COMPARED EXPERIENCES REGARDING PUBLIC DEBT MANAGEMENT

MIRELA-ANCA POSTOLE, RODICA GHERGHINA, IOANA DUCA, IRINA ZGREABAN
ACADEMY OF ECONOMIC SCIENCES, TITU MAIORESCU UNIVERSITY BUCHAREST
anca_postole@yahoo.com , rodicagherghina@yahoo.com, ioana.duca@utm.ro,
irinazgreaban@yahoo.com

Abstract:
The growing public debt levels, the tendency towards increased central banks independence and the changes regarding the public debts objectives and priorities in the OECD countries in the past two decades have influenced the choice for public debt management institutional arrangements. Although there are recurrent policy aspects, which these governments have had to approach, the evolution has not been identical in all the countries, to the extent to which the ways of structuring and the organizational change process, it has been influenced by the local institutions, traditions, economic conditions, circumstances, such as the creation of the European Union.

Key words: *public debt management, public policies, monetary policies, market risks*

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

Introduction

By the end of the 1980s, public debt management had been considered an extension of the monetary policy, being dispersed across the entire public sector. Throughout the 1990s, debt management was more and more acknowledged as a separate public policy, with separate objectives. Some of the OECD countries opted for separate debt offices, representing the most appropriate institutional arrangement for the improvement in operational efficiency. Other OECD countries tried to offset the public policy against debt management, opting for preserving the Public Debt Management Office as part of the Ministry of Finances.

1. Debt management - a monetary policy extension

The expansionist macroeconomic policies of the 1960s and 1970s led to an increase in fiscal deficits and debt level, and the OECD governments became more and more concerned with inflation and the fiscal policy. At the end of the 1980s and the beginning of the 1990s, the debt/GDP ratio in Ireland, Belgium and Italy exceeded 100%. In Sweden, the governmental debt level increased from 46% of the GDB in 1991 to 82% in 1995, while in Denmark the increase was of 64% in 1991, reaching 80% in 1993. At the highest level, the public debt in New Zeeland reached the level of 63% of the GDP[1] in 1992. Nevertheless, if sustainability becomes a problem, the debt issue should be stopped, and the central bank would eventually be forced to ensure this lack of funding by means of seignorage. In case the central banks stop funding the government, the connection between the high debt levels and inflation would be interrupted and the government would be forced to fill the funding gap by changing the fiscal position and by lowering the deficit.

This idea led to a clear and limited stability of the central banks' objectives, to their greater independence from the government and to the interdiction that the central banks fund the fiscal deficit. Issuing the debts to other parties, different from the central banks, became the only formal means of funding the deficit. This is also the logic according to which the Maastricht Treaty forbade the overdraft facilities and other types

of credit facilities for the governments, as well as the direct purchase of bonds on the primary market by the European Central Bank or the European Union Central Banks.

The Central Bank independence did not necessarily lead to debt management independence. Debt management was still used in certain countries in order to achieve the monetary purposes.

In New Zeeland, the central bankers saw the potential in using the governmental debt in order to strengthen the monetary policy credibility. For example, the Central Bank promoted the foreign currency debt issue in order to hedge the national currency. Nevertheless, such actions created a higher financial risk for the government, which obtained the largest part of its revenues in the national currency, and this conflicted with the debt management cost/risk objectives.

The specialized literature, regarding the interface between the monetary policy and debt management, discusses the possible conflicts of interest which occur when the Central Bank is responsible for both situations. (Blejer 1999, Sundararajan, Dattel and Blommestein 1997).

Even if debt management is handled by a separate department within the Central Bank, there is the risk that the debt management decisions be perceived as being influenced by inside information regarding the interest rate. In this case, neither the monetary policy, nor the debt management policy can be optimum. For example, in Great Britain, before 1997, debt management was performed by the Bank of England. The publicly stated objective was to support and complement the monetary policy, at the same time avoiding distortions on the financial markets and relative to the public expenditures fund. The need to avoid the possible conflicts of interests and their occurrence between debt management and the monetary policy made the government eliminate the debt management activity from the bank and give it separate objectives. Thus, the separation of duties between the Central Bank and the HM Treasury was desired, because the two institutions had different concerns regarding the debt.

However, this was a gradual process in most countries. In New Zeeland, for example, the Debt Management Office was set up in 1988, but the Central Bank continued to interfere in the debt management policy until the mid-1990s, through monetary policy elements. In certain cases, it was a very slow process, but there was still an overlap between the two bodies' policies.

Great Britain was one of the countries with the clearest separation of the objectives regarding the debt management by the Central Bank. Even after the central banks stopped expressing their viewpoints on the debt policy, in many OECD countries debt management lacked the objectives and a structured and precise debt management strategy. Although there is a general awareness of the refunding risks (for example, grouping maturities) as well as of the debt impact on the floating interest rate or on foreign currency debts, there never was a systematic approach to the decision on the overall debt portfolio structure. Debt management was efficiently limited to the operational areas of the debt issue and debt service – corresponding to the main and secondary functions of the Debt Management Office[2]. These functions were often dispersed among various institutions and/or among various departments within HM Treasury.

While the debt level became a concern in the central policy, fiscal regulations were introduced in order to limit the deficit and debt. In Europe, these were considered essential in giving credibility to the introduction of the European currency (Euro). For example, a debt level amounting to 60% of the GDP and a 3% deficit in the GDP were established as targets in 1992 through the Maastricht Treaty.

In many OECD countries, the debt service payment volatility, which represented a large part of the budget, became a major problem and consequently the improvement

in foreign currency debt management and in the risks regarding the floating interest rate, as well as the decrease in the debt service costs became priorities.

The high risk profile of the various debt portfolios in various OECD countries led to redefining the debt management objectives. This change in thinking was used by Ireland, Denmark, Finland and Sweden, which redefined debt management. The new direction initially resulted in the debt managers in these countries imitating the debt portfolio management practices in the private sector. In Ireland, an entity separate from HM Treasury was created in 1990, namely The National Treasury Management Agency because "the debt management structure became a complex and sophisticated activity which required flexible marketing structures and skilled personnel in order to make the most of the savings potential"[3]. Ireland was practically the only country in which the Debt Management Office performed activities on the domestic debt market (Irish pounds) against a reference standard. At the beginning of the 1990s, the Debt Management Office regime was seen as the best practice. While Sweden and Denmark transacted actively against a reference standard, using only foreign currency, in Sweden the governance agreements were changed in 1989, so that the Swedish National Debt Office reported directly to the Finances Ministry. This was followed by changes in the operational policies in order to lower Sweden's external debt obligation after the crisis which occurred in the European Monetary System in 1992.

The justification was formulated in terms of technical efficiency, professionalism and responsibility, which would be materialized if the Management Office were separated from "the political process" (Cassard and Folkerts-Landau 1997). The need to be isolated from the politicians appeared due to the political pressures on the Office to fund cheaply on the short term, even if it involved a higher risk.

In Denmark, the decision was made in 1991 to transfer the Debt Management Office from the Ministry of Finances to the Central Bank, in capacity as agent for the Ministry of Finances, while the responsibility to the Parliament for the government's loans was still the responsibility of the Ministry of Finances. The decision was made after the General Auditor's report was released, which indicated the fact that most tasks related to the government debt were already performed by the Central Bank, and a closer coordination between the foreign currency reserves and the foreign currency debt would be advisable. The General Auditor's report suggested that, from the perspective of the *assets and liabilities management* (the ALM strategy), it was normal to try to match the debt structure in terms of the foreign currency with the foreign currency structure of the foreign currency reserve, the foreign currency risk being eliminated. As a result, the Central Bank in Denmark was put in charge of all the functions related to the government debt management. The responsibility sector was established in an official agreement between the Ministry of Finances and the Central Bank. Through special authorizations, the Central Bank officials are authorized to sign loan documents in the name of the Ministry of Finances[4]. These were a unique case in which the Debt Management Office was located in the Central Bank.

During the 1990s, various countries such as Portugal, Austria and Hungary took the example of Ireland and Sweden, creating what could be called "a second generation of the Debt Management Office", with debt offices outside the Ministry of Finances. In other countries, the debt management front office and back office functions were shared not only within the Treasury, but also allocated to the various departments and organizations, and the domestic and external debt management was shared by various management departments. For example, in Ireland and Denmark, before the National Treasury Management Agency was set up and, respectively, the debt management functions were consolidated within the Danish Central Bank, external and domestic loans were shared by the Ministry of Finances and the Central Bank.

In principle, it should not matter very much that the debt management functions are dispersed, as long as the debt management objectives are clearly defined and the coordination between the various departments is effective. But in practice, as it was presented the horizontal dispersion usually reflects the lack of a coherent debt management objective, as well as the bureaucratic rivalry between departments, resulting in a poor coordination. In addition, dispersion involves a higher operational risk since the responsibility and the duty are not harmonized. Finally, the horizontal dispersion tends to be reflected in a lack of a global orientation strategic risk among the debt managers, while the units involved focus only on individual duties.

In several countries, such a lack of objective clarity and the existence of interdepartmental and inter-institutional rivalries represented major obstacles in achieving the debt management reforms. At present there is a consensus regarding the consolidation of debt management functions in one office, which seems to be one of the most important measures, which could be taken to improve the debt management overall quality, thus paving the way for a strategic management.

2. Debt management – strategic component of the public policy

A group of OECD countries, including New Zeeland, France, Holland and Australia, defined debt management in terms of limiting the fiscal risk, which places portfolio management within a wider public policy framework. This line emphasizes the public policy objectives in public debt management, also related to the market development regarding the domestic debt. Besides, New Zeeland, France, Holland and Australia maintained the Debt Management Office within the Ministry of Finances and the Treasury[5].

At the end of the 1990s and the beginning of the 2000s, the debt management strategy began to be formulated efficiently in a number of countries within the Assets and Liabilities Management (ALM)[6]. In compliance with such a framework, budgetary risks are identified as primary risks which the government is faced with. Instead of analyzing the liabilities portfolio in an isolated manner, several governments noticed that it was useful to consider debt management taking into account the wider government activity framework. This implies that the type of government revenues and the liquidity flows must be examined. Identifying and managing market risks (exchange rate and interest rate ones) mean analyzing the financial characteristics of revenues and other liquidity flows, available to the debt service and then selecting a debt portfolio which has the same characteristics as much as possible. In most countries, government revenues are mainly the fiscal revenues expressed in the national currency. In this case, the risk could be lowered basically by issuing long-term debts with a fixed bond rate in the national currency.

The ALM approach was extended to include the implicit conditioned liabilities, such as securities for debts incurred by governmental institutions and state capital entities as well as the pre-crediting of these entities by means of the central government[7]. The poor management of conditioned liabilities led to significant losses for governments, many of them attempting to manage them in a cautious way and systematic manner. Some governments gave the Management Offices a very important part in conditioned liabilities risk management, often in close coordination with the departments which draw up the budget. The latter can promote the budget transparency, while the Management Office can contribute to quantifying and managing risks and together they can contribute to the government's drawing up a general policy regarding conditioned liabilities. For example, in Sweden, New Zeeland, Canada, the Management Office monitors and manages the risks in the clear conditioned liabilities. In some countries, the debt managers are in charge of supervising the potential exposures due to debts outside the balance sheet. (Magnusson 1999b).

New Zeeland was the first country to set up a modern debt management office according to the guidelines presented above. The debt management office was located within the Ministry of Finances, with elements from the private sector and with its own identity within the ministry. The debt management reform led to a gradual consolidation of the Management Office authority, with a clear separation from the monetary policy, clearly defined objective, stable organizational structures which allow for internal control, a better information management system and more technical personnel[8]. The Debt Management Office in New Zeeland was set up in 1998 in order to improve the management of the risks associated with the government debt portfolio, so as to provide forecasts regarding the debt service, as well as recommendations for the capital markets and other Treasury departments. The government argued that the location within the Treasury allowed for carefully monitoring the effectiveness of the office in managing the government's portfolios. The Debt Management Office in New Zeeland fought the issue of including the private sector practices into the financial management operations, simultaneously giving priority to public policy arguments. For example, the first argument taken into account was to reduce the position of the net foreign currency liabilities and the development of domestic debt markets which were vital issues, compared to managing risks of the foreign currency obligations portfolio, using foreign currency diversification strategies.

The Financial Management Office in Australia was also set up towards the end of the 1990's as an agency within the Treasury, taking a comprehensive approach to financial risk management, but with a clear awareness of the public policy issues regarding risk management.

Moreover, certain governments considered that, for democratic duty and governance reasons, and also due to the interconnections between public debt management and other public policy domains, removing the Debt Management Office from the Ministry of Finances was useless. At the same time, France, through the Agence France Trésor, doubted the state participation as financial intermediary and training it in order to gain a market position. In return, it was demonstrated that the Debt Management Office had to create and manage a basic position and that priority had to be given to the connections between debt management and the remaining public policy objectives. In the countries which had high debt levels, such as the USA, there was no portfolio management element in debt management, and the emphasis was on developing the market, on the transparency and efficiency of achieving the objectives of minimizing long-term costs.

Final remarks

During the past 15 years, in a series of OECD countries, public debt management has changed significantly. From representing the fiscal and monetary policy dimensions, it turned into an activity with its own portfolio management objectives regarding the cost and risk, being coordinated with other key domains of the public policy. The institutional measures were different, according to the way in which governments approached issues related to consolidating the institutional capacity in different manners, emphasizing the portfolio management skills in the private sector and the integration with the remaining public policy. What is an adequate regime regarding debt management very much depends on each country's particular circumstances, for example, the domestic financial market depth, no matter if the monetary policy and debt management policy are separated or not, regardless of the systems and the human resources capacity within the debt office and the Central Bank, etc. Each institutional choice for location and organization has advantages and disadvantages. The similarity between all these OECD countries is that when they decided to implement a major revision of the debt management policies, of the organizational procedures and regulations, a "modern" debt management was created.

REFERENCES

1. Blejer, M., - *Public Debt management and Monetary Policy: Macroeconomic and Institutional Interactions in European Union Accession. The Challenge for Public Liability Management in Central Europe*. Edited by the European Borrowers Network (A European Commission and World Bank Initiative), 1999
2. Cassard, M. and Folkerts-Landau - *Risk Management of Sovereign Assets and Liabilities*, International Monetary Fund,1997, Working Paper WP/97/166,Washington, DC
3. Currie, E., – *Update on European DMOs*, The World Bank, mimeographed, 2000
4. Currie, E., – *The Potential Role of Government Debt Management Offices in Monitoring and Managing Contingent Liabilities*, paper presented at a CEPAL conference in Santiago, Chile, January 2002, mimeographed
5. Currie, E., Dethier, JJ and Togo, E., - *Institutional Arrangements for Public Debt Management,* World Bank Policy Research Working Paper 3021, April, 2003
6. Magnusson, T., - *Sovereign Financial Guarantees*, Swedish National Debt Office, April 1999b
7. Mylonas, P., Schich, S., Thorgeirsson, T. and Wehinger, G., - *Challenges for Public Debt Management in the Major OECD Countries*, Financial Market Trends, No.75, 2000
8. Sundararajan,V., Dattels, P. and Blommestein, H., editors, - *Coordinating Public Debt and Monetary Management.* International Monetary Fund,1997; Washington, DC
9. World Bank / International Monetary Fund. - *Guidelines for Public Debt Management*, March 21, 2001
10. World Bank / International Monetary Fund - *Developing Government Bond Markets. A handbook*, 2001b, Washington, DC
11. World Bank / International Monetary Fund - *Guidelines for Public Debt Management, Accompanying Document and Selected Case Studies*, 2003, Washington, DC

---

[1] Currie, E., Dethier, J.J. and Togo, E.," Institutional Arrangements for Public Debt Management", World Bank Policy Research, Working Paper 3021 April 2003, pp. 11.

[2] There are usually three types of functions in a DMO, each with distinct duties and separate reporting lines. The front office is responsible for funding and sometimes for the transaction operations. The middle office is responsible for analysing and advising on the debt management strategy, as well as for the operational role of implementing the risk controls, especially if the front office is involved in the active transactions, or for adopting speculative positions regarding the government orientation. The back office is responsible for reimbursing for the transactions, as well as for recording the debts and payments.

[3]Currie, E., Dethier, J.J. and Togo, E., "Institutional Arrangements for Public Debt Management", World Bank Policy Research, Working Paper 3021 April 2003, pp.16.

[4] The reason why it was possible for Denmark to have an efficient debt management within the Central Bank is the monetary policy objective, which essentially must maintain a stable exchange rate against the Euro. This fixed interest exchange policy which has been in force since 1982 implies that the monetary policy is closely related to the European Central Bank monetary policy. The fixed exchange rate policy in fact represented the main reason for which the debt policy did not interfere with the monetary policy. In order to support the separation between the monetary policy and the debt policy, a funding rule came into force as early as 1982 according to which the state's need for funding must be covered by loans on the financial markets.

[5] Currie, E., Dethier, J.J. and Togo, E.," Institutional Arrangements for Public Debt Management", World Bank Policy Research, Working Paper 3021 April 2003, pp. 22.

[6] International Monetary Fund/ World Bank, Guidelines for Public Debt Management, March 21, 2002, pp. 24.

[7] Implicit contingent debts, such as the systemic risks resulting from vulnerabilities in the financial sector or from the pensions sector are not the duty of the Debt Management Office.

[8] Currie, E., Dethier, J.J. and Togo, E.," Institutional Arrangements for Public Debt Management", World Bank Policy Research, Working Paper 3021 April 2003, pp. 24.