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Transparent Debt Strategies: Why, How, What results ? Lessons from 40 countries

by

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TRANSPARENT DEBT STRATEGIES: WHY, HOW, WHAT RESULTS ? LESSONS FROM 40 COUNTRIES

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STRUCTURE

- Introduction and context
- Why is a debt strategy vital ?
- How: technical content, process and transparency issues
- Progress in building strategies
- Key areas of future focus

INTRODUCTION AND CONTEXT

- DFI Group (Debt Relief International), has since 1991 assisted 41 countries to formulate, approve and implement debt strategies (funded by 10 donors and 35% by countries)
- Capacity-building actions in cooperation with regional organisations financed and run by developing countries, and executed 95% by country experts helping one another (high existing capacity)
- Presentation based on countries' own and independent evaluators' analysis and resulting publications – details at www.development-finance.org.
- Perspective of developing country debt managers

WHY A STRATEGY ?

- Best known to debt managers: Guidelines – "government financing needs at lowest cost and prudent risk" – but also:
- Ministry of Finance/Planning/Central Bank/DMO Reasons
  - Macroeconomic reasons: fiscal and debt sustainability, development of domestic financial markets
  - Fiscal vs monetary vs debt management objectives
  - Respecting regional "convergence" agreements
- Political reasons: (president, cabinet, parliament)
  - ensuring can finance government development objectives, especially "vital projects", (+ fulfil macro goals?)
  - distortion by electoral cycles, "pet projects", corruption
  - broader financing goals – especially in aid-dependent countries, aid "effectiveness" and quality eg low conditionality
  - promoting country/"self" on international markets
  - avoiding stigma of default/switch to maximising debt relief
  - avoiding discussing potential risk especially of inflation/devaluation – risks to policy credibility

WHY A STRATEGY ?

- Institutional reasons:
- Positive:
  - autonomy and credible policy separation
  - motivation and work focus for staff
  - keep continuing focus on debt management and avoid relegation to “care and maintenance” front/back office
  - decentralisation eg states, municipalities, parastatals, private sector guarantees – vs lack of capacity, irresponsibility due to implicit guarantees, lack of legal and institutional framework
- Negative:
  - promotion of own institutional mandate or specific type of debt eg CB and domestic market development, DMO and bond issuance
  - lack of coordination (and in CB or DMO often of accountability, except to presidency)

WHY A STRATEGY ?

- Civil society
  - Pressure to fulfil government plans/promises
  - Pressure not to borrow – avoid debt dependency/crisis
  - Parliamentary/executive accountability varies dramatically
  - Representativeness of CSOs/private sector
- External influences
  - multilateral and other advice – MDGs vs debt/macro emphasis
  - lenders/donors - maximise disbursement (shifting to results ?), aid dependence reduces use of domestic, volatility increases;
  - governments/countries - political and strategic influence therefore “key” projects; trade and investment promotion;
  - creditors - maximise repayment (“defensive lending”) and minimise debt relief (occasionally maximise if funds committed)
  - corruption – therefore pressure against transparency
  - vendors – eg bond/loan sellers, credit rating agencies (fees)
  - technical assistance – keeping selves in job>capacity-building

WHY A STRATEGY ?

- All these reasons and interests don't necessarily fit together at all (in developed or developing countries):
  - Debt managers' motives and reasons – though must be strongly expressed - may not be anywhere near top priorities;
  - Depending partly on strength of laws/institutions, will only get heard to degree take account of others' (changing) priorities
  - Process of designing, approving and implementing strategy has to involve, discuss and reconcile conflicting interests – will not always be optimal result
  - Fundamentally a political process: assuming is only technical may lead to no strategy or implementation
  - Must be domestically driven through coordination among institutions, clear mandates and responsibilities for each agency (eg MoF/DMO, CB) and capacity-building:
  - External TA/reform pressure, regional convergence agreements, have limited success in overcoming fundamental interests

HOW A STRATEGY ?

- Highest-quality technical content using international best practice - but adapt to cover priority national issues, and is not too technical - comprehensible
- Maximise legal mandate, and institutional coordination and reinforcement, to resist political and external pressures
- Ensure through approval, consultation, sensitisation process that attempts to overcome key political risks for country and take concerns of stakeholders into account
- Transparency to ensure government accountable and penalties for breaches of policy
- Build national capacity to assure implementation and regular updating

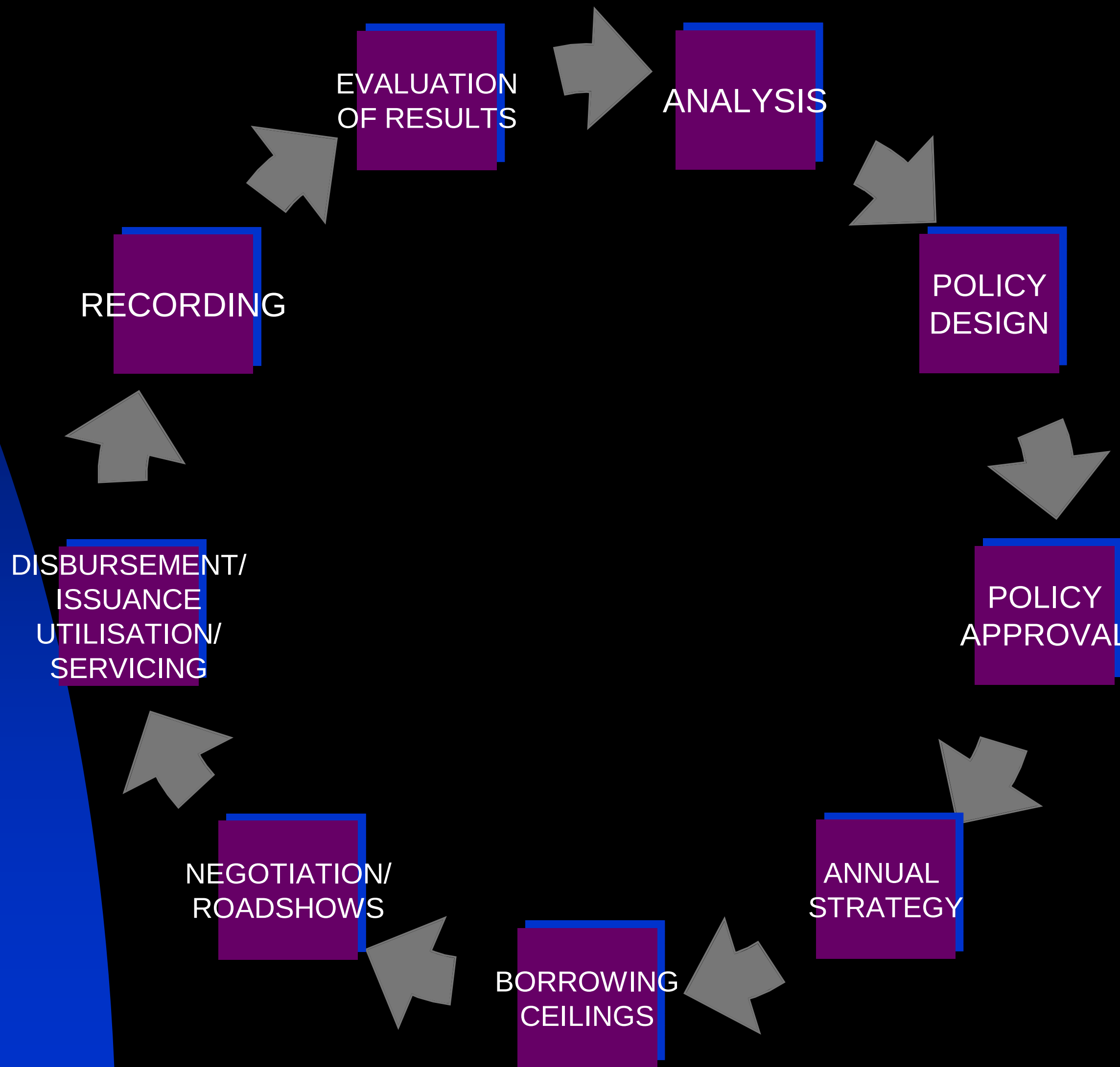
HOW: TECHNICAL CONTENT

- Adapt focus on risk to country need (exchange rate or inflation risk may be large but politicians will not want to admit, interest rate risk relatively low in most LICs and main risks from domestic debt incl refinancing)
- Key issues are cost, macroeconomic/exogenous risks (commodities, private flows, aid), and contingent liabilities
- Cover all types of debt – not just central government external and domestic, but decentralised, guarantees, private sector, contingent liabilities (and grants if major)
- Ensure key projects financed – MDG scenarios and vital strategic projects – or politicians unlikely to respect strategy
- Examine quality of/access to financing for maximum results for development, look at tradeoffs beyond cost and risk.
- Detailed analysis of external finance prospects by creditor, and domestic market development to absorb gvt debt
- Integrate new financing with forecasts of debt relief or restructuring impact, if needed to keep debt sustainable
- Include cash management policies to reduce liquidity risk

HOW: LEGAL AND INSTITUTIONAL

- Legal:
  - ideal = clear law mandating government to produce policy and annual borrowing strategy covering all types of debt, to accompany national budget; and establishing timetables, coordination and work procedures for this, as well as responsibilities esp. for borrowing (Nicaragua, Tanzania)
  - reality may be law complex and lengthy to negotiate, only some aspects possible – can successfully introduce through regulations or government institutional reforms
  - nothing is permanent or unbreakable – even a law !
- Institutional:
  - key aspect is coordination among agencies (not just economic but wider political for ownership – eg presidency, foreign ministry, decentralised/sectoral agencies as needed
  - little evidence that one DMO (especially if not fully accountable) improves strategy, but one locus of negotiation and signature highly preferable
  - stress debt managers' internal power/capacity in agencies (access to policymakers, hierarchy, mandate, staff levels)

DEBT STRATEGY CYCLE/PROCESS



STRATEGY PROCESS

- **Design:**
  - national technicians lead all technical work and presentation – ensure voice/respect by policymakers
  - role of TA/IFIs only to comment/validate, not run tools/write or present report (with nationals relegated to supply data/comment)
  - usually requires comprehensive capacity–building plan for skills needs of all individuals/posts, units and institutions
- **Approval (internal to government):**
  - adapt participants to local political reality (econ team, Cabinet, parliament)
  - consult at all stages to ensure key leaders' policy problems overcome
  - to enhance ownership, minimise external voice or leverage – don't encourage politicians to rely on these !
- **Implementation**
  - Capacity-building must cover this – ie front and back office skills
  - May be very gradual with good reason eg recapitalisation of CB (with potential considerable budget costs) to allow separation of gvt/CB debts
  - Need very clear (variable) sequencing, much possible without full approval or complex legal/institutional reform

STRATEGY TRANSPARENCY

- **Guidelines:**
  - "publicly disclose objectives, analysis, targets, responsibilities"
- **Consultation:**
  - More than disclosure/dissemination needed – not much in OECD ?
  - Ideally widest possible, beyond parliament to include CSOs/private sector/ sources of domestic and external finance (external donors and lenders, bond markets, domestic buyers of debt)
  - widest consultation preferable but no method is guarantor of high-quality design or responsible implementation
  - Cases where confidentiality needed – eg pre-restructuring
- **Dissemination:**
  - ensure publication not too technical and focusses on key policy issues or will be ignored
  - gradual learning by all actors – issues will get more complex
- **Accountability**
  - Clear targets and responsibilities needed – but also for decentralised agencies, and lenders – don't knee-jerk blame gvt
  - Preferably self-assessment and independent evaluation of results

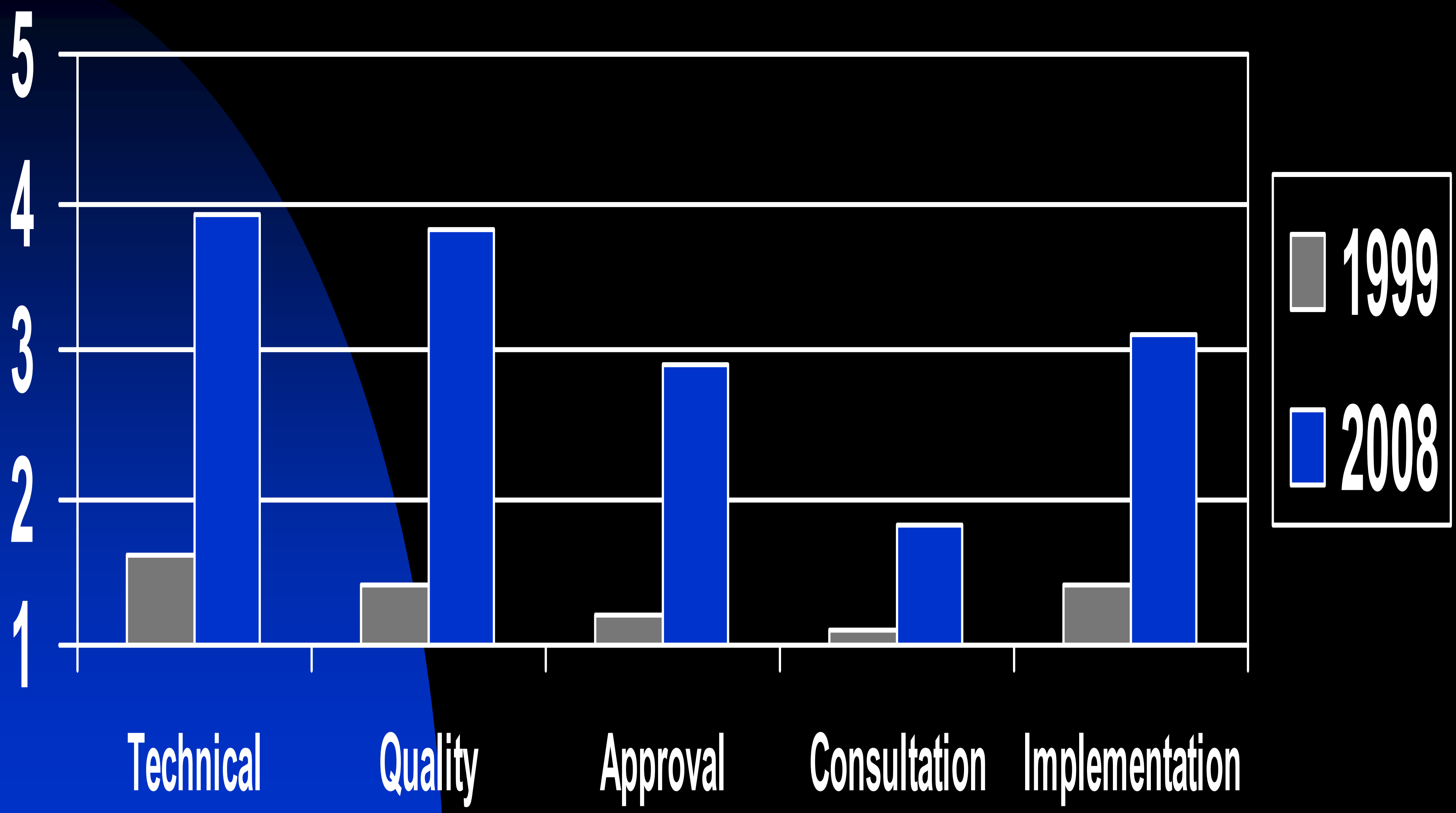
PROGRESS IN DEBT STRATEGIES

- World Bank DeMPA concludes that in 20 countries strategy development relatively weak (44/80)
- countries participating in HIPC CBP evalue their own capacities annually (give selves scores from 1- low - to 5 – high) in 14 areas, identify gaps and measures to fill, design action plans
- Self-evaluation essential for ownership, and is very realistic (if necessary quality-controlled by regional organisations/DFI)
- Evaluates: “Back office” – monitoring; “Middle office” – analysis, design of policy/strategy and evaluation of results; and “Front office” – negotiation/mobilisation
- But allows more detailed analysis of middle office (strategy) to identify underlying problems

RECENT STRATEGY PROGRESS

- **Technical Capacity:** huge improvement since 2000 (but new tools mean more need for country-tailored capacity-building)
- **Quality:** excellent on financing options and macro risks, now gradually incorporating new stress on debt-related risks and tradeoffs
- **Approval:** lower than other scores, because much approval is limited to MoF/CB/DMO, though considerable progress, update averages 2-3 years
- **Consultation/Dissemination:** very weak, limited largely to donors, only a few countries to parliament, fewer still to CSOs, little publication
- **Implementation:** surprisingly high, partly because less fully approved strategies are implemented

RECENT STRATEGY PROGRESS



KEY PRIORITIES : CAPACITY-BUILDING

- Genuine capacity-building (not renamed TA), preferably from sources independent of lenders to avoid conflict of interest, and primarily through exchange among developing countries (more relevant)
- Monitoring/recording as underpinning for strategy – UNCTAD/Comsec – but integrate with "quality of finance" aspects and grants – and accelerate transfer of training and maintenance to countries
- Enhance technical quality of debt policies and apply annual borrowing strategies and ceilings, including especially detailed analysis of "quality" of finance, domestic market demand, and debt-related risk: preferably also integrate into policies on public and private sector development finance
- Capacity to negotiate financing in line with strategy (reduce costs, minimise risks, increase development impact through project and programme design and implementation)

KEY PRIORITIES: WIDER ISSUES

- Consultation/transparency beyond economic team – also expand capacity-building efforts to presidencies, foreign ministries, sectoral ministries, parliaments, decentralised government units, independent institutions such as audit offices, civil society
- Political engagement: to use capacity/listen to officials, lead consultations/negotiations, learn lessons from other countries
- Democratic commitment to ensure accountability to parliament (budget defining detailed targets), and to civil society
- Donor political openness: accept own responsibility, reduce volatility of funds, allow increased borrowing to fund key programmes
- Global information exchange
  - lender trends/performance/practices - independent of lenders
  - success stories in market development and capacity-building
- Only overcoming these wider issues will validate capacity-building, improve debt management sustainably and allow countries to finance development