. An inappropriate behaviour will immediately lead to capital leak and to an exchange rate crisis.

Moreover, if the central bank has a clear duty to maintain the inflation at a low level, the high debt level would be more likely to be found in the "unpleasant monetarist arithmetic" (King, 1998). In case there are inflationist pressures, the independent central bank will maintain the interest rates high, and in such circumstances the fiscal policy should take on the difficult adjustment task.[4]

Otherwise, *the independent debt managers* operate outside the influence of the central bank and Ministry of Finances, targeting the unique objective of meeting the government requirements regarding loans.

Regarding *the relevant conditions for the development of an efficient state bonds market*[5] in most countries the development of a state bonds market was essential to the establishment of an efficient and liquid public debt market. Although the countries took different approaches in scheduling and implementing measures in order to develop these markets, they target the main elements of several programmes. A prerequisite for ensuring the investors' confidence is a history of the stable macroeconomic environment. It includes implementing the appropriate fiscal and monetary policies, together with a viable balance of payments, and the exchange rate regime. In addition, the development of a domestic market involves issuing state bonds, even at the initial establishment stages, the bonds market regulation, the market infrastructure.

The debt management decisions are usually faced with selecting the tools, stating institutional techniques and arrangements in order to minimize the debt service costs, taking into account an already established risk profile (table no.1)

Table no. 1 Institutional aspects of public loans

Country	**The institution authorized to grant loans; the debt management authority**	**The debt management agent**	**The debt management main objective**	**Performance assessment**	**Aspects regarding the monetary policy**
USA	Treasury	The Federal Reserve System	Provides funds to the government, brings the cost to a minimum, brings the market disturbance to a minimum, maintains a balanced maturity structure	Yes	None
Japan	Ministry of Finances	The Bank of Japan	Issues low-cost bonds (favoured solvency and liquidity)	Yes, but without formal measures	None
Germany	Government	Bundesbank	Provides funds to the government, minimizes the cost	Without formal measures	Without institutional coordination arrangements; the Bundesbank approval is necessary for the public authorities' bond issues

France	Ministry of Finances, Treasury Department	The Bank of France	Minimizes the long-term loan costs	Without a systematic performance measurement; the control of the state Treasury general operations by the Court of Audit	None
The UK	Treasury	The Bank of England	Reduces the costs, considers the risk, brings the market disorganization to a minimum	Yes	Funds loans in a non-inflationist manner
Italy	Treasury	The Bank of Italy	Provides fund to the government, minimizes the long-term cost	The Treasury releases quarterly reports on the public debt management by the Court of Auditors (since 1996)	Without institutional coordination arrangements
Canada	Government, Finances Department	The Bank of Canada	Provides stability, low costs for government funding	External assessors; ad-hoc revision of the debt management process	Indirect; the Finances Department consults with the Bank of Canada
Sweden	The Swedish National Debt Office (in the name of the government)	The Swedish National Debt Office	Provides the public funds allocated within the limits set by the monetary policy; minimizes the costs (for loans and for debt management), on the long term	Yes; reference state bonds portfolios (benchmark)	Yes (the Debt Office must confer with the central bank; the Coordination committee with the Central Bank and Ministry of Finances representatives)

Source: BIS (1999b), Blommestein / Thunholm (1997), Bröker (1993), Deutsche Bundesbank (1997), Ferré Carracedo / Dattels (1997), Kroszner (1998), and OECD; P.Mylonas, S. Schich, T.Thorgeirsson and G.Wehinger- "New issues in public debt management", OECD, Economic Department WP no. 239, pp. 27

In our opinion, the changes in the international economic environment and the new debt management requirements make the countries revise the institutional regulations for the public loan sector and for its management.

Final Remarks

In most cases, the conflicts between debt management and monetary policies may occur due to the different objectives, because debt management focuses on the cost/risk exchanges, whereas the monetary policy aims at achieving inflation stability. At the same time, conflict may occur between debt managers and fiscal authorities, regarding the cash flows which are inherent to a given debt structure (issuing a zero coupon in order to transfer the debt to the future generations).

Where the financial development level allows for a separation between debt management responsibilities and objectives and the monetary policies, it should exist[6]. In this context, the clarity of the debt management and monetary policies roles and objectives minimizes the possible conflicts.

While the monetary policy arguments and actions are relatively isolated from the debt management ones, it is well-known that the monetary transmission mechanism may be affected by the debt structure impact on the market expectations. Similarly, a high debt level could create time expectations that are inconsistent with the monetary policies.

The cautious debt management, the fiscal and monetary policies can support one another in order to decrease the risk premiums in the long-term structure of interest rates. The monetary authorities should inform the fiscal authorities of the government debt level effect on the achievement of their monetary objectives. Thus, the loan limits and the risk management practices can help to hedge the state patrimony against the debt service shocks.

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[3] Sundararajan, V., Dattels, P. and Blommestein, H., J., *Coordinating Public Debt and Monetary Management*, International Monetary Fund, Washington, 1997, pp. 7

[4] In the Euro zone, for these reasons, "The Stability and Growth Pact" includes the deficit limits for each and every country and their debt levels.

[5] International Monetary Fund / World Bank, *Guidelines for Public Debt Management*, March 21, 2002, pp.33

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