
Legal Frameworks in Sovereign Debt Management

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Introduction

- Objectives & features of current best practice legislation
 - Subjects of Legislation: Central Government; Local Governments; EBFs; SOEs
 - Necessary Content of Primary Legislation
 - Authorizations
 - Status of Debt
 - Servicing of Debt
 - Limitations on Debt (inc. Guarantees)
 - Purposes for which Debt may be Raised
 - Relationships (e.g. Central Bank, local governments)
 - Control, Audit and Reporting Requirements
 - Country Variations
 - Note: *Much of the above is included for completeness; discussion can be focused on topical areas – fiscal rules and fiscal risks*
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Objectives & Features of Public Debt Laws – Transparency & Generality

- Creditor/investor security and comfort is paramount (+ credit rating agencies)
 - Laws must be available and open to scrutiny by all
 - Laws should be written in plain language understandable by the layperson
 - Laws passed by (or laid before) Parliament are open for debate and challenge
 - Generality of purpose
 - Laws must be general rather than specific
 - The purpose of a law is to regulate actions; *not* to restrict actions unnecessarily.
 - The law is applicable to the whole set; *not* a subset.
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Objectives & Features of Public Debt Laws – Generality and Clarity

■ Generality of subject

- Any parameter which is likely to change should be generalized (e.g. Financial instruments)
- Institutional arrangements are usually too detailed for statute (e.g. Where is the DMO?)

■ Clarity

- Ambiguity occurs regularly – particularly when a law is amended
 - Public Debt Law must be compatible with existing laws which are not amended or repealed by it – particularly budget system laws
 - Problems with non-central government areas – e.g. statutory bodies, local government acts
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Objectives & Features of Public Debt Laws – Accountability

- Legislature accountable for the performance of all aspects of sovereign debt management
 - Usually one member of the government – Minister of Finance
 - Lines of authorized delegations strictly defined
 - Government decentralization policies stated
 - Purposes for debts, on-lending and guarantees stated
 - Procedures for issuance of government guarantees specified
 - Formal debt strategy required to be presented (approved?) in Parliament
 - Strategy enables debt managers to manage liability portfolio without interference from ‘non-professionals’
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Objectives & Features of Public Debt Laws – Budget Financing & Portfolio Management

- An important objective of the law is to ensure that financing and portfolio restrictions on the DMO are minimized
 - Better to centralize all central government borrowings in MoF if possible. *Not* allow EBFs and Line Ministries to arrange borrowings independently of the full debt(/asset) portfolio. Borrowing should be for general budget support – debt financing earmarked for specific projects and purposes should be avoided
 - E.g. Capital projects are often developed around specific debt offerings without connecting these to the overall debt portfolio and its associated risk management
 - Matching financing to a project *appears* to be a natural hedge and therefore looks attractive: But no account is taken of the overall government asset/liability position and government projects do not usually form closed financial systems
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Objectives & Features of Public Debt Laws – Coordination with Other Laws and Controls

- Fiscal control – *(for later discussion)*
 - Fiscal rules
 - Part of Public Debt Law? Coordinated with Public Debt Law?
 - Direct restrictions on debt stock ratio? On debt servicing ratio?
 - Indirect restrictions – debt ratios smoothed over the economic cycle?
 - How can these be accommodated in the Debt Manager's portfolio activities? MTEF; Debt Sustainability Analysis
 - Fiscal Risks
 - Part of Public Debt Law? – market risks included in MTDS
 - Direct contingent liabilities included – guarantees; PPPs
 - Reporting and estimation of risk
 - Other risks – moral hazard; natural disasters; financial crises; SOEs; etc?
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Subjects of Legislation

- Central government
 - All financial liabilities of the State (as defined in the law – usually as the central government) must be covered by the legislation
 - All direct contingent financial liabilities of the State should be covered – State guarantees etc
 - Care is required where EBFs and Line Ministries have borrowing capabilities
 - Local (or Sub-National) Governments
 - The capacity for these – at all levels – to borrow on their own behalf should be defined in the Public Debt Law
 - It is necessary to state clearly whether these debts are liabilities of the central government (State) or not
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Subjects of Legislation

- Local Governments (*continued*)
 - Define the capacity and the limits placed on local governments to issue debt and contingent liabilities, and their monitoring
 - Responsibility for called guarantees given by a local authority
 - Extrabudgetary Funds
 - Statutory bodies having their own individual legislation
 - EBF to obtain debt authorization from MoF and report to MoF
 - State Owned Enterprises
 - Major shareholder support to be placed within the Public Debt Law – e.g. loan guarantees, on-lending
 - International Law – e.g. EU State Aid Regulations – moral hazard
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Necessary Content of Primary Legislation

- Definitions – particularly of: Central government debt; Public debt; TSA; Permanent and indefinite appropriation; Government securities; Risk fund; Public entity, Statutory body etc.
 - All debt contracted by and in the name of the State is a direct obligation of the sovereign as issuer. May be in Constitution or assumed but more transparent to include in primary statute law
 - All State debt is absolutely and unconditionally guaranteed by the State.
 - Ensures that the State cannot imply at any time that its debt obligations have any subjective conditions attaching to them which may be used to avoid payment
 - Keep to contract law?
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Necessary Content of Primary Legislation

- All State debt is to be treated equally and have parity of rank. No present or future State assets may be pledged in order to secure the fulfilment of State liabilities
 - To ensure no preferential treatment for any individual creditors
 - Keep to contract law?
 - Permanent and indefinite appropriation for the payment of all debt service requirements of State debt
 - gives comfort to creditors and potential creditors of the State that payments due to them will not be avoided because the government feels that its policies have priority over its debt obligations
 - Authority is given to the Minister of Finance to act as the sole borrowing agent of the State
 - Control of all State financial obligations is under one accountable person
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Necessary Content of Primary Legislation

- Authority is given to the Minister of Finance to borrow for the following purposes: To cover budget deficits & called government guarantees; to on-lend to public entities; to service all State debts; to maintain a liquidity reserve etc.
 - Authority is given to the Minister of Finance to act as the sole issuer of State guarantees and loans and that such guarantees and loans can only be issued to public entities
 - allows control and accountability to be focussed on one person regarding State liabilities or contingent liabilities, and that private companies cannot be preferentially treated by the State
 - A called guarantee is a direct obligation of the State related to the guarantee Risk Fund
 - Credibility for creditors of advantaged public entities – or contract law?
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Necessary Content of Primary Legislation

- Rules to determine whether Local Governments may borrow on their own behalf, on-lend or issue guarantees; fiscal rules relating to LG liabilities – in Public Debt Law?
 - Loans contracted or guaranteed by LGs are part of public debt, but do not represent obligations of the central government; ‘General government’ definition but avoid moral hazard
 - Authority is given to the Minister of Finance to establish and control an organization responsible for the management of all State debt obligations – e.g. in the Ministry, the Central Bank or as a separate agency
 - Sole authority is given to the Minister of Finance to make all necessary debt service payments on behalf of the State and to select the instruments necessary for the State to borrow
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Necessary Content of Primary Legislation

- The Minister of Finance shall determine annual limits on the domestic and external State (and Public?) debt stock
 - no necessity to establish a quantitative limit in the law?
 - many modern laws make reference to the annual budget law, the official debt management strategy or a debt sustainability analysis in order to determine the required ceilings
 - Fiscal Rules?
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Necessary Content of Primary Legislation

- The Minister of Finance shall establish national debt and guarantee ledgers, and produce reports to parliament on the debt stock and guarantees issued by the government
 - The Minister of Finance shall produce an annual medium term debt management strategy: approved by the government; a report on the performance to date of the existing debt management strategy; and lay before parliament by a certain date
 - Authority is given to the Minister of Finance to appoint the Central Bank, under a written agency agreement, to act as agent in the operation of fiscal management of the government cash and debt
 - The Minister of Finance shall establish internal and external audit and control mechanisms in the operation of debt management and publish reports as necessary
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Variations

- Historical, cultural and political reasons for differences in existing systems (OECD)
 - (1) Tight constitutional controls – e.g. USA, Continental Europe, many Asian countries – legislature controls executive through statute
 - (2) Westminster systems – e.g. UK, Nordic States, NZ – less defined constitution, legislature / executive distinction not clear
 - 1 – many laws/codes
 - 2 – few laws, often relying on *ex post* scrutiny, & often no distinct Public Debt Law
 - Interactions with budget system laws – many different models
 - Fiscal rules
 - Contingency reserves
 - Cash management
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Variations

- There are many different legal treatments of local governments structures
 - Some allow parts of the structure to borrow and not others – e.g. allow area health boards borrowing discretion but not local authorities
 - Some allow provincial states only to borrow directly from the central Treasury. Some encourage this through economies of scale whilst letting the provincial governments obtain their own credit ratings
 - Some prohibit any borrowing or guaranteeing powers to the municipalities and provincial governments, insisting on central government on-lending and equalization financing – this may lead to strange effects and perverse incentives (e.g. bank ownership)
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THANK YOU
