

Improving Public Debt Management in the OIC Member Countries - Global Practices

by Prof. Siegfried Schoenherr and Dr. Marina Riem

8th Meeting of the COMCEC Financial Cooperation Working Group
Crowne Plaza Hotel, Ankara

March 30, 2017

Overview

1 Introduction

- Scope of Study
- Public Debt Management Overview

2 Global Public Debt Dynamics and Structures

3 Institutional Frameworks

- Efficiency of Public Debt Management Practices
- Governance and Strategy Development

4 Lessons Learned for OIC Countries

The ifo Institute for Economic Research, Munich / Germany



- Germany's leading economic think tank
- Public policy consultancy through rigorous scientific analysis
- Not for profit and fully independent from any party or ideology

COMCEC Study on Public Debt Management

Research goal:

- ① Analysis of global practices of public debt management
- ② Assessment of public debt management in OIC member countries
- ③ OIC country-specific case studies
- ④ Policy recommendations

Methodology:

- Quantitative analysis of **public debt databases**, e.g. IMF or World Bank
- **CESifo World Economic Survey (WES)**: quarterly interviews with over 1,000 experts in ca. 100 countries worldwide about current and expected economic situation in their country
- **COMCEC-ifo Country Survey**: specific questionnaire about public debt management practices in OIC member states
- Individual **field visits** to Indonesia, Kazakhstan, Oman and Iran

Definition: Public Debt Management

Public Debt Management:

Establishing a strategy for managing the government's debt...

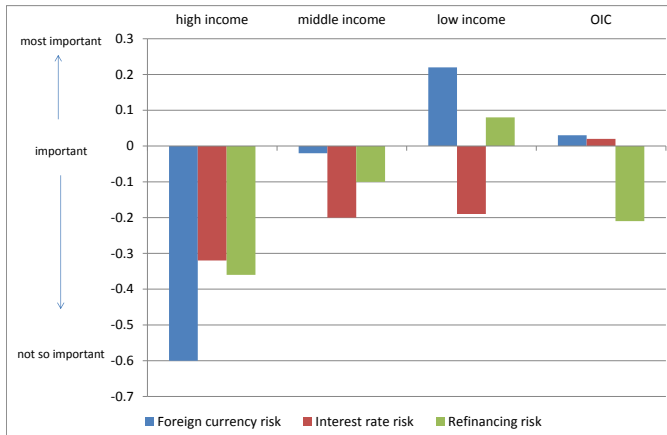
- ① ... to raise the required amount of funding
- ② ... at the lowest possible cover cost
- ③ ... over the medium- to long-run
- ④ ... consistent with a prudent degree of risk

Main Risks for Public Debt Management

<i>Type of risk</i>	<i>Description</i>
Refinancing risk	Refinancing of maturing debt not possible or very costly
Interest rate risk	Increase of servicing costs of current debt
Foreign currency risk	Change of value of foreign currency-denominated debt expressed in local currency due to exchange rate volatility

CESifo World Economic Survey: Risks

Question: “What is the main risk for public debt management in your country?”



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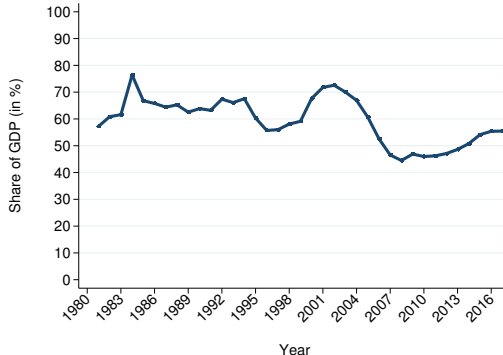
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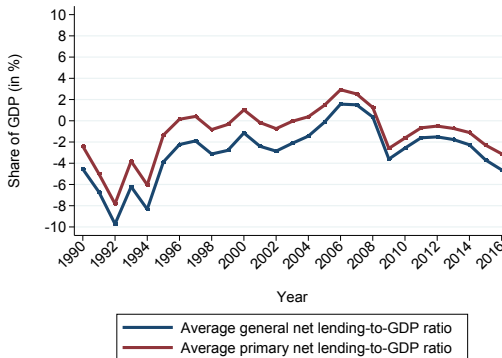
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Worldwide Averaged Gross Public Debt-to-GDP Ratio



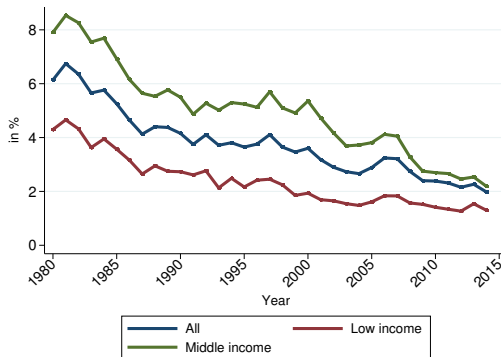
- Worldwide debt ratios stable or declining in past due to strong GDP growth
- But: increasing trend since global financial crisis 2007

Global Government Budget Balances



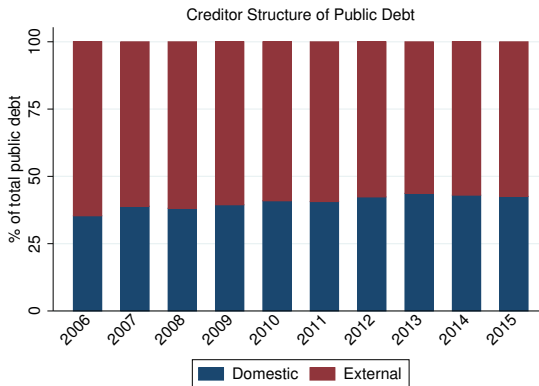
- Average government budget balances almost consistently negative
- Aftermath of global financial crisis in 2007 interrupted positive trend

Average Interest Rates on Public Debt



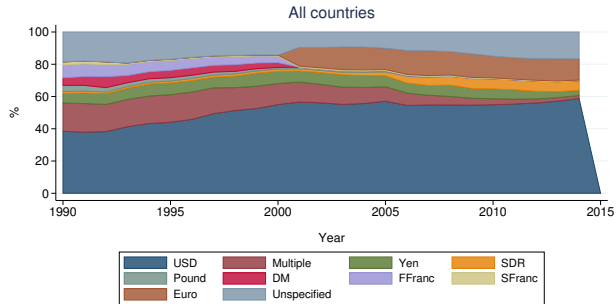
- Average nominal interest rates on public debt steadily declining
- Decreasing spreads between income groups

Average Creditor Structure of Public Debt



Relatively stable creditor composition, slight increase of domestic investors

Global Currency Composition of Public Debt



Increasing importance of US Dollar and Euro, declining share of Japanese Yen

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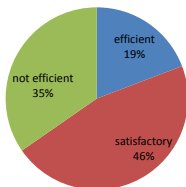
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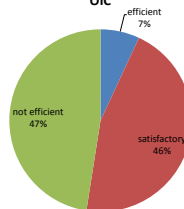
CESifo World Economic Survey: Efficiency

Question: "How do you assess the public debt management of your country?"

All countries



OIC



Governance and Strategy Best Practices

<i>Institutional framework</i>	<i>Description</i>
Legal framework	Establishment of Debt Management Office (DMO) Independent, clearly mandated and legally accountable
Managerial structure	DMO competence centralized at Ministry of Finance Policy coordination with other ministries
Medium-term debt management strategy	Portfolio structuring decisions Refinancing and risk management procedures
Transparency, information availability and auditing	Clear, forwarded guided communication Publication of public debt data and reports Evaluated by independent agency

Coordination with Macroeconomic Policies

Fiscal policy

⇐ *Coordination* ⇒

Monetary policy

Debt management operations according to mandate

...

... minimizing costs for given risks

... taking entire public balance sheet into account

Coordination with, but clear separation from fiscal policy

✗ Direct fiscal financing with inflation

✗ Decisions about interest rates driven by fiscal needs

The Role of Domestic Debt Markets

Importance of domestic debt markets:

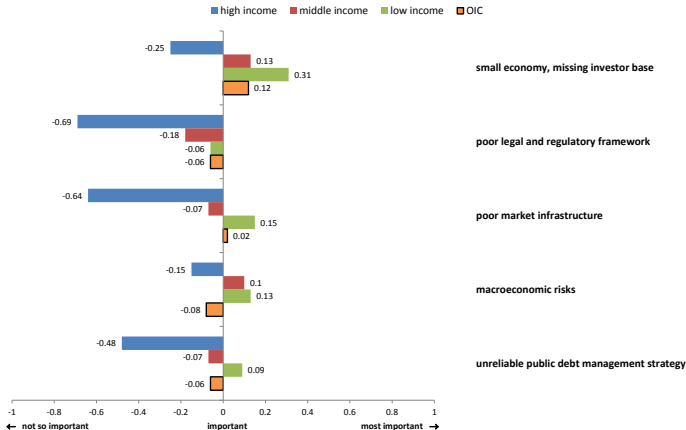
- Important source of financial resource for governments
- Lower financing risk due to additional investor diversification opportunities

Deficiencies in domestic market development:

- Domestic debt markets in OIC member countries perform rather unsatisfactory according to CESifo WES survey

CESifo World Economic Survey: Domestic Debt Markets Challenges

Question: "What are the main challenges for domestic debt markets in your country?"



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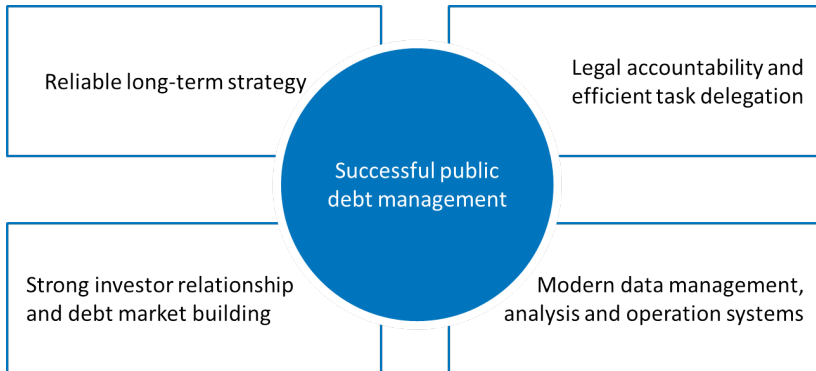
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Global Best Practice Model of Debt Management



World Bank DeMPA Performance Indicators

<i>Indicators</i>	<i>Characteristics</i>
1. Governance and strategy development	Legal and managerial structure Objectives of debt management strategy
2. Coordination with fiscal and monetary policies	Independent and separated DMO Objectives of debt management strategy
3. Borrowing and related financial activities	Development of domestic debt market Degree of foreign borrowing
4. Cash flow forecasting and cash management	Forecasting of cash balances Sufficient fiscal liquidity
5. Debt recording and operational risk management	Quality of data collection and storage Level of integration of debt administration

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ISLAMIC FINANCE IN PUBLIC DEBT MANAGEMENT

Islamic Finance: Broad Definitions

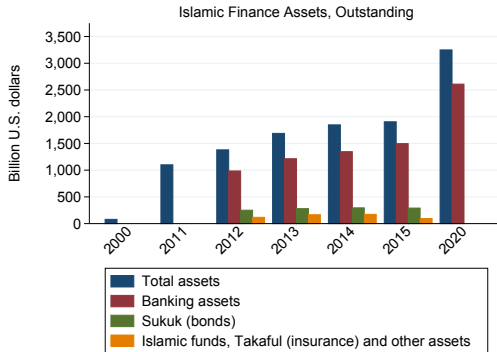
Islamic finance: Sharia-compliant financial system based on Islamic economics

- Principle of profit and loss sharing among investment partners
- Returns on real underlying assets and real economic activities

Sovereign sukuk: Sharia-compliant Islamic government bond

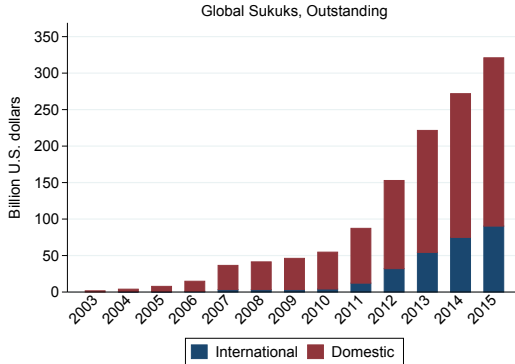
- Shares in the ownership of public tangible assets, services or particular projects
- Securities allowing investors to participate in government revenues

Global Assets of Islamic Finance



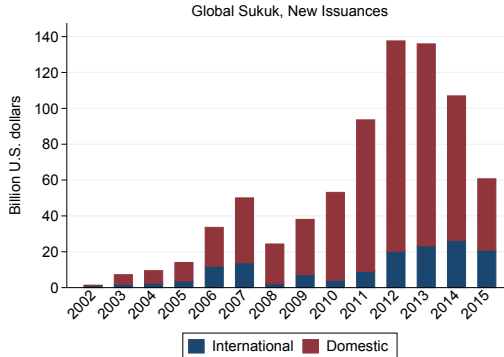
- Growth between 2000 and 2015: + 2,000% of total Islamic finance assets
- Forecast: strong growth continues, increasing importance in global finance

Global Sukuk Outstanding



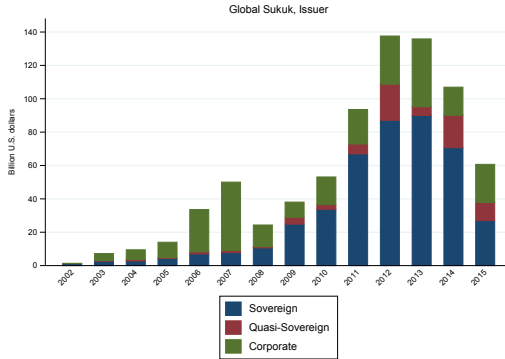
Exponential growth of outstanding sukuk volume during last 15 years

Global Sukuk Issued



- Significant increase in this decade
- Greater participation of international investors

Global Sukuk Issued



⇒ Instrument used by ca. $\frac{2}{3}$ of OIC member countries, increasing trend

Case Study: Malaysia - A Leader in Sukuk Financing

Past:

First modern Sukuk issuance worldwide in 1990 by Malaysia Shell
Early sovereign Sukuk issuance in 2002 by Malaysian government

Presence:

Accounting for over $1/2$ of global sovereign sukuk volume
A3 ("upper medium grade") rating by Moody's

Future:

Strategic targets specifically for Islamic public finance instruments
+19% projected average annual growth rate of the Islamic banking sector until 2019