Breakout Session 4 - Improving Governance in Public Debt Management

Traditionally, sovereign debt management had been confined to resource mobilization, debt data recording, and debt service. Particularly in developing countries, there was a fragmented structure with many front-office functions, one for each borrowing and grant source, which led to several debt databases. Until the early 1980s, there was no systematic analysis of the debt portfolio and its cost-risk profile, and the legal framework was limited to borrowing authorization and detailed rules for the use of different borrowing instruments.

Public debt management started to change radically in the early 1980s. Influenced by developments in the private sector, a new performance and evaluation orientation was introduced. This shift resulted in increased emphasis on the three “Es” (economy, efficiency, and effectiveness), roles and responsibilities of all players in public management were clarified, and specialized units with increased operational autonomy were created. In addition, accountability of the executive to parliament/congress was enhanced, and the independence and functioning of the external audit bodies were strengthened.

These developments, coupled with innovations in financial instruments and deregulation in the financial sector, led to substantial changes in the institutional arrangements for sovereign debt management in many countries. Today, we see clear development in establishment of dedicated debt management units, strategy development, and performance audits. Issues still open for discussions are the degree of independence of the dedicated debt management unit and the degree of decision-making power (if any).

In May 2010, the European Central Bank (ECB) issued the following statement on a proposal by Cyprus to transfer the responsibility of government debt management from the Central Bank of Cyprus (CBC) to the Ministry of Finance: "If the Ministry of Finance is to be directly responsible for debt management, debt management should be kept separate from budget and fiscal control, and sufficient material resources and expertise will need to be secured for a public debt management office to substitute the CBC in its public debt management tasks." The introduction of this new approach brought some new questions to the forefront:

- What are longer-term debt management objectives or goals?
- What is the debt management strategy for achieving these goals?
- Which decisions should be made at the political level and which are best left to professional debt managers?
- Should debt management functions be consolidated into one designated debt management entity, commonly called a debt management office (DMO)?
- What legal framework is needed in this new environment?
- How is debt management performance evaluated?
- What is the requirement of the audit function in this new environment? Should traditional audit of the financial accounts be complemented by performance audit?
These questions formed the basis of the discussion for this SDMF session. Presentations by Mr. Phaedon M. Kalozois, Director of Finance of the Public Debt Management Office of Cyprus and Mr. Branko Drcelic, Head of the Public Debt Administration from Serbia pointed to the differences among countries in terms of the flexibility of the DMOs in the decision making of new instruments and borrowings.

In the case of Cyprus, proposed reform includes a move towards a more autonomous DMO within the finance ministry, with increased powers and competencies. While the framework of debt management, the strategy and general rules and procedures will be defined at the political level, the DMO aims to make all decisions related to strategy implementation, such as determination of the terms and conditions, selection of borrowing instruments, and the ability to reject bids. To improve public debt management, the DMO will seek to increase transparency and communication with stakeholders and introduce reporting requirements, including on contingent liabilities.

In Serbia, on the other hand, the newly established DMO has limited decision making power and a low degree of flexibility in terms of debt management. All transactions pass through the government and the Parliament (in the case of external loans). As an example, Serbia had to postpone an issuance in the external market in the first half of the year due to decision makers’ reluctance before the elections. Similar to Cyprus, Serbia did increase its transparency on debt management and started to regularly publish debt statistics and share the latest developments with the general public.

Mr. Jose Oyola explained how the auditors can help improve debt management practices, in particular regarding the governance framework. He noted that a key objective of performance audits is assessing whether the rules and processes are in place to properly manage debt, rather than focusing on whether “the lowest cost with an acceptable level of risk” is achieved.