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Summary of
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"Coordinating Public Debt and Monetary Management During Financial Reforms" by Sérgio Pereira Leite

The interplay between financial reforms and public debt management strongly suggests that financial reforms should take account of fiscal policy and that a public debt strategy should reflect the importance of debt management to financial sector performance and monetary policy implementation.

This paper portrays the typical state of public debt management at the onset of financial reform and discusses monetary policy and public debt through the different phases of the reform. It concludes that, irrespective of institutional arrangements, little can be done to implement financial reforms if the government is unwilling to accept two basic principles: (1) that it should pay market-related rates on its borrowing; and (2) that it should incur a short-term cost in developing an active financial market in government securities to ensure longer-term access to these markets at reasonable rates in the future.

Coordination between the central bank and the treasury becomes less stressful and more effective as reform progresses, particularly if the government has reduced the budget deficit to manageable levels. However, it is not only the budget deficit that places a burden on monetary management; the reverse is also true. Poorly conceived monetary instruments, such as reserve requirements and rediscount policies, can make it extremely difficult to develop a sufficiently deep and active government securities market.

Although central bank independence is very much in vogue, there may be a case for "treasury independence," that is, a treasury that is independent of the central bank. The treasury achieves independence when it is able to finance the government without using either central bank financing or regulations to force economic agents to hold its securities. There is substantial evidence indicating that the coordination between public debt and monetary management becomes much easier as the treasury acquires its independence.

The paper recommends setting up a committee of central bank and treasury officials to coordinate public debt and monetary management. It also suggests that both the treasury and the central bank should have units in charge of public debt management. In the treasury, the unit should be responsible either for making final decisions on placements of securities after consultation with the central bank or for monitoring the central bank's performance as debt manager if this task has been fully delegated to the central bank. The central bank unit will be in charge of monitoring developments in government financial markets and managing government security auctions. Operations in the secondary market, however, should be conducted by a separate central bank unit in charge of monetary policy implementation.