What is Public Debt Management and Why is it Important?

4. Public debt management is the process of establishing and executing a strategy for managing the government’s debt in order to raise the required amount of funding at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk. It should also meet any other public debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

5. In a broader macroeconomic context for public policy, governments should seek to ensure that both the level and rate of growth in their public debt are on a sustainable path and that the debt can be serviced under a wide range of circumstances, including economic and financial market stress, while meeting cost and risk objectives. While the responsibility for compliance with debt ceilings and for conducting debt sustainability analysis lies with the fiscal authorities, public debt managers should share fiscal and monetary policy authorities’ concerns that public sector indebtedness remains on a sustainable path. Debt managers should ensure that the fiscal authorities are aware of the impact of government’s financing requirements and debt levels on borrowing costs. Examples of indicators that address the issue of debt sustainability include the public sector debt service ratio, and ratios of public debt to GDP, exports, and tax revenue. Such indicators should be evaluated considering a wide range of scenarios.

6. Every government faces policy choices concerning debt management objectives, in particular its preferred risk tolerance, the parts of the government balance sheet that debt managers should be responsible for, the management of contingent liabilities, and the establishment of sound governance for public debt management. On many of these issues, there is increasing convergence on what are considered prudent public debt management practices that can also reduce vulnerability to contagion and financial shocks. These include recognition of the benefits of clear objectives for debt management; weighing risks against cost considerations; the separation of debt and monetary management objectives and accountabilities (where appropriate, combined with consultation and information sharing between the debt manager and the central bank); the need to carefully manage refinancing and market risks and the interest costs of debt burdens; and the necessity of developing a sound institutional structure and policies for reducing operational risk, including clear delegation of responsibilities and associated accountabilities among government agencies involved in debt management.

7. Poorly structured debt portfolios, in terms of maturity, currency, or interest rate composition and large contingent liabilities, have been important factors in inducing or propagating economic crises in many countries throughout history.1 For example, irrespective of the exchange rate regime, or whether domestic or foreign currency debt is involved, crises have often arisen because of an excessive focus by governments on possible cost savings associated with short-term or floating rate debt. Issuance of large volumes of such debt instruments has left government budgets seriously exposed to changing growth and financial market conditions, including changes in the country’s creditworthiness, when this debt has to be refinanced. Excessive reliance on foreign currency debt poses particular risks as it can lead to exchange rate and/or monetary pressures if investors become reluctant to refinance the government’s debt. By reducing the risk that the government’s own debt portfolio will become a source of

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1 For the purpose of this document, contingent liability refers to explicit contingent liabilities unless stated otherwise.
Revised Guidelines for Public Debt Management

instability for the private sector, prudent government debt management, along with sound policies for managing contingent liabilities, can make countries less susceptible to contagion and financial risk. Further, a debt portfolio that is robust to shocks places the government in a better position to effectively manage financial crises.

8. **Sound risk management practices are essential given that a government’s debt portfolio is usually the largest financial portfolio in the country and can contain complex and risky financial structures, which have the potential to generate substantial risk to the government’s balance sheet and overall financial stability.** Sound risk management by the public sector is also essential for risk management by the private sector. Sound debt structures help governments reduce their exposure to interest rate, currency, refinancing, and other risks. Many governments seek to support these structures by establishing targets and ranges for key risk indicators or, where feasible, target portfolios related to the desired currency composition, duration, and maturity structure of the debt to guide borrowing activities and other debt transactions. When made public, such targets help to increase the predictability and transparency of debt management operations, and in turn reduce uncertainty for investors.

9. **Debt crises have highlighted the importance of sound debt management practices and the need for an efficient and liquid domestic capital market.** Although government debt management policies may not have been the sole or even the main cause of such crises, the maturity structure, and interest rate and currency composition of the government’s debt portfolio, together with substantial obligations in respect of explicit and implicit contingent liabilities—not least in relation to the financial sector—have contributed to the severity of the crises. Even in situations where there are sound macroeconomic policy settings, risky debt management practices increase the vulnerability of the economy to economic and financial shocks. Sometimes these risks can be readily addressed by relatively straightforward measures, such as by lengthening the maturities of borrowings and paying any associated debt servicing costs, or by adjusting the amount, maturity, and composition of foreign exchange reserves. It is also important for governments to review criteria and governance arrangements in respect of contingent liabilities to ensure that these are consistent with transparent and sound fiscal and budget management principles.

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