CONTRIBUTING TO DEBT MANAGEMENT CAPACITY BUILDING

OPTIONS FOR DFID

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Table of Contents

ABBREVIATIONS

ACBF	Africa Capacity Building Foundation
ALSF	African Legal Support Facility (African Development Bank)
AOFM	Australian Office of Financial Management
BCEAO	Banque Centrale de l'Afrique de l'Ouest
BEAC	Banque des Etats de l'Afrique Centrale
Bn.	Billion
BOP	Balance of Payments
CANEC-DMAS	Canada-Eastern Caribbean Debt Management Advisory Service
CEMLA	Centre for Latin American Monetary Studies
CFTC	Commonwealth Fund for Technical Cooperation
ComSec	Commonwealth Secretariat
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
CS-SAS	Commonwealth Secretariat Securities Auctioning System
DeMPA	Debt Management Performance Appraisal
DFI	Development Finance International
DFID	Department for International Development
DFTAD	Department of Foreign Affairs, Trade and Development (Canada)
DMF	Debt Management Facility
DMFAS	Debt Management and Financial Analysis System
DMO	Debt Management Office
DPI	Debt Performance Indicator
DRS	Debtor Reporting System (Word Bank)
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
FAD	Fiscal Affairs Department (IMF)
GDDS	General Data Dissemination Standard
GDIF	Government Debt and Infrastructure Finance
GEMLOC	Global Emerging Markets Local Currency Bond Program (World Bank)
GFS	Government Finance Statistics
GNI	Gross National Income
HCBP	HIPC Capacity Building Programme
HIPC	Heavily Indebted Poor Country Initiative
ICD	Institute for Capacity Development (IMF)
IFI	International Financial Institutions
IFMIS	Integrated Financial Management Systems
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
IP	Implementing Partners
LIC	Low Income Country
MCM	Monetary and Capital Market Department (World Bank)
MDRI	Multilateral Debt Relief Initiative
MEFMI	Macro Economic and Financial Management Institute
MFM GP	Macroeconomic and Fiscal Management Global Practice (World Bank)
MIT	Massachusetts Institute of Technology
Mn.	Million
MOOCs	Massive Open Online Courses

MTDS	Medium Term Debt Strategy
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PDM	Public Debt Management
PIFTAC	Pacific Financial Technical Assistance Centre (IMF)
PPI	Private Infrastructure Project (World Bank web site)
PPP	Public Private Partnership
Q	Quarter
RAID	Redundant Array of Independent Disks
RDB	Regional Development Bank
RTAC	Regional Technical Assistance Centres (IMF)
RTC	Regional Training Centre (IMF)
RTP	Regional Training Program (IMF)
SAA	Sub-Saharan Africa
SDDS	Special Data Dissemination Standard
SECO	State Secretariat for Economic Affairs (Swiss Government)
SNA	System of National Accounts
SPARC	State Partnership for Accountability, Responsiveness and Capability (DFID)
TA	Technical Assistance
TAL	Technical Assistance Loan (Word Bank)
TFFS	Task Force on Financial Statistics
TOR	Terms of Reference
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Council for Africa
USD	United States Dollar
UST OTA	United States Treasury Office of Technical Assistance
WAIFEM	West African Institute for Economic Management
WB	World Bank

Executive Summary

Although the overall debt situation of developing countries is not currently considered to be alarming, the last few years have seen a discernible rise in public debt levels driven, *inter alia*, by the 2008 financial crisis and an increase in domestic debt. The composition of external debt flows has changed, with a shift from public and publicly guaranteed to private nonguaranteed debt, a shortening in average maturity, and a slight hardening of borrowing terms caused partly by a major increase in bond financing, especially in Africa. Given the uncertain world economic situation, this trend calls for the adoption of prudent debt management policies. DFID's interest in getting further involved in debt management capacity building is therefore very timely as any new initiative is likely to have a preventive effect on debt sustainability rather than being a response to a crisis.

Debt management continues to evolve rapidly as developing countries seek to modernize by adopting best practice in PDM. As they graduate to higher income groups, countries also gain access to a wider choice of funding sources both domestically and on the international financial markets. This has required debt managers to undertake more rigorous analysis in order to select appropriate funding options in line with countries' cost-risk preferences. In addition, debt offices are now faced with a whole array of new functions such as the integration of cash and debt management; the management of contingent liabilities; and the development of primary and secondary markets for domestic borrowing.

The need for capacity building and technical assistance has consequently increased. In addition, a number of challenges and constraints continue to affect efforts to build lasting debt management capacity including difficulties in (a) identifying funds to implement necessary reforms; (b) retaining qualified staff; and (c) securing buy-in of stakeholders.

There is a core group of about a dozen institutions dedicated to building capacity in debt management and there is reasonably good coordination among these providers. However, some fragmentation and duplication can sometimes arise when TA from bilateral and multilateral sources is provided outside the above-mentioned network or without consultation.

Global DeMPA scores show that there are still major weaknesses in certain thematic areas of debt management including the production and implementation of debt management strategies; debt data audit; cash flow forecasting; debt administration and data security; and operational risk.

DFID has achieved remarkable results in debt management capacity building including its assistance to Nigeria. Should DFID decide to get further involved, the following three proposals appear as the most appropriate options for it to do so:

1. The setting up of a project/fund to complement the work of the DMF and assist DFID priority countries to implement required reforms;
2. The design of a new programme in "Policy Design and Negotiation for Debt Sustainability" which would focus on a number of specific areas related to fiscal risks that threaten debt sustainability in the short to medium-term, such as contingent liabilities (including risks associated with PPPs) and bond issuance;
3. The scaling up of its assistance to Nigeria to improve the management of sub-national debt.

The choice among these three options would depend on the level of funding available; the preferred time horizon; and DFID's corporate objectives. The above options are not mutually exclusive and DFID could consider implementing more than one option as components of a single but larger PDM programme.

1. Introduction

The Department for International Development has commissioned this study to inform its policy thinking and strategy development with regard to debt management capacity building[1], whilst bearing in mind the needs of its twenty-eight priority countries. This is part of the organisation's broader objective of ending extreme poverty by promoting and supporting policies that lead to sustainable growth and socio-economic development.

Debt management is an important policy tool alongside fiscal, monetary and exchange rate policies. Since the 1980s, recurrent debt crises in developing and emerging countries - and more recently in some countries of the Eurozone - have highlighted the high economic, political and social costs of debt defaults and bailouts. Unsustainable levels of debt simply make it impossible for countries to grow, create employment and achieve national as well as international development goals and targets. DFID, along with other IFIs and development partners, has been a strong supporter of both the HIPC and MDRI initiatives set up in 1996 and 2005 respectively.

DFID, along with other institutions and donors, has also continued to assist developing countries to improve their debt management capacity so that they are able to manage their debt more effectively and maintain debt sustainability. This Report reviews the efforts that are being made and provides options for DFID to get further involved, should additional funding become available.

This Report reviews the current state of capacity building in debt management based on the TOR at **Annex 1**. The assignment was undertaken as a desk review, supported by telephone interviews to a sample of institutions providing capacity building services in debt management as well as representatives of beneficiary countries. A list of institutions and persons interviewed is at **Annex 2** and a selected Bibliography is at **Annex 3**.

This Report aims to provide:

(1) An overview of how debt management and related capacity building needs of developing countries have evolved since HIPC[2];

(2) An independent opinion on how the various capacity building initiatives are addressing those needs; and

(3) Suggestions as to how DFID could best contribute to this area.

Providing an independent opinion on the "state of debt management capacity building" inevitably involves making a judgement call. The questions that we raise in this Report are not meant to be a criticism of existing programmes and implementing agencies but, rather, to offer suggestions that could improve programme delivery in the interest of benefitting countries. Capacity building is a complex area where there is often no single solution to a problem. All the institutions mentioned in this Report should be commended for their effort in developing the capacity of developing countries in debt management.

The rest of this Report is organised as follows**: Section 2** provides an overview of the global economic and financial environment that debt managers have had to confront in recent years; **Section 3** discusses the way debt management has evolved in response to the changing economic environment both on the domestic front and externally; **Section 4** surveys the work of major

[1] In this Report we have used the terms "capacity building" and "capacity development" interchangeably.
[2] The chosen time frame may appear rather long. As discussed in this Report, capacity building is a long-term process and any meaningful analysis of progress and impact can only be discerned in the long run.

capacity building providers; **Section 5** syntheses the information collected during this study and provides answers to the questions contained in the TOR. We conclude in **Section 6** by suggesting options that DFID could consider, should it decide to devote additional resources to the area of debt management.

The consultant would like to thank all those who made themselves available to be interviewed and who so generously and frankly shared their experience and perspectives. We would also like to thank members of the DFID IFI strategy team, in particular Lindsey Craig, Lara Lambert, Faten Mohamed and Imran Shahryar for their support and guidance during this exercise. Responsibility for the views expressed in this Report and for any errors rest with the consultant.

2. The current global economic and financial environment facing debt managers

As the world economy edges its way out of the financial crisis that started in 2008/2009, most observers agree that, as a group, developing countries have shown a fair amount of resilience and have fared better than might have been expected. This was partly due to the implementation of sound macroeconomic policies in the years preceding the crisis as well as the fiscal space that was created as a result of the HIPC and MDRI initiatives.

However, many developing countries still had to resort to fiscal stimulus and other support measures which were financed either from domestic or external sources, including IMF facilities put in place for this purpose. As a result, total external debt stocks have steadily increased in recent years to reach USD5,506.4 Bn. in 2013, as depicted in **Table 1** below:

Table 1: External Debt Stocks of Developing Countries 2005 and 2010-2013 in USD Bn.

	External Debt Stocks of Developing Countries						
		% of Total		USD Bn			% of Total
	2005	2005	2010	2011	2012	2013	2013
Total External Debt Stocks	2,352.00	100%	4,109.40	4,571.60	5,032.10	5,506.40	100%
Long-term external debt	1,807.80	76.86%	2,909.40	3,194.10	3,540.70	3,854.30	70.00%
Public and Publicly guaranteed	1,240.50	52.74%	1,561.30	1,638.00	1,823.70	1,956.20	35.53%
Private creditor	562.50	23.92%	725.90	769.90	923.50	1,041.70	18.92%
Bonds	404.70	17.21%	568.00	618.80	751.10	818.00	14.86%
Private nonguaranteed	567.30	24.12%	1,348.10	1,556.10	1,717.00	1,898.20	34.47%
Short term external debt	481.40	20.47%	1,041.00	1,218.50	1,345.60	1,530.80	27.80%

Source: International Debt Statistics 2015, World Bank

Three main trends are discernible from the above data:

(a) **A fall in the share of public and publicly guaranteed debt** which accounted for slightly more than half of total debt stocks in 2005 and only 35.53% in 2013;

(b) **The growth of private non-guaranteed debt** which reached 34.47% of total external debt in 2013 – a source of funding which can be very volatile; and

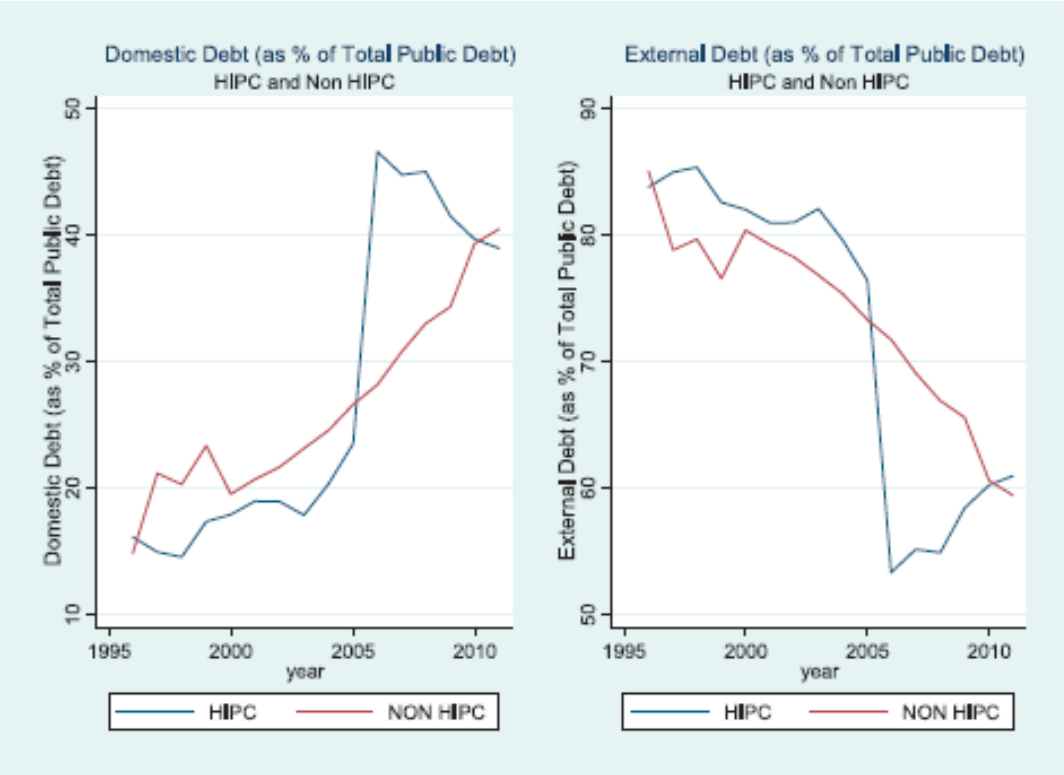
(c) **A shortening in the maturity of external debt**, with the share of short-term debt rising from 20.47% to 27.8% of total external debt stocks over the same period. This can be attributed to a shift

from concessional multilateral and bilateral funding to commercial sources, which has also caused the average level of concessionality (or grant element) to fall (IMF, 2014c)

An analysis of external debt provides only a partial picture. Domestic borrowing has also grown steadily since the 1990's to become an important source of funding for many developing countries. Indeed, in some countries there has been a complete reversal with domestic debt now commanding a higher share of total public debt than external debt[3].

Based on panel data collected for 36 LICs, Bua & al (Bua & al 2014) provide some insights on the evolution of domestic and external debt as a percentage of total public debt broken down by HIPC and non-HIPC countries over the period 1971 – 2011, as shown in **Figure 1** below:

Figure 1: Domestic and External Debt as a % of Total Public Debt 1996-2010



Source: Bua & al (2014)

As shown in the left panel, domestic debt has increased in both HIPC and non-HIPC, although the former group has experienced a decrease since the peak of 2005-2006. In both groups of countries domestic debt accounted for about 40% of total public debt in 2010. The right panel illustrates the drastic fall in external debt levels in HIPCs, due to debt relief, and a gradual rise thereafter. Non-HIPCs have also experienced a fall in external debt but through the substitution of domestic debt. All in all, by 2010, the ratios of external and domestic debt to total public debt had tilted in favour of domestic debt with a 60:40 ratio. This is a significant structural shift compared to the situation that existed in 1995/96 where external debt was by far the predominant source of funding.

Recent analysis by the IMF shows that although public debt levels of low income countries have declined quite significantly compared to earlier years, a number of countries - more precisely early

[3] This is the reason behind the introduction of public debt thresholds by the IMF in 2012 as part of the Debt Sustainability Framework (DSF).

HIPCs[4] - have experienced an upward trend of late (IMF 2014 c). While external debt still accounts for most of the debt increase in early HIPCs (except for Ghana and Malawi where domestic debt rose significantly), domestic debt has expanded dramatically in non-HIPCs (e.g. Kenya and Nigeria). This confirms the trend depicted in **Figure 1**.

The same IMF paper quoted above indicates that while debt sustainability is not an issue for most of the low income developing countries, one third of these countries have debt levels that are high or steadily increasing and that at least 12 of them are classified as "high risk" or in "external debt distress". The paper identifies two risk factors related to this situation:

- "Weaknesses in fiscal institutions… that could endanger macroeconomic stability over time" and
- "The lack of a comprehensive debt management strategy poses also a risk, particularly for LIDCs now gaining external market access."

2.1 The boom in Eurobond borrowing

A main feature of developing country debt since 2011 has been the boom in Eurobond borrowing – especially in Africa. This has been a cause of concern and the subject of several recent papers (ODI 2015; ODI 2014).

A decade ago, very few developing countries could access the Eurobond market. Following the substantial reduction in debt burdens brought about by debt relief and the ensuing amelioration in credit rating, an increasing number of countries (including former HIPCs) have ventured on the international capital markets to issue international bonds. The discovery of significant amounts of natural resources (oil, natural gas, metals) in some countries may have also boosted their confidence to do so.

Among the DFID priority list of countries, eight countries have accessed the Eurobond markets eleven times[5] between 2011 and the third quarter of 2014 raising USD8.85 Bn. The borrowing trend between 2011 and 3Q 2014 is depicted in **Figure 2** below.

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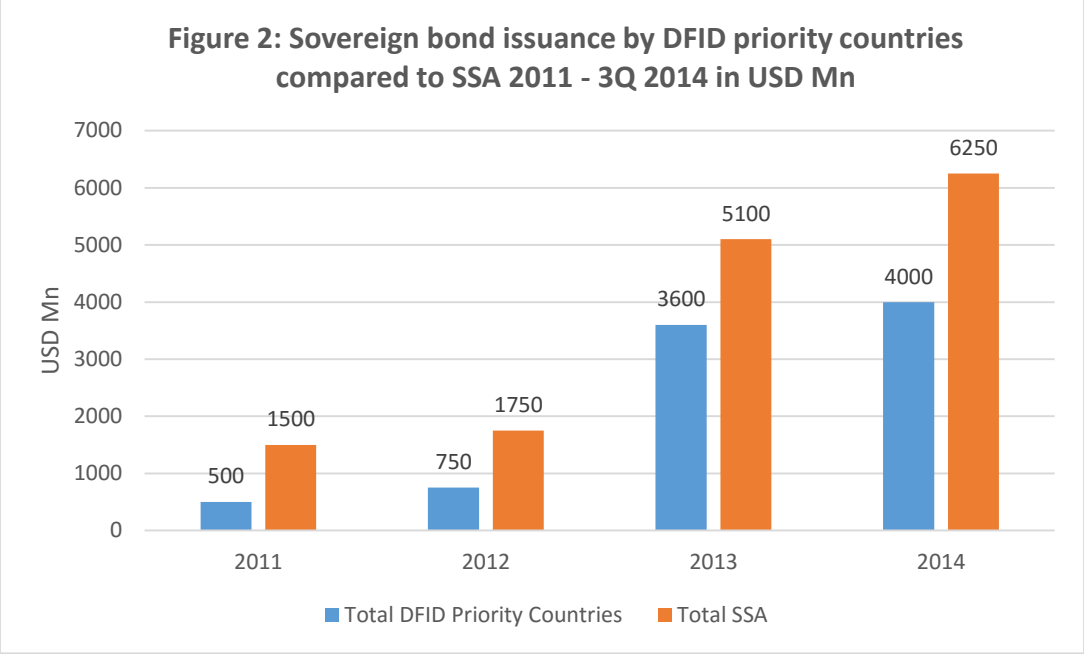
[4] Early HIPCs are defined by the IMF as those who reached Completion Point before 2007.
[5] Ethiopia (2014); Ghana (2013, 2015); Mozambique (2013); Nigeria (2011 and 2013); Pakistan (2014); Rwanda (2013); Tanzania (2013) and Zambia (2012 and 2014).



Source: ODI (2015). Excludes South Africa

The need to address the "infrastructure deficit" in Africa is what has been driving borrowing on the international capital markets. However, commercial borrowing is not subject to conditions on the use of funds and, according to the IMF's Fiscal Monitor, there is evidence that Eurobonds have been used, at least partially, to fund wages and salaries, election related expenditure and even military equipment (see IMF 2014b, Page 14 for examples). On the supply side, an abundance of liquidity coupled with the search for yield continued to motivate investors to invest in the so-called "frontier markets".

Eurobonds do have some definite advantages to issuers: they are a source of quick disbursing funds for infrastructure projects; they allow countries to diversify their sources of funding and can facilitate access by private borrowers. However, they are not without challenges, the two main ones being exchange rate risk and roll over risk.

- **Exchange rate risk** – being mainly denominated in USD, any depreciation of the local currency against the loan currency will lead to an increase in the cost of debt service in local currency terms, thus putting pressure on the fiscal balance. This situation is currently a cause of concern for several countries. According to an ODI study, the Ghanaian Cedi and Nigerian Naira have both depreciated by more than 20% in 2014 with a peak of 60% for the Cedi, which only recovered after fiscal reforms were agreed with the IMF (ODI, 2015)

- **Roll over risk** - Eurobonds are usually paid in one lump sum at maturity. This could lead to a bunching of payments at the time of repayment. While countries can refinance existing debt obligations by issuing another bond, should a reversal of market sentiments or a change in their economic fundamentals occur, this option could become impossible or onerous. A number of factors could lead to a reversal of capital flows from developing countries including an increase in yields in developed countries.

While the yield on a foreign bond may look favourable compared to high domestic interest rates, an analysis incorporating exchange rate movements[6] may lead to a completely different conclusion.

[6] Base of the Uncovered Interest Parity theory. For a discussion and examples, see (IMF, 2014a) Pages 16-17

Countries may therefore be borrowing at a higher cost than necessary while increasing their portfolio risk at the same time.

In addition, foreign bond issuance requires good negotiation skills, the ability to understand the implications of international bonds contracts and a knowledge of international capital markets. Such skills are not easily found in developing countries. As we discuss in **Section 6**, this is one of the areas that would benefit from additional capacity building assistance.

Section summary: Although in aggregate terms the external debt of developing countries is within debt sustainability thresholds, closer scrutiny reveals a more worrying picture. External debt is on the rise and certain regions and country groups are more severely affected than others. Increasing recourse to borrowing on the international financial markets, the increase in domestic borrowing and the creation of contingent liabilities put fiscal sustainability at risk, especially as the fiscal space that existed before the 2008 crisis has now been eroded. As we discuss in the next Section, these developments have put debt management at the forefront of economic policy making.

3. The widening scope of public debt management and the evolution of debt management capacity building since HIPC

Public Debt Management in developing countries has greatly evolved over the past two decades, both in scope and rigour. Debt management now encompasses a large number of functions which hitherto were either scattered among several institutions or, in some cases, just not performed. This has occurred as countries have embarked on reforms in an effort to embrace best practice in debt management. Also, as countries graduate to middle income status[7], they can no longer access IDA and other soft-window funding and thus turn to other types of loan instruments and to the international capital markets. Debt managers are thus confronted with a complex situation that requires the use of more advanced analytical frameworks and tools to enable them to take informed borrowing decisions.

3.1 Extension in the scope of debt management

The continuous extension in the scope of public debt management is one the reasons why capacity development requires such a long-term engagement. This situation gives little comfort to development partners who support projects over a finite time horizon and a limited budget and who, legitimately so, expect results. However, an appreciation of the changes that are taking place in public debt management should help in the design of projects and programmes.

The changes that have occurred are many. We consider only four examples: the increasing importance of domestic debt; contingent liabilities; the integration of cash and debt management; and the use of risk management techniques and procedures.

[7] Ghana and Zambia have already graduated from low income status. It is projected that by 2025, 37 of the 62 IDA-eligible countries would have graduated to middle income status including 24 HIPCS (A. Prizzon and S. Mustapha, 2014)

3.1.1 Domestic debt

In an attempt to diversify their sources of funding, most developing countries have made efforts to develop their domestic debt markets – both for short-term instruments (Treasury Bills/Notes) as well as long-term (government bonds). Indeed, the development of the domestic debt market is often one of the stated objectives in debt management legislation and strategies.

The existence of a fully functioning domestic debt market ultimately allows countries to reduce - or even eliminate, as some developed countries have managed to do - foreign currency risk. However, unless the domestic debt markets are matured, there is a premium to pay in terms of nominal domestic interest rates which tend to be much higher than those prevailing on the international financial markets. This requires the debt manager to take some critical decisions so as to achieve the right balance between cost and risk.

Some countries have made good progress in extending the maturity of instruments offered and in deepening their domestic debt markets, thereby bringing down yields. They also have been able to substitute domestic for external borrowing, thus reducing currency risk. However, to put in place a fully functioning domestic bond market requires time and the existence of a number of conditions such as: an adequate legal and regulatory framework; appropriate market infrastructure; an issuance strategy; the development of an investors' base; and the development of the secondary market to enhance liquidity.

One of the institutions we have interviewed which works in this area confirmed that for many developing countries, the development of domestic debt markets "is still work in progress". Smaller countries are particularly challenged in view of the exiguity of their domestic debt markets.

3.1.2 Contingent Liabilities

The other area that debt managers have had to grapple with in recent times is that of contingent liabilities. This issue is not new as it was brought to the attention of debt managers as far back as 2002 with the publication of "Government at Risk" by the World Bank[8]. (World Bank 2002).

Contingent liabilities refer to "obligations whose timing and magnitude depend on the occurrence of some uncertain future event outside the control of government" (IMF, 2008). They can be "explicit", i.e. defined by a contract or "implicit", i.e. those that are incurred on moral grounds or as the result of public pressure (e.g. Government's response to a bank failure). One notable feature of contingent liability is that they are generally "off balance sheet" and therefore represent "blind spots" in public financial management.

With regards to debt, the two activities that give rise to contingent liabilities are the issue of government guarantees and on-lending operations to public sector entities. In both cases the government bears the credit risk if the public entity defaults. In the case of on-lending, there can also be a currency risk if the public entity repays the loan in local currency and the government has to repay the "parent loan" in a foreign currency.

[8] Hana Polackova Brixi and Allen Shick (Eds), 2002, Government at Risk: Contingent Liabilities and Fiscal Risk, World Bank.

There are other contingent liability risks which, although not within the immediate remit of the debt manager, may ultimately need to be funded through borrowing. The use of Public Private Partnerships is another example.

PPPs are a long-term contractual arrangements for the delivery of public services to the private sector[9]. A distinguishing feature of PPPs is the risk sharing element between the Government and the private project partner. PPPs are also generally long-term agreements, typically ten or more years. They have been used in a wide number of sectors - transport, energy, water and sewage and telecom being the major ones. When they are well-structured and carefully implemented, PPPs can lead to major benefits, including the development of new and innovative services, improved service delivery and value for money.

PPPs have been put to good use in a number of developed and developing countries and this has contributed to the increase in their popularity. PPPs should only be contracted within appropriate policy, legal and regulatory frameworks. Structuring and negotiating PPPs can also be very complex and requires a multi-disciplinary team with knowledge of the sector; project evaluation skills; knowledge of project finance; legal skills; negotiation skills and PPP experience. These are scarce skills in developing countries.

The fiscal risk associated with PPPs are related to the contingent liabilities that they create. In most PPP deals, the Government will offer various incentives to the private counterpart or investor in the form of guarantees that cover credit and political risks, minimum levels of revenue or even exchange rate fluctuations. When these guarantees are triggered, the Government is required to compensate the private operator for any shortfall in revenue. Ideally, there should be an evaluation of the possible impact of these guarantees on the fiscal balance and on debt sustainability at the time the deals are being negotiated and also for each budget exercise. How many developing countries actually do so is uncertain. According to a DFID document "Fifteen years of UK partnerships with Nigeria on debt management – Lessons for DFID's wider approach to capacity building", even Nigeria, which has a well-functioning debt management setup in place, had not been able to close this gap by mid-2013: "The DMO is conducting an annual in-house Debt Sustainability Analysis (DSA) consistent with the IMF-World Bank framework…..but the exercise does not yet cover contingent liabilities or PPPs…" (Dora Akunyili, Menachem Katz, Alex Duncan, 2013).

A number of countries have passed PPP legislation and set up PPP units. However, since PPPs projects are considered to be "investments", PPP units tend to be institutionally removed from debt management departments and little or no consideration is given to the impact projects can have on the fiscal balance and ultimately on the debt situation.

The management, disclosure, valuation and mitigation of contingent liabilities remains a "grey area" in public finance. We know of at least three organisations that are currently undertaking studies on contingent liabilities with a view to implementing an analytical framework within which these can be managed. While advanced countries are able to value contingent liabilities using models based on option pricing or market data, such techniques are of little use to developing countries. The Public Sector Statistics Guide concedes: "standards for contingent liabilities are still evolving because these liabilities are complex arrangements and no single measurement approach can fit all situations." (IMF, 2013).

It is therefore imperative for countries to improve the management of contingent liabilities. As the IMF states "Improved monitoring and reporting of contingent liabilities is essential to prudent fiscal policies, as these liabilities tend to be significantly underestimated in good times. It is crucial at this

[9] See Yong H K (Editor), 2010, Public Private Partnerships, Policy and Practice, Commonwealth Secretariat

juncture for emerging market economies to strengthen their legal, institutional, and reporting budgetary processes so as to better manage long-term fiscal risks and risks arising from contingent liabilities." (IMF, 2014b).

3.1.3 Integration of cash and debt management

Over the past ten to fifteen years, there has been a trend towards the integration of Governments' cash and debt management in developed countries and this function has been attributed to entities managing debt. Cash management is defined as "having the right amount of money at the right time". Poor cash management practices can lead to cash shortages in a government department or ministry, although excess cash may be available elsewhere. This can result in arrears or the need to borrow short term, for example through treasury bills, thus increasing the level and cost of borrowing. In addition, idle cash balances represents an opportunity cost as the funds could have been invested in interest bearing accounts overnight. In the UK, full responsibility for the Exchequer cash management function was transferred from the Bank of England to the UK DMO in 2000.

In view of the benefits of implementing an integrated approach for cash and debt management, many developing countries have been improving their cash forecasting capability, setting up Treasury Single Accounts and adopting a more proactive management of cash balances. This has been made possible by progress in IT infrastructure, as countries have implemented IFMIS as part of their public financial management strategies. This is also "work in progress" and according to several debt management consultants, demand for assistance in this area remains high.

3.1.4 Introduction of risk management in debt analysis and debt management operations

There are two aspects of risk management that concern debt managers: the use of risk-based models for undertaking analytical work and the application of operational risk measures in the day to day management of the debt office. We discuss both areas in turn.

Only a decade ago, the application of risk management in debt management was only undertaken by a handful of countries, mainly from the OECD. The publication "Advances in Risk Management in Government Debt" in 2005, described the progress achieved and challenges faced by these countries in developing models based on risk management techniques.

The usefulness of risk management techniques ultimately depends on the level of development of a country. At one end of the spectrum, countries with a high dependency on grants and official concessional finance cannot make much use of these models as they are not in a position to control the sources and characteristics (currency mix; interest type etc.) of their borrowings. However, as countries move to the other end of the spectrum by graduating between income groups, developing their domestic debt markets and accessing the international capital markets, they have more choices and the use of risk management techniques becomes increasingly important.

The move to risk-based analysis has not been an easy one for many developing countries. Although one cannot escape the learning curve related to the use of cost-risk techniques, there is a need to introduce debt managers to the concepts and tools in stages. The Commonwealth Secretariat has also released its own cost and risk tool (Horizon) in 2012 but its adoption has been slow – at the time

of writing it is only used in South Africa and deployment is still on going in other countries – a fact which supports the above-mentioned observation.

The World Bank's MTDS is actually a relatively simple cost-risk framework. Advanced and emerging countries have developed even more complex models based on so-called stochastic methods. It is only a question of time before such models become the standard, as the main impediment to their dissemination – computing power – is no longer an issue[10].

The other area to consider is the application of operational risk measures in institutions which are responsible for debt management. Operational risk management is defined by the Basel Committee as "the risk of loss resulting from inadequate or failed internal processes, people and systems and from external events". This definition covers a wide range of risks that include internal and external fraud; manual or IT systems failure; damage to physical assets etc. Managing operational risks involves assessing and monitoring possible risks, maintaining risk registers, putting in place business continuity and disaster recovery plans and regularly testing these plans.

While operational risk is widely used in private financial institutions e.g. banks, its adoption in the public sector of developing countries – hence by debt management entities – has been very slow. Consequently this is an area that scores very low in DeMPA assessments as discussed in **Section 5**.

3.2 Evolution of debt management of capacity building

Capacity building in debt management has evolved in parallel to advances in PDM. This evolution has been driven by a number of factors:

- Lessons learnt as the result of successive debt crises of the 1990s;
- The development and spread of "best" practice from the developed economies and the benefits that can be derived from adopting these, as discussed above;
- Changes in debt management practices that have occurred over the years;
- New requirements e.g. in terms of reporting in the countries themselves; and
- Improvements in information technology.

This has prompted many developing countries to embark on reforms to upgrade their debt management laws, reorganise debt departments in Front/Middle/Back office structures, and put in place computerised debt recording and management systems. Also, as countries graduate from low to middle income status, they are likely to face new challenges which access to the international capital brings about.

This sub-section provides a brief overview of how capacity building efforts in debt management have evolved since HIPC and some of the key milestones in this development.

Prior to HIPC, debt management capacity building focussed primarily on debt data recording and accounting. Much of the work was led by the Commonwealth Secretariat and UNCTAD. The World Bank put its efforts in building and improving its DRS. Debt management projects were funded either through the World Bank's Trust Fund or through TALs. Regional Development Banks and a small number of bilateral donors and institutions (e.g. Sweden, Canada's International Development Research Centre) also provided funding for individual country or regional projects.

[10] The World Bank must also be thinking about the issue for in recent survey they carried out (see page 25 of this Report), countries were asked whether they make use of deterministic or stochastic analytical framework.

The HIPC process was a turning point as it revealed a serious lack of capacity in HIPC eligible countries to undertake the analysis required to participate in the tripartite process with the World Bank and the IMF. The launching and implementation of the HCBP, to which DFID and other development partners contributed, played a significant role in filling this gap and not only helped raise awareness about the importance of debt management but also enhanced the ability of government officials in both Ministries of Finance and Central Banks to undertake Debt Sustainability Analysis – which was the key methodology used to determine the level of debt relief. Much effort was dedicated to develop and refine the theoretical framework and appropriate tools to undertake the DSAs required as part of the HIPC process[11]. This work has now been consolidated in the Debt Sustainability Framework which is used by the Bretton Woods' institutions and RDBs. As discussed in **Section 1**, the positive impact of the HIPC and MDRI initiatives on beneficiary countries' economies and fiscal situation is still being felt today.

Around the same time, a number of regional organisations were created so that capacity could be transferred to the regional level. The fact that all of these organisations still exist[12] and continue to contribute to debt management capacity in their respective regions is an indication that the transfer has been successful. We review the work of these regional organisations in **Section 4**.

The publication of the "Guidelines for Public Debt Management" – together with the companion volume "Accompanying Documents and Selected Case Studies" by the World Bank in 2001 was the first attempt to summarise in one document the "areas in which there is widespread agreement on elements of sound debt management practice" (World Bank 2001) with the intention to "help governments identify appropriate debt management reforms and areas in which they can build capacity." A revised edition of the Guidelines was recently published by the IMF in 2014 to take into account developments in debt management since 2001.

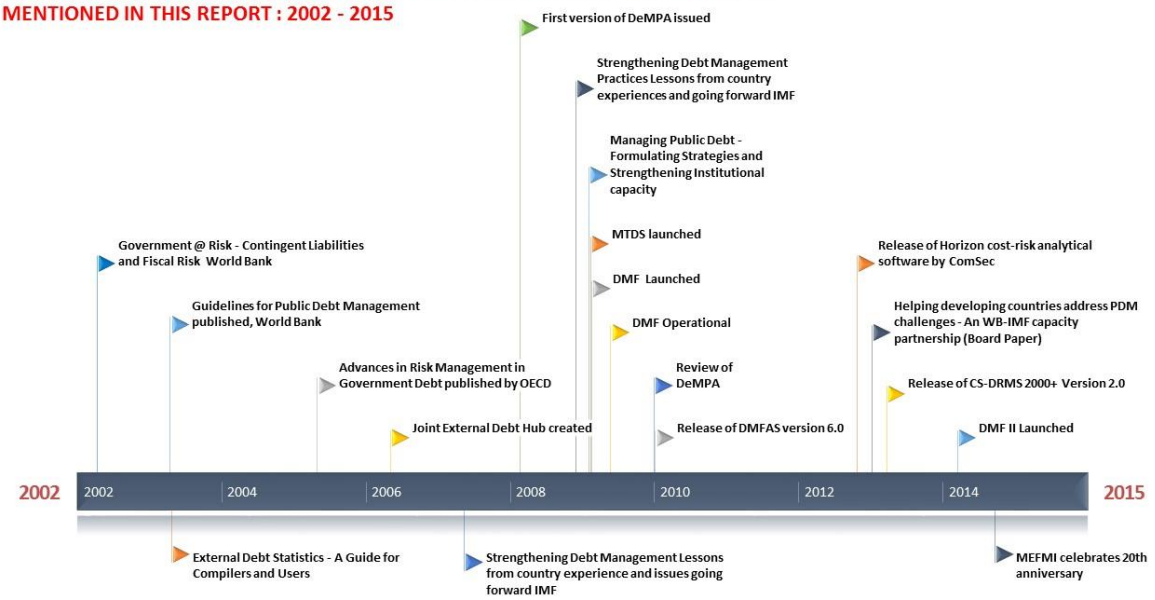
The international debt crises of the 1990's had highlighted the need for more comprehensive, reliable and comparable information on external debt. A less well known but very important initiative is the IMF-led TFFS which was set up in 1992 but reconvened in 1998 to review the definition and coverage of debt statistics. This led to the first edition of the "External Debt Statistics: Guide for Compilers and Users" in 2003. This publication, which is regularly updated by the TFFS, is a reference document providing comprehensive guidance for the measurement and presentation of external debt statistics. A second edition was published in 2013. A "Public Sector Debt Statistics: A Guide for Compilers and Users" was also published in the same year to take into account the increasing importance of domestic debt and contingent liabilities among other areas.

The period 2008-2010 was an active one for debt management capacity building. Following rounds of consultations, the World Bank tabled a paper to its Board for approval (World Bank 2007) in which it detailed the launching of a new capacity building programme based around DeMPA and MTDS, which were both launched in 2008. That year also saw the establishment of the DMF, a multi-donor funded programme which is discussed in **Section 4**.

Figure 3 summarises the major milestones in debt management capacity building mentioned in this Report over the period 2002 - present.

[11] These include the development of World Bank's Debt Strategy Module plus (DSM+) and DebtPro, a commercial product.
[12] With the exception of the Pole Dette which closed in 2011.

Figure 3: TIME LINE OF MAJOR EVENTS IN DEBT MANAGEMENT CAPACITY BUILDING MENTIONED IN THIS REPORT : 2002 - 2015



Section summary: The management of domestic debt and of contingent liabilities, the integration of cash and debt management and the introduction of risk management techniques and operational risk in debt management are four in a long list of topics that have increased the scope of debt management. Other issues include: the move towards accrual accounting; the development of a secondary market for government securities; the building of yield curves; the monitoring of private non-guaranteed sector debt; linking debt recording to IFMIS systems etc. In an attempt to embrace best practice, developing countries are involved in a "catching up exercise". As we have seen, best practice itself evolves. Capacity building has to a large extent followed suit, sometimes ahead but most of the time lagging behind.

4. Review of main debt management capacity building initiatives and programmes

This section reviews the programmes currently being implemented by the main capacity building providers. Where the scope, objectives and activities of institutions are very similar, we have grouped and discussed the institutions/programmes together.

4.1 The Debt Management Facility

The DMF is by far the largest capacity building initiative in debt management currently being implemented - both in terms of the level of funding and scope of operations. All DFID target countries, with the exception of South Africa, are eligible for DMF assistance. Among those, only four countries - Burma (Myanmar), India, Occupied Palestinian Territories and Somalia – have not yet taken advantage of the Initiative. **Annex 4** provides information about DMF activities in DFID target countries broken down by main products and year of intervention.

A new phase (DMF II) was launched in April 2014 with the support of six donor countries (besides the World Bank and IMF contributions): Austria; Germany; Netherlands; Norway; Switzerland; and Russia. DMF includes a new partnership with the IMF and also expands the scope of the Facility to include assistance in domestic debt market development, the issuance of debt on international markets and assessing macroeconomic and financial risks. DMF II ends in 2017.

DMF assistance revolves around six specific products and services described in **Table 2** below:

Table 2: Products and Services offered as part of the DMF

Product / Service	Description
Debt Management Assessment Performance (DeMPA)	A methodology for assessing debt management performance using a set of fifteen indicators that cover the entire range of functions in debt management.
Medium Term Debt Strategy (MTDS) Analytical Tool	The MTDS is an Excel-based analytical tool which allows debt managers to assess the cost and risk trade-offs of various borrowing scenarios.
Reform Plan:	Following a DeMPA assessment, a Reform Plan provides a more in-depth diagnostic and a sequenced set of action to be undertaken to address weakness in debt management policy determination and operations.
DMF Stakeholders Forum:	An annual forum organised by the World Bank to share knowledge on latest developments in public debt management. Five DMF SFs have been organised between 2010 to 2014
Debt Management Practitioners Programme:	A 3-month attachment programme at the World Bank for debt management officers of DMF-eligible countries to facilitate knowledge sharing and experience and expose the debt managers to cross-country experience.
Knowledge sharing products:	This includes the Debt Managers Network which hosts live forums over the internet to discuss topics relevant to debt managers; the publication of a quarterly Newsletter and the maintenance of the DMF website.

Since the beginning of DMF II, training using the DSF is also being provided[13].

An independent Evaluation undertaken at the end of the first phase confirmed that the DMF is relevant to both developing countries' needs and the priorities of the World Bank and those of the donors. The Evaluation goes on to state that the initiative is "innovative" and that the products and services are "highly regarded". The evaluators felt that the DMF has brought a major contribution to enhancing both awareness and knowledge sharing regarding debt management.

Our discussions with other providers reinforced this view. In West Africa for instance, DeMPA has "raised awareness about debt management and provided a tool to measure performance and progress". There is anecdotal evidence that countries compare their scores with other countries with similar characteristics, and are thus motivated to improve their debt management capacity. Ghana, for instance, has hosted two DeMPA and two Reform Plan missions and the restructuring of the Aid and Debt Management Unit is being guided by these plans. In Nigeria, a special task force was setup to report progress in improving areas of weakness identified in the DeMPA assessment carried out in 2011.

There are a number of weaknesses in the DMF programme design which are discussed in the DMF I Evaluation Report.

1. **The DeMPA tool:** The tool itself is very useful and the fact that we are using its methodology and results in this study demonstrates its versatility. So far, the World Bank retains full ownership of DeMPA and its application in countries. The DMF indicated that they are not

[13] This was a recommendation of the DMF I Evaluation Report.

opposed to other parties – e.g. Implementing Partners – undertaking DeMPAs as long as the assessment reports are quality assured by the DMF. However, there is no explicit policy or strategy to transfer the diagnostic function to IPs or to accredit private DeMPA assessors.

2. **The MTDS analytical tool:** The MTDS is the first cost-risk model to be made widely available to developing countries for the design of medium-term debt strategies. It can be used both as a learning tool to understand cost-risk concepts and as an analytical model to assist in the design of actual strategies.

   The DMF I Evaluation Report found that MTDS is deemed difficult to understand and to use by many country officials[14]. Even with the training being provided as part of the DMF, it is not clear whether countries (apart from a few exceptions) fully understand the concepts and the tool and can undertake or update an MTDS without assistance from the WB/IMF or external consultants. Several consultants we talked to share this view. Another problem in using MTDS is that it can appear as a "black box" to Ministers of Finance who may be reluctant to approve debt strategies that neither their senior officials nor themselves fully understand. While some countries have published MTDS, it is unclear how many are actually implementing, regularly evaluating and updating these strategies, as reflected in the DeMPA scores discussed in **Section 5**.

   We believe that for MTDS to become a "mission critical application" in Middle Offices around the world, a completely different setup and approach is required for its dissemination, regular maintenance, periodic improvement and continuous support - which should include a help desk for user assistance along the lines that ComSec and UNCTAD have in place for their respective software products.

3. **Reform Plans:** Another of the DMF I Evaluation's findings, which is relevant to this study, is the issue of **Reform Plans** and the implementation of downstream capacity building activities by the DMF. The implementation of Reform Plans was not originally envisaged in the design of the DMF[15]. The Evaluation Report quotes the DMF Trust Fund proposal document which states "the facility's focus is on upstream and pre-upstream activities and will not finance downstream work, such as the implementation of detailed reform plans. Rather it is expected that such projects …will be financed through World Bank country programs or the development programs of other donor agencies and/or regional development banks in collaboration with country authorities". (Universalia, 2013: P29).

   One of the two Reform Plans we could consult is the one for Madagascar undertaken in February 2014. The Introduction to the Report confirms the above-mentioned point:

   "… Thus, proposed plan focuses mainly on specific activities in 2014 and 2015, many of which can be undertaken within existing capacities of the DDP without substantial support. In some areas, however, such as operation risk management, *it is recommended that external consultants are engaged to support the establishment of risk identification and monitoring process*. It is recommended that this reform plan, once it is finalized by...[the]…Treasury, is *shared with the donor community*." (World Bank 2014) – Author's own emphasis.

[14] The Evaluation recommends the development of a "lite" version of the MTDS.

[15] The DMF charter is clear about this: "Any "downstream" activity arising from DMF II activities, specifically implementation of reform plan, will not be financed under the DMF II" (DMF, 2013)

Between 2009 and 2013, 13 of the DFID priority countries had hosted Reform Plan missions. Should extra donor support be available, a facility to assist these countries in implementing these Reform Plans would be a very useful contribution to debt management capacity. This is further discussed in **Section 6**.

The fact that the DMF is only engaged in training and assessment work (including undertaking Reform Plans) is perhaps what explains the apparent lack of impact at the end of the first phase. The Evaluation indicated that "it was too early to expect evidence of the intended eventual impact of the programme, there is some evidence of outcomes that, if sustained, may lead to the desired impact." (Universalia, 2013)

The discussions we had about the impact of the DMF, suggest that so far results have been mixed. There is a group of countries that have clearly benefitted from the programme and have undertaken debt management reforms. This group includes Bangladesh; Nigeria; Kenya; Rwanda. However, concerning Middle Office functions (e.g. use of the MTDS and Strategy development), some of the interviewees had doubts whether all of these countries are able to update or undertake a Strategy using only in-house expertise.

There is also a second group of countries where progress has been uneven. For various reasons, including staff turnover and the inability to find funding to implement reforms, these countries continue to lag behind in many areas of debt management.

Finally, there is a group of countries that has not made any progress and, in at least one case that what mentioned, has regressed in certain aspects due to staff turnover. The lack of leadership and trained staff required to bring about required changes remain major constraints. However, the DMF felt that this group is shrinking.

In **Section 5** we consider global DeMPA scores by thematic areas of debt management to gain a better picture of the situation.

4.2 The Bretton Woods institutions – IMF and World Bank

The DMF is not the only avenue for the World Bank and the IMF to contribute to debt management capacity building. They also do so as part of their own technical assistance activities.

At least three groups in the World Bank have programmes related to public debt management:

- **The Macroeconomic and Fiscal Management Global Practice** which interfaces with the DMF and which works with developing countries, especially LICs, to strengthen debt management;
- **The World Bank Treasury** through its Government Debt and Risk Management team provides research, training and advisory services to IBRD countries and covers both assets (reserves) and liability (debt) management[16]. The Treasury has also been collaborating with the DMF in emerging countries.
- **The Finance and Markets Global Practice** specialises in the development of public and private debt markets. In the area of public debt markets the group targets middle income countries that have a certain bond market size through its GEMLOC programme.

[16] This is a fee-based service.

The IMF also has its own technical assistance programme which it implements through its network of nine RTACs and seven RTCs and RTPs. There has been a strategic move to combine technical assistance and training to achieve synergy between institutional and human capacity building. Much of the TA provided by the IMF is as part of its programmes although training is opened to all suitably qualified government officials from eligible countries.

Internally the **Monetary and Capital Markets Department** coordinates technical assistance and liaises with the **Fiscal Affairs Department** when it comes to debt management. Given the internal sharing of capacity building responsibilities which occurs between the different groups in the two organisations and with other programmes, it was difficult for the consultant to precisely determine the total level of assistance that is devoted to debt management.

4.2 A tale of two debt software providers: ComSec and UNCTAD

ComSec and UNCTAD are the two main providers of computerised debt recording and management systems to developing countries. The two organisations became involved in debt management practically at the same time, in 1983 and 1985 respectively in the aftermath of the Mexican debt crisis, and for the same reason: the lack of adequate debt records in their respective member countries was an obstacle to the debt reconciliation required for Paris Club negotiations and rescheduling. Both organisations are members of the IMF-led TFFS as well as Implementing Partners of the DMF.

The two organisations share the "market" for debt management systems almost equally: the CS-DRMS is installed in 56 countries, while UNCTAD's DMFAS software is used in 57 countries[17]. There are, however, some major differences in the scope of the two programmes. While both institutions are engaged in the delivery of their respective software products and related training as well as the production and dissemination of debt data statistics, ComSec sees itself more of a "one stop shop" in debt management and offers advisory services in a wide range of thematic areas. Also, while UNCTAD deploys only one product - DMFAS 6.0 - ComSec offers a suite of three products namely:

- **CS-SAS:** an auctioning system for the issuance of domestic debt securities;
- **CS-DRMS 2000+:** the core debt recoding, management and reporting system covering both external and domestic debt; and
- **Horizon:** a cost-risk analytical tool.

There is no doubt that both organisations have brought an important contribution to debt management capacity building over the years, demonstrating the positive effect that long-term commitment can have. This contribution has gone beyond the provision of software and the setting up of timely debt databases but has also greatly contributed to good governance, transparency and accountability in debt operations and debt statistics compilation and dissemination. Both organisations have thus been instrumental in getting user countries to report debt data to the World Bank through the DRS and have facilitated their subscription to the IMF's GDDS and SDDS.

The existence of two competing debt management software products has both advantages and disadvantages. The duopoly situation has led to "friendly competition" between the two providers

[17] The following DFID priority countries use CS-DRMS: Afghanistan, Myanmar (planned), Ghana, India, Kenya, Liberia, Malawi, Mozambique, Nepal, Nigeria, Sierra Leone, and South Africa. UNCTAD's DMFAS system is used in Bangladesh, Ethiopia, Pakistan, Rwanda, and Sudan.

and has prompted them to innovate. Countries also have a choice of software, depending on their technical preference or source of funding. There has not been any duplication in terms of geographical coverage, as both institutions have left the choice of product to the countries and managed to find their own niches. There is only one case that we know of (Trinidad and Tobago) whereby a country has moved from one system to another. However, it is a fact that financial resources (largely from donor sources) are being spent to develop and maintain two very similar products. A look at the new features recently introduced in the latest versions of CS-DRMS and DMFAS confirms this view.

A new development may bring about profound changes in the area. A Business Model Review undertaken by UNCTAD in 2014 recommended that "UNCTAD should explore a strategic alliance with ComSec with the purpose of developing a common platform for debt management services, a shared software program and cooperation in providing related service. Such a strategic alliance would both be an efficient use of donor funds and ensure better quality of services to client countries. The strategic alliance could also include other areas of cooperation such as training." (UNCTAD, 2014)

Both organisations have met to discuss the proposal and, at the time of writing, the matter was under consideration.

4.3 Regional capacity building organisations and initiatives in debt management: MEFMI, WAIFEM, CEMLA, CANEC-DMAS

A major feature of the HCBP was the transfer of capacity to regional organisations. MEFMI and WAIFEM were created for the purpose of developing capacity in their respective regions. The scope of their work is similar and they both deliver programmes in debt, financial sector and macroeconomic management. The creation of a new institution for the Central and South American region was not warranted and a debt management programme was instead created in CEMLA[18] in 2003. The programme currently benefits from SECO funding. All three organizations/programme are Implementing Partners of the DMF.

The regional institutions are now well established and bring a valuable contribution to debt management capacity building in their respective regions. They cover the whole range of functions in debt management including debt database development and management; institutional and legal aspects; analysis, policy and strategy development. They are also able to respond to regional or member-specific needs such as sub-national debt in Nigeria. Over the years, the regional organisations have proven that they enjoy the support and trust of their members. This is illustrated by the fact that they now generate a much higher share of their revenues from their membership – WAIFEM 74.9% (2012) and MEFMI 72% (2013).

Their modes of delivery are also similar: courses, workshops and seminars for mid-level and senior professionals; country missions; retreats for heads of relevant departments; special policy-related studies; and the preparation of manuals and guidelines. In the delivery of their respective Work Programmes, the regional institutions not only partner with the main providers of debt management capacity building (e.g. IMF, WB, UNCTAD) but also with other international and private organisations (e.g. UNECA, Crown Agents). For example, in 2014 CEMLA delivered 20 debt management programmes of which eight were delivered in collaboration with partners.

[18] CEMLA was established in 1952 as a training and research institute in monetary and banking matters for Latin America and the Caribbean. It is owned and funded by the Central Banks of the region.

One of the comparative advantages of membership-based organisations is the close relationship they enjoy with their members, which allows them to successfully engage with senior government officials when implementing reforms. This is also an advantage when engaging in sensitisation campaigns with senior officials and Parliamentarians. For instance, MEFMI has recently started conducting sensitisation workshops for Parliamentarians – an important group of stakeholders in national policy determination. The workshop, which we had the opportunity to facilitate, discussed in a very open way, very sensitive issues such as the link between election cycles and debt management.

One interesting development since 2008 is the Debt Management Advice Service (DMAS) setup at the Eastern Caribbean Central Bank with funding from DFTAD. The objective of the Programme is "to address debt issues of ECCB member countries and to establish sustainable systems and procedures for improved debt management"[19]. The Programme has been supporting capacity building in the sub-region through workshops in areas such as negotiation techniques and the use of CS-DRMS etc. Training has also been provided in MTDS development in three countries: St Vincent and the Grenadines, Antigua and Barbuda and Dominica[20]. A Task Force on Debt, Growth and Development has been set up as part of the project, which amounts to CAN$ 7.5 Mn. The project has recently benefited from a no cost extension until 2017 to facilitate further capacity building in the ECCU region.

An analysis of regional capacity building initiatives reveals some gaps:

As far as we are aware, there are no institutions or programmes providing long-term support to Francophone countries in Africa , following the closure of the Pole Dette in 2011. However we were informed by one of the interviewees that the BEAC and BCEAO are considering putting in place a new capacity building initiative for their member countries and that a stakeholder meeting to discuss the matter is being scheduled.

The Asia-Pacific region also does not benefit from a regional initiative to support debt management. However, the AOFM supports some debt management activities in the Pacific region. For example in 2013-14, the AOFM seconded two of its staff members to Papua New Guinea and the Solomon Islands (AOFM 2014). The creation of PIFTAC by the IMF and coverage by the DMF and ComSec are also additional sources of support.

4.5 Institutions dedicated to training in debt management: UNITAR and ICD

Training is an important delivery mechanism of capacity development. Most of the organisations mentioned in this paper undertake training as part of their capacity building programmes and several provide distance or e-learning courses to supplement face to face training. UNITAR and ICD are two organisations dedicated solely to providing training.

UNITAR is a training arm of the United Nations System, serving some 25,000 beneficiaries annually by conducting more than 400 capacity development and research activities around the world. The mission of UNITAR is to develop capacities of individuals, organisations and institutions to enhance global decision-making and to support country-level action for shaping a better future.

[19] ECCB's Web site: www.eccb.org

[20] Dominica's MTDS is published on the Government's web site at: http://www.dominica.gov.dm/images/documents/medium_term_debt_management_strategy_2013_2017.pdf

UNITAR was one of the first organisations to offer face to face, self-learning and eventually e-learning courses in debt management. It currently offers six web-based debt management courses including Conducting Debt Audits; Debt Sustainability Analysis; Paris Club rescheduling; Fundamentals of the Bond Market; Advanced Risk Management etc. Apart from a DSA course which was designed in collaboration with WAIFEM and which is offered free of charge, other courses attract a fee that varies between USD400 and USD800.

The ICD, which celebrated its 50th anniversary in 2014, offers over 70 courses in areas that are of interest to the IMF including financial programming and policies, macroeconomic policy formulation, finance, fiscal affairs, financial and economic statistics. Courses are offered at ICD's Headquarters in Washington DC and throughout the world through a network of 7 RTCs and RCPs.

The ICD also offers courses online. A recent innovation has been the piloting of two of its courses, including a course in Debt Sustainability Analysis, on the online platform edX[21]. edX is non-profit initiative setup by Harvard University and MIT in collaboration with a large number of other academic institutions. It offers online courses free of charge to the general public. The use of massive open online courses (also known as MOOCs) for debt management training is a very positive and exciting development as the benefits go beyond what traditional e-learning can offer. The scale and level of interaction and peer learning that MOOCs offer cannot be equalled by platforms operated by a single institution that offer a course to say, twenty or twenty five participants at a time. We believe MOOCs have the potential to "mainstream" and help raise the profile of debt management across the board and its application merits further investigation.

4.5 Other official and non-profit institutions: ALSF, DFI, US OTA, INTOSAI

There are a number of other official and non-profit organisations that bring an invaluable contribution to debt management. These include:

African Legal Support Facility

The ALSF was setup in 2010 to support countries negotiate legal transactions in a number of sectors including debt management and litigation and in the negotiation of PPP and natural resources agreements. The ALSF is hosted and financed by the African Development Bank and a number of development partners including DFID.

One area that the ALSF has been focussing on is that of litigation, an issue that has made the headlines on a number of occasions. Over the years, a thriving secondary market for developing country debt has emerged, including for loans that are in default. Companies (referred to as Vulture Funds) buy this debt at deep discount from the original creditors and then take the borrower country to international courts in an attempt to recoup the face value of the loan. The rate of return they can make are huge, varying from 300% to 2000% after legal fees[22]. In so doing, Vulture Funds not only by pass multilateral mechanisms such as the Paris Club and London Clubs but also come up with arm twisting tactics to win their cases such as attempts to appropriate countries' assets abroad.

In such litigation cases, the odds are unfortunately stacked against borrowing countries as the legal capacity required to fight the cases in court is practically non-existent and extremely expensive to procure. Also, international commercial law has little regard for developmental considerations –

[21] See https://www.edx.org/

[22] According to the ALSF web site (http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/)

such as the indebtedness or income level of the countries concerned – and courts have therefore tended to rule in favour of the Vulture Funds. According to the ALSF web site, of the 25 judgements that have occurred so far, 72% have been in favour of the Vulture Funds.

While the ALSF has been playing a crucial role in helping countries deal with litigation cases, it is equally important to build the capacity of countries to negotiate sound loan agreements, as this is the only way to ensure that any subsequent legal cases can be effectively challenged.

Section 6 suggests how the work of the ALSF could be linked to some of the options that are being suggested.

Development Finance International

The Development Finance International Group is a non-profit organisation working in the area of public debt management and finance including private capital flows. It delivers programmes through various means:

- Research and analysis;
- Capacity building (training and the transfer of skills);
- Advocacy; and
- Advisory services

This four-pronged approach distinguishes DFI from other providers as it not only undertakes technical research to support its capacity building activities (evidence-based capacity building) but it can also influence decision makers through sensitisation at local level and advocacy at an international level.

DFI played a key role during the HIPC process building the capacity of both countries and regional organisations in debt management. It has also undertaken pioneering work in debt management capacity self-assessment (even prior to DeMPA), and capital flows including private sector flows monitoring.

DFI is an Implementing Partner of the DMF.

The US Treasury Office of Technical Assistance

The Office of Technical Assistance of the US Treasury runs a programme on Government Debt and Infrastructure Finance as well as training programmes in sovereign debt and risk management.

The GDIF programme focusses on the development of domestic debt markets including the legal and regulatory framework; institutional and staff capacity; financing instruments; issuance and settlement etc. This programme is implemented through the placement of long-term and "intermittent" short-term advisers. According to their current work programme, the OTA has projects in the following DFID priority countries – Ghana (GFMIS including cash management); Kenya (debt issuance, establishment of a DMO and risk management capacity building), Tanzania (developing domestic debt market) and Uganda (risk management).

In FY 2013, an estimated USD6.8 Mn[23] was spent on the GDIF programmes across three regions (Latin America and the Caribbean; Asia; and Sub-Saharan Africa) out of OTA's total budget of USD39.3 Mn.

[23] Author's own calculations based on OTA's 2013 Report to Congress.

Although it is not an Implementing Partner of the DMF, OTA collaborates with the IMF and WB on a case by case basis.

The International Organisation of Supreme Audit Institution

INTOSAI is an umbrella organisation regrouping Supreme Audit Institutions from around the world. It develops the institutionalised frameworks for the auditing of governments in various areas including debt management. Through the INTOSAI Development Initiative it supports in-country capacity development programmes. INTOSAI has developed some very useful guidelines related to auditing and public debt management including:

- Fiscal Exposures: Implications for Debt Management and the Role for SAIs
- Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt
- Debt Indicators
- Guidance on Definition and Disclosure of Public Debt

Given that auditing has been identified as one of the weaker areas of debt management, the work of INTOSAI in the coming years will gain in importance.

4.6 Regional Development Banks and bilateral donors

Developing countries are also able to seek assistance in debt management through projects or programmes from multilateral organisations, RDBs and development partners. These are difficult to track although terms of reference and invitations to bid are routinely advertised. These initiatives can be short, medium or long-term.

Given that RDBs are organised regionally, one would not expect duplication in such projects. However, one of the consultants we interviewed mentioned at least two cases whereby consultants were hired by the same RDB to undertake very similar assignments, in the same country, within a short interval!

When properly coordinated and integrated within mainstream capacity building efforts, assistance from RDBs and the bilateral donors can be very useful in helping countries carry out reform programmes in debt management. The intervention of DFID in Nigeria, discussed in **Section 6**, is a testimony to this view.

4.7 Private Consultancy firms and consultants

There is also a number of private consultancy firms involved in providing training and advisory services in debt management. In the UK, Crown Agents is arguably the most active company providing regular courses in various aspects of debt management as well as consultancy services. They are also the distributor of CS-DRMS to non-Commonwealth countries. Crown Agents approaches debt management from a Public Financial Management angle which has advantages.

Last but not least, there exists a community of independent consultants offering advice in debt management. These consultants are often used to supplement staff resources of official institutions.

Section summary: There is a large network of providers who are engaged in debt management capacity both globally and regionally. Some institutions have specialised in certain aspects of debt

management (e.g. INTOSAI in the area of debt audits; the UST OTA in the development of domestic debt markets and public financial management). Others, such as the IMF, the World Bank and ComSec work across a whole range of functions. There is also a dedicated group of non-profit and private operators who contribute to debt management capacity building.

It can be noted that there is a fair amount of collaboration and information sharing among providers and little evidence of duplication. Initiatives such as the DMF have reinforced this collaboration.

The need for long-term involvement in capacity development is apparent. This view is supported by the former Managing Director of the World Bank Treasury, Graham Wheeler:

"Programs aimed at developing a sound government debt management capability can take many years…. OECD countries during the late 1980s and early 1990s often took five years or longer given the challenges of recruiting and training staff, developing risk management strategy and supporting it with appropriate management information systems and documentation on policies and procedures. Comprehensive reform can take a decade or more when initial conditions are much less supportive than those prevailing in many OECD countries at the start of their programmes." (World Bank 2004).

5. Are capacity building needs of countries in debt management being met?

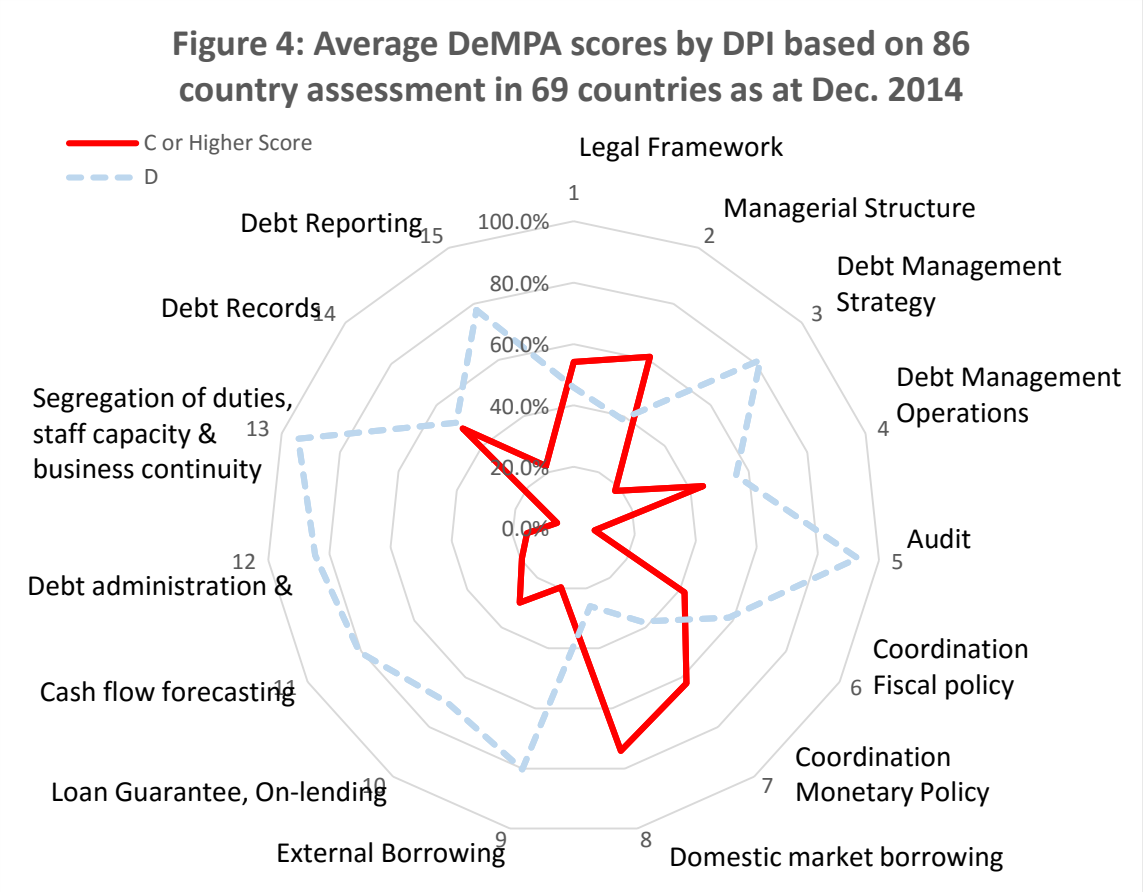
Having reviewed how the needs of debt managers have evolved in **Section 3** and the work and areas of interventions of the main capacity building providers in **Section 4**, we now examine to what extent the capacity building needs of countries are being met.

A word of caution is required at this stage: when undertaking such a broad analysis, there is a danger of arriving at equally broad but meaningless generalisations. While there are common challenges across the board, in the final analysis each country has its own unique set of challenges and priorities for debt management reform.

With this important *caveat* in mind we have undertaken an analysis based of debt management capacity by thematic areas. We adopted the DeMPA classification i.e. with six major areas[24] broken down in 15 functions and used global average DeMPA scores based on 86 country assessments which have been undertaken in 69 countries as at end of 2014[25]. The data was supplied by the World Bank. The results are displayed as a radar plot, **Figure 4** below:

[24] Another possibility would have been to use the classification of the Public Debt Management Guidelines which also identifies six major functional areas. However, the coverage of functional areas differs slightly from that of DeMPA.

[25] Care should be taken when interpreting global DeMPA scores because the DeMPA methodology was revised in 2009. Radar plots such as the one depicted above only provide **an estimate** of the level of debt management capacity (broken down by functional areas) for the group of countries analysed.



Source: DMF, World Bank

The above diagram provides a snapshot of debt management capacity as at the end of 2014. The red line shows the percentage of countries that achieved a C or higher in the various thematic areas, while the dotted blue line represents the percentage of countries that failed to meet the minimum C requirement. As the number of country assessments exceeds the number of countries, the data includes cases where more than one DeMPA exercise has been undertaken.

Three thematic areas appear to be reasonably strong. These are:

1. **Domestic Market Borrowing**, where 74.1% of countries achieve the minimum score of C or higher
2. **Coordination with monetary policy**, where 62.5% of countries achieve the minimum score or higher; and
3. **Managerial structure**, where 61.1% of countries achieve the minimum score of C or higher.

However, capacity is still weak in a large number of functions including:

1. **External borrowing,** where only 19.7% of countries achieve the minimum score or higher;
2. **Cash flow forecasting,** where only 19.4% achieve the minimum score or higher;
3. **Debt management strategy**, where only 18.1% of countries achieve the minimum score of C or higher;
4. **Debt Administration and data security**, where only 15.3% of countries achieve the minimum score or higher;
5. **Audit,** where only 6.9% of countries achieve the minimum score or higher; and
6. **Segregation of duties, staff capacity and business continuity**, where only 5.6% of countries achieve the minimum score or higher.

We note that, in some cases, the global DeMPA results do not seem to reflect the amount of effort capacity building organisations have contributed over the years. For example, in spite of the contribution of ComSec and UNCTAD over thirty years, only 48.6% of countries meet the minimum requirements for a C score for Debt Records and only 22.2% meet the minimum requirements in Data Reporting. This is counter-intuitive given the vast improvements that have occurred in these two areas over the years. This could be the result of two factors:

1. The DeMPA tool itself, which is very sensitive to a number of specific factors. To achieve a given score in a Debt Management Performance Indicator (DPI), countries have to meet multiple conditions. Even if only one of the conditions is not satisfied, the country is likely to achieve a lower score. This is a problem often found in such benchmarking tools.

2. The fact that capacity building takes time and meaningful progress can only be discerned in the long run. This is because many of the reforms which are being undertaken concern the "infrastructure" of debt management itself such as the legal framework; the institutional framework; the development of markets; the introduction of new technology etc.

Unfortunately we could not have access to individual country scores as these are not made public. It would be useful for the DMF to undertake a more detailed analysis of the data to be able to draw more meaningful insights.

We amplify on the above results in **Table 3** below by providing a short description of each of the thematic functions and commenting on how we think the areas are evolving.

A discussion of constraints is provided in **Section 5.1**.

Box 1: Results of recent PDM survey undertaken by the World Bank's Treasury Department

As this Report was being finalized, the World Bank published a Working Paper entitled "How strategically is Public Debt Management managed around the globe: a survey of Public Debt Management Strategies".

The legal requirement for and existence of a debt management strategy – as well as its approval, publication and dissemination – is regarded as a crucial indicator of the level of PDM and is indeed one of the DeMPA indicators.

117 countries responded to the survey. Bunching together OECD countries with LICs in the same sample calls for careful analysis but the results indicate that:

- 60% of respondents have a formal debt management strategy in place and 40% (or 47 countries out of 117) did not.

Of those countries that have a debt management strategy in place:

- 44% have a legal requirement to do so;
- 97% have the document approved (mainly by the Minister of Finance);
- 77% of countries make the document public;
- 76% use some type of target or benchmark; and
- 71% use a qualitative framework or model.

Broken down by country group, 58% of low income countries responded they have a formal debt management strategy in place. This may seem at odds with the results obtained through DeMPA assessments, where only 18.1% of countries met the minimum requirement for the "debt management strategy" performance indicator. However, given the small number of LICs in the sample (10% only), the actual number of countries in that category with a formal debt management strategy must be few and closer to the DeMPA assessment results.

The Working Paper can be accessed at: http://treasury.worldbank.org/bdm/pdf/DebtManagementSurveyCabral.pdf

Table 3: Comments on the level of PDM capacity by thematic areas and average DeMPA scores

Thematic Areas/Sub-Area	Description (1)	Comments	% of countries achieving the minimum C or higher DeMPA score taken end of 2014 (86 country assessments in 69 countries)
Governance and Strategy development			
1. Legal Framework	The Legal Framework is a key area of the governance architecture for debt management. The legislation sets out the objectives of debt management as well as the power to borrow and the accountabilities that ensue.	Since 2000, many emerging and developing countries have reviewed their legal frameworks for debt management and consolidated them into a Public Management Debt law. (Turkey 2002; Tanzania 2003; Thailand 2005; Dominican Republic 2006; Mauritius 2008; Sierra Leone 2011; Jamaica 2012). Assistance is provided by The World Bank, the Commonwealth Secretariat and sometimes multilateral and bilateral donors. The drafting of laws by Attorney General Offices (or equivalent) and the enactment process tend to be lengthy. Of late there has been demand to review secondary legislation (statutory rules and regulations) as well.	54.2
2. Managerial Structure	This area concerns the managerial structure for central government borrowings and debt-related transactions as well as arrangements that are in place for the preparation and issuance of loan guarantees.	This area has improved over the years and the separation between the political level and debt management decisions is, on the whole, clearer. Political interference does sometimes occur especially for projects of strategic importance. This area is related to the legal and institutional arrangements that are in place. Sensitisation as to the role of Parliamentarians in public financial management and borrowing could assist.	61.1
3. Debt Management Strategy	This thematic area includes the quality of the debt management strategy and arrangements for the decision process, updating and publication of the strategy.	Since the launch of the MTDS in 2009, many countries have been trained in its methodology and in applying the tool. Most of those interviewed agreed that few countries are able to undertake or update a debt strategy on their own. Some countries also publish the Strategy but do not implement them.	18.1

4. Evaluations of Debt Management Operations	This area deals with the level of disclosure (e.g. in an annual report or its equivalent) of government debt management activities, the evaluation of outcome against objectives and compliance to the debt management strategy.	Although many countries publish debt statistical bulletins, few produce an annual report on the activities related to government debt and undertake an evaluation of outcomes against objectives and the level compliance to the strategy.	44.4
5. Audit	This covers the frequency of internal and external audits of government debt activities and policies and operations as well as the publication of external reports and the commitment to address the outcomes of the audits.	Auditing tends to be weak in developing countries in general. Audits are often undertaken with a considerable lag and recommendations are not always acted upon. INTOSAI has been leading the work in this area by raising awareness and conducting workshops in the audit of debt records for accountants/auditors. Other capacity building organisations are reacting to the situation: one of UNITAR's e-learning courses in debt management includes a module on the Audit of Public debt. WAIFEM will be conducting a Regional workshop on Audit of Public Debt Management in June this year.	6.9
Coordination with macroeconomic policy			
6. Coordination with Fiscal Policy	This functional area considers the coordination with fiscal policy through the provision of accurate and timely forecasts on central government debt service under various scenarios. This area also covers the availability of key macroeconomic variables and the frequency debt sustainability analysis are carried out.	This functional area effectively covers the coordination that exists between those responsible for macroeconomic, fiscal policy and debt policy. An important exercise is the conduct of Debt Sustainability Analysis (DSA) and the sharing of the results. Countries located in regions where there is a regional capacity building institutions are well covered but other areas less so.	41.7
7. Coordination with Monetary Policy	This functional area is concerned with the clarity of separation between monetary policy operations and debt management; the amount of coordination and information sharing on current and future debt transactions and the central government's cash flow. The extent to which borrowing from the Central Bank is possible is also included.	Progress has been made in this area and central government borrowing from the Central Bank is much less common. Some countries differentiate between instruments used for short term borrowing and those used for open market operations. Where the Central Bank acts as an agent of the Ministry of Finance, more and more countries have setup Agency Agreements. In some countries, however, the relationship between the Ministry of Finance and Central Bank may not be very good, hence information exchange can be restricted.	62.5

Borrowing and Related Financing Activities			
8. Domestic Debt Borrowing	This thematic area covers domestic market borrowing including the extent to which market-based mechanisms are used to issue domestic debt; the existence of a borrowing plan for T-bills and T-bonds; and the preparation of an aggregate plan. The availability and the quality of documented procedures for borrowing in the domestic debt market is also important.	All interviewees agree that progress has been achieved in relation to the market for Treasury Bills and Notes. Countries are improving market mechanisms and in the process of extending bond maturities. Others are working towards developing the secondary market and establishing yield curves. This is recognized to be an area that will take time to evolve. Apart from the Bretton Woods institutions, The US Treasury OTA is the main agency assisting countries in this area through the placement of resident advisers.	74.1
9. External Debt Borrowing	This thematic area covers how the terms of external borrowing are evaluated and the availability and quality of documented procedures. It also includes the availability and degree of involvement of legal advisers before external loans signed.	The situation regarding this area varies from country to country. While the assessment of loans from official sources is straightforward (e.g. using grant element calculation etc.) new types of loans can be more difficult to evaluate. As discussed in the text, there seems to be a lack of capacity in evaluating commercial instruments such as Eurobonds, especially in comparison with domestic instruments. Specialist knowledge in legal aspects of financial products is lacking in many countries.	19.7
10. Loan Guarantees, On-lending and Derivatives	This area deals with the availability and quality of documented policies and procedures for the approval and issuance of loan guarantees and on-lending agreements by the central government as well as the existence of a debt management system to handle derivatives and the availability of documented procedures for derivatives.	This function is weak across countries. As discussed in the text, few countries have adequate procedures in place for the granting of government guarantees to state enterprises and other public bodies. While some countries have developed home-grown methodologies and frameworks (e.g. South Africa) these are not always applicable to other countries. On-lending is also an area which is not well addressed and which can be another cause of contingent liabilities. Developing countries do not in general make use of the derivatives market although it is fair to assume that this is just a question of time.	29.9

Cash Flow Forecasting and Cash Balance Management			
11. Cash Flow Forecasting and Cash Balance Management	This functional area relates to the effectiveness of the debt entity to forecast and manage the aggregate level of cash balance as well as to integrate this information with the domestic debt borrowing programme.	Several countries are in the process of setting up Treasury Single Account (TSA) and improving their cash flow forecasting. These projects tend to be implemented under wider Public Financial Management (PFM) reforms.	19.4
Operational Risk Management			
12. Debt Administration and Data Security	This functional area is about the availability and quality of documented procedures for debt data recording and validation, storage of agreements and other records, the processing of debt service, access to a central DRMS and the frequency and security of off-site data backups	Many countries have put in place Procedures Manuals covering the borrowing cycle. Given the availability and drop in the price of scanners, countries are now able to keep digital versions of loan agreement and related documentation. One of the main debt recording and management system even allows these scanned copies to be attached to the debt database. In general countries take backups and keep copies off site. However, few countries have comprehensive Contingency Plans in place. With the fall in the price of storage media and the advent of new technologies (RAID; Cloud computing) and better awareness, this area should improve in the future.	15.3
13. Segregation of Duties, Staff Capacity, Business Continuity	This functional area encompasses the segregation of duties of some key functions as well as the presence of a risk monitoring and compliance function, staff capacity and HR management as well as the existence of an operational risk management plan including business continuity and disaster recovery arrangements	Recommendations on institutional arrangements normally include advice on appropriate structures that incorporate segregation of duties. The risk monitoring and compliance function often does not exist as this is a new area and may not exist in the public sector. Unless they are separate (as an independent entity or as an agency of the Ministry of Finance) Debt Departments will inevitably inherit the existing HR management systems and work culture of the parent Ministry. Business continuity and disaster recovery is a new area for many countries but is gaining ground.	5.6

Debt Records and Reporting			
14. Debt Records	This function deals with the completeness and timeliness of debt records for central government debt as well as that of data held on holders of government securities in a Registry System.	The TFFS sets the standard for the definition, statistical coverage and methodology for external and public sector debt. This area is further catered for by the two main providers of computerised debt recording and management systems - ComSec and UNCTAD. A fair amount of effort is spent on ensuring that the debt databases of countries are complete and accurate. The DRMS have tools to help track data entry errors and methodologies for debt data verifications/audits have been developed. Some countries still suffer from data quality issues due to staff turnover. Neither ComSec nor UNCTAD offer Registry Systems (also referred to as Central Depository Systems) and a number of countries use the "Book Entry System", a privately distributed software. Some countries have developed their own Registry Systems but this can be expensive.	48.6
15. Debt Reporting	This function includes the contractual reporting requirements of central government debt, non-financial public sector debt and guarantees to all domestic and external entities	Both Comsec and UNCTAD have been encouraging countries to publish statistical debt bulletins and have provided relevant training. Several countries now publish annual bulletins and in some cases, even more frquent updates. (61% of DMFAS and 3 CS-DRMS user countries produce annual debt bulletins in 2014). Both organisations also encourage countries to report electronically to the World Bank Debtor Reporting System (90% and 70% of DMFAS and CS-DRMS user countries respectively reported data to the DRS in 2014) as well as to the SDDS and GDDS.	22.2

(1) This column draws on DeMPA training documentation (World Bank).
Source: World Bank. Last column shows average DeMPA scores (C or higher) by DPI based on 86 country assessments in 69 countries (also illustrated graphically in Figure 4)

5.1 Main constraints to debt management capacity building

Our discussions with the interviewees revealed there are a number of recurrent constraints affecting the successful implementation of debt management reforms and the achievement of sustainable PDM capacity. These are discussed below in no particular order. Again the same *caveat* expressed at the beginning of this Section concerning the risk of generalisation applies.

- **Staff retention in countries**. This remains a major challenge in practically all developing countries. It results in a loss of institutional memory and a need for constant re-training. The problem is attributed to salary differentials between the public and private sectors in developing countries; poor HR structures and management in the civil service; and a lack of recognition of the importance of debt management. One of the interviewees mentioned the case of a debt management entity that operates a rotation policy, including that of specialists. This has negatively affected the performance of the Middle Office.

  It was pointed out that the creation of a separate entity for debt management has, in some cases, addressed this problem (Nigeria). External support to top up local salaries of key staff (including that of debt managers) has also been used with good results in one West African country (Sierra Leone), although this may not be sustainable in the long-term. One interviewee noted that staff promotion can also be a reason for staff movement in some countries and this is not necessarily a negative outcome.

  One possibility would be to make training conditional to staff being retained in the debt office/department at least for a certain period of time. This may not completely prevent officers from leaving but it may mitigate the problem. Another possible solution is the development of HR structures, with adequate career path, training opportunities etc. thereby raising the level of debt management. The development of self-learning material to quickly bring new staff on board is also another mitigating option.

- **Funding issues**. As discussed in **Section 4.1**, there seems to be a bottleneck in the implementation of downstream activities resulting from DeMPA. This was confirmed by the majority of the people interviewed although the WB attributed the lack of progress in the implementation of RPs to low stakeholder buy in, which is discussed below. Our conversation with a country official (Bhutan) did confirm, however, that it can take a long time for countries to identify funding for building capacity in debt management.

- **Lack of stakeholder buy in**: Some interlocutors felt that in certain countries, lack political will and low stakeholder buy negatively impact on debt management reforms. Resistance to change, institutional rivalry, and a lack of capacity in Ministries of Finance were other reasons mentioned.

  One way this issue could be addressed would to require the countries to demonstrate their commitment to implementing the required changes at the beginning of any technical assistance project, as we suggest DFID should contemplate doing (**Section 6**).

- **Poor project/programme design:**

  Many of the interviewees felt that there is a tendency to equate training with capacity building and that the distinction between **human capacity building** - which aims at imparting knowledge and skills through training - and **institutional capacity building** – which, in the debt management context, involves the setting up of appropriate legal, regulatory and institutional framework for debt management – was lacking. Institutional capacity building takes much longer to implement but it also ensures the sustainability of reforms.

  A number of interviewees also felt that in some cases, the design of debt management project/programmes are weak. Terms of Reference are at times written by non-experts and this is reflected in either a lack of precision of requirements or unachievable scope.

This discussion about constraints generated much debate with those interviewed. The meaning of capacity building itself was questioned and the different modes of delivery (short-term and intermittent interventions by consultants versus the placement of long-term advisers) discussed. Most of the capacity building providers we talked to felt that the use of long-term advisers was not the optimal mode of delivery (except in some specific situations where there is no local capacity e.g. post conflict countries). Short-term interventions managed by a third party allowed the use of experts for specific tasks while providing continuity at the project management level. The importance of fully involving local counterparts was also mentioned as a key factor for successful capacity building projects. Many of these suggestions also stem out of DFID's experience in Nigeria as discussed below.

6. Conclusion and recommendations

During the course of discussions on the TOR for this assignment, we were asked to consider the assistance provided by DFID to Nigeria between 1998/89 to 2013 so as to determine whether lessons learnt could inform the organisation's future involvement in debt management capacity building. This analysis, based on the review of various documents related to the project, is provided in **Annex 5**. Indeed, some important lessons can be learnt that should guide DFID's future debt management projects. These are relevant to all the options we propose below.

Having carefully considered various options that DFID could adopt to further contribute to capacity development in the area of debt management should funding become available, we have narrowed these down to **three** options.

Each of these three strategic choices have their own advantages and disadvantages and these are pointed out in the text. In the final analysis, a choice can be made by considering the amount of funding that is available, the time horizon that is envisaged and by aligning the expected results and impact of the project with DFID's own corporate goals. The options are also not mutually exclusive. A full needs assessment should be undertaken for the chosen option/s to inform project design.

The three options are as follows:

6.1 Option 1: DFID to set up a project/fund to complement the work of the DMF by financing downstream activities in its priority countries.

As discussed in **Section 4**, it is felt that an issue in the design of the DMF programme is the fact that downstream activities related to the implementation of the Reform Plans cannot be financed by the DMF. To date, 12 DFID priority countries have completed Reform Plans and it is likely that more will follow. It is not clear how these reforms have been or will be funded.

DFID could set up a project/fund to assist its priority countries fund debt management reforms arising from DMF's diagnostic work. The Programme, which would be demand driven, would involve a number of activities including:

- Assessing the countries' readiness to implement the Reform Plan;
- Discussing priorities with country authorities;
- Breaking down the Reform Plan into an Action Plan so as to sequence the reforms;
- Designing individual country projects with identified activities, tangible outputs and outcomes, a set of indicators to monitor progress and drawing up budgets;
- Engaging consultants to deliver specific advice and monitoring their work;
- Assessing the knowledge and skills gap and organising required training; and
- Managing each country project within DFID's results based management framework.

Box 2: Assisting countries submit proposals in a demand driven context

It was rightly pointed out to us that countries with weak capacity may find it difficult to articulate their needs when submitting a project request and may therefore be penalised in a "demand driven" process. This is a valid argument. However, weaknesses in putting forward a project proposal and lack of commitment are two different issues. Once a country's commitment has been ascertained, DFID could assist countries (e.g. by funding independent assistance as part of the project) to put together a project proposal. To avoid any possible conflict of interest, those assisting with project preparation should not be allowed to get involved with the implementation of reforms in that particular country.

Such a project/fund would need to be managed independently. It would be important to ensure that only countries that can demonstrate a strong commitment to implementing reforms can participate in the programme. This option would call for a long-term commitment by DFID over an estimated three to five years, subject to available funding and demand.

DFID has proven that it can bring about sustainable change in debt management even in the most complex and challenging environment. The work undertaken in Nigeria is one of the most successful debt management reform projects ever to be carried out. DFID should be able to replicate this success in other countries, if the right conditions exist. **Annex 5** provides a summary of the more important lessons that can be drawn from the Nigeria "case study" and which can inform the future management of similar projects.

As this option follows from DMF activities, DFID should engage with the World Bank, IMF and other providers so that there is a smooth transition and, eventually, feedback between the diagnostic and the reform implementation phases. Coordination with any downstream work that may be under consideration by other institutions would be particularly important in order to avoid any duplication.

6.3 Option 2: DFID to initiate a new programme in "Policy Design and Negotiation for Debt Sustainability".

This new and innovative programme would still complement the work being undertaken by the DMF and other providers of debt management capacity building. However, rather than addressing the long-term "systemic" issues of debt management, it would focus on the fiscal risks that relate to debt sustainability identified in this Report that threaten debt sustainability in the short and medium-term.

The capacity building programme would target three main areas[26]:

- **Domestic and External Bond issuance** (including Eurobonds but also other types of external bonds such as diaspora bonds and domestic bonds). This would cover the analysis and comparison of external and with domestic funding; legal considerations[27]; placement options; negotiation; pricing and issuance.
- **Contingent Liabilities** including research and development of best practice guidelines in the granting of government guarantees and their valuation in a developing country context; the calculation and charging of guarantee fees; the setting up of sinking funds to mitigate guarantee risks; the management of risks arising from on-lending from central government to parastatal bodies; and
- **PPPs** with particular reference to the performance guarantees that create contingent liabilities and the link with debt sustainability analysis.

The programme would respond to ODI's suggestion for "a whole of government approach" (ODI, 2014), i.e. joining the dots to ensure that policy making across government gives due consideration to fiscal risk and its impact on debt sustainability. The programme would target the following thematic areas:

Managerial structure (thematic area 2); debt management strategy (thematic area 3); coordination with fiscal policy (thematic area 6); domestic debt borrowing (thematic area 8); external debt borrowing (thematic area 9); contingent liability issues arising from loan guarantees and on-lending (thematic area 10).

Such a programme could be implemented within a shorter time frame – two to three years - than **Option 1** and achieve results fairly quickly. It would be delivered in close partnership with other capacity building providers, including the regional capacity building organisations, in the following way:

- Sensitisation seminars for Parliamentarians and senior officials to explain the risks linked to accessing international capital markets, providing guarantees and engaging in PPPs investment deals;
- The development of methodologies and frameworks based on case studies and live data. These should be fed back to software providers (ComSec and UNCTAD) and the IMF/WB so that they can be incorporated in debt analytical systems and possibly in the DSA and MTDS frameworks;

[26] Other areas could be added to cater for specific group of countries. For example, a component on asset and liability management for resource rich countries could be added given that a number of countries on the DFID priority list of countries have recently discovered oil or other minerals (e.g. Uganda, Ghana, and Sierra Leone).
[27] In collaboration with the ALSF.

- In-country and Regional technical workshops for practitioners in the areas mentioned above; and
- Country assistance and advisory services to implement required policy reforms.

Towards the end of the programme, training material and other resources could be put in the public domain as e-learning courses and toolkits, which regional capacity building organisations could continue to disseminate and occasionally update. Countries wanting to participate in the project would need to demonstrate ownership and a strong commitment to make the necessary changes to their policy determination process.

One of features of the second phase of the DMF is the partnership between the World Bank and the IMF. We were informed that the latter is currently providing advice on "the pros and cons of Eurobonds", domestic debt market development, risk management etc. Given the IMF's focus, we do not think that the scope of this assistance and the way it is being delivered is similar to what we are proposing above. However, it will be important at the project design stage to hold discussions with the WB and IMF to ensure that there is no duplication but synergy between their work and the new DFID programme that is being proposed.

6.4 Option 3: DFID to "scale up" its assistance to Nigeria regarding sub-national debt

DFID has been assisting Nigeria at the state level as part of the SPARC programme which was set up in 2008. The seven-year programme is one of five DFID programmes aimed at "helping Nigeria use its resources more efficiently and effectively."[28] SPARC focusses on "technical aspects of public policy and strategy, public sector financial management, public service reforms and supports central ministries" and is being implemented in ten states. The project builds upon the success achieved by DFID in the area of debt management in Nigeria which is described at **Annex 5**.

While SPARC deals with wider PFM issues, the debt component of the project aims to develop sound debt management capacity at the state level so as to prevent an unsustainable debt situation arising - which would ultimately have severe financial repercussions at the national level. Initial efforts, coordinated by the Nigeria Debt Management Office, have focussed on:[29]

- The promulgation of debt management and fiscal responsibility legislation at state level;
- The creation of debt management departments in respective states;
- The development of templates and guidelines to promote prudent borrowing policies;
- The provision of training in sub-national debt management; and
- The reconciliation the debt of the states and publication of state debt data.

Bearing in mind the scale of this initiative, its complexity and the different levels states are at in terms of capacity, results achieved so far are laudable. In particular:

[28] Information and quotes about the SPARC programme are from the programme website at: http://www.sparc-nigeria.com/index.php

[29] Information about the current status of sub-national debt in Nigeria is based on discussions with two institutions that have been involved in the project and a confidential document entitled "Report on DMO activities at the sub-national level from 2007-date," which is yet to be published.

- As at mid-2013, 18 states (or 50%)[30] had passed either a debt management or fiscal responsibility law;
- All states have established debt management departments; and
- Data on the debt stocks of all states are regularly complied and published on the DMO's website.[31]

However, in spite of the progress achieved, it is felt that, overall, sub-national debt management in Nigeria remains weak.

- Many of the newly created state debt management departments face both human resources and IT equipment challenges;
- While progress has been made in reconciling debt data of the states, this has been more of an accounting exercise and even then, the timeliness and quality of this data has been variable and a real challenge for some states; and
- Only four states have implemented computerised debt recording systems (using CS-DRMS)[32] and have compiled databases that could be used for debt sustainability and other analysis.

With only one or two exceptions, states therefore do not have debt recording and management systems in place, they do not have the ability to conduct debt sustainability analysis and there are no formal debt management strategies in place. There are several reasons that call for faster progress, the main two being:

- States continue to borrow on the domestic market, both from commercial banks and by raising bonds, at very high interest rates and administrative costs. This is inevitably resulting in an inefficient use of financial resources; and
- Given the large number of states, it is important to achieve some early results in the more advanced states as this is likely to cause a "demonstration effect", encouraging other states to follow suit.

The third option for DFID is therefore to step up its efforts in assisting Nigeria in the area of sub-national debt. Given the scale of the problem and bearing in mind other considerations, we would recommend the adoption of a "coordinated multi-institutional approach" that would involve a number of partners including the Nigeria DMO, WAIFEM, whose experience in capacity building would be key in such a project, the Commonwealth Secretariat[33] and possibly a private service provider. The DMF should be co-opted to evaluate capacity at the beginning and end of each individual project using the sub-national DeMPA. Other development partners could also be brought on board if felt appropriate[34]. The project would be coordinated and steered by a committee led by DFID or a designated institution.

This option should be considered bearing in mind DFID's overall involvement in Nigeria including through the SPARC project. Should this project be closing at the end of its seventh year, this Option would need to be implemented as a new project focusing exclusively on sub-national debt. The project could be implemented in phases as assistance to states is deepened and broadened.

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[30] Another source indicates that 22 states had done so by 31st December 2012.
[31] The latest figures produced are up-to-date as of 31st December 2014.
[32] These are Adamawa, Bauchi, Cross River and Kano states.
[33] Given that the DMO uses CS-DRMS, a strong case (based on compatibility of data format and economies of scale) could be made to extend the use of the software to states. In addition, ComSec has experience working on sub-national debt in six states India and some lessons learnt may be relevant.
[34] Canada has funded the implementation of CS-DRMS in Bauchi state.

Annex 1

Terms of Reference

Analytical Work on Debt Management Capacity Building

Introduction

The Department for International Development (DFID) leads the UK's work to end extreme poverty. As part of this objective, DFID places significant value on working towards debt sustainability in developing countries.

This terms of reference covers analytical and research work that would add value to DFID's thinking and policy development relating to debt management capacity building in developing countries, and how DFID could potentially make a positive impact in this space.

Objective

To deliver an analytical/research piece on debt management capacity building in developing countries, with a focus on DFID's priority countries.

Requirements

There is 1 deliverable:

1) **Produce a paper on the current situation of debt management capacity building initiatives in developing countries, and the remaining gaps.**

- The paper should cover the following points:
    - Which areas of debt management capacity building, and which regions of the world, are already well-covered by existing debt management capacity building initiatives?
    - Which areas of debt management capacity building, from the strategic level down to the implementation level, are being less well-covered by existing debt management capacity building initiatives?
    - With a focus on DFID's priority countries, what are the key remaining gaps in terms of ensuring long-term debt sustainability that could feasibly be met (to at least an extent) by new or expanded debt management capacity building initiatives?
    - What are the key constraints in ensuring full success of existing debt management capacity building initiatives (e.g. financial? the availability of experts? lack of implementation capacity in recipient countries? other?)?
    - Is there a need for extra donor support in this area, and if so, on which activities? And are there suggested support measures that are likely to be most effective?

- The paper should be roughly _____ pages in length.

- Delivery will be to DFID's IFI Strategy Team, with a final deadline of _____. A draft paper should be delivered by _____, to be commented on by DFID staff in preparation for the final draft.

- We expect this deliverable to include _____ full days of work.

Performance requirements

The provider will liaise with DFID's IFI Strategy Team during the period of work, and where requested and reasonable, will share methodology and background information with DFID staff.

Reporting

Reporting will be to DFID's IFI Strategy Team (Lindsey Craig, Faten Mohamed, Lara Lambert).

Timeframe
The deliverable has a delivery deadline set out above.

Annex 2

List of people interviewed

Name	Designation	Organisation
Bakanova, Marina	World Bank, Senior Country Economist	World Bank Country office, Tajikistan
Corkill, John	Debt Adviser	Crown Agents, Sutton, UK
Isioma Usiade, Monday	Assistant Director	DMO, Abuja, Nigeria
Kamal, Babar	Programme Coordinator	UNITAR, Geneva, Swizerland
Macamo, Piedade	Deputy Director, National Treasury	Maputo, Mozambique
McLaren Pamella	Adviser (Debt Management)	Commonwealth Secretariat, London, UK
Martin, Matthew	Director	Development Finance International, London
Musa, Baba	Director, Debt Management Dpt.	WAIFEM, Lagos, Nigeria
Otieno, Raphael	Head, Debt Management	MEFMI, Harare, Zimbabwe
Prasad, Abha	Senior Debt Specialist	World Bank, Washington, USA
Roy, Arindam	Adviser and Head, DMS	Commonwealth Secretariat, London, UK
Sangarabalan, Sanga	Consultant	London, UK
Storkey, Ian	Consultant	Storkey and Co., Wellington, New Zealand
Teeling, Gerry	Chief, DMFAS Programme	UNCTAD, Geneva, Switzerland
Tshering Dorji	Head, Debt Management Department	Bhutan
Useree, Dev	Director, Debt & PFM	Crown Agents, Sutton, UK
von Koch, Debra	Director,	United States. Department of Treasury - Office of Technical Assistance, Washington DC, USA
Williams, Mike	Consultant	London, UK

Annex 3

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Annex 4

DMF activities in DFID priority countries

	Missions			In-country Training	
DFID Priority List	**DeMPA Assessment undertaken**	**Reform Plan Assessment undertaken**	**MTDS Mission**	**DeMPA In-countryTraining**	**MTDS In-country Training**
Afghanistan	2010				
Bangladesh	2013	2009	2010		
Burma					
Democratic Republic of Congo	2009	2012			
Ethiopia	2013	2013	2012/2014		
Ghana	2012	2013	2010	2011/2012 (SN)	2011/2013
India					
Kenya	2014		2009	2012	
Kyrgyzstan					
Liberia	2009	2012	2013		
Malawi	2009	2011	2010/2013		
Mozambique			2010/2014		
Nepal	2010/2014				
Nigeria	2011/2014 (SN)		2010/2011	2013 (RW)	
Occupied Palestinian Territories					
Pakistan	2010	2014 (SN)			
Rwanda			2011		2009
Sierra Leone	2009	2010	2013		
Somalia					
South Africa					
Sudan	2012	2013			
South Sudan	2010				
Tajikistan	2011	2011	2012		
Tanzania	2010	2012	2011/2013		
Uganda	2014 (SN)		2013 (BL)		
Yemen	2010				
Zambia	2011	2012			
Zimbabwe	2011	2011			
SN: Sub-national					
BL: Base line					
RW: Regional Workshop					

Source : Compiled by the consultant based on DMF sources.

Annex 5

Lessons from DFID's Debt Management Project in Nigeria[35]

DFID's debt management project in Nigeria is one of the most successful capacity building intervention in the area of debt management that we are aware of. The project was implemented in three phases over fifteen years – from 1998 to 2003 – at a cost of GBP8.0 Mn.

The project achieved a number of remarkable outcomes including:

- The passing of debt management legislation;
- The establishment of an effective public debt recording and management system;
- The establishment and operation of the Debt Management Office in 2000; and
- The achievement of an historic deal with the Paris and London Clubs in 2005.

The results achieved have proved sustainable and the Nigeria DMO is today one of the strongest DMO in Africa and is even assisting other countries on the continent. The reforms paved the way for the development of Nigeria's domestic government bond market which has seen local bonds being included in major emerging market bond indices.

One could argue that Nigeria was a "special case". There were some important factors that improved the visibility of the reforms including: Nigeria's economic importance in West Africa; the size of its debt at the time and the history of successive rescheduling through the Paris and London Clubs; and the potential the country had to develop its domestic debt market etc.

However, at the project management level, there are definitely important lessons that DFID can draw. The top five are:

1. T**he political will to see the reforms through** was, in our view, the most critical determinant of success;
2. **The promotion of country ownership** whereby assistance was provided to support home grown strategies;
3. **The time scale.** Continuous support was provided over fifteen years. DFID's decision to provide the flexibility needed to adjust programme priorities and activities was also crucial, especially over such a long period of time;
4. The 2005 debt deal provided a **quick and early win** that was needed to lend credibility to the reforms that were being implemented; and
5. **The involvement of international partners** and the adoption of best practice played a major role but there was flexibility in **adapting these practices to suit the local environment**.

All the five lessons mentioned above are relevant to the options we have provided in **Section 6**.

[35] This Annex draws on (Dora Akunyili, Menachem Katz and Alex Duncan, 2013) as well as various project documents provided by DFID and which are listed at Annex 3.