



ZIMBABWE ECONOMIC
POLICY ANALYSIS AND
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Feasibility and Rationale for Establishing a Debt Management Office in Zimbabwe

Albert Makochekanwa

Gibson Chigumira

Jacob Nyamadzawo

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ABSTRACT

This study looks at the feasibility and rationale of establishing a Debt Management Office (DMO) in Zimbabwe. This follows calls for the setting up of such an office by the Ministry of Finance as part of broad reforms to improve the conduct of debt management in the country. The study acknowledges that the current debt management practices in the country have a number of loopholes that may have contributed to the accumulation of the current high and unsustainable external debt, which remains a millstone around the country's neck. The study notes that in line with recent trends in debt management, the country could improve its debt management practices through the setting up of a dedicated DMO. The study explored international best practices in debt management, structures and the ideal location of DMOs and recommend that the DMO be initially located within the Ministry of Finance during the initial years, in view of the financial and regulatory considerations, which require amendments to the current laws on debt management as well as enactment of the requisite legislation to create a statutory DMO in the medium-to-long term.

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LIST OF ACRONYMS

ACCGEN	Accountant General
AFFM	Australian Office of Financial Management
AG	Attorney General's Office
BPD	United States Bureau of Public Debt
CB	Central Bank
CSDRMS	Commonwealth Secretariat Debt Recording and Management Systems
DMFAS	Debt Management and Financial Analysis System
DMO	Debt Management Office
DSTA	Dutch State Treasury Agency
ELCC	External Loans Coordinating Committee
GDM	Danmark Nationalbank Government Debt Management
GoZ	Government of Zimbabwe
IGCP	Portuguese Instituto de Gestão do Crédito Público
IMF	International Monetary Fund
MEFMI	Macroeconomic & financial Management Institute of Eastern & Southern Africa
MoF	Ministry of Finance
NDMA	Iceland National Debt Management Agency
NTMA	Irish National Treasury Management Agency
NZDMO	New Zealand Debt Management Office
PDO	Public Debt Office
PFMA	Public Finance Management Act
PPG	Public and Publicly Guaranteed
RBZ	Reserve Bank of Zimbabwe
SNDO	Swedish National Debt Office
STERP	Short Term Emergency Recovery Programme
UK DMO	UK Debt Management Office
ZIA	Zimbabwe Investment Authority

1 INTRODUCTION

Traditionally and in most countries including Zimbabwe, debt management policy was not considered a separate macroeconomic policy, but was subordinated and interdependent with both fiscal and monetary policies (Togo, 2007 and Currie et al, 2003). This setup was mainly due to the fact that managing debt servicing cost, which is highly volatile, through sound debt management has implications for securing short-term fiscal space as well as the management of long-term fiscal risks. In addition, debt management is also a concern for the conduct of monetary policy when viewed as the management of the composition of assets available to the public between money and government paper (Togo 2007). Figure 1 provides a snapshot of the interdependencies between debt management, fiscal policy and monetary policy. Despite the existence of this interdependence, there has been growing consensus among practitioners on the need to separate debt management from both fiscal and monetary policies. This paradigm shift was initially a response to the debt crises of the 1980s and 1990s that affected a number of countries including Mexico, Belgium, France, and Ireland, among others. However, to avoid recurrences of such crises, countries have reacted by treating the debt management function as an independent policy with its own objectives. Consequently, separate policy instruments have been set up to manage this function.

With a highly unsustainable¹ debt burden of US\$6.9 billion², of which 69.6% (US\$4.8 billion) is in arrears, the country faces immense challenges in accessing offshore finance for its developmental programs and projects. The country's credit rating has also fallen due to high default and country risk profile among other factors. Projects have either been suspended or canceled due to the accumulation of arrears and litigations by creditors have increased. In this regard, the Government of Zimbabwe (GoZ) is exploring ways of resolving this debt including reforming the debt management practices in the country. Whilst declining macro-economic performance over the last decade is largely blamed for the debt crisis, weak debt management practices can be seen as an attendant contributor to the current debt crisis. Currently, the debt management function is dispersed across three offices, namely the Domestic and International Finance (DIF), the Accountant General's department (ACCGEN), both in the Ministry of Finance (MoF); and the Reserve Bank of Zimbabwe's (RBZ) External Sector and Financial Markets departments. Although, there is scope for the active participation of a legal department, the Attorney General's Office (AG) role in the debt management set up, is limited to loan negotiation and dispute resolutions.

The current debt management set up has its own challenges, mainly to do with consolidation, functional gaps and fragmentation, which might have contributed to the current debt crisis. Rightly so and in line with international trends in debt management, the Government sees an opportunity of improving debt management through consolidating the current fragmented debt management functions into a single debt management unit.

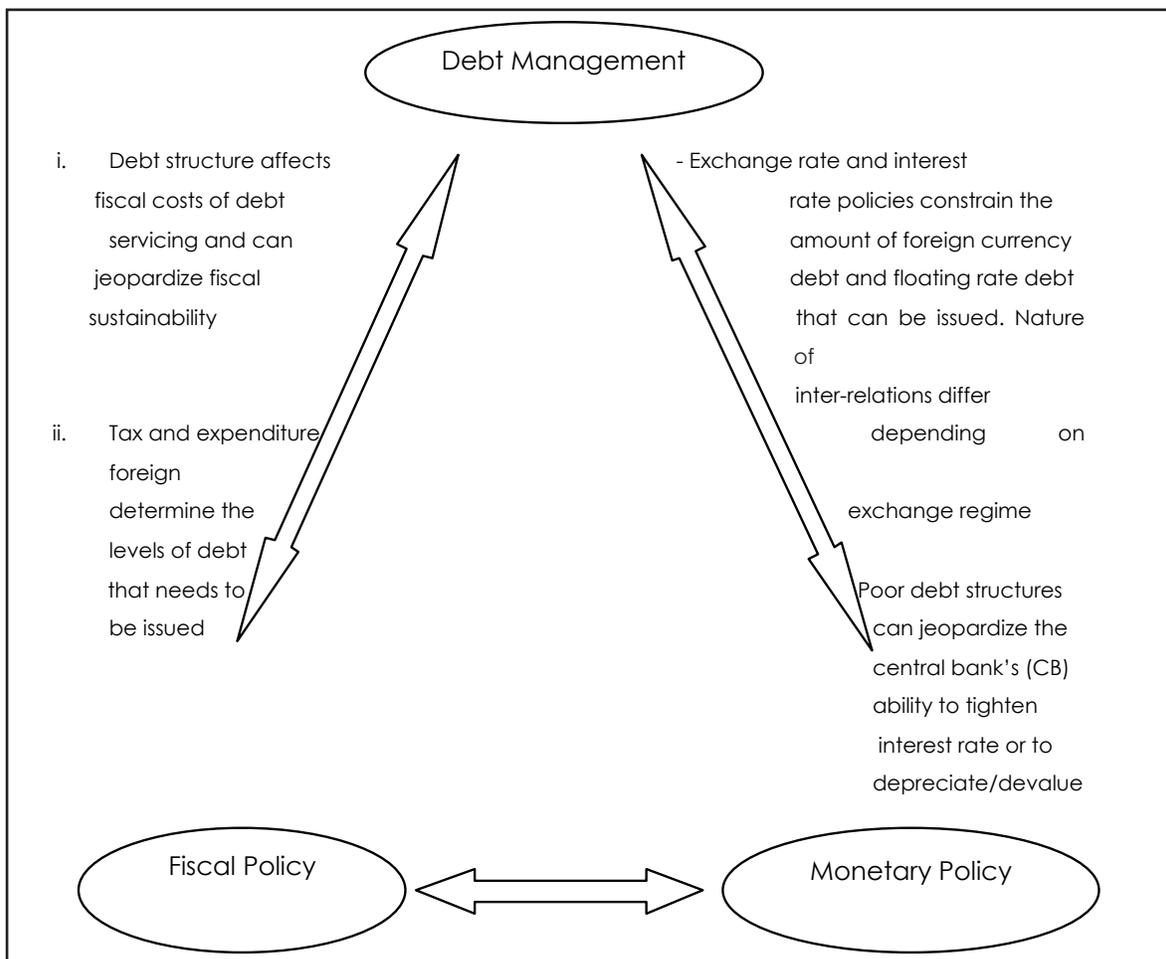
¹According to the DSA conducted in August 2009, Debt/GDP Ratio was 160%, debt/Exports was 340% and debt/Revenue was 570% against thresholds of 30%, 100% and 200% respectively, IMF 2010

²The 2011 National Budget Statement

The Government of Zimbabwe through the 2010 National Budget and the 14th July 2010 Mid-Year Fiscal Review (MYFR) proposed the setting up of a debt management office (DMO) as a possible way in which the country can effectively and efficiently manage its debt. The 2010 MYFR alluded to the fact that effective management of public debt is paramount if the economic recovery and growth are to be sustained in future. As such, GoZ consider it important that debt management functions be consolidated to ensure effective debt management arrangements. Consolidation and enhanced institutional framework for public debt management through the establishment of a DMO could facilitate effective management of the national debt in a manner consistent with the country's overall fiscal and monetary policy objectives aimed at enhancing Zimbabwe's growth:

- High and volatile inflation and interest rate may reduce government revenue by slowing down economic activity of the private sector. Sterilization and quasi-fiscal deficit can directly increase the level of debt.
- Poor fiscal management and high levels of debt can increase inflationary expectations and cause rates to rise, and/or force the country to depreciate its currency.

Figure 1: Interdependencies between Debt Management, Fiscal Policy and Monetary Policy



Source: Togo E, (2007)

This study is principally motivated by the need to provide evidence-based advice to the Government on the proposed establishment of a DMO in Zimbabwe. Important questions which come to the fore in the Zimbabwean context which relates to DMO are:

- i. Is it necessary to create a debt management office (DMO)?
- ii. What are challenges being faced with the current debt management set-up?
- iii. What will be the best location of the DMO?
- iv. How should the DMO be legally established or incorporated? and
- v. What will be the critical success factors which will ensure the effectiveness of the DMO?

1.1 Study objectives

The following are the specific objectives of this study:

- i. Provide a situational analysis of the current debt management system highlighting its strength and weaknesses;
- ii. Explore the benefits (advantages) and drawbacks (disadvantages) of replacing the current debt management system with the DMO;
- iii. Investigate other country experiences with DMO highlighting best practices; and
- iv. Propose appropriate DMO structures, functions and objectives that address Zimbabwe's challenges.

2 RATIONALE FOR ESTABLISHING A DMO

2.1 Economic rationale

Whilst other countries have successfully set up DMOs, it is important to note that countries differ significantly in terms of economic, organizational and institutional structures, which may affect the relevance and efficiency of a DMO. Hence, prior to the setting up of a DMO in Zimbabwe, there are issues that need to be analysed to see whether it is feasible and relevant within the country's economic set up. These aspects includes: consolidation, financial repression and conflicts of interest.

Consolidation: A well structured debt management office is one where all information about onshore and offshore liabilities, and contingent liabilities, is centralized into a single database. This enables better information transmission to the bond market, which yields increased confidence and thus lowered interest rates (Togo, 2007). Amalgamation of information also eases and quickens strategy formulation aimed at optimizing the cost of borrowing.

In Zimbabwe, debt management is not consolidated into one office or department. It is rather dispersed over a number of departments, as already alluded to. Under such circumstances, lines of action and accountability can be unclear. Hence, this could be addressed by having the fragmented debt management functions consolidated into a single debt office. International experience shows that there are important gains from consolidation (Wheeler,

2004). A consolidated debt management function gives debt managers an overall and holistic picture of the total government borrowings, entire portfolio and maturity structures, making it easy to coordinate future borrowings and manage risk.

Financial Repression: According to India's Ministry of Finance (2008), debt management is relatively simple when financial firms are forced to purchase government bonds through financial repression. However, the effectiveness of financial repression declines as households tend to utilize less constrained components of the financial system. In the case of Zimbabwe the fact that the country is evolving towards market liberalization following the adoption of broad macroeconomic reforms in early 2009 under the Short Term Emergence Recovery Programme (STERP), makes the task of funding public debt more complex. However, since the adoption of multiple currencies in February 2009, the domestic debt market has not been active, mainly due to cash budgeting framework being implemented and the liquidity position. Going forward, Government may consider reviving the domestic debt market, hence it is important to undertake institutional reform that strengthens debt management alongside the process of financial sector reforms that eases financial repression.

Conflicts of interest: Literature, for instance IMF and World Bank (2002) and OECD (2002b); which analyze the interface between monetary and debt management discusses possible conflicts of interests when the central bank is responsible for both monetary and debt management functions. In theory, Currie and Togo (2003) contends that a central bank with dual mandate for conducting monetary policy and debt management policy may be:

- Reluctant to increase interest rates to control inflationary pressure since it would have an adverse effect on its domestic liability portfolio;
- Tempted to manipulate financial markets to reduce interest rates at which government debt is issued or to inflate the value of nominal debt; and
- Tempted to inject liquidity in the market prior to debt refinancing, or to bias the maturity structure or the currency composition of the debt portfolio according to the stance of its monetary policy.

Incorporating the debt management function and monetary policy may create a perception that debt management decisions are being influenced by inside information on interest rate decisions, rendering both monetary policy and debt management policy suboptimal. In this regard, separating the two, eliminates conflicts of interest as each agency has a clear focus and mandate.

2.2 International Experience

Joint "Guidelines for Public Debt Management" by the International Monetary Fund and World Bank (IMF and World Bank, 2003) considered moving public debt management from the Central Bank to a DMO as internationally accepted best practice. The establishment of DMOs in the contemporary world began with the New Zealand Government in the 1980s, when the then incoming Government recognized that without proper policy assignment

and accountability framework for debt management, the risk remained that the fiscal targets that were set in the country's Fiscal Responsibility Act would not be met (Togo, 2007). Thereafter, several countries especially in Europe that were heavily indebted in the late 1980s and early 1990s such as Iceland, Ireland, Denmark, and Austria (Table 1) took the decision to reform the debt management function through creating appropriate structures, in a manner consistent with the need to achieve the various economic growth and development targets. At the turn of the century, experiences from the aforementioned countries and other debt management reforms witnessed in a number of countries indeed inspired several emerging and developing economies, including Brazil, Argentina, Colombia, and Nigeria to restructured and consolidated debt management systems, as a key imperator to sustained economic growth. Table 1 provides a list of countries with functioning DMOs (or equivalent units), while Annex 1 provides some brief examples of DMOs in selected countries.

Table 1: List of Countries with Functional DMOs

Country	DMO (equivalent Unit)	Date Established
Sweden	Swedish National Debt Office (SNDO) – 1789 (change in governance 1998)	1789
Netherlands	Dutch State Treasury Agency (DSTA)	1841 (March)
USA	United States Bureau of Public Debt (BPD)	1940
New Zealand	New Zealand Debt Management Office (NZDMO)	1988 (July)
Iceland	Iceland National Debt Management Agency (NDMA)	1990 (May)
Ireland	Irish National Treasury Management Agency (NTMA)	1990 (December)
Denmark	Dansk Nationalbank Government Debt Management (GDM)	1991 (July)
Austria	Austrian Federal Financing Agency (ÖBFA) – December 1992	1992
Hungary	Hungarian Government Debt Management Agency (ÁKK)	1995 (May)
Portugal	Portuguese Instituto de Gestão do Crédito Público (IGCP)	1996 (December)
United Kingdom	UK Debt Management Office (UK DMO)	1998 (April)
Belgium	Belgian Debt Agency (BDA)	1998 (October)
Australia	Australian Office of Financial Management (AFFM)	1999 (July)
Greece	Greek Public Debt Management Agency (PDMA)	1999
Thailand	Thailand Public Debt Management Office (PDMO)	1999 (December)
Nigeria	Nigerian Debt Management Office (DMO)	2000 (4 th October)
France	Agency France Trésor (AFT)	2001 (February)
Germany	Federal Republic of Germany Finance Agency (GmbH)	2001 (June)
Indonesia	Indonesian Directorate General of Debt Management (DGDM) –	2001 (January)
Israel	Israeli Government Debt Management Unit (GDMU)	2002 (January)
Czech Republic	Czech Republic Debt and Financial Assets Management Department	2003 (October)
Slovak	Slovakian Agentúra Pre Riadenie Dlhú a Likvidity (ARDAL)	2003 (February)
Suriname	Suriname Debt Management Office (SDMO)	2004 (February)
Malta	Malta Debt Management Office	2006 (December)
Kenya	Kenya Debt Management Office (DMO)	Under construction
Brazil	Public Debt Office (PDO)	2000
Colombia	Directorate of Public Credit and National Treasury (DPCNT)	2003

Sources: http://www.storkeyandco.com/Newsletter/Archive/Newsletter_No31.pdf and Authors' compilation

: Respective countries' DMO websites

Although experiences from countries with functional DMOs indicate that debt management arrangements vary between countries, Zimbabwe can draw a number of lessons from countries that have successfully implemented debt management reforms. Such lessons show that:

- i. Debt management is consolidated into a single unit, with a front-middle-back office structure;
- ii. The public debt management function is weaned from the Central Bank, hence eliminating the perceived conflict of interest between monetary policy and debt management function as each agent has a clear mandate;
- iii. The debt management unit focuses on ensuring that the government's financing requirements are met at the least cost; and
- iv. The DMO also focuses on maintaining clear and efficient communication lines with financial markets.

3 CURRENT PUBLIC DEBT MANAGEMENT PRACTICES IN ZIMBABWE

3.1 Categories of debt

According to Government of Zimbabwe's External Debt and Arrears Strategy (GoZ, 2009) the country's total public debt is categorized into two broad types of domestic and external debt.

Domestic debt includes market loans, special securities issued to the RBZ, compensation and other bonds, treasury bills, commercial banks and other parties, as well as non-negotiable and non-interest bearing Zimbabwean dollar (Z\$)³ securities issued to international financial institutions. External debt consists of liabilities denominated in foreign currencies owed to foreign entities, mostly in the form of long term official loans. In other words, external debt represents loans received from foreign governments and multilateral institutions.

Currently, GoZ (2009) indicates that "the management of the two categories of debt is not consolidated in a particular office although it is recognised that MoF is the lead institution in public debt management affairs". Procedurally, the MoF is responsible for Public and Publicly Guaranteed (PPG) medium-to-long term external debt and the RBZ is responsible for the capturing of external private parastatal non-guaranteed and private sector debt as well as domestic debt. Also, the data for the country's total debt is not consolidated into one database to provide information on the total public debt for Zimbabwe.

³Z\$ ceased to operate on 31st January 2009 and all Z\$ denominated domestic debt of Z\$5 500 quintillion was cleared in January 2009 according to the 29 January 2009 National Budget Statement.

3.2 Legal Framework

Prior to April 2010, the main pieces of legislation governing debt management in Zimbabwe were the Constitution of Zimbabwe, the State Loans and Guarantees Act, and the Audit and Exchequer Act and amendments arising thereto. However, the State Loans and Guarantees Act and the Audit and Exchequer Act were repealed and replaced with the Public Finance Management Act (PFMA), which came into effect in April 2010. Hence, the country's debt management functions are now governed by the provisions of the PFMA and the Constitution of Zimbabwe. The PFMA seeks to consolidate and strengthen the provisions of the repealed Acts through clarifying the roles and responsibilities of the various players in the resource mobilization and management chain, enhancing good corporate governance and reporting practices in public finances.

Under the of the Constitution of Zimbabwe Chapter XI titled FINANCE – Appendix I - and in particular Section 101 provides for the establishment, use and authorization of expenditure procedures from the Consolidated Revenue Fund.

3.3 Operational Framework

International debt management practices indicate that the debt management function is undertaken by three offices of 'Front Office', 'Middle Office' and 'Back Office'. In summary, the Front Office is the loan negotiator, while the Middle Office undertakes portfolio and sustainability analysis and conducts policy formulation. The Back Office is mainly responsible for debt data recoding and accounting as well as data consolidation.

3.3.1 Institutional Arrangements in Zimbabwe

The MoF is the lead institution charged with the overall management of debt in Zimbabwe. The MoF delegates some of its authority to line ministries in so far as parastatals and local authorities are concerned. The RBZ acts as an agent of the MoF in transacting in government securities. The Attorney General's Office (AG) plays the role of legal advisor to the MoF on ensuring that the laws and regulation are followed.

3.3.2.1 Ministry of Finance (MoF)

The MoF has overall responsibility for debt management and organisationally the roles are shared by two departments: the Domestic and International Finance Department (DIF) and the Accountant General's Office.

Domestic & International Finance Department.

The department performs two functions namely Front Office and Middle Office. These functions include designing debt strategy, sourcing of external and domestic financing, negotiating loan agreements, portfolio and sustainability analysis, dealing with on-lent loans

(guarantees) to public enterprises and local authorities, and initiating external debt service payments. Further, the department keeps original guarantee and loan agreements. The DIF also participates in the External Loans Coordinating Committee (ELCC), whose other members include the Zimbabwe Investment Authority (ZIA) and the RBZ (Exchange Control and External Sector divisions). The ELCC conducts scenarios to determine capacity to repay given the negotiated terms and conditions and recommends for approval by the Minister of Finance if the loan terms and conditions meets the set thresholds and the borrower has demonstrable capacity to repay

The department is also in charge of the Aid Coordination function and also liaises with project executing agencies and ministries during negotiations and implementation.

Accountant General's Office.

The Accountant General's Office (ACCGEN) is responsible for Back Office functions. These include keeping copies of loan agreements, debt recording, receiving disbursements and liaising with implementing ministries and project coordinators, accounting for all loan receipts and external loan repayments. The ACCGEN's office also participates during loan negotiations and the ELCC.

3.3.2.3 Reserve Bank of Zimbabwe

The RBZ performs all three functions with regards to domestic debt management, i.e., Front Office (forecasting liquidity in the market, market canvassing, raising domestic debt through the issuance of government securities), Middle Office (portfolio analysis of domestic debt (mainly securities)) Back Office (maintaining the domestic debt register and settling maturities) Furthermore, the RBZ also plays the back office function for private sector and parastatal non-guaranteed external debt.

In essence there are three offices undertaking the back office function: the ACCGEN (public and publicly guaranteed debt), the RBZ external sector (private sector and parastatal debt) and the RBZ's financial markets department (domestic debt). This creates serious problems of accuracy, credibility and consolidation of the country's overall debt position.

3.3.2.4 Attorney General's Office (AG)

The AG is responsible for the legal aspect of contracting debt. In terms of Section 76 of the Constitution of Zimbabwe, the Attorney General (AG) is the principal legal advisor to Government. In this regard, the AG is responsible for advising Government in all legal matters relating to the conduct of public debt management. However in practice, the role of the AG's Office is only limited to loan negotiation and dispute resolution, in the event of such occurring. This creates a number of challenges in that, debt management does not end at contraction. There are other aspects, particularly debt servicing were services of a legal department may be required, for the avoidance of violating debt servicing clauses such as pari-pasu clause as well as the Negative Pledge Clause of the IBRD loans.

A dedicated legal mind in the debt management function will enable the AG, as principal legal advisor to effectively advise Government on the relevant legal provisions which may be at play at any given time during the whole loan cycle. The roles and responsibilities of MoF, RBZ and AG's office can therefore be summarized as shown in Table 2 below:

Table 2: Debt Management Structure in Zimbabwe

Institution /Office type (function)		Front Office	Middle Office	Back Office
Ministry of Finance (MoF)	Domestic & International Finance Department	<ul style="list-style-type: none"> Debt strategy design; External and domestic funds sourcing Loan agreements negotiator Loan proposal and portfolio analysis Public enterprise and local authorities Loan guarantee Keeping of original guarantee and loan agreement documents Sustainability analysis; Portfolio management 		
	Accounts General's Office (ACCGEN)	<ul style="list-style-type: none"> Loan negotiations 		<ul style="list-style-type: none"> Debt accounting and statistics Keep copies of loan agreements, Debt recording and monitoring Receives disbursements and liaise with implementing agencies external loan repayments;
RBZ		<ul style="list-style-type: none"> Forecasting liquidity in the market, market canvassing, raising domestic debt through the issuance of government securities, 	<ul style="list-style-type: none"> Portfolio analysis of domestic debt (mainly securities) and parastatal external debt, 	<ul style="list-style-type: none"> Maintains domestic debt register Keeps parastatal and private sector external debt database settles maturities receives external debt payments instructions from NDF
Office of the Attorney General		<ul style="list-style-type: none"> Provide legal advise to government as the principal legal advisor Should be involved in the whole process of contracting state debt commencing at negotiation, drafting and signing of the contract of debt, disbursement and servicing. 		

Source: Authors' Compilation

3.4 Problems Associated with the Current Debt Management Structure

The public debt management set up created fundamental challenges, including the following operational inefficiencies and lack of proper coordination.

3.4.1 Fragmented Functions

Currently and as indicated in Table 2, the management of the two categories of debt (domestic and external) is not consolidated in a particular office given that the functions are currently dispersed across three offices namely (i) Ministry of Finance's Domestic and International Finance Department; (ii) Ministry of Finance's Accounts General's Office; and (iii) Reserve Bank of Zimbabwe. This creates coordination problems within debt managers as well as monetary and fiscal authorities.

3.4.2 Functional Gaps

Although there is clarity with regards to the front (DIF) and back (ACCGEN) office function, there is a glaring functional gap with regards to the middle office in external debt management.

The DIF is often overwhelmed by other tasks related to coordination of incoming mission, international meetings and conferences, and its core front office functions. Hence the middle office functions of risk analysis, portfolio and sustainability analysis and borrowing strategy are often neglected.

3.4.3 Fragmented debt data.

The data for the country's debt data is kept in two different offices, hence it takes time to reconcile the total debt for Zimbabwe. Thus, by the nature of the way in which the debt is managed there is limited coordination of debt data recording system and poor information flow across agencies often resulting in inaccurate and incomplete debt records. Inaccurate and incomplete data affects the quality and timeliness of decision making. Furthermore, a non-integrated database makes the process of gathering debt data cumbersome and time consuming.

3.4.4 Verification problem

Linked to the fragmented problem, is the fact that the system result in verification problems of creditors' claims due to conflicting figures from the various departments managing the debt data for example, the RBZ keeps parastatal debt whilst the other component of on-lent debt to parastatals is kept at the MoF (where Government will have borrowed on behalf of parastatals or guaranteed). This creates debt data credibility problems, which could be resolved by keeping one comprehensive and well managed debt database.

3.4.5 Complicated system

The current system has resulted in complicated and inefficient debt service arrangements, which created protracted payment procedure, leading to accumulation of penalty charges to the total debt stock, particularly with regards to external debt. This mainly emanates from the fact that the external debt data is managed by two offices hence difficulties in tracking maturities.

3.4.6 Inadequate and inexperienced manpower

The system faces inadequate manpower and poor incentive structure for the respective personnel and this in turn affects output and performance. The civil service has suffered from brain drain and the debt offices are no exception. This tends to compromise quality and efficiency in debt management, given the high staff turnover by the more experienced and trained officials.

3.5 The Reasons for Establishing a DMO

The myriad problems associated with current debt management framework presents an opportunity for the GoZ to consider other possible debt management frameworks, among them, establishment of a dedicated DMO. The following are some of the reasons why it is necessary to establish a dedicated DMO in Zimbabwe.

Sound debt management

Setting up a DMO results in good debt management practices that complement other macroeconomic policies in enhancing economic growth and national development. Effective debt management under the DMO will ensure that the government's financing requirements are met at the optimal cost. Also, the creation of a well constituted DMO with a proper regulatory, institutional and operational framework would be able to ensure that the contracted debt and its growth remains sustainable in future and is serviceable without resorting to exceptional financing such as loan restructuring or a major correction of the government's fiscal position. In short, the DMO should be able to ensure that the overall debt management practice remains consistent with the country's long-term fiscal and monetary policy objectives.

Consolidation

Establishing a debt management office would consolidate all debt management functions into a single agency, with clear structure, roles and responsibilities for the front, middle and back office functions. A consolidated office can readily provide complete information on the country's total debt and can clearly communicate with financial markets. It is internationally accepted best practice that debt management should be consolidated into a single office, isolated from monetary policy, and taken out of the realm of the central bank. In Table 1 we showed some of the countries with operational debt management offices from which Zimbabwe can draw lessons from their experiences.

Prudency

The DMO provides enhanced efficiency and prudency in mobilizing resources to fund Government deficits at affordable costs and manageable risks in the medium- and long-term, through a well articulated borrowing plan, consistent with the goal of promoting economic growth and development. The DMO will ensure that borrowing is not done in a haphazard manner but well coordinated through constant tracking of market trends by the middle office.

Avoiding debt Crisis

The DMO could help in avoiding debt crisis, which negatively impacts on economic growth and development. The rate in the growth of national debt is well monitored and linked to macroeconomic fundamentals of exports, revenues and GDP to ensure long-term sustainability. This can be achieved through regular Debt Sustainability Analysis (DSA). DSA is aimed at early detection of debt related vulnerabilities and is a key instrument in efficient debt management. Although DSA is usually conducted annually, the last DSA was conducted in August 2009 with a four year gap since the one conducted in August 2005.

4 PREREQUISITES FOR ESTABLISHING A DMO

There is strong international consensus that a well-run economy should have a dedicated consolidated public debt manager (India's Ministry of Finance, 2008). However, to ensure

effectiveness and operational efficiency of the DMO, the following are some of the prerequisites:

4.1 Operational Requirements

4.1.1 Debt Management Objectives

It is important that the debt management objectives should be clearly specified and that, where possible, these be translated into medium term strategic targets which reflect the government's risk preferences, including policy guidelines for risk-management (Currie et al, 2003). Table 3 provides examples of debt management objectives in selected countries.

Table 3: Debt Management Office Objectives in selected countries

Country	Debt Management Office Objectives
Australia	To raise, managed and retire debt at the lowest possible long-term cost, consistent with an acceptable degree of risk exposure.
Denmark (GDM)	The overall objective of the government debt policy is to achieve the lowest possible long-term borrowing costs. The objective is supplemented by other considerations: <ol style="list-style-type: none"> i. To keep the risk at an acceptable level ii. To build up and support a well-functioning, effective financial market in Denmark iii. To ease the central government's access to the financial markets in the longer term.
Ireland (NTMA)	To fund maturing debt and the annual borrowing requirement of the government in such a way that protects both short term and long term liquidity, contain the level and volatility of annual fiscal debt service costs, contain the government's exposure to risk and outperform a benchmark or shadow portfolio.
New Zealand (NZDMO)	To maximize the long-term economic return on the Government's financial assets and debt in the context of the Government's fiscal strategy, particularly its aversion to risk.
Portugal (IGCP)	To raise funds and to execute other financial transactions, on behalf of the Republic of Portugal, in such a way that: <ol style="list-style-type: none"> i. Fulfills the borrowing requirements of the Republic in a stable manner; ii. Minimizes the cost of the government debt on a long-term perspective subject to the risk strategies defined by the Government. While providing a service of public interest, the IGCP develops its activities based on principles of efficiency and transparency.
Sweden (SNDMO)	To minimize, on a long-term basis, the costs of the debt with due regard to the risks associated with debt management. Specific responsibilities are: <ul style="list-style-type: none"> ▪ Financing the Crowns' gross requirement, managing foreign-currency assets required to meet net foreign-currency interest and principal requirements and settling and accounting for all related debt transaction. ▪ Maintaining and developing an appropriate framework for efficiently managing the portfolio and the risks associated with it. ▪ Disbursing cash to departments and facilitating departmental cash management. ▪ Advancing funds to government entities in accordance with government policy. ▪ Providing capital markets services and derivative transactions for departments and government entities. ▪ Maintaining a diversified fund base and, where appropriate, enhancing relationships with investors who hold, or are potential holders or, Sweden government securities and with financial intermediaries and the international credit rating agencies.

U.K. (UKDMO)	<ul style="list-style-type: none"> - To carry out the Government's debt management policy of minimizing its financing cost over the long-term - To minimize the cost of offsetting the government's net cash flows over time, (while operating within a risk appetite approved by Minister) - To provide loans to local authorities for capital purposes; and - To manage the funds of selected public sector bodies.
Nigeria (NDMO)	<ul style="list-style-type: none"> - Maintaining and disseminating timely, reliable debt data; - Ensuring effective and efficient management of Nigeria's public debt portfolio - Assisting Government in formulating and implementing sustainable debt strategies; - Advising on borrowing policies and assisting in the management of government's contingent liabilities; and - Tracking Federal Government's loans to sister African countries;

Source: Currie et al, 2003 and Authors' compilation

4.1.2 Debt Management Strategy

Currie et al, (2003) noted that, the defined set of objectives needs to be translated into an implementable debt management strategy expressed in terms of Strategic Targets. The strategic targets or debt management strategy should be consistent with effective debt management objectives and level of sovereign risk preferences. These strategic targets could be in the form of a set on variables or indicators such currency composition of the debt portfolio, debt-to-GDP or debt-to-export ratios and interest rates. Once these are set and agreed upon, it becomes the DMO's responsibility to implement and ensure that the set targets are achieved. The DMO should also ensure that these strategic targets are published on its website as a commitment to transparency and accountability.

In order to enhance transparency, accountability and predictability, Parliament can be involved in drawing up debt management manual/ guidelines, specifying the debt strategy targets. The debt manual/ guidelines are then published on the DMO website. Involvement of Parliament will also help in enhancing political commitment to public debt management.

4.1.3 Performance Benchmarks

Performance benchmarks can then be set as a way of assessing performance of debt managers in implementing and achieving the set strategic targets, as enshrined in the debt strategy. The benchmarks are mainly to appraise and measure the performance of the debt managers, holding them accountable for their actions. The World Bank/IMF (2002) contends that the benchmark can be used for evaluation purposes, which naturally leads to the expectation of out-performing the benchmark. For example, performance scores are set for the achievement or failure thereof, for each strategic target. These scores are then summed up to determine the debt manager's performance. A system of rewards can be developed in line with the levels of performance for the debt managers.

4.1.4 Competitive Performance Rewards

To achieve the desired level of performance, there is need for the DMO to establish incentive package compatible contracts so that the debt manager is motivated to make

the necessary efforts and perform well. Given the complex tasks in debt management, and the need to attract experienced, well qualified and highly motivated staff, the DMO should have a remuneration package competitive with that obtaining in the private sector. The pay system and other incentive schemes should be linked to performance and separated from the rigid civil service pay structure. Such competitive remuneration packages would be key in attracting and retaining skilled staff, hence attainment of the set strategic targets.

4.1.5 Supervision and Control

Given that the DMO will be detached from either the fiscal or monetary authorities, there is need to establish supervisory mechanisms. This function could be carried out by setting up an independent risk control department to avoid cases where the front office personnel may be manipulating back office information. The supervision and control mechanism should also ensure that guidelines are adhered to and targets are met.

Alternatively, a Board of Directors can be set up to oversee and control the organizational and operational matters of the DMO. Several governments have established Board of Directors for the DMOs, with a fiduciary responsibility to monitor, ratify and sanction the decisions of the DMO. The Board of Directors proposes debt management guidelines, lays down the principles as to how the guidelines will be implemented and establishes limits for the management of the risks associated with the DMO's activities (Currie et al, 2003). The Board of Directors composed of technically competent officials from both public and private sectors will be appointed by the Government. This is typically the case in DMOs that are outside the Ministry of Finance. However, for those DMOs located within the Ministry of Finance, an Advisory Board comprising public and private sector experts could be set up to enhance accountability and quality of outputs of the DMO.

To ensure accountability, the DMO should be made to report regularly to the Minister of Finance. Quarterly or semi-annual reports should also be made to Parliament, whilst reports by both internal and external audits should be made public through the DMO website.

4.2. Key Factors for a Successful DMO

The following are some of the key factors that can ensure success, regardless of the location of the DMO.

- i) Legal and Institutional set-up is crucial for the successful operations of a DMO. Regardless of its status (either a fully fledged department or a unit within departments), the DMO should have a clear legal and institutional framework governing its operations. Such a framework will clearly define and separate roles of the DMO to that of other government departments. This will avoid duplication and enhance cooperation and interaction with other government departments, hence, it becomes easier for the DMO to get inputs from other departments.

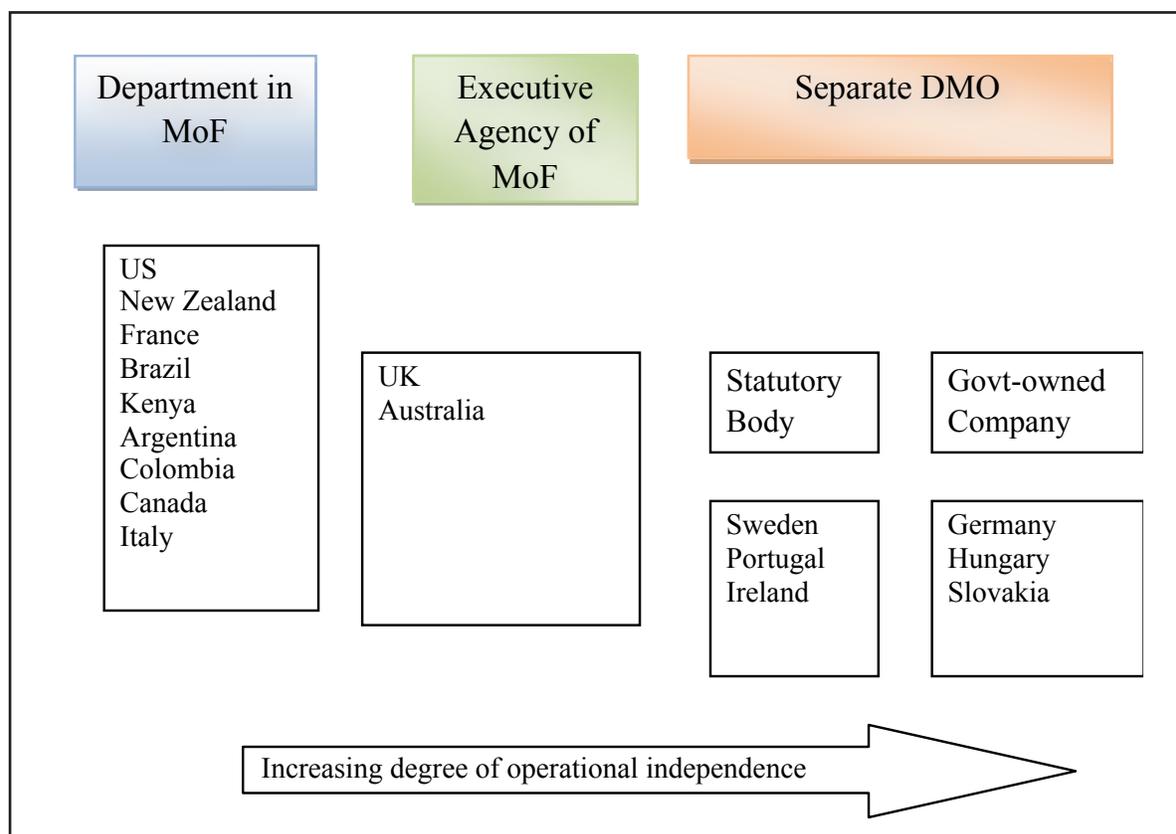
- ii) There is need for 2 or 3 senior, highly qualified and experienced officials within government that have the drive and commitment to overcome the attendant barriers and effect change. This is important given that these officials will use their rapport and experience in dealing with bureaucrats to effect reforms leading to the formation of the DMO. This requires high-level approvals up to ministerial or the executive levels to not only establish the DMO but also to clearly define the roles and responsibilities of the DMO.
- iii) Staff motivation. Poorly motivated and remunerated staff is likely to be highly inefficient and ineffective on the job. Hence, attractive packs would be required to ensure that the DMO attracts and retain the best qualified and result oriented staff. As already alluded to, DMO staff should be offered incentive-compatible contract so that desirable levels of effort/skill is applied. In this regard, a remuneration package separate from the general civil service pay structure is recommended to attract, retain and motivate staff.
- iv) Capacity building. Closely related to the above is the need for intensive training programmes to capacitate the recruited staff on best practices in debt management. Study tours and exchange programmes with DMOs within the region and selected OECD countries are of paramount importance. In addition, an internship program through which staff recruited into the DMO at all levels spends six to twelve months working in selected DMOs could help build capacity of the DMO staff. Individual staff of the indentified reputable DMOs can also be attached to the country's DMO to advice on the establishment and operationalisation of the DMO.
- v) The There is also the need for an efficient debt data recording and reporting system to enhance the credibility of data and timely decision making. This can be achieved through an efficient Computer Based Debt Management System (CBDMS). Modern debt offices cannot operate without an up-to-date CBDMS. A number of countries in the regions including Zimbabwe, Zambia, Mozambique, Uganda and Angola use the Debt Management and Financial Accounting System (DMFAS) whilst Namibia, Botswana, Malawi, Kenya and Swaziland use CS-DRMS of. These softwares play a critical role in enhancing efficiency and reliability of public debt accounting and reporting, thereby, improving the DMO's capacity and transparency in the conduct of public debt management. The country is, therefore, encouraged to upgrade its software to the latest version from the current DMFAS 5.3. This would also require some capacity building activities for the debt data experts to be conversant with the latest versions.

4.3 Possible Configuration and Location of the DMO

It is now widely believed that consolidating debt management functions into one office is one of the most important steps that can be taken to improve the overall quality of debt management, and pave the way for a more strategic management (Currie et al, 2003). However, there is a range of institutional alternatives for locating the sovereign debt

management functions, depending on countries' preferences and institutional set ups. These includes the following: (i) a division or unit within the MoF, (ii) an executive agency of the MoF (iii) a statutory body which functions as a separate unit from the MoF, or (iv) a state-owned company managing public debt, on behalf of the government. Figure 2 indicates possible locations of a DMO which are currently being used in other countries, for which Zimbabwe can draw some lessons from.

Figure 2: Possible Position of a DMO



Source: India's Ministry of Finance, 2008 & Authors' Compilation

4.3.1 DMO within the Ministry of Finance

Establishing the DMO as a department within the MoF would entail consolidating all the fragmented debt management functions into a single department under the MoF. This could be relatively easy given that the MoF is the lead institution in public debt management in the country. Hence, there will be less legal and institutional restructuring requirements. The DMO would largely occupy and recruit the existing offices and officials from DIF, ACCGEN. However, additional space would be required for the other debt functions currently under the RBZ and additional staff recruited. This operational set up has been implemented in a number of developing and emerging economies such as Colombia, Kenya and Brazil, whilst some high income countries including the US, Canada, Italy and New Zealand have also followed this model, (Figure 2).

Establishing the DMO under the MoF should be taken as a way of restructuring debt management not a lack of reform. There are a number of advantages emerging from countries that have adopted this model, which includes: easy reporting to the Minister of Finance, hence higher level of accountability, easy consolidating the debt management functions into one unit, and debt management inter-interfaces with wider fiscal planning and annual budgeting. In addition, there are efficient gains in inter-twining fiscal policy and debt management in that portfolio management expertise gained by the debt managers can easily feed into other MoF programmes.

Notwithstanding the above advantages, there are downside risks associated with establishing the DMO as a department within the MoF. These includes: (i) being under the MoF, the DMO may be subject to political pressures to act in a manner inconsistent with prudent debt management practices, (ii) the DMO will rely on a government budget and a rigid civil service pay structure, hence inability to attract, and retain highly qualified and result oriented experts in the various areas under its purview including IT experts, specialized internal auditors, accounting and legal services, which are key for its growth and efficient operations, and (iii) there is also high risks of diluted attention towards public debt, given that the MoF is also managing a host of other policies and programmes that compete for attention and resources (Togo et al., 2003).

These constraints can however, be addressed by setting the DMO some distance away from the MoF, to allow, debt managers to concentrate on debt management, whilst being sensitive to wider fiscal and monetary considerations. Also, separating the DMO from the MoF can facilitate paying higher salaries different from those obtaining in the public service. This will ensure output, given that the right quality of officials are employed and retained.

4.3.2 DMO as an Agency of the MoF

Given the challenges associated with the above set up, wherein the DMO is a department within the MoF, some distance could be created by setting the DMO as an agency of the MoF with some executive authority. The UK and Australia have successfully implemented this model (Figure 2). Under such a scenario, the legal requirements for establishing the body are relatively small and in the case of the UK, a formal agreement rather than a statute, anchors the relationship between the DMO and Treasury, which lays down the respective responsibilities, rights and obligations of each party⁴ (India Ministry of Finance 2008).

Under this set up, the DMO remain within the legal framework of MoF, although at some distance from the thick of policy, making it easy to monitor and enforce regular reporting to the Minister of Finance. However, being within the legal framework of the MoF, there are high risks of lack of independence in decision making due to excessive influence over its day-to-day operations. The UK has successfully implemented this model through outsourcing specialized functions to executive agencies for several years, and have considerable

⁴United Kingdom: Debt Management Office, Executive Agency Framework Document.

experience balancing flexibility and appropriate Ministerial control. Furthermore, a framework for establishing executive agencies already existed in the UK when the DMO was created⁵. However, in the case of Zimbabwe this could be costly and complex and may not achieve the intended objectives of enhancing efficiency and effectiveness in debt management. On the downside, as an Executive Agent of the MoF, the DMO would still face similar challenges to those when it is a department of the MoF. These includes; resource constraints, political pressures hence lack of independence. The net effect of which, is a suboptimal debt management strategy.

4.3.3 DMO as a Government Owned Company

To overcome the challenges associated with setting the DMO as a department or executive Agents of the MoF, some countries such as Germany and Hungary, have established DMOs as government owned companies (Figure 2). The major advantage of this model is operational flexibility and independence, ability to attract and retain highly qualified experts and overcoming resource constraints and political pressures. Establishing the DMO as a company would mean that it would be bound by all the relevant legislation governing all registered companies. These would include; registration of a Memorandum and Articles of Association with the Registrar of Companies, liable to corporate taxation, insolvency, among others. This may affect the DMO's structure, functions or accountability framework. In this regard, the government would have to devise suitable formal arrangements to ensure that they have sufficient information and control over the company's activities, particularly in relation to debt management.

However, the India Ministry of Finance (2008) notes that this model is most suited for countries that apply a civil law system, as in Germany and Hungary, rather than a common law system as is the case in Zimbabwe.

4.3.4 DMO as a Statutory Body

Finally, the study explored the possibility of setting up the DMO as a separate, Agency created by an Act of Parliament that define their legal status, responsibility, reporting hierarchies and organizational structure. Under this set up, the DMO would be independent from political pressures, enjoy operational flexibility, be able to mobilize its own resources and be able to recruit and retain highly qualified financial experts. As a Statutory Board, the DMO would be bound to make regular reports to both government and the Parliament, which enhances accountability

In view of the foregoing caveats, a statutory body which is set by an Act of Parliament as opposed to other arrangements for instance where the DMO is set through political appointments (e.g., by Ministerial appointment), would be the most ideal model for the DMO set up in Zimbabwe. Countries such as Sweden, Portugal and Ireland have followed

⁵HM Treasury, Select Committee Report (2000)

this model (Figure 2) and Zimbabwe could draw some key lessons from the experiences of these countries. However, the set up would require a number of amendments to the current legislation governing conduct of public debt management and the enactment of a legislation providing for the creation of such a statutory body. Experiences show that such a process can take some time, given the lengthy approval processes and the existing backlog of bills to be debated by Parliament. In addition, after the enactment of the requisite legislation, the process of setting up the DMO structures is also involving and may take some time as well. Hence, the whole process to operationalise the Statutory DMO could be up-to at least three years.

5 CONCLUSION AND POLICY RECOMMENDATIONS

This study examined the feasibility of setting up a DMO in Zimbabwe, structure and the ideal location. The study noted that the current conduct of public debt management in the country has a number of loopholes, which may have contributed the current debt crisis. These include issues to do with; fragmented functions and debt data, functional gaps, inadequate and inexperienced manpower and complex debt service arrangement. The study concludes that in line with international trends, these constraints could be addressed through a properly constituted DMO. Whilst the location of the DMO is not an issue, experiences show that setting up and operationalizing the DMO is a complex exercise and may take up to three years. Hence, it is recommended that the DMO be initially located within the MoF during the initial years in view of the financial and regulatory considerations, which may require amendments to the current laws on debt management as well as enactment of the requisite legislation to creating the DMO.

The study argues against placing the debt management function under the central bank, in favour of having it initially under the MoF before being transformed into a statutory body. International experiences from countries with functional DMOs have shown that debt management is integrated into one entity and that their central banks no longer manage public debt. The separation between monetary policy and debt management helps to overcome possible conflict of interest between the two functions. There is always the risk that debt management decisions could be influenced by inside information on interest rate in cases where the DMO is established as a department under the central bank. Therefore, allowing the central bank to concentrate on monetary policy, whilst the debt management function is handled by a separate unit produce optimal monetary and debt policy.

Having the DMO under the MoF during the set-up stages would be relatively easy as it entails consolidating and capacitating the current structures within the MOF & RBZ into a DMO with clearly defined functions. This will help to address issues of fragmentation, functional gaps and personnel constraints in the current set up. This would be necessary in the short-term given that the DMO's immediate mandate will among other include implementation of the Government approved debt strategy. Once constituted the DMO should lead the

process of debt data reconciliation and validation with creditors as well as come up with an implementation matrix for the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDs).

However, given the challenges with regards to issues around political pressures, resource constraints, and diluted attention, associated with a department operating under any line Ministry, the study recognizes that the DMO should eventually be transferred into a statutory body. This will help it overcome the above challenges and enjoy some independence and operational flexibility for the attainment of its mandate. Furthermore, as a statutory body, the DMO would be able to mobilize resources and attract highly qualified professional staff capable of carrying the debt management agenda forward.

To enhance efficiency and effectiveness, the study underscored the need for: (i) clearly defined objectives, (ii) debt management strategy, (iii) performance benchmarks, (iv) competitive performance rewards and, (v) close supervision and control, as the key prerequisites for setting up the DMO.

The study also emphasizes the need for (i) a legal and institutional framework (ii) need for 2 or 3 senior officials within Government that have the drive and commitment to overcome attendant barriers and effect change, (iii) need for high-level approvals up to ministerial or executive levels which culminates into an Act of Parliament which will not only set the basis to establish the DMO but also to clearly define the roles and responsibilities of the DMO, (iv) capacity building, and (v) an efficient Computer Based Debt Management System (CBDMS) to enhance accuracy and credibility in debt data, as five key imperators for successful and efficient DMO.

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ANNEX 1: CASE STUDIES OF SELECTED DMOS

Box 1. The New Zealand Debt Management Office

During the 1980s in New Zealand, three different groups within the Treasury dealt with different debt and cash management functions, in addition to their other responsibilities. Lines of reporting were unclear and there were gaps in accountability. Personnel managing public debt did not know what was expected of them, and often took ad hoc decisions rather than being guided by an overarching debt management strategy. In an attempt to tackle ballooning public debt, debt and cash management were consolidated in a single unit within the New Zealand Treasury in 1988.

The New Zealand Debt Management Office (NZDMO) was created as a branch of the Department of Treasury responsible for managing the government's debt, overall net cash flows, and some of its interest-bearing assets within a risk management framework. The Secretary to the Treasury is directly responsible to the Minister of Finance for the actions of the NZDMO. An Advisory Board provides the Secretary to the Treasury with quality assurance of the NZDMO's activities, risk management framework and business plan. Even though it has no corporate existence independent of the Treasury, NZDMO has a separate culture and identity, based on a corporate treasury approach, with senior officers skilled in debt management being retained with relatively competitive salaries. However, as part of the Treasury it has clear links with the rest of public policy and its perspective is one of managing the debt portfolio as part of the government's balance sheet. Moreover, it coordinates with other parts of the Treasury that advises the Minister of Finance on the content of the government's annual budget and prepares budget documents and on the government's financial statements. There is also a close working relationship with the Reserve Bank, which is formalized in agency agreements.

By design, the structure of NZDMO resembles that of a private-sector financial-markets institution, with separate front, middle, and back offices. That structure leads to clearly defined responsibilities and accountabilities, procedural controls, and the segregation of duties, which is consistent with best practice. The NZDMO focuses on balancing portfolio management with clearly defined public policy objectives, and tries to combine a private sector model with public sector goals.

The Portfolio Management Group is responsible for portfolio analysis, developing and negotiating transactions, managing the government's liquidity and cash-disbursement system, and managing relationships with international investors and rating agencies. The Risk Policy and Technology Group is responsible for measuring NZDMO's performance in adding value, measuring risk, monitoring compliance with the approved policies for managing the government's net debt portfolio, maintaining NZDMO's portfolio and risk management framework consistent with international best practice, and maintaining NZDMO's information technology systems. Accounting and Transactional Services Group

is responsible for NZDMO's accounting and forecasting functions and ensuring that transactions are settled in a timely, efficient, and secure manner

The objective is to maximize the long-term economic return on the government's financial assets and debt in the context of the government's fiscal strategy, particularly its aversion to risk. This requires that the likely risks incurred in minimizing cost be balanced. The risk aversion of NZDMO is based on the average tax-payers' risk-aversion, their incapacity to avoid costs imposed by losses incurred in the government's portfolio and the fact that the government does not have competitive advantage over other market participants in attempting to derive excess returns from its portfolio management.

NZDMO has analyzed and managed the government's debt within the structure of the government's assets and liabilities, namely, its balance sheet. The guiding principle is to reduce financial risk for the government by matching the financial characteristics of its liabilities to those of its assets.

The Minister of Finance approves the strategic parameters of the portfolio, and the annual borrowing program, on the recommendation of the NZDMO, and the latter is also permitted to carry out tactical trading in its foreign currency operations around the benchmark, subject to performance evaluations. Source:

Source: New Zealand DMO web site; Zohrab (1993) extracted in Togo et al. (2003). Anderson and Horman (2002)

Box 2: Brazil Restructures Debt Management

Brazil's Public Debt Office (PDO) was set up within the National Treasury Secretariat in 2000. Its mandate is "cost minimization over the long term, taking into consideration the maintenance of judicious levels of risks". Its secondary objective is the development of the domestic government securities market. The PDO was the culmination of fiscal and monetary reform in Brazil since the late 1980s.

Brazil's Central Bank used to manage public debt until 1987. However, the Brazilian debt crisis of the early 1980s forced several reforms of public finance institutions. The National Treasury Secretariat (NTS) was created in 1986. In 1987 domestic debt management was transferred from the Central Bank to the Treasury's debt unit (CODIP). In 1988, the Federal Constitution forbade the Central Bank from buying treasury bills in primary auctions.

In the early 1990s, Brazil took steps to further segregate the operation of fiscal and monetary policies. In 1991, the External Debt Office was established in NTS. However, external debt management was still divided between the Central Bank and NTS.

Over the next few years, the Treasury improved its performance by focusing on internal research, data collection, staff-replacement and training, and building relationships with investors and rating agencies. The Treasury and the Central Bank coordinated more closely with each other, including regular joint meetings with investors, dealers and banks.

In 2000, the Public Debt Office was established in the NTS. External debt management was transferred to the PDO. However, the PDO dissolved the division between domestic and external debt management, and adopted a front, middle and back office structure.

- The front office focuses on the development of short term strategies related to securities issuances in the domestic and external markets. It also conducts primary market auctions and external issuances.
- The middle office is responsible for medium and long term strategies, risk management, monitoring macroeconomic aspects and domestic and external investor relations.
- The back office performs the functions of registering and controlling issuance, payment and monitoring the domestic and external debt budget.

The restructured PDO aims to consolidate custody and settlement of securities. It is focusing on building state-of-the-art risk management models and adopting the ALM framework into its work.

The PDO emphasizes staff training and retention. It revised the Treasury salary scale so that it could recruit highly skilled professionals in the financial sector, and also defined the specialized skills it required from potential employees, i.e. if offered better compensation, but also demanded high standards from PDO personnel.

Source: (Barbosa, 2000); (IMF and World Bank, 2002), National Treasury Secretariat website

Box 3: Colombia Public Debt Management

Until 2003, Colombia's institutional arrangements for public debt management were fragmented within the Ministry of Finance and Public Credit. The Directorate of Public Credit was responsible for issuing market-friendly longer-dated domestic market government bonds while the Treasury was responsible for T-Bill issuance and direct negotiations with sub-national governments and state-owned enterprises, which were required by law to invest in government securities. The net result was a fragmented domestic debt market.

At the request of the Colombian authorities, World Bank public debt management experts carried out an evaluation of these institutional arrangements. The evaluation concluded that while the current arrangement gave the Treasury greater confidence in its ability to meet the government's cash management objectives, it hampered further development of the domestic debt and money markets. The Ministry of Finance lacked an overall strategy for domestic debt market development, including issuance of both short- and long-term debt, because each directorate had different priorities.

The World Bank advised Colombia to consolidate debt management and treasury functions, to reduce coordination and information requirements, eliminate duplication of functions, and strengthen accountability. More importantly, consolidation facilitated the development of a strategy for managing the aggregate domestic debt portfolio, which addressed debt management objectives and contributed to the development of a more liquid domestic debt market. In late 2003 Colombia consolidated debt and cash management responsibilities into a single unit, the Directorate of Public Credit and National Treasury.

Other advances include Colombia's implementation of a money market development program with the technical assistance of World Bank global capital markets experts. The program focused on improving T-Bill auction practices and developing regulatory and operational frameworks for repurchase/sell-buybacks (including an automated platform for securities lending). The World Bank also provided technical assistance to the authorities and the private sector to create a money market reference rate—the Indicador Bancario de Referencia—that is currently published daily (overnight and 30 day rate) by the central bank.

Source: <http://treasury.worldbank.org/bdm/htm/CaseStudies.html>

Box 4: Transferring Debt Management out of the Central Bank in the UK

The Bank of England has been traditionally responsible for the Government's cash and debt management. In May 1997, the Chancellor of the Exchequer announced that these responsibilities would be transferred to the Treasury while the operational responsibility for setting interest rates would be transferred to the Bank of England. This decision followed the 1995 Debt Management Review which, in a distinctive break from past policy, indicated that debt management was not a major tool of monetary policy.

A DMO was established on 1 April 1998 as an executive agency of the Treasury, and was given operational responsibility for debt management, working within a policy framework set by the Treasury. The transfer of responsibility for cash management to the DMO was completed on 3 April 2000. The Treasury offered three reasons for the transfer of debt management from the Bank of England to the DMO:

1. The need to prevent inside information, particularly on monetary policy, from influencing debt management policy. Policy decision and implementation "should be, and should be seen to be" unaffected by short-term monetary policy considerations. The subsequent decision to establish the DMO as an executive agency ensured that it did not have advance access to other policy decisions or the output of the Office for National Statistics (except in relation to the Government's financing needs).
2. Possible conflicts of interest between debt management and monetary policy which could undermine the achievement of the debt management objective of minimizing the cost of Government financing subject to risk.
3. A need to create a clearer allocation of the responsibilities for debt management and monetary policy was a "key factor in shaping the new ... arrangements".

The decision to transfer debt management from the Bank of England to the DMO was not the result of suspicions in the markets that actual conflicts of interest with monetary policy had arisen, or that debt management policy were being driven by inappropriate short-term considerations. The primary reasons for the change were the need for debt management to be seen to be separate from monetary policy, and for accountability and responsibility for debt management to be crystal clear.

The reasons given for transferring cash management from the Bank of England to the DMO were similar to those cited in relation to the transfer of debt management. In particular, the Treasury believed that "money market operations need to be distinguished from those involving Government cash management to avoid confusion over monetary policy signals". Thus, as with the transfer of debt management, an important consideration was the need for cash management arrangements to be seen to be free of conflicts of interest or of influence from inside information.

Source: HM Treasury, Select Committee Report (2000)

Box 5: Public Debt Management Reforms in Hungary

Up to 1995 public debt management tasks – domestic and foreign currency securities issuance, loan raising etc. – were split among the different departments of the Ministry of Finance and the National Bank of Hungary (NBH). In May 1995 the ÁKK (Government Debt Management Agency) was founded within the Ministry of Finance with the objective of placing all debt management tasks into one organization.

In 1996, Hungary reformed its public finance management system creating two important institutions to improve budget execution and debt operations: the Treasury and the Debt Management Agency (Allamadósság Kezelő Központ, ÁKK). The ÁKK prepares the financing strategy of the Treasury, which is approved by the Ministry of Finance, and carries out the borrowing decisions. It has two other important functions: organizing the domestic market and providing information for market participants. The management of the foreign portion of the public debt was transferred from the National Bank of Hungary (NBH) to the ÁKK in 1997, after one year of discussions and preparations. The Hungarian State Treasury started functioning on January 1, 1996. It is an independent organization operating under the supervision of the Minister of Finance.

Since 1 November 1996 retail investors can buy and sell government securities in the branch network of the Hungarian State Treasury. This activity is co-ordinated by the ÁKK. In 1997 ÁKK began the management of the foreign currency debt as well, and since 1999 ÁKK has been issuing foreign currency bonds and raising loans in the name of the Republic of Hungary (previously this was done by the NBH).

In practice, the Treasury and its branch network was built around budget implementation functions which were carried out by the State Development Institute and the NBH. The ledger system of NBH, containing the accounts of government agencies, was transferred to the Treasury. To facilitate the recruitment and retention of qualified staff, the Treasury obtained a special salary scale for its public employees and absorbed experienced professionals from the State Development Institute, the NBH and its 19 county directorates.

In March 2001, in a move to modernize debt management, ÁKK Rt was established as a joint stock company, organizationally independent but under the supervision of the Ministry of Finance. The tasks of the new agency include, among others, the fine-tuning of instruments for the issuing of public debt, and the systematic use of benchmarking in order to minimize risk and costs associated with securities, both denominated in HUF and in foreign exchange. The ÁKK monitors debt risks in order to ensure the long term sustainability of the Hungarian debt.

The name of the company became Government Debt Management Agency Pte. Ltd. (short form ÁKK Pte. Ltd.) from 28 August 2006. With the change of the government structure, the ownership rights of ÁKK Pte. Ltd. is exercised by the Minister for National Economy from 29 May 2010.

The mission of ÁKK is to finance the government debt and the central government deficit at the lowest costs in the long run taking account of risks, at a high professional level and by using sophisticated methods. Pursuant to the Act on Public Finances the minister responsible for public finances (currently the Minister for National Economy) is responsible for financing the budget deficit and debt management. The Minister carries out these tasks through ÁKK.

Thus, the main duties of ÁKK are to

- ensure the solvency of the budget on the basis of the annual Budget Act and by taking into account the forecasts given by the State Treasury;
- ensure that the central government deficit and debt redemptions are financed, and that the government debt and the temporarily free cash-funds of the state are properly managed;
- record the central government debt.

These include:

- the elaboration of the long-term financing strategy;
- the preparation of the annual financing plan of the central government in line with the strategy and the planning of the annual interest expenses;
- the execution of the necessary funding operations in the domestic and the international financial markets (organization of auctions and subscriptions, issuance of foreign exchange bonds and raising foreign exchange loans);
- effecting coupon payments and debt redemptions;
- the management of the central government debt using marketable instruments and methods;
- the liquidity management of the Single Treasury Account;
- dealing on own account on the secondary government securities market, concluding securities lending, repo and reverse repo transactions, concluding prompt, forward, hedge- and swap, and derivative transactions; the continuous development of the government securities market;
- the release of information on government debt financing and the government securities market in a timely and easily accessible way.

Sources: *Hungarian Government Debt Management Agency Ltd.*, <http://www.allampapir.hu> and *Búzás, Hungarian Public Debt Management*, http://www.worldbank.org/pdm/pdf/buzas_debt.pdf

Box 6: Portugal's Autonomous DMO

Between 1995 and 1998, debt managers in Portugal were concerned with managing convergence to join the Economic and Monetary Union, and with preparations to join the single currency. The management of convergence attempted to reconcile several objectives: positioning the debt portfolio to take advantage of the expected reduction of interest rates; protecting the portfolio and the Budget from domestic money market turbulence linked to the exchange rate stabilization process; and promoting the domestic capital market and ensure a more active and flexible management of the debt portfolio.

European monetary unification was the catalyst for a thorough restructuring of public debt management. In 1996, Portugal created the Portuguese Government Debt Agency (IGCP), a separate agency structured according to the model of a private financial institution. All the functions connected with public debt management and State financing which had formerly been split between two different public authorities were transferred to the IGCP.

The IGCP is a distinct legal entity. It is created by a law on management of public debt also lays down fiscal responsibility measures. This law is a model of clarity, and reflects the thoughtful systemic restructuring that accompanied legislation to create the IGCP. The IGCP's structure, functions, powers and accountability are detailed in delegated legislation. The transition to the IGCP unfolded over three years in order to avoid disturbances in debt management or in the operation of the relevant markets.

In the first year, 1997, the agency took physical shape, procedures and management framework were defined, and functions formerly split between two different public authorities were gradually transferred to the IGCP. The government also promoted the new institution to market participants.

The second year, 1998, saw the reorganization of the internal structure of the Agency, taking the different operational pieces inherited from the former structures and attempting to fuse them into a streamlined institution. The strategic objectives to be pursued in government debt management and State financing were made explicit by the Public Debt Law (Law no. 7/98 of February 3rd, with the amendments introduced by article 81 of Law no. 87-B/98 of December, 31st), which states that these activities should aim to guarantee the financial resources required for the execution of the State budget and be conducted in such a way as to:

- Minimize the direct and indirect cost of public debt on a long-term perspective
- Guarantee a balanced distribution of debt costs through the several annual budgets
- Prevent an excessive temporal concentration of redemptions
- Avoid excessive risks
- Promote an efficient and balanced functioning of financial markets

The last year, 1999, coincided with joining the competitive environment brought about by the introduction of the Euro. Since the IGCP was up and running, it concentrated on becoming more efficient. It adopted a sophisticated information system, created a benchmark to evaluate debt management, clarified the terms of its "management contract" with the Government, and crystallized Guidelines which set boundaries on the autonomy of debt management by the IGCP.

The minimization of debt cost was already an implicit objective of debt management before the approval of the Public Debt Law. Its publication, nevertheless, has been an important step as it formalized these objectives, clarified that the minimization of cost should be pursued on a long-term perspective and introduced an explicit reference to risk limitation, namely in what concerns refinancing risk and the volatility of debt cost over time.

The scope of debt management activity: Debt management includes the issuance of debt instruments, the execution of other types of transactions (repurchase of debt, repos and derivatives) with the purpose of adjusting the structure of the debt portfolio. There is no limitation in the Law as to the nature of the financing instruments that can be used for the funding. However, concerns with the liquidity of the government debt led to a progressive concentration of the financing activity into the issuance of a restricted number of standard fixed rate Treasury bonds (OT). The issuance of Treasury Bills (BT) is, since 2003, another important structural funding source.

In order to adjust the redemption profile of the government debt, the Law includes within the scope of the operations allowed to debt managers the early redemption and buy-back of existing debt and the direct exchange of securities. Since 2000 this kind of operations has been used more intensively, also with the purpose of promoting liquidity in the Treasury bond market through the concentration of existing debt into larger and more liquid issues.

Specific short-term cash needs are satisfied with financing repo transactions (temporarily sell of securities with the agreement for the repurchase of those securities at a specified time and price). Other repo transactions are carried out under a window facility of last resort created, in August 2000 for OT and in July 2003 for BT, aiming to support the market-making activity of the primary dealers in MEDIP.

The Law also includes within the scope of debt management the trading of derivatives, namely interest rate swaps, currency swaps, forwards, futures and options. Those transactions must be hedging existing risks and hence be linked to the underlying instrument in the debt portfolio.

Legal framework: The legal framework that regulates the issuance of central government debt and the management of public debt includes, as main legal instruments, the Public Debt Law, the annual Budget Law and the Decree-Law that regulates the activity of the

IGCP (IGCP by-laws). According to these, it is IGCP's responsibility to negotiate and to execute all financial transactions related to the issuing of central government debt and to the management of the portfolio in compliance with the guidelines approved by the Minister of Finance.

The Public Debt Law states that the State financing has to be authorized by the Parliament. The annual Budget Law establishes limits for the amounts that the Government is authorized to borrow during the year (in terms of net borrowing) and may also define maximum terms for the floating debt to be issued – debt issued to be fully redeemed until the end of the fiscal year in which it was issued – and limits to the currency exposure and to the floating rate debt.

The decisions on the debt instruments to be used in State financing each year and their respective gross borrowing limits are approved by the Government through a Council of Ministers' Resolution. The Minister of Finance is empowered to define specific guidelines to be followed by the IGCP in the execution of the financing policy approved by the Government and in the completion of other transactions concerning the buy-back of securities and the active management of the debt portfolio.

Permanent guidelines from the Minister of Finance were formalized through the adoption of a long-term benchmark structure for the composition of the debt portfolio, which reflects selected targets concerning the duration and the profile of redemptions. This benchmark was set as the reference for the evaluation of the cost/performance of the actual debt portfolio and for the definition of limits to the interest rate risk, currency risk and refinancing risk that it may undertake.

Source: Extract from Bento (2000), in Togo, Dethier, and Currie (2003); IGCP website: <http://www.igcp.pt/gca/?id=51>

Box 7: Sweden NDO

The Swedish National Debt Office is the central government financial manager was established in 1998. It is a public authority responsible to the Ministry of Finance. The Government appoints our board and our Director General. The Debt Office was established in 1789.

The Debt Office's assignment includes:

- providing banking services for the central government
- raising loans and managing central government debt
- providing state guarantees and loans

The NDO is also assigned to promote consumer protection and ensure the stability of the financial system by:

- being responsible for the deposit insurance and investor protection schemes
- managing government support for banks'

The overall objective of the Debt Office is to minimize the costs of central government financial management without taking excessive risks. Our work helps to ensure that taxpayers' money is used as efficiently as possible and that the financial system remains stable.

By concentrating the responsibility for cash management, debt management, guarantees, loans and bank support, the government is provided with coordinated and efficient financial management. The NDO is responsible for central government payments, and government agencies can borrow and invest cash with the NDO. The net of the payments affects central government debt. The NDO's goal is to manage government debt at the lowest possible interest costs without assuming too high risks.

Source: https://www.riksdagen.se/templates/RGK_Templates/Startpage_Debt Office EN 1567.aspx

Box 8: Nigeria's Debt Management Office

The DMO was established on 4th October, 2000 to centrally coordinate the management of Nigeria's debt, which was hitherto being done by a myriad of establishments in an uncoordinated fashion. This diffused debt management strategy led to inefficiencies. For instance, in the FMF alone, four different departments have functions for the management of external debt in the following format:

- External Finance Department: responsible for all Paris Club debts and for the management of public debt statistics;
- Multilateral Institutions Department: responsible for relationships with all multilateral institutions (excluding the African Development Bank and its subsidiaries such as ADF and the NTF, which is handled by the ABER Department). It is also responsible for managing and servicing multilateral debt;
- Africa and Bilateral Economic Relations (ABER) Department: responsible for liaising with the ADB and its subsidiaries, ECOWAS, and all non-Paris Club bilateral creditors;
- Treasury Department (OAGF): responsible for issuing mandate to the CBN for payment of all external debts;
- Foreign Exchange and Trade Relations Department: responsible for issuing reconfirmation for payment externalization to the CBN and for documenting repayment and servicing of external debts;

In the CBN, the following departments had some involvement with external debt management:

- Debt Management Department: responsible for the London Club debts consisting of trade debts, par bonds, and promissory notes;
- Debt Conversion Committee: responsible for managing various debt conversion options such as debt-for-debt, debt-for-equity, debt-for-export, and debt-for-development; and
- Various departments: responsible for processing and effecting loan repayments on behalf of all the other agencies or departments of government listed above.

This diffusion in the management of public debt created fundamental problems, including the following:

Operational inefficiency and poor coordination;

- Inadequate debt data recording system and poor information flow across agencies with consequent inaccurate and incomplete debt records;
- Extreme difficulty in the verification of creditors' claims due to conflicting figures from the various bodies handling the debt management function;
- Complicated and inefficient debt service arrangements, which created protracted payment procedure and often led to penalties that added to the nation's debt stock;
- Inadequate manpower and poor incentive systems for the affected personnel, which affected outputs and performance;
- Lack of consistent well-defined borrowing policies and debt management strategies;

The consideration of these myriad problems led government to support the establishment of a relatively autonomous debt management office, which resulted in the formation of the DMO in October 2000. The need for the creation of a separate public debt management office was therefore aimed at achieving the following advantages:

- Good debt management practices that make positive impact on economic growth and national development, particularly in reducing debt stock and cost of public debt servicing in a manner that saves resources for investment in poverty reduction programs;
- Prudently raising financing to fund government deficits at affordable costs and manageable risks in the medium- and long-term;
- Achieving positive impact on overall macroeconomic management, including monetary and fiscal policies;
- Consciously avoiding debt crisis and achieving an orderly growth and development of the national economy;
- Improving the nation's borrowing capacity and its ability to manage debt efficiently in promoting economic growth and national development;
- Projecting and promoting a good image of Nigeria as a disciplined and organized nation, capable of managing its assets and liabilities;
- Providing opportunity for professionalism and good practice in nation building.

Source: <http://www.dmo.gov.ng/backgroundb.php>.

**Zimbabwe Economic Policy Analysis
and Research Unit (ZEPARU)**

55 Mull Road, Belvedere,
Harare, Zimbabwe.

Tel: +263 4 778423

Fax: + 263 4 778415

Email: administration@zeparu.co.zw

Web: www.zeparu.co.zw

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