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Opinion Article

Importance of public debt management

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DESCRIPTION

Sovereign debt management is the process of developing and implementing a strategy for managing the government's debt in order to raise the necessary funds, meet risk and cost objectives, and achieve any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient government securities market. Governments should endeavour to guarantee that both the size and pace of expansion of their public debt is fundamentally sustainable, and that it can be paid under a variety of situations while fulfilling cost and risk goals in a larger macroeconomic framework for public policy. Sovereign debt managers share the concerns of fiscal and monetary policy advisers that public sector debt is on a sustainable path and that a credible strategy is in place to decrease excessive debt levels. Debt managers should make sure that the fiscal authorities are informed of how government funding requirements and debt levels affect borrowing costs. The public sector debt service ratio, as well as public debt to GDP and tax revenue ratios, are examples of measures that address debt sustainability.

In numerous countries throughout history, poorly structured debt in terms of duration, currency, or interest rate composition, as well as significant and unmet contingent obligations, have been key contributors in causing or propagating economic crises. For example, crises have frequently emerged as a result of governments' undue concentration on putative cost reductions associated with huge volumes of short-term or floating-rate debt, regardless of the exchange rate regime or whether domestic or foreign currency debt is involved. When the debt has to be rolled over, this has left government budgets vulnerable to shifting financial market conditions, particularly changes in the country's creditworthiness. Excessive dependence on foreign currency debt can result in exchange rate and/or monetary pressures if investors are hesitant to refinance the government's foreign-currency debt. Prudent government debt management, along with strong policies for managing contingent liabilities, can make nations less susceptible to contagion and financial risk by minimising the danger that the government's own portfolio management will become a source of instability for the private sector. The debt portfolio of a government is often the country's largest financial portfolio. It frequently involves complicated and dangerous financial arrangements, posing a significant risk to the government's balance sheet and financial stability. "Recent experience has emphasised the need for governments to minimise the build-up of liquidity exposures and other risks that render their economies especially sensitive to external shocks," according to the Financial Stability Forum's Working Group on Capital Flows. 2 As a result, good risk management in the public sector is equally important for risk management in other sectors of the economy, "since individual firms in the private sector often experience significant issues when poor sovereign risk management leads to liquidity crisis susceptibility. Governments with sound debt arrangements are less vulnerable to interest rate, currency, and other hazards. Many governments aim to support these arrangements by setting portfolio benchmarks relating to the intended currency composition, duration, and maturity structure of the debt, when possible, to influence the portfolio's future composition.

Several debt market crises have brought attention to the necessity of effective debt management techniques as well as the requirement for a well-functioning capital market. Although government debt management policies may not have been the sole or even primary cause of these crises, the maturity structure, interest rate, and currency composition of the government's debt portfolio, as well as significant obligations in respect of contingent liabilities, have all played a role in the severity of the crisis. Risky debt management methods raise the economy's vulnerability to economic and financial shocks, even when macroeconomic policy settings are solid. These dangers can sometimes be easily identified. Lengthening borrowing maturities and paying the associated higher debt servicing costs (assuming an upward sloping

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yield curve), adjusting the amount, maturity, and composition of foreign exchange reserves, and reviewing criteria and governance arrangements in respect of contingent liabilities are all relatively simple measures that can be taken.

Risky loan arrangements are frequently the result of ineffective economic policies like fiscal, monetary, and exchange rate policies, but the feedback consequences are undeniably bidirectional. Sound debt management policies, on the other hand, have their limitations. Debt management measures are not a panacea or a replacement for effective fiscal and monetary policy. Sound sovereign debt management may not be enough to avoid a crisis if macroeconomic policy settings are bad. By acting as a catalyst for the larger financial market, sound debt management strategies lessen vulnerability to contagion and financial risk.