LIC Government Debt Market Development

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## Reasons for a LIC Framework

<table>
<thead>
<tr>
<th>Observations</th>
<th>Gov’t/Mkt</th>
<th>Microstructure</th>
<th>Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rarely implemented</td>
<td>“Phantom liquidity” in market making (continuous market)</td>
<td>Many and diverse parties with local relationships</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Causes</th>
<th>Capacity constraints</th>
<th>High costs associated with low liquidity through negative feedback loops (NFLs)</th>
<th>“Weak” institutional framework</th>
</tr>
</thead>
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<thead>
<tr>
<th>Proposed solutions</th>
<th>Incremental approach ▼ Four-stage approach</th>
<th>Grow out of NFLs by making the most of liquidity available in the market (combination of right microstructures)</th>
<th>Stakeholder management through “champions”</th>
</tr>
</thead>
</table>
Advanced Market Observations Were Reduced into Sound Practices.

More deduction than reduction
Market development model based on ex ante facto projections

More reduction than deduction
Market development model based on ex post facto observations

Highly advanced markets

Middle-income countries

Low-income countries
# Flexible Application of Four-stage Approach

<table>
<thead>
<tr>
<th>Stage</th>
<th>I (Nascent)</th>
<th>II (Advancing)</th>
<th>III (Advanced)</th>
<th>IV (Highly advanced)</th>
</tr>
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<tbody>
<tr>
<td>Investor base</td>
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<tr>
<td>Sound Practices</td>
<td>Generally consistent and congruous</td>
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<tr>
<td>Policy theme</td>
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<td>Accounting</td>
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<td>Legal</td>
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<tr>
<td>Primary market</td>
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<tr>
<td>Debt management (DM)</td>
<td>Generally consistent and congruous</td>
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<td>Secondary market</td>
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<tr>
<td>Money market</td>
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<tr>
<td>Derivatives/Futures</td>
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<td>Clearing &amp; settlement</td>
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</table>

Development Stages of Emerging Markets

- **Nascent emerging market**
  - Dealer club market
  - Cost of setting up and running and organized market, etc.

- **Advancing emerging market**
  - Call market

- **Advanced emerging market**
  - Partial market making market

- **Highly advanced emerging market**
  - Full-scale market making market

- **Ignored or overlooked market-risk cost, etc.**

Trading cost
Why Stakeholder Dynamics?

- Local relationships among stakeholders
- “Weak” institutional frameworks
- “Champions”
  - Identify a market development champion
  - Identify the most useful stakeholders
  - Steer the interests of stakeholders

High-level Policy Makers
MOF
Central Bank
State-owned Commercial Banks
Commercial Banks
NBFIs
Securities Market Regulator
Legislators
Institutional Investors
Retail Investors
Mass Media
Development Institutions
Academia

Highly advanced market
LIC market

same or different stakeholders with differing degrees of power and competence.

Note: This diagram is based on the authors' subjective valuations but not on objective measurements.