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## Economic Systems

journal homepage: [www.elsevier.com/locate/ecosys](http://www.elsevier.com/locate/ecosys)



# Formulation of public debt management strategies: An empirical study of possible drivers

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### ARTICLE INFO

#### Article history:

Received 14 July 2011

Received in revised form 13 August 2011

Accepted 17 August 2011

#### JEL classification:

H63

H74

O23

O50

#### Keywords:

Public debt management strategy

Cross-country survey

Institutional factors

Regional location

Debt crises

Development assistance

### ABSTRACT

A well-designed public debt management strategy can help countries reduce their borrowing cost, contain financial risks and develop their domestic markets. Using survey data on debt management strategies, this paper studies whether the probability that a country has a formal debt management strategy, publishes the strategy document, and uses quantitative benchmarks to formulate its debt management strategy is affected by democratic accountability, institutional quality, past debt crises/defaults, official development assistance, and participation in debt management programs. We find that countries located in Latin America and the Caribbean are less likely to have developed a debt management strategy and, if they have, are less likely to publish it. In contrast, countries located in the Middle East and North Africa are less likely to use quantitative benchmarks in the formulation of their debt management strategies. A country is more likely to have developed a debt management strategy if it has the experience of a past debt crisis, but not of repeated debt crises. Institutional quality and democratic accountability could significantly contribute to the emergence of more transparent and accountable debt management strategies in developing countries. IFIs' technical assistance on public debt management could be enhanced by IFIs conducting their own, prior diagnostic reviews.

Published by Elsevier B.V.

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## 1. Introduction

Governments often have to borrow in order to finance expenditures on public goods and services that support economic growth. The government not only aims to raise funding at low cost but also to structure the composition of its debt portfolio in such a way as to minimize the impact of relevant shocks on its budget and medium-term expenditure plan (see, e.g. Gill and Pinto, 2005). Public debt managers are responsible for choosing the appropriate borrowing instrument to raise the needed funds for the government, based on the delegated authority from the government.<sup>1</sup> The fundamental document that guides debt managers in their decisions and operations is the public debt management strategy.<sup>2</sup> A good public debt management, based on a well-designed medium-term strategy, can then help countries reduce their borrowing cost, contain financial risks and develop their domestic markets. A well-designed and implemented debt management strategy can give confidence to investors and reduce their lending spread. Further, domestic financial institutions benefit from having available public debt instruments for investment that can also provide a benchmark for pricing of other securities and help develop domestic capital markets. A carefully designed public debt composition, and a strategy how to achieve it, can contain risks which are harder to manage for countries with fewer sources of financing (IMF and World Bank, 2001; Baliño and Sundararajan, 2008; Anderson et al., 2010; Weist et al., 2010).

In regard to the desired properties of public debt management strategies, Wheeler (2004) argues that the strategy should be explicit and made public, to inform the markets and facilitate monitoring of the debt manager's performance. This is to ensure sufficient transparency and accountability of the debt manager's operations. A formal debt management strategy can take two basic forms. It can either be presented in terms of guidelines or quantitative benchmarks for the optimal government debt portfolio. The former relates to a document which guides the debt managers on the types of risks that should be considered as relatively more important, and thus indirectly points to the desired structure of a debt portfolio. Therefore, the guidelines provide directions for future debt management operations rather than quantitative targets. On the other hand, strategic benchmarks state explicitly, in a quantitative manner, which are the desired risk characteristics of the optimal debt portfolio within the existing constraints. It is hard to argue whether a guideline strategy or benchmark strategy is unconditionally more desirable, as specific country circumstances need to be taken into account. However, in order to build up credibility and better anchor market expectations about future debt manager's operations, a benchmark strategy could be more preferable, because in principle the benchmark strategy provides less discretion for debt manager's operations. The debate on rules versus discretion that takes place in regard to monetary and fiscal policy implementation (e.g. Barro, 1986; Taylor and Williams, 2010) is thus also relevant for public debt management.

This paper analyzes data from a survey on debt management strategies conducted by the World Bank. The analysis focuses on three main aspects of debt management strategies in the surveyed countries. Namely, (i) whether a public debt management strategy has been developed by a given country, (ii) whether it is published, and (iii) whether it is formulated in terms of guidelines or quantitative benchmarks. First, we describe the survey and summarize the survey data statistics based on selected country group characteristics. Then, we investigate whether the probability of (i) having a formal debt management strategy, (ii) publicly disclosing the debt management strategy document, and (iii) formulating the debt strategy using quantitative benchmarks is affected by democratic accountability, institutional quality, past debt crises/defaults, IMF and World Bank development assistance, and participation in debt management programs. We also include regional dummy

<sup>1</sup> The process underlying delegation of authority to the debt management office to borrow and execute related transactions in financial markets on behalf of the state is described in more detail in IMF and World Bank (2001) and Wheeler (2004).

<sup>2</sup> The strategy is built upon goals stated in the government's debt management objectives. The debt management objectives are usually expressed along the following lines (see IMF and World Bank, 2001): *The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.* The debt management objectives also typically contain sections addressing the government's involvement in domestic bond market development and coordination of its actions with fiscal and monetary policies. The latter relates to the fact that the objectives of fiscal policy, monetary policy, and public debt management differ but there are various interdependencies among their policy instruments, see, e.g. Wheeler (2004) or Togo (2007).

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