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Africa Debt Monitor Analysis

More debt reporting, more marketable debt

CONTENTS

1. INTRODUCTION

OVERVIEW

The Africa Debt Monitor (ADM), launched in September 2019, provides a unique platform for sharing information on African central government debt and debt management policies, practices and institutional arrangements. It offers multiple tools for cross-country peer-learning on public debt issuance and management and provides policymakers with additional insight into the capacity and capability of their debt offices to manage debt and associated risk.

This report forms part of the ADM Analysis series, a set of reports which look into trends in debt management in Africa using quantitative and qualitative information available on the ADM. The other two reports available in 2019 are ‘Three C’s for DMOs: Co-ordination, clarity and consistency’ and ‘Primary-dealer systems and stock exchanges: Gateways to local market development’. Additional reports will be produced annually as a complement to the annual Africa Debt Monitor data update.

Comprehensive public debt reporting provides policy-makers with the arsenal of information they require to limit the risks associated with acquisition of unsustainable debt. It provides creditors with reliable information on the use of their funds and progress of the annual borrowing plan, facilitating market confidence, longer maturities and lower borrowing costs (see, for example, IMF 2003; Hameed 2005; Parry 2007; Glennerster & Shin 2008; Arbatli & Escolano 2012; Bastida, Guillamón & Benito 2017). When presented in an accessible format, information-sharing on debt management, also ensures that the impact of borrowing on citizens is understood, allowing them to hold policy-makers accountable for funding decisions, contributing to fiscal sustainability.

This report details another reason why debt management offices (DMOs) should emphasise information-sharing and reporting. Using data from the Africa Debt Monitor (ADM), it provides preliminary evidence that there is a significant correlation between more transparent DMO reporting and more marketable government debt. In addition, effective information-sharing appears correlated to more of that marketable debt being long term.

Using data points on marketable debt and institutional practices, provided by participating governments, it is possible to identify patterns indicating that reporting is a key tool for debt managers in their efforts to increase the sustainability of debt. Future iterations of the ADM will allow for more substantial causal analysis and the processes by which these benefits of information-sharing and reporting emerge.

The report proceeds as follows: the second section defines marketable debt and its importance for fiscal sustainability, particularly in the context of secondary markets for government debt. The third section links reporting to transparency. It reviews the numerous ways DMOs may increase transparency to improve policy-makers’ awareness of and accountability for the risks associated with borrowing. The fourth section discusses the findings of the ADM survey and provides evidence that more reporting is associated with more marketable debt, particularly more long-term marketable debt. The fifth section highlights the particular importance for marketable debt of one form of reporting – the medium-term debt strategy (MTDS). The sixth section concludes by summarising the relevance of these findings for DMOs.

2. MARKETABLE DEBT AND SECONDARY MARKETS

Debt managers possess a variety of tools for increasing the effectiveness of public debt management, contributing to the government's objective of sustainable debt. One of these tools is increasing the ratio of marketable debt (financial instruments that can be traded after the initial debtor–creditor transaction) to non-marketable debt (IMF 2011).

For governments, specifically, marketable debt refers to government obligations that primary-market players can turn around and sell to other investors on a secondary market. In practice, primary dealers, such as domestic banks, are typically the main intermediaries through which these marketable instruments create and reach a secondary market. While not always a prerequisite for secondary-market development, it is notable that the 60 per cent of CABRI ADM respondents that have a formal primary-dealer system see some improvements in secondary-market activity (CABRI 2019a).

While non-marketable debt tied to special purposes or projects serves an important macroeconomic and development function, it does not provide material for secondary-market operations. A greater share of marketable debt reflects the presence of a variety of instruments with which a secondary market can emerge and deepen (World Bank & IMF 2001). Marketable debt, therefore, is related directly to liquid secondary markets. By providing material for secondary markets, governments obtain tangible benefits. Most fundamentally, secondary markets help to stabilise government finances and aid the work of debt managers. This is true in terms of both prices and maturities.

Firstly, marketable debt that contributes to secondary-market development may lower the rates governments pay when issuing debt. Because 'investors will be willing to accept lower yields if they are able to easily unwind their positions when they wish' (Arvai & Heenan 2008: 6–7), marketable debt provides instruments that enhance the flexibility of primary-market investors. In other words, flexibility means that the rates governments pay should reduce over time because investors can exit their positions in a secondary market.

Secondly and relatedly, marketable debt that contributes to secondary-market development should stimulate appetite for longer-term maturities among primary dealers. Following the same logic as above, having access to instruments around which a secondary market can deepen should help 'provide an exit mechanism for investors in medium- and long-term securities, [which permits] governments to issue longer-term debt' (World Bank 2007: 49). By providing material around which secondary markets can operate, marketable debt should increase the average maturity of government bonds because primary dealers will be more open to longer-term debt if they can exit their position via secondary markets over the lifetime of the debt.

By providing material for secondary-market development, marketable debt contributes to lower borrowing costs and longer maturities

These price and maturity gains are central to effective debt management and a sustainable debt portfolio. Marketable debt is, thus, a key tool for debt managers because it aids the development of the secondary markets that provide these gains. However, secondary markets are difficult to develop. Producing the right mix of marketable instruments is not the only factor. Auction infrastructure, voluntary participation, legal frameworks that protect investor autonomy and decision-making, and an efficient clearing system are all important for well-functioning secondary markets (Fry 1997). Other CABRI ADM research provides evidence of these benefits in the African context (CABRI 2019a). However, many of the pre-requisites are not easily or independently created by debt managers.

Therefore, the question becomes: are there simpler tasks or 'low-hanging fruit' that DMOs can undertake to enhance demand for marketable debt and aid secondary-market development? Less-often discussed is the importance of effective information-sharing in secondary-market development. The remainder of this report considers whether, and how, information-sharing and reporting might increase the amount of marketable debt a government can issue, with an eye to deepening the secondary market and obtaining the stabilising benefits of marketable debt and secondary markets described above.

3. TRANSPARENCY AND REPORTING

CABRI has long found important benefits in general budget transparency:

> *the existence of effective transparency and accountability mechanisms is critical to ensure that governments fulfil their obligations and promises. Without transparency and accountability, citizens cannot track the use of resources and the delivery of services promised in the budget, let alone hold government responsible. The resulting level of mistrust can go as far as undermining social stability and economic growth. Therefore, budget transparency and accountability are intrinsic elements of good public financial governance, and form a key part of the public financial management reform agenda.* (CABRI 2019b)

Debt transparency is a crucial component of general budget transparency. As detailed in the introduction, the focus of the current discussion is on how transparent public debt management 'facilitates secondary market activity [and] increases demand for government securities, as issues become more predictable and are better designed to meet investors' preferences' (Arvai & Heenan 2008: 5).

In practice, producing and sharing debt information 'such as that concerning the annual borrowing requirement, how the government plans to raise debt, which financial markets will be targeted and what instruments are to be used ... [r]egular updates (at least once a month) on the size of the debt portfolio, interest and redemption payments and the progress made on the annual funding programme' are important examples of what transparent debt operations may look like (Krynauw n.d: 5).

This makes reporting crucial for transparency. Importantly, these forms of reporting are relatively feasible. For example, reporting on current debt positions, medium- and long-term forecasts and debt-issuance plans does not require major institutional changes or an unusual amount of political will, but can still provide major transparency benefits valued by primary- and secondary-market players alike. Moreover, while somewhat politically and practically challenging to develop (Kopits 2013), all but two of the ADM respondent countries have their debt management activities audited. In short, many forms of reporting are available to DMOs seeking to increase debt transparency.

CABRI's new ADM provides new insight into the status of debt reporting across African governments. To be sure, the ADM is a sample and there is probably bias towards transparency among the countries that participated in the ADM survey. Nevertheless, the ADM provides important information on the following 10 reporting practices across 20 participating African DMOs:

#01
FOLLOW INTERNATIONAL REPORTING STANDARDS

#02
LEGALLY MANDATED INTERNAL REPORTING REQUIREMENTS

#03
REGULAR UPDATES

#04
ANNUAL DEBT REPORT

#05
DEBT MANAGEMENT STRATEGY

#06
DEBT SUSTAINABILITY ANALYSIS (DSA)

#07
STATISTICAL BULLETIN

#08
DEBT-MANAGEMENT ACTIVITIES ARE AUDITED

#09
PUBLICISED AUDITS

#10
PUBLIC PRESENTATION INTERVALS

The CABRI ADM provides a snapshot of the extent to which these 20 African DMOs undertake these forms of reporting. It is reasonable to conclude that the more of these reporting practices a DMO undertakes, the more transparent are the DMO and government debt. The question becomes whether more transparent reporting and oversight influences national debt profiles. The next section investigates this question in the context of marketable debt, asking whether there is a correlation between transparent reporting and marketable debt.

4. FINDINGS AND ANALYSIS

Do more transparent governments have more sustainable debt portfolios? This report asks a specific version of this question: do countries that report more also have more marketable debt? The link between the two is based on the idea that information-sharing is expected to increase primary- and secondary-market demand for marketable government debt, lowering interest rates and lengthening maturities.

The CABRI ADM provides evidence that the number of reports a DMO produces is correlated to more marketable debt. Additionally, more of that marketable debt is long term, reducing the refinancing risk facing governments and increasing the flexibility with which primary-market players can act in the secondary market. This section summarises country responses in the ADM survey and charts the correlations seen between more transparency and more marketable debt. Although the ADM is new and does not yet provide sufficient data points to test causal effects, the patterns identified here suggest plausible links between debt transparency and marketable debt. It is also worth noting that these preliminary conclusions, despite the relatively large sample of participants, may not be fully reflective because the countries more inclined to participate may be those more inclined, in the first place, to report comprehensively.

The CABRI ADM asked countries to respond to questions about their reporting standards. This report focuses on ten forms of reporting DMOs may or may not undertake. To aggregate qualitative responses for purposes of quantitative analysis, country responses were coded according to the following rules:

The CABRI ADM provides evidence that the number of reports a DMO produces is correlated to more marketable debt

#01
FOLLOW INTERNATIONAL REPORTING STANDARDS. For this form of reporting, countries are coded as 1 if they follow any internationally recognised reporting standard, and 0 if not.[1]

#02
LEGALLY MANDATED INTERNAL REPORTING REQUIREMENTS. For this form of reporting, countries are coded as 1 if domestic law requires reporting, and 0 if not.

#03
REGULAR UPDATES. For this form of reporting, countries are coded as 1 if they provide updates more than annually or in exceptional circumstances, and 0 if not.

#04
ANNUAL DEBT REPORT. For this form of reporting, countries are coded as 1 if they publish annual debt reports, and 0 if not.

#05
DEBT MANAGEMENT STRATEGY. For this form of reporting, countries are coded as 1 if they produce a debt management strategy with a 3–5-year outlook, and 0 if not.

#06
DEBT SUSTAINABILITY ANALYSIS (DSA). For this form of reporting, countries are coded as 1 if they produce their own DSA in addition to or more frequently than DSAs produced as part of annual IMF Article IV reports.

#07
STATISTICAL BULLETIN. For this form of reporting, countries are coded as 1 if they produce statistical bulletin updates multiple times per year, and 0 if not.

#08
AUDITS. For this form of reporting, countries are coded as 1 if they host external audits, and 0 if not.

#09
PUBLICISED AUDITS. For this form of reporting, countries are coded as 1 if they publicise audit results, and 0 if not.

#10
PUBLIC PRESENTATION INTERVALS. For this form of reporting, countries are coded as 1 if they regularly report to policy-makers multiple times annually. If they report only annually or only when policy-makers request a report, they are coded as 0.

1 Namibia, for example, is coded as 1 because it follows a variety of international best practices rather than one specific guideline.

Although other forms of reporting are possible, and responses are self-reported, country practices in these ten possible reporting areas provide a useful window into African DMO transparency. Figure 1 indicates the number of reports, at least those covered in the ADM, that each country uses. The number of reports each country's DMO undertakes varies significantly. While the lowest is three (Central African Republic, Madagascar and Eswatini), many other respondents report on debt in at least twice as many of the practices identified here.

This variance appears to matter a great deal for marketable debt. Figure 2 shows that, on average, countries that report the most hold a greater amount of marketable outstanding debt as a percentage of total outstanding debt. Furthermore, Figure 3 shows countries that report more also have, on average, more long-term marketable debt (i.e. debt that matures in more than one year).

Taken together, Figures 2 and 3 suggest a positive relationship between reporting and marketable debt. Figure 2 shows that countries reporting in most of the ways tracked by the ADM have, on average, nearly 50 per cent of their debt in marketable instruments. It is also notable that if you remove Namibia and Seychelles from the analysis, countries that report in five or fewer ways have less than 10 per cent of their debt in marketable instruments, a significantly lower percentage than pertains in those countries that report more.

Figure 3 suggests that more debt reporting increases the amount of long-term marketable debt that a country can issue. Specifically, Figure 3 shows that participating in at least six of the reporting practices tracked by the ADM means, on average, nearly double the amount of long-term marketable debt of those that report less.

Participating in at least six of the reporting practices tracked by the ADM means nearly double the long-term marketable debt of those that report less

To be sure, this leaves causation unclear. Market fundamentals or the existing presence of marketable debt may incentivise more reporting. However, as detailed in previous sections, it has been seen for other types of debt, that transparency provides interest rate and maturity benefits. It is reasonable to suspect that similar benefits from transparency exist in secondary markets. Despite the preliminary and suggestive nature of these patterns, the effects of reporting and transparency on marketable debt appear substantial. At the very least, this is further evidence that even bad debt information is better than providing no debt information at all:

> *Concealing information can prove costly for the debt office – during a crisis, investors assume the worst and charge for that. When data transparency is high, investors can more rationally and reasonably assess risks thereby reducing the risk premium on government debt instruments and increasing government's credibility as an issuer.* (Serebro & Krynauw 2018)

Figure 1: Reporting practices by country

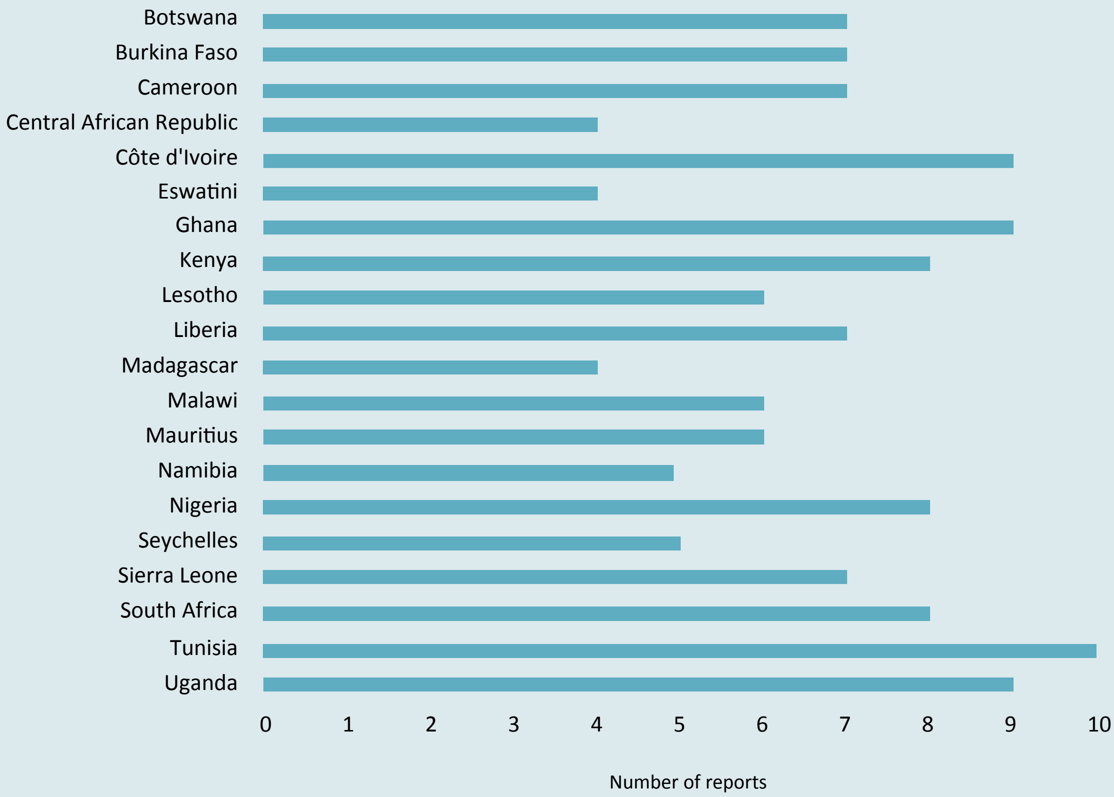


Figure 2: Reporting practices and marketable domestic debt

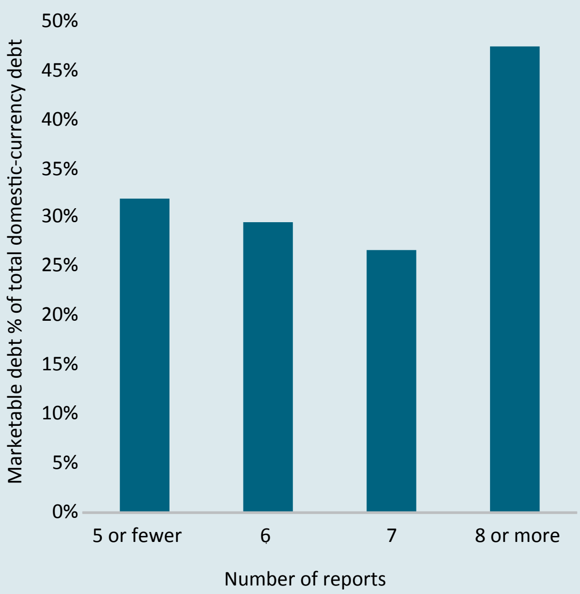
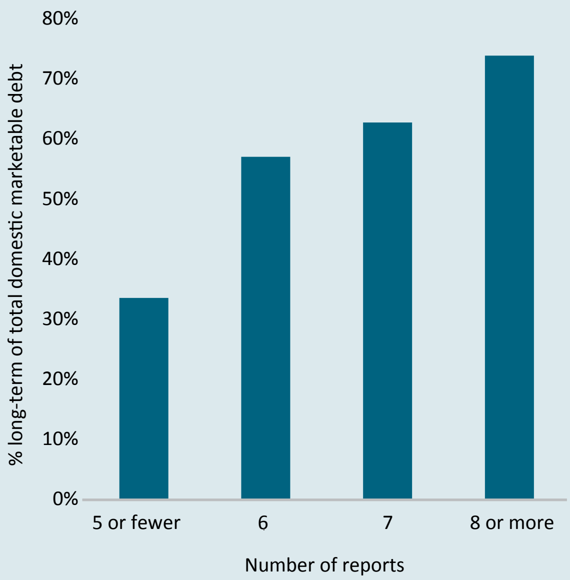


Figure 3: Reporting practices and long-term marketable domestic debt



5. A NOTE ON THE IMPORTANCE OF MEDIUM-TERM DEBT STRATEGIES

Developing effective debt-management strategies ensures that the DMO has a clear and future-oriented strategic direction. Once approved, these strategies should be well communicated and included in the medium-term debt strategy (MTDS). Much emphasis has been placed on the importance of publicising an MTDS. The Bank of International Settlements, with reference to Kenya, but in terms applicable to all governments, argues:

> *the MTDS is a critical tool for informing policy decisions, avoiding any onerous debt burden or fiscal vulnerability and improving investor relations, including those with development partners. In addition, the strategy incorporates initiatives to develop a vibrant domestic market.*
> (BIS 2014: 77)

The importance of an MTDS is highlighted here because of its vital relationship with marketable debt. The ADM indicates that all but two countries publish an MTDS. The majority of respondents report MTDSs that forecast and plan in a range of three-to-five years. We coded each country's MTDS according to the latest year of its coverage. Overall, publishing an MTDS appears crucial for having substantial levels of marketable debt, as well as any long-term marketable debt.

Specifically, Figure 4 suggests that publishing an MTDS, regardless of how many years of coverage, is necessary for having a sizeable share of marketable domestic debt. All countries that do report an MTDS have sizable percentages of marketable to non-marketable domestic debt. Countries that do not publish an MTDS report that only 2 per cent of their debt is marketable.

Furthermore, Figure 5 suggests that for any marketable debt to be long term, an MTDS is necessary. The countries that do not report an MTDS have 0 per cent of their marketable debt as long-term debt. Countries that report an MTDS, regardless of whether coverage is three, four or five years, have significant long-term ratios in their marketable debt portfolio.

Together, these relationships highlight the particular importance of publishing an MTDS. They appear central to having a sizable proportion of marketable to non-marketable debt and longer-term ratios in that marketable portfolio.

Figure 4: MTDS coverage and marketable debt

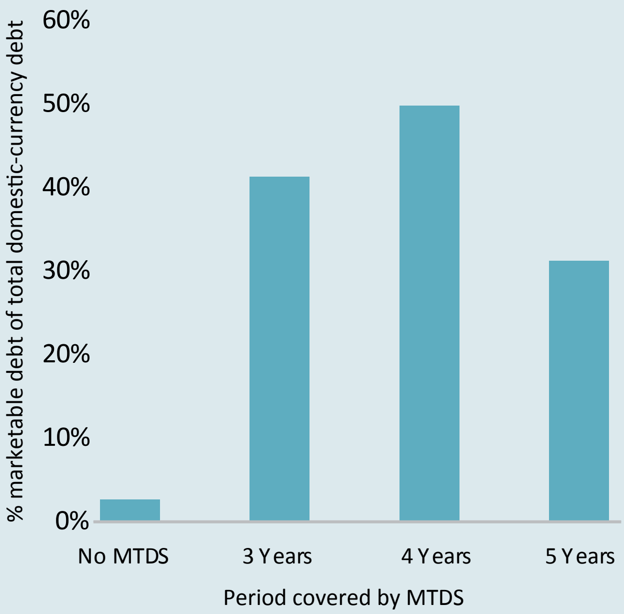
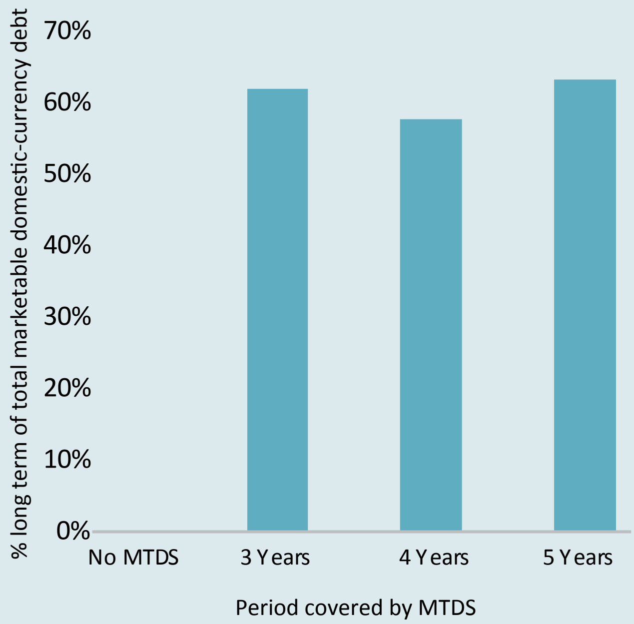


Figure 5: MTDS coverage and long-term marketable debt



These relationships appear central to having a sizable proportion of marketable to non-marketable debt and longer-term ratios in that marketable portfolio

6. CONCLUSION

A DMO's most important function is to raise or fund the annual borrowing requirement at the lowest possible cost and at acceptable levels of risk. Transparent reporting is one of the debt manager's most important tools for adding certainty and clarity to the budget process. The reason for this is that more complete information, provided to fiscal policy-makers and other stakeholders, allows for more-informed decision-making as well as accountability. Transparent reporting and regular communication on the total debt stock are also critical for of attaining the market's trust. This report details some of the key reporting methods available to DMOs and identifies current trends in African DMO reporting practice. It also identifies patterns suggesting that transparent reporting practices are associated with secondary-market activity. More specifically, an increase in transparency is related to a government issuing more marketable debt and more long-term marketable debt. While causal analysis must be left until the CABRI ADM develops more data points, plausible correlations are identified throughout this report. Future iterations of the ADM survey will attempt to understand causality better and probe the intermediate relationships, such as accountability and participation, that may explain why transparency results in more marketable debt and lower interest rates.

Notably, many of the transparent reporting practices identified here, and in the ADM, can be pursued by DMOs without major institutional changes or major political or financial implications. In other words, the practices covered here are feasible operations that DMOs can undertake in a relatively independent manner.

CABRI's recognition of the importance of transparent public finances, particularly transparency within debt management, motivated the development of the ADM platform. Undeniably, country-level transparency is paramount in reporting to CABRI through the ADM survey. However, it is hoped that the existence of the ADM, and the identification of other benefits of debt transparency, will encourage wider participation in future iterations of the ADM and, ultimately, improve transparency at the country level.

A DMO's most important function is to raise or fund the annual borrowing requirement at the lowest possible cost and at acceptable levels of risk

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