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PUBLIC DEBT MANAGEMENT – FUNDAMENTAL COMPONENT OF PUBLIC POLICY¹

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Abstract. *The global financial crisis has put considerable pressure on public finances, particularly on government debt. Public debt in many countries of the world have increased in recent years to levels that were not registered by the end of the Second World War, facing today with a high risk regarding fiscal sustainability. Debt portfolio is usually the largest financial portfolio of a state, with a complex structure that can generate high risks that may affect public balance and financial stability of the country. Thus, proper management of public debt must become a priority for both the creditor and debtor countries. This paper aims to highlight the importance of effective management of government debt and to make a brief assessment of Romania's public debt structure and dynamic.*

Keywords: public debt management, Romania's public debt structure, financial stability

JEL Classification: F34; H12

1. WHY IS IT IMPORTANT THE EFFICIENT MANAGEMENT OF PUBLIC DEBT?

Government Debt Management is the process of designing and implementing a strategy for prudent management of public debt in order to meet funding needs of the government, to achieve the cost and risk objectives and other management goals of the government debt that it can establish, as developing and maintaining an efficient market for government securities (Wheeler, 2004).

Government debt portfolio is usually the largest financial portfolio of a country, containing complex structures that can generate substantial risk, with implications for the public balance and financial stability. In general, debt service costs are very high and their payment involves reducing the amount of available resources for other purposes.

A debt management strategy poorly designed, implemented and communicated may send a negative signal to investors, increase debt service costs, damage the reputation of the government and exacerbate the financial market instability. Inefficient structure of government debt portfolio was, historically, a very influential factor in the induction or propagation of economic crises in

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many countries. For example, most crisis were based on the use by governments of loans with short-term maturity and/or floating interest rates, leaving government budgets exposed to financial markets conditions changes, including to the government creditworthiness changes. Even insituations where there are sound macroeconomic policies, risky public debtmanagement practices increases economic vulnerability to economic and financial shocks. Poor practices in terms of debt management have often been citedby agencies as reasons fordemotions sovereign rating.

Sound public debt management policies can reduce the volume of service debt and mayalso reduce susceptibility to contagion and financial risk by assuming a catalyst role for broaderfinancial market development and financial deepening.

2. GOVERNMENT DEBT MANAGEMENT OBJECTIVES

Based on a survey conducted in 2000, members of the Organization for Economic Cooperation and Development have identified four general objectives of debt management policies (Kappagoda, 2001):

- Ensuring the financing needs of government;
- Minimising borrowing costs;
- Maintaining the risks to an acceptable level;
- Support the development of domestic markets.

While these objectives are suitable mainly for developed countries which access international capital markets and which has well-developed domestic capital market, many developing countries will give priority initially to cover public sector borrowing needs at low cost. In the initial stages of development, countries have little choice in terms of funding sources and currencies, loans coming generally from official sources. While access to international capital markets increases, the objectives should take into account also the risk tolerance of the government.

The main objective of public debt management should be to ensure that public sector financial needs are met at the lowest possible cost, maintaining an acceptable risk level on medium and long-term. It should be included in the mandate of the responsible office for public debt management.

It is vital that public debt management objectives to be clearly stated and, where possible, be developed the medium-term strategic objectives, which reflect the government's preference on risk, including policy directives of risk management of public debt. Table no. 1 provides examples of debt management objectivesin some countries (Currie, Dethier and Togo, 2003):

Table 1 - Public Debt Management Objectives

Country	Objectives
Australia	The main objective of debt management is that debt portfolio to be created, managed and retired at the lowest cost long term, according to an acceptable level of risk exposure.
Den mark	The main objective of the government debt policy is to achieve the lowest borrowing costs in the long term potential. The objective is supplemented by other considerations: maintaining an acceptable risk; building and supporting a functional and efficient financial market; facilitating government the long-term access to financial markets.
Ireland	The debt management objective is to fund debts outstanding and annual government loan demand, so as to protect both the long and short-term obligations, maintaining the level and volatility of annual debt service fiscal costs, to minimize government exposure to risk.
New Zealand	To maximize financial assets income of government debt in the context of government fiscal strategy, particularly risk aversion.
Portugal	The mission is to raise funds and perform other financial transactions, so as to meet loan requirements in a stable manner and minimize the cost of government debt in a long term perspective.
Sweden	The main objective of government debt management is to minimize costs, in the long run, given the risk associated with debt management. However, management should always be held in the directives imposed by monetary policy, and according to the guidelines established by the Council of Ministers.
England	To meet annual reductions set by the Treasury for the sale and purchase of debt securities with fixed rate interest, taking into account long term cost minimization. In this regard, the office will take into account several policy considerations that may constrain strict cost minimization.

Source: Currie, E., Dethier, J.J., Togo, E. (2003) *Institutional Arrangements for Public Debt Management*, World Bank Policy Research WP 3021, p. 32

In Romania, according to the *Strategy of public debt management for 2011-2013*, developed by the Ministry of Finance, the main objectives of debt management are:

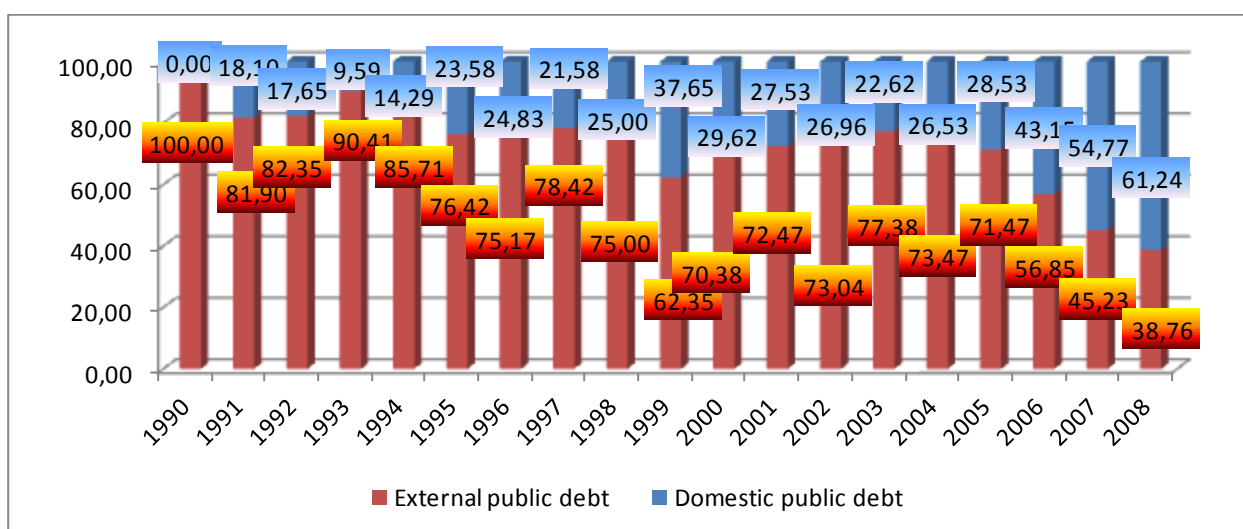
- Controlled growth and maintaining a sustainable level of public debt;
- Reduction of long term government debt costs in terms of an acceptable level of government debt stock;
- Development of the government securities market.

3. THE STRUCTURE AND DYNAMICS OF ROMANIA PUBLIC DEBT

In terms of *provenance*, Romania's public debt was contracted, in period 1990 – 2008, mostly from the outside, mainly justified by the underdevelopment of domestic capital market, lack of regulations on the main techniques and tools for debt contracting and poor development of foreign trade, thus increasing financial dependence on foreign countries.

Due capital and government securities market regulation, since 1996, the domestic public debt recorded a considerably growth, reaching in 2008 the share of 61.24% in total debt.

Figure 1 - Romania's total debt structure in the period 1990-2008



Source: Elaborated by author based on data from the Ministry of Finance

Until 2007, when the Ministry of Finance has given priority to the process of financing by issuing securities on the domestic market, the budget deficit financing and debt refinancing from domestic sources was achieved by temporary loans from the general treasury current account availability.

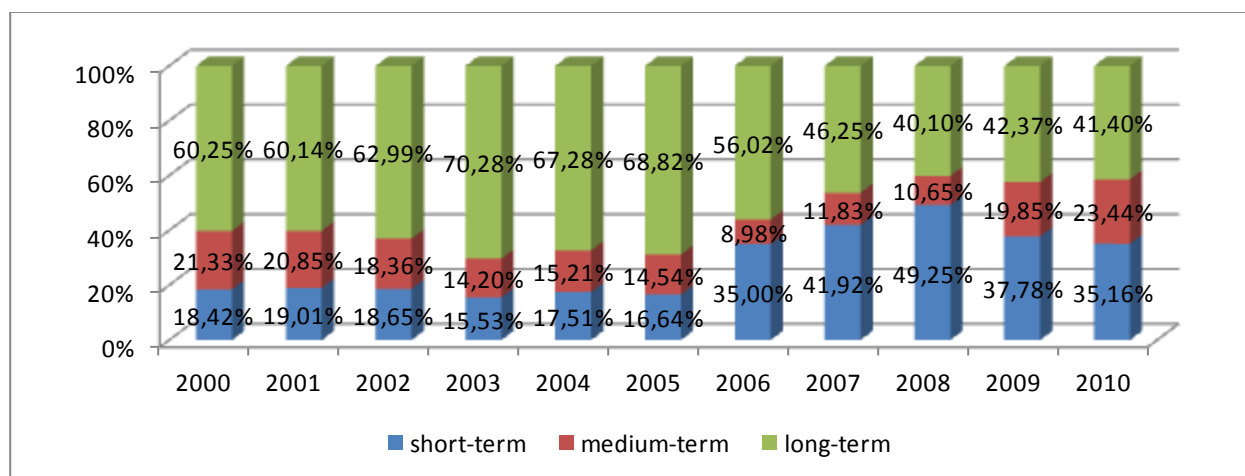
First for the Romanian market, were launched benchmark bonds with maturities of 3, 5 and 10 years in order to create the necessary conditions to develop the secondary market for government securities.

Structure by *initial maturity* of the debt portfolio shows that long-term debt (over 5 years), although decreasing as a share of total debt from 60.25% in 2000 to 41.40% in 2010, is an important share, mainly due to the borrowing from international financial institutions, which have a duration between 12 and 17 years.

Short-time debt has increased significantly, reaching a maximum of 49.25% in 2008, because of the bond issuance as a result of ministry's strategy for financing the budget deficit mainly from domestic sources and due to the temporary financing of budget deficits, in previous years, from the treasury general current account.

In the years 2009 and 2010, short-term debt declined because for the budget deficit financing were not used loans from treasury general current account availability but issuance of government securities on domestic market and external borrowing. Thus, in 2009, temporary loans from treasury general current account availability decreased by 11.5 billion from the end of 2008 and, at the end of 2010, stood in absolute value at a level of 31.4 billion RON.

Figure 2 - Romania's public debt structure according to the initial maturity

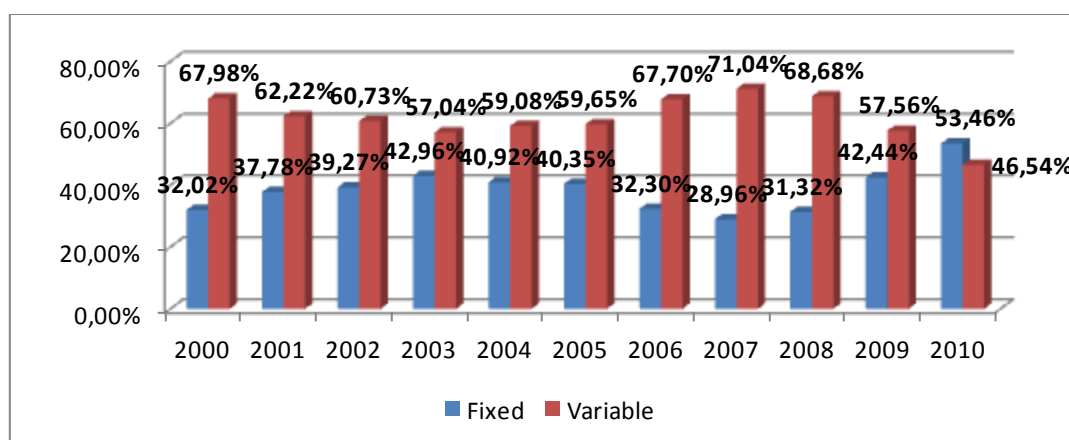


Source: Elaborated by author based on data from the Ministry of Finance

High share of short-term debt, although under a downward trend, highlights yet a refinancing risk of the government debt portfolio, as a result of temporary financing from the treasury general current account, but also as a result of issuance of treasury bills in 2009 and first half of 2010.

The structure of government debt on *interest rate type* shows a continuous increase, in the last three years, of the loans share with fixed interest rate from 31.32%, as recorded in the late of 2008, to 42.44% in the late of 2009 and 53.46% at the end of 2010, primarily due to loans from the EU, domestic loans in foreign currency, the issuance of medium-term benchmark and the issuance of Eurobonds in March, 2010. This dynamic reduces the interest rate risk of the government debt portfolio.

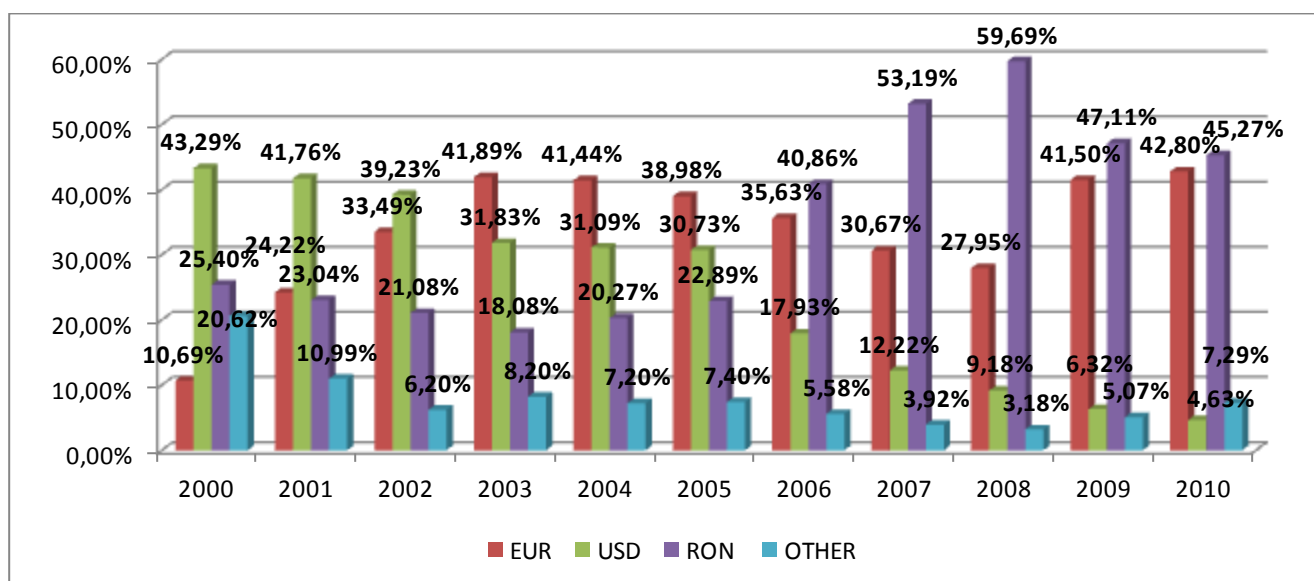
Figure 3 - Romania's public debt structure by type of interest rate (%)



Source: Elaborated by author based on data from the Ministry of Finance

Currency composition of government debt shows an increase in lei denominated debt from 25.40% in 2000 to 45.27% in 2010. Euro denominated debt recorded a decrease in the total public debt ratio from 41.89 % in 2003 to 27.95% in 2008, followed by a return to 42.80% in 2010. Regarding the debt contracted in dollars, its share has been in constant decline, reaching 4.63% in 2010, mainly due to the default strategy of the Ministry of Finance to reduce currency risk and to contract foreign loans only in euro, in the perspective of euro adoption in 2014.

Figure 4 - Romania's public debt structure by type of currencies(%)



Source: Elaborated by author based on data from the Ministry of Finance

It is noted that in 2009 – 2010, exposure to some market risks increased, the fact reflected by the decrease of public debt denominated in lei. Thus, in 2009-2010, the share of government debt denominated in lei in total debt has declined as a result of government foreign borrowing from domestic market, of foreign loans and of Eurobonds issuance, required to support high levels of budget deficits for the years 2009 - 2010 and to balance the maturity of the debt portfolio.

CONCLUSIONS

Debt portfolio contains complex financial engineering that can generate a substantial risk to state property and financial stability of the country. A well structured debt enables the state to reduce its exposure to interest risk, foreign exchange and more. In this sense, the main objective in the

government debt management is to ensure that public sector financial needs are met at the lowest possible cost, maintaining an acceptable risk level on medium and long-term.

Analyzing the Romania's public debt structure in terms of provenance, we observed the preference of Romanian authorities for external financing, so that domestic public debt lower values correspond to the external public debt much higher levels in the period 1990-2006. Given the large needs of budget deficit financing-according to estimates of the public financial imbalances, the need to strengthen and develop the internal market for government securities and high external volatility existing on capital market, we believe that the best scenario is one in which budget deficit funding will be done in balanced proportion from internal and external sources.

Regarding the public debt structure by initial maturity we noted that, although long-term debt has the largest share, there is a significant increase of short-time debt. The accumulation of financial deficits temporary financed is another item for which is required that temporary financing to be refinanced gradually by government bond over a long period of time, in order to reduce the impact on the domestic market and do not affect major cost of this funding. It is recommended therefore limiting refinancing risk by extending the maturity of government securities and issuance of a significant degree of borrowing with maturities over the medium and long-term.

Structure analysis by currencies shows us, for the period 2000-2010, a change in public authorities preference for the currency of debt, loans in euros taking the place of the loans in dollar. This change was mainly due to the Ministry of Finance strategy to reduce currency risk and contract loans only in euro, in order to reduce currency risk in the perspective of euro adoption in 2011. To reduce the currency risk, we consider necessary to increase the share of government debt denominated in lei in total government debt, taking account also the important role of foreign currency loans to reduce refinancing risk and to minimize costs for medium and long-term loans.

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