



The Role of Parliament in Public Debt Management

Weathering the COVID-19 Crisis and Beyond

London, June 2020

Geoff Dubrow, MA, MPA

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Acronyms

Abbreviation	Meaning
BPS	Budget Policy Statement
BRI	Belts and Roads Initiative
CBSL	Central Bank of Sri Lanka
CGD	Centre for Global Development
DeMPA	Debt Management Performance Assessment
DSA	Debt Sustainability Analysis
DMU	Debt Management Unit
FEE	Foreign Exchange Earnings
FMD	Funds Management Division
GDP	Gross Domestic Product
IMF	International Monetary Fund
INTOSAI	International Association of Supreme Audit Institutions
LICs	Low-income countries
MTBPS	Medium Term Budget Policy Statement (South Africa)
MTDS	Medium-term debt management strategy
MTEF	Medium-Term Economic Framework
PAC	Public Accounts Committee
PIC	Public Investments Committee
PIM	Public investment management
SDGs	Sustainable Development Goals
SOEs	State-owned enterprises
UNCTAD	United Nations Conference on Trade and Development

1. Executive Summary

Risk of debt distress can be analogous to standing too close to the edge of a cliff. Forces beyond our control, such as natural disasters, global economic downturns or falls in commodity prices can push countries right over the edge into debt distress. Indeed, the global economic crisis resulting from COVID-19 has pushed some countries closer to the edge and others over the cliff. For example, Lebanon was propelled into debt default for the first time in its history, when it halted a Eurobond payment of \$1.2 billion in early March. In mid-April, the United Nations Secretary General called for creditors to grant all developing countries a “debt standstill”.¹

According to the International Monetary Fund (IMF), as of March 2018, the share of countries at elevated risk of debt distress, or already unable to service their debt fully had almost doubled to 40 percent since 2013.² As of November 2019, of the 73 countries that had completed a Debt Sustainability Analysis (DSA), nine were already in debt distress and another 25 countries were at high risk of debt distress.³

This brief examines the multifaceted role of parliament in the oversight of public debt and debt management. This brief was commissioned prior to the COVID-19 outbreak, when concerns were already being raised about rising public debt levels in developing countries.

The world has seen debt crises before. Much of the global South was in debt crisis in the 1980s and 90s when global commodity prices started to fall and the size of foreign debt payments ballooned. The mid-1990s led to calls for debt cancellation, leading to the creation and improvement of debt relief schemes run by the IMF and the World Bank, known as the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative.⁴

While the nature of public debt has changed in many ways, many weaknesses in governance systems have remained similar. Often the result is that economies appearing to be healthy or at low risk of debt distress are propelled into crisis by debt that was not publicly known or recorded as a result of secret debt agreements, contingent liabilities or bailouts of State-Owned Enterprises (SOEs).

It is clear that there are significant risks associated with leaving governments to effectively manage public debt without proper oversight. Parliament needs to, among other things, set and modernize legal frameworks for debt management, properly examine and ratify loan agreements and oversee the riskiest generators of public debt—SOEs.

The introduction to this policy brief (**Chapter 2**) addresses a number of key concepts and trade-offs that parliaments and governments face in managing their debt, and provides a brief summary of the role of 'other' key players in debt management beyond parliament, including the ministry of finance, the central bank and the Supreme Audit Institution (SAI). This brief is divided into a series of key issues that underscores the essential role of parliament in oversight of public debt and public debt management. This includes:

- *Understanding public debt, on and off balance sheet.* Public debt is a complex and highly technical issue that cannot be explained away by a single key indicator. For example, while the debt-to-GDP ratio is considered a 'headline indicator' that can galvanize public attention around countries' debt situations, there are a number of indicators that need to be examined in order to obtain a more fulsome picture. Some of these factors, such as the level of external debt, can be found on the 'balance sheet', while others, such as contingent liabilities, will be found 'off balance sheet'. **Chapter 3** examines the key indicators of public debt that can be found on the balance sheet. This includes both the headline indicators and a number of other key indicators that parliamentarians should look for—including high levels of external debt—when trying to understand or prepare to question officials on the debt situation.¹ **Chapter 4** looks at contingent liabilities, which are hidden debt risks that are generally not found on the balance sheet but can have dire consequences on a country's economy if ignored.
- *Setting a legislative framework for debt management.* Parliament's legislative role includes setting a legal framework for public debt management that "provides strategic direction to borrowing decisions and clearly specifies the roles and responsibilities for the institutions involved in debt management".⁵ Developing and modernizing debt management legislation is key to putting the processes in place required for governments to provide parliament and the public with the necessary information for public debt to be effectively scrutinized. **Chapter 5** examines parliament's legislative role in debt management and looks at the key elements of a debt management framework.
- *Parliamentary ratification of loan agreements.* Further to the previous point, one of the key elements of a modern legal framework is that parliament should ratify any major loan agreement signed by the government before it comes into effect. Recent (and not-so-recent) history is replete with examples, in which countries were propelled into debt crises as a result of a lack of scrutiny of loan agreements or by deliberately and illegally bypassing parliament. According to a survey cited in this brief, about 60% of parliaments responding played a role in ratifying loan agreements while about one-third had a role in the loan-approval process. In developing countries, loans are often used to fund critical infrastructure projects. In addition to the limited time often provided to parliaments to actively scrutinize loans prior to their ratification, there is limited-to-no guidance to parliaments on what the criteria for loan ratification should be. **Chapter 6** examines the role of parliament in the ratification of loan agreements and proposes some criteria for parliamentary scrutiny of loan agreements as part of the ratification process, drawing on the literature on Public Investment Management (PIM).
- *Integrating public debt into the budget cycle.* Discussion around the annual budget in parliament tends to be split according to party lines with members of the governing party defending the budget and the government's record and the opposition attacking it. Issues of fiscal space and debt sustainability tend to get lost in the shuffle. Similarly, during the ex-post oversight process, parliaments, including public accounts committees (PACs), tend to focus on legal compliance, while under-utilizing key information related to the government's public debt situation. **Chapter 7** examines how to incorporate parliament's oversight of debt and debt management in to the four phases of the budget cycle - formulation, approval, execution and oversight.
- Finally, **Chapter 8** addresses how parliament can pay special attention to SOEs, which are often major drivers of debt and debt crises and often not subject to the same scrutiny as central government departments.

¹ See Box 5 for a case study entitled "external debt and debt trap diplomacy".

2. Introduction

Key concepts and Trade-Offs

Over a cliff: Exogenous shocks. As noted in the executive summary, external or exogenous shocks have historically had a negative effect on GDP growth, and by extension, on debt accumulation. For example, the small island countries in the Caribbean and Pacific have historically been very vulnerable to natural disasters, which have become more frequent and severe as a result of climate change. On average, these small island countries have seen their GDP decline by 2 to 3 per cent of GDP per year over the past 30 years as a result of natural disasters.⁶ These frequent exogenous shocks explain in part why Caribbean countries are among the most highly indebted in the world. In 2018, the average Caribbean debt was 70.5% of GDP.⁷ ¹¹

Tragically, COVID-19 has introduced a global exogenous shock that is unprecedented in modern times. According to the Institute of International Finance:

“Global debt across all sectors rose by over \$10 trillion in 2019, topping \$255 trillion. At over 322% of GDP, global debt is now 40 percentage points (\$87 trillion) higher than at the onset of the 2008 financial crisis—a sobering realization as governments worldwide gear up to fight the pandemic”.⁸

COVID-19 was the external shock that set Lebanon into debt default for the first time in the country’s history, when the country halted a Eurobond payment of \$1.2 billion in early March. In 2019, Lebanon’s public debt was estimated at 160% of GDP—one of the highest in the world—and was projected to rise to near 180% by 2023, according to the IMF. Prior to the COVID-19 outbreak, Lebanon was already spending almost half the taxes and other fiscal revenue collected on interest payments.⁹ According to the Prime Minister, “we are paying the price for the mistakes of the past”.¹⁰

¹¹ Debt-to-GDP ratio is one of the ‘headline indicators’ measuring the level of public debt. This is further covered in Chapter 3.



Photo: Wikimedia Commons / Women protesting in Lebanon

Why countries borrow. In developing countries, taxation and development financing from bilateral and multilateral agencies are the primary sources of funding to cover government expenses. When the total funds collected through taxation and development financing is insufficient to fully fund the government's various commitments, governments need to borrow money. In the short-run, governments increase public debt for a variety of reasons, including to stimulate the economy during an economic downturn and to pay for infrastructure investment, which can boost long-term growth, and in turn generate revenues to service the higher debt.¹¹

Growth vs. debt. When state borrowing becomes excessive, high levels of public debt can undermine development because governments need to use available funds to pay interest and principal. This reduces the funds available for key investments, such as infrastructure and social spending. To illustrate, as one report issued by the United Nations noted, "countries face pressing demands for additional public investments in the SDGs at a time when constraints on further debt financing are likely to become more binding".¹² According to the United Nations Conference on Trade and Development (UNCTAD), estimates for financial shortfalls to deliver the SDGs for basic infrastructure, food security, climate change mitigation, health and education suggest an average annual shortfall of US\$2.5 trillion, given current investment levels.¹³

As the head of the IMF noted, "finding the right balance between financing development and safeguarding debt sustainability" is a constant challenge.¹⁴ The Secretary General of the United Nations, who noted the trade-off between debt and achieving the SDGs, echoes similar challenges:

"As the global economic environment is set to remain unstable, it is becoming more difficult for developing economies to leverage debt financing for sustainable development. At the same time, the international community has adopted the most ambitious development agenda yet, the 2030 Agenda for Sustainable Development".¹⁵

Lack of economic growth can increase public debt. Where the ratio of debt to Gross Domestic Product (GDP), the conventional measure of debt, continues to rise over a long period of time (a negative debt trajectory), economic growth can be negatively impacted. For example:

- One study of 40 "advanced" and "emerging" economies over four decades indicates where debt-to-GDP ratio continues to increase annually by 3 percent, GDP growth outcomes that are 0.2 to 0.3 percentage points lower on average¹⁶; and
- Another study concluded that even if countries have the same debt levels, countries with decreasing debt have better growth performance than countries with increasing debt levels.¹⁷
-

Limitations on spending: Fiscal space. In general, governments have only a certain amount of **fiscal space** to spend or cut taxes before undermining their capacity to finance government operations, service their debt obligations and ensure that the government can remain solvent. Governments can, however, "create additional fiscal space by raising additional tax revenues, making expenditures more efficient or by increasing external and internal borrowing".¹⁸ However, developing economies typically have limited capacity to raise taxes—approximately 10-20% of GDP, while the average in high-income countries is about 40%.¹⁹ In Africa, the IMF estimates that "actual revenue collection is 3-5 percentage points of GDP below revenue potential".²⁰

The changing nature of debt. One of the reasons in which debt levels have risen is that both the creditors and the debt structure^{III} have changed significantly. As the International Fund for Rural Development notes:

"Low-income countries (LICs) that previously drew only on concessional aid assistance are now actively using less concessional types of financing, including resources mobilized from multilateral, bilateral and commercial creditors, as well as international bond markets".²¹ According to UNCTAD, public debt at market conditions as a share of total debt doubled between 2007 and 2016 in low-income countries, rising to 46 percent.²² Concessional financing is defined in box 1, below.

III The term 'debt structure' refers to the duration and timing of principal and interest payments. The structure typically refers to characteristics such as the maturity dates, the principal repayment terms, and the provisions for prepaying the loan.

Box 1: Concessional Financing

According to the Jubilee Debt Campaign UK, “a concessional loan is a loan with ‘lower’ interest rates...sometimes it means the interest rate is lower than the lender would normally lend at. Sometimes it means the interest rate is lower than the borrower would normally borrow at (which could still mean the interest rate is high enough for the lender to make a large profit)”.²³ Additionally, concessional loans typically have long grace periods.²⁴

By way of example, Kenya’s precarious debt situation is forcing it to turn to more expensive loan options. As of August 2019, Kenya’s stock of expensive loans rose to 36% of total debt, from 24% in June 2016. However, the fraction of cheap loans from multilateral institutions such as the World Bank declined from 45% to 30% during this same time frame.²⁵

The Perils of Bypassing Parliament: The Importance of Debt Transparency. The ethical side of international lending practices, transparency in particular, has emerged as a key concern. Questions in many forums have been raised about the extent to which indebted countries are solely responsible for their debts, particularly if transparency is thwarted? A case in point is that of Mozambique, where questionable lending practices by Credit Suisse and VTB (a Russian Bank) resulted in many of the loans being sold by the Banks to other speculators. The loans in this case, though made when the Mozambique economy was perceived to be thriving, were made in secret and therefore illegal in that the Mozambique Parliament was bypassed. The Minister of Finance, instead, guaranteed the loans. The companies set up under the loans defaulted on the debt once global commodity prices fell.²⁶

The issue of debt transparency and its alleviation, through a reform initiative of the World Bank and the IMF would see more data being made available on low-income countries and new transparency requirements. Private banks addressing the Credit Suisse and VTB malfeasances in Mozambique should also endorse this requirement. Here transparency was missing for due authorization and procedures for approving loans, which could be addressed via the UNCTAD “Principles on Responsible Lending and Borrowing”.²⁷ For an example of strides towards fiscal transparency, see box 2, below.

Box 2: North Macedonia: Strides Towards Fiscal Transparency

The IMF recently recognized several key strengths of fiscal transparency practices in North Macedonia. According to the IMF’s 2018 *Fiscal Transparency Evaluation* report, North Macedonia’s fiscal reports cover the bulk of general government activities and are published in a frequent and timely manner, and in accordance with a clear legal framework for budget formulation. Several risks to the public finances are disclosed regularly, including figures on public debt.²⁸ The Ministry of Finance’s International Finance and Public Debt Management Department also publishes an annual report with various macroeconomic data, including debt figures.²⁹

Despite these positive steps there is always room for improvement in parliamentary oversight. For example, the government’s Medium-Term Economic Framework (MTEF)/Fiscal Strategy report is sent to parliament for informational purposes only; Parliament does not scrutinize the report.

Other Key Players in Debt Management

In addition to parliament, key institutional stakeholders that should be actively engaged in debt management include: the government represented by the Minister of Finance, the Central Bank and the SAI. Each stakeholder has a distinct role and set of responsibilities in debt management, which when brought together enable a system of checks and balances to come into play and help set in motion a debt management process based on the dual principles of transparency and accountability.

The **Minister of Finance** is vested with the borrowing authority on behalf of the government and is responsible for setting the debt structure and debt management strategy, as well as monitoring the debt situation to ensure that it remains sustainable. Fundamentally, the Minister is responsible for ensuring that spending decisions do not negatively affect the country's future credit rating. This means that Finance Ministers must exercise leadership on:

- Establishing a debt management unit (DMU), which is generally located in the ministry of finance, guided by international best practices, including the segregation of duties between certain debt management responsibilities;^{IV}
- Taking a proactive multi-year management approach to debt management, including the development of a medium-term debt management strategy (MTDS);
- Promoting a DSA that assesses the long-term sustainability of alternative debt paths; and
- Introducing a robust legal framework that sets the overall objectives for debt management, accountability and reporting requirements, as well as clarifies the authority to borrow and to issue new debt, invest, and undertake transactions on the government's behalf.



Photo:
Westminster Foundation for Democracy

IV Segregation of duties is covered in Chapter 7 (execution phase) and Annex 1.

In most emerging market economies, both the government and **central bank** is active in sovereign debt markets, which are also known as bond markets. Governmental participation in bond markets is usually for the purpose of issuing debt in order to finance fiscal deficits, while central banks sell debt securities to finance the purchase of assets, particularly foreign exchange reserves.³⁰ Often, as is the case in Indonesia, the central bank is appointed by the government as an auction agent to issue new debt (the primary market).³¹

While a secondary role of the central bank is viewed within the purview of monetary policy, not debt management, central banks typically intervene if inflation increases in the economy. Inflation can be the result of an increase in domestic debt.

The SAI plays a central role in exercising independent external oversight on public debt management and in publicly reporting on audit results (and to parliament in the Westminster system). The SAI audits the government's consolidated financial statements, examining the government's compliance with rules and regulations, and conducting value-for-money or performance audits. The role of SAIs in debt management is covered in Chapter 7 (see ex-post oversight phase).

Civil society organizations (CSOs), including think tanks, have historically played an active role in bringing about international debt relief initiatives, strengthening debt management capabilities in developing countries and making a contribution to economic policy research on debt issues.^V The United Nations Research Institute for Social Development highlighted the historical role of civil society organizations in pushing for debt relief:

"For decades, the debt issue has remained a front-runner—or perhaps even the front-runner—on the agendas of civil society organizations and movements throughout the world...An impressively wide range of civil society organizations have been working on the debt issue: from single-issue HIV/AIDS organizations to churches, from radical groups to academics. Within these movements, perhaps the most prominent issue of contention is the approach of development aid as a form of charity versus a call for global justice. Civil society in the South argues for immediate and complete cancellation of debts, appealing to human rights, moral justice and the historic debt of the North toward the South".³²

CSOs have also been instrumental in pressing for governments to take action or be held to account during debt crises. For example in Mozambique, CSOs, including the Budget Monitoring Forum, Mozambique Debt Group and Transparency and Fiscal Justice Coalition "called for a criminal investigation into the officials responsible" for the issuance of illegal loans that "were not approved by the Mozambique parliament as required in the constitution". They also called for a "declaration that the debts are illegal, and non-payment of the debts".³³

V A list of CSOs involved in debt management issues can be found on UNCTAD's website at <https://unctad.org/en/Pages/GDS/Sovereign-Debt-Portal/Sovereign-Debt-Links-4.aspx>

3. Demystifying Public Debt for Parliamentarians: Key Indicators on the Balance Sheet

Headline Indicators

Of the two “headline indicators” for measuring public debt—**net debt** and **gross government debt**—it is the latter, expressed as a percentage of GDP (**debt-to-GDP ratio**) that dominates public discourse and is likely to be referred to in the media (see box 3 below for definitions).

Some countries set a **fiscal rule** (see box 4, below) not to exceed a certain **debt-to-GDP** target. This is highly pertinent to parliamentarians because fiscal rules are often enshrined in the constitution or in primary or secondary legislation so that governments cannot frequently change limits on spending levels or tax revenues.³⁴

Box 3: Headline Indicators: Definitions of Debt

Net debt: Gross debt minus financial assets.

Gross government debt: All liabilities that require payment or payments of interest and/or principal by the debtor to the creditor at a date or dates in the future). Also expressed as a percentage of GDP (debt-to-GDP ratio)

The limit or target for fiscal rules is often set at the recommended '**prudential limit**', which is 60% of GDP in advanced economies and 40% of GDP in emerging economies. It should be noted however that while these percentages constitute a “useful benchmark”,³⁵ there is consensus that these thresholds are not a perfect science. For example, the London-based Centre for Economic Policy Research recommends that governments “guard against succumbing to the allure of the seeming accuracy of numerical limits on debt-to-GDP ratios”.³⁶ However, “prudence dictates that countries target a debt level well below the limit”.³⁷

Box 4: Fiscal Rules

One UK-based organization defines fiscal rules as “parameters set by the government to limit its own tax and spend excesses”.³⁸ In addition to debt rules, there are three other types of fiscal rules (budget balance rules, expenditure rules and revenue rules).

Indonesia’s debt rule, which has been in place since 2004, is that total central and local government debt should not exceed 60% of GDP. This rule is set out in the State Finance law.³⁹ Georgia’s debt rule is that the ratio of State Debt to GDP shall not exceed 60%.⁴⁰ Botswana’s debt limit caps total domestic and foreign debt each at 20% of GDP.⁴¹

Beyond the Headlines

Beyond the headline indicators, there are a number of important indicators that parliamentarians will want to examine in order to obtain a more fulsome picture of the public debt situation. ‘Composition of government debt’ refers to the percentage of externally held debt, the maturity structure of debt and the amount of foreign-denominated debt. Each of these terms is discussed below.

I. Percentage of externally held debt

External debt is the “portion of a country’s debt that was borrowed from foreign lenders, including commercial banks, governments, or international financial institutions. These loans, including interest, must usually be paid in the currency in which the loan was made”.^{vi}

External debt is serviced from foreign exchange earnings, drawn down against foreign currency reserves and/or additional borrowings. If growth in external public debt exceeds Foreign Exchange Earnings (FEE), the ratio of external public debt to FEE will continue to increase.

External debt has shifted towards the private sector from official bilateral and multilateral creditors. This is largely owing to increased access to international financial markets. The share of external public and publicly guaranteed debt owed to private creditors has increased to 62 per cent by 2015 from 41 per cent of the total in 2000.

A high ratio of external debt to domestic debt “could have an influence on a country’s room for manoeuvre, forcing debtor nations to impose fiscal austerity to appease foreign creditors”. For example, with over three-quarters of Greece’s debt held externally, there was “strong pressure coming from creditors for drastic fiscal tightening.”⁴² There can also be consequences on national sovereignty. For example, Sri Lanka’s handing over of the Hambantota Port to China on a 99-year lease illustrates the economic and political risks of external debt (see box 5).

Box 5: External Debt and Debt Trap Diplomacy

The term “debt trap” emerged in 2017 when an academic from India warned “countries are becoming ensnared in a debt trap that leaves them vulnerable to China’s influence”.⁴³ According to the academic, Brahma Chellaney: “China (through its Belts and Roads Initiative–BRI) is supporting infrastructure projects in strategically located developing countries, often by extending huge loans to their governments. As a result, countries are becoming ensnared in a debt trap that leaves them vulnerable to China’s influence”.⁴⁴

As the Centre for Global Development (CGD) points out, BRI aims to deliver trillions of dollars in infrastructure financing to Asia, Europe and Africa.⁴⁵ According to the Asia Times, “rather than offering grants or concessionary loans (at below-market interest rates), China provides huge project-related loans at market-based rates, without transparency, and often little or no environmental or social-impact assessments”.⁴⁶ The CGD concludes that 10-15 countries could suffer from debt distress due to future BRI-related financing, with eight countries of particular concern”.^{vii}

The case of Sri Lanka’s Hambantota Port, located in a busy shipping route, illustrates the economic and political risks of external debt. Sri Lanka’s vision for Hambantota was that it would bring more ships to Sri Lanka, and ease pressure on its Colombo port, which is one of Asia’s most important container terminals.⁴⁷ Phase I of the Port project, which opened in November 2010, was financed by a loan from China’s state-owned Export-Import Bank (Exim).

VI A more technical definition of external debt is “the outstanding amount of those actual current liabilities that require payment(s) of interest and/or principal by the debtor at some point(s) in the future and that are owed to non-residents by residents of an economy”. See <https://datahelpdesk.worldbank.org/knowledgebase/articles/474124-what-is-external-debt>. Externally-held general government debt as a percentage of GDP can be used as a measure. See Bloch, Debra et al. “Government Debt Indicators: Understanding the Data”. OECD Economics Department. Working Papers No. 1228, June 2015, p.

VII The eight countries of concern are: These countries are Djibouti, the Kyrgyz Republic (Kyrgyzstan), Lao People’s Democratic Republic (Laos), the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan. See <https://www.cgdev.org/sites/default/files/examining-debt-implications-belt-and-road-initiative-policy-perspective.pdf>



Photo: Mahinda Rajapaksa / Crowds at Magam Ruhunupura Mahinda Rajapaksa Port

As predicted by economic feasibility studies, Hambantota Port did not thrive financially, causing Sri Lanka's government to seek out additional loans. In December 2018, under mounting financial pressures and continued losses from the port, Sri Lanka agreed to hand over 85% equity of the port to China Merchants Port, a preferred company of the Chinese government. In addition, China Merchants Port negotiated the ownership of 15,000 acres of land around the port.

While the economic risks of Sri Lanka's debt to China has clearly manifested itself in a loss of ownership over sea and land-based assets, the Hambantota Port episode also demonstrates political risks to external debt that are somewhat subtler but no less harmful.

While China's "debt trap diplomacy" has received much attention as of late, some CSOs point out that debt trap diplomacy is simply another in a long line of 'neo-colonialist' tools applied since former colonies gained their independence. For example, the Committee for the Abolition of Illegitimate Debt explains that:

"Developing countries were actively encouraged to take on loans by the World Bank, private banks, and by the governments of highly industrialised countries. Then there was a sudden radical change at the end of 1979, when the US Treasury imposed a sudden rise in interest rates as neoliberal policies kicked in. This sudden jump in interest rates, combined with the drop in the commodities market, completely changed things. During the 1980s the creditors were making huge profits. Since the 1997 South-East Asia and Korean financial crises, the net financial transfer on debt in favour of the creditors (including The World Bank) has been growing at a considerable rate, while at the same time, the debt has continued to soar to peaks never seen before".⁴⁸

II. Maturity structure

Debt maturity structure^{VIII} can be measured as the ratio of long-term debt to total debt.⁴⁹

As opposed to external debt, governments can essentially borrow domestically with low risk of debt default, subject to the availability of domestic borrowing sources such as domestic commercial banks. However, domestic public debt is associated with increased rollover risk. This is the case because in many developing countries, domestic commercial banks prefer to issue short-term loans. This is the case in much of sub-Saharan Africa. For more information about the trends related to short-term debt, see box 6, below.

Box 6: The ongoing nature of short-term debt

Short-term debt is the main risk associated with maturity structure. According to the IMF, “short-term debt exposes borrowers to rollover risk where the terms of financing are renegotiated to the detriment of the borrower”.⁵⁰ Typically, governments assume that borrowers will take over a new loan to pay existing lenders. However, if interest rates rise or it is not possible to refinance a loan, it is necessary to have sufficient funds available to pay off the loan. According to the United Nations:

“Short-term debt as a share of total external debt in developing countries overall has been increasing progressively, from 14 per cent in 2000 to 31 per cent in 2014, but decreased to 27 per cent in 2015. This trend, most pronounced in East Asia and the Pacific, is worrying, as short-term debt carries higher rollover risk and increases countries’ exposure to global interest rate changes”.⁵¹

III. Amount of foreign-denominated debt

This is the amount of debt held in foreign currency. Foreign currency borrowing is particularly common in emerging markets, as it is a way of attracting investors who do not want the risk of a potentially volatile local currency. However, foreign-denominated debt can become painfully expensive to service if the value of the local currency depreciates significantly.⁵²

Debt in foreign currency can expose governments to exchange rate risks, which could affect the cost of debt. This is known as exchange rate volatility.

For example, Mozambique’s economy was badly impacted when the price of its commodity exports fell. Mozambique’s local currency, the metical, fell by 50% against the US dollar in 2015 and 2016. The relative size of the dollar-denominated debts ballooned as a consequence.⁵³

VIII A more formal definition of debt maturity structure is the time profile of the maturities of claims or liabilities. This is also known as “maturity profile” or “maturity distribution.”

4. Contingent Liabilities: Beyond the Balance Sheet

There are other key considerations that can influence the long-term sustainability of public finances that parliamentarians may want to pay attention to. In particular, it is important to take into consideration future government obligations such as **contingent liabilities**. As one economist put it, "history is full of episodes in which financial position of the public sector is substantially altered – or its true nature uncovered – as a result of government bailouts of financial or non-financial entities in both the private and public sector".⁵⁴

Contingent liabilities refer to "obligations whose timing and magnitude depend on the occurrence of some uncertain future event outside the control of the government".⁵⁵ Contingent liabilities include lines of credit, letters of credit, and loan commitments.⁵⁶ In that respect they are 'off-balance sheet', because they are not recognized as part of the debt until they are called. Contingent liabilities are only paid when an unexpected event occurs. Most governments include a line item for contingencies in their budgets. This is where contingent liabilities should be paid.



Photo: Prince Roy /
China Aid project in Nurek, Tajikistan

Box 7: Explicit and Implicit Contingent Liabilities

Some contingent liabilities are **explicitly** recognized by a law or contract, such as:

- State guarantees for non-sovereign borrowing by, and other obligations of, sub-national governments and public and private sector entities;
- Umbrella state guarantees for various types of loans (mortgage loans, student loans, agriculture loans, small business loans); and
- State insurance schemes (deposit insurance, crop insurance, flood insurance).⁵⁷

Some contingent liabilities will not be recognized in a contract or law, but government may have an **implicit** or moral obligation, reflecting public and interest group pressures. Implicit contingent liabilities may include:

- The default of a sub-national (i.e. municipal) level of government or a public/private entity on debt obligations that were not guaranteed by the state;
- Banking failure (support beyond government insurance, if any); and
- Clean up of liabilities of entities being privatized.⁵⁸

Box 8: North Macedonia: SOE oversight and contingent liabilities

A notable challenge in accurately assessing debt levels in North Macedonia is that losses attributable to SOEs are not counted in official figures. North Macedonian SOEs are underwritten by the government and therefore a contingent liability. For example, the Public Enterprise for State Roads, an SOE established in 2012, has accumulated significant debt.

5. Parliament's Legislative Role

Parliament plays an important role in adopting and modernizing the development of a legislative framework for debt management. This includes debt management legislation as well as secondary or subsidiary legislation.

Parliament can enhance transparency and accountability by adopting a single integrated debt management law. Such a law “provides strategic direction to borrowing decisions and clearly specifies the roles and responsibilities for the institutions involved in debt management.” This is crucial as the “absence of modern public debt management legislation undermines the transparency and accountability of fiscal and debt management operations”.⁵⁹



Photo:
Mister_Jack / Man in Mombasa, Kenya

Primary and Secondary Legislation

The Debt Management Performance Assessment (DeMPA) methodology recommends that to assess the state of debt management practices, the following indicative questions be posed:⁶⁰

- Is there clear authorization in primary legislation to approve borrowings and loan guarantees on behalf of the central government assigned to the cabinet or directly to the minister of finance? If so, which legislation provides authorization, and what are the relevant sections or clauses?
- Who signs the loan documents and other documents necessary for particular borrowing? Which legislation provides this authorization, and what are the relevant sections or clauses?
- Is there clear authorization in secondary legislation to undertake debt-related transactions and to issue loan guarantees on behalf of the central government? If so, which legislation provides authorization, and what are the relevant sections or clauses? Which sections or clauses in the legislation cover specified borrowing purposes; the formation of clear debt management objectives?

One example of how a debt management law can strengthen accountability and transparency is by specifying the purposes for which the government can borrow. Indeed, this is a minimum requirement of debt management legislation and is intended to “safeguard against borrowing for speculative investments or to finance expenditures that have neither been included in the annual budget nor approved by the parliament...in some other fashion”.⁶¹

Key Elements of a Debt Management Framework

The key elements of a debt management law that parliamentarians may want to ensure are included in their debt management framework are listed in Table 1, below:^{IX}

Table 1: Key Elements of a Debt Management Law⁶²

Element	Justification
1. The borrowing power is regulated by a statement of purpose, which establishes eligible borrowing objectives, and restricted by a borrowing limit defined in terms of a debt ceiling or an annual borrowing limit.	Specifying the borrowing ⁶³ purpose safeguards against borrowing for speculative investments or to finance expenditures that have neither been included in the annual budget nor approved by the parliament or congress in some other fashion;
2. The parliament retains ⁶⁴ the authority to ratify and issue loan agreements, particularly loans contracted abroad and classified as treaties.	This deters the occurrence of imprudent borrowing without the appropriate government accountability and supports the accountability of the government for all public liabilities.
3. Parliamentary approval of contingent liabilities or information on contingent liabilities provided to parliament.	Helps to ensure that parliament and the public are aware of the contingent liabilities that are being taken on by the government.
4. Government is required to report to Parliament annually on the government's debt management activities including plans for the upcoming fiscal year and activities of the previous year.	This improves fiscal transparency and provides information on how the government's budget will be financed.
5. Government is required to draft and table a strategy that sets out the medium-term framework for how the government will achieve its debt management objectives. The MTDS ^X should be updated or revised regularly.	Having a regularly reviewed strategy raises the profile of debt management activities and objectives, prevents ad hoc and frequent changes and strengthens transparency;
6. The objectives for debt management are clearly defined and publicly disclosed along with stock and composition of its debt and financial assets, and relevant legislation; the measures of cost and risk that are adopted are explained.	For accountability purposes, it is important to ensure that there is a formal objective against which the parliament can assess the government's performance.
7. Debt management activities are audited annually by an external independent auditor or the SAI, including performance and financial audits. Debt managers' performance, systems and control procedures are audited regularly.	Ensures that debt management objectives comply with procedures and policies and that all borrowing is appropriately recorded and financially accurate.

IX The elements are drawn from a variety of sources, including the DeMPA Methodology.

X The MTDS is a framework designed to help governments implement sound debt management for the three-to-five-year horizon. The MTDS process can clarify a government's cost and risk trade-offs.

6. Parliamentary Ratification of Loan Agreements

As addressed in the previous section, parliaments should retain the authority to ratify and issue loan agreements. This deters the occurrence of imprudent borrowing without the appropriate government accountability.

According to a 2013 study conducted by the Inter-Parliamentary Union and the World Bank:⁶⁵

- Just under 60% of respondents have laws requiring parliament to ratify loan agreements before they become effective;
- While 64% of respondents are not involved in the loan approval process (as distinct from the ratification process), 24% are involved in the final stage;^{XI} and
- 65% of parliaments responding stated that the loan approval process is designed to go through the committee system. Twenty percent of parliaments rely only on a single committee, primarily the finance, budget, or economic committee, while 45 percent have two or more committees involved, with the additional committees focusing on specific areas, such as infrastructure, agriculture, health or transport.

Parliamentary involvement in loan approval or in the ratification process enables parliament to verify that the government has undertaken rigorous economic appraisal, selection and costing of any public investment project, and has a monitoring strategy in place. This is known as PIM. Put simply, PIM is an “approach to managing government expenditures for public infrastructure strategically and efficiently”.⁶⁶

XI The survey states that “Among the countries where the law gives parliament ratification authority, a large number, 58 percent, are also involved in the loan approval process at some stage (i.e., either before, during, or in the final stages)”.

Table 2, below, spells out the four stages of PIM:

Table 2: Four Stages of PIM and Potential Lines of Inquiry for Parliamentarians

Stage of PIM	Description	Potential Lines of Inquiry ⁶⁷
Appraisal	The use of ⁶⁸ robust appraisal methods to conduct feasibility or prefeasibility studies for major investment projects and the publication of the results.	Which type(s) of appraisal methods were used to conduct a feasibility or pre-feasibility study for the proposed investment project(s)? Were the results of analyses published? Did the appraisal include a review of the social or economic costs and policy benefits—including health and environmental impacts? What about gender impacts? Was a cost-benefit analysis, cost-effectiveness analysis or multi-criteria analysis conducted? Was the analysis reviewed by an entity other than the sponsoring entity?
Selection	A project-selection process that prioritizes investment projects against clearly defined criteria.	How was this investment project selected? Was it ranked and selected against clearly defined criteria? Did the government publish and adhere to standard criteria for project selection? ^{xii}
Costing	“Projections of the total life-cycle cost ^{xiii} of major investment projects, including both capital and recurrent costs together with a year-by-year breakdown of the costs for at least the next three years, are included in the budget documents”.	Are projections of the total life-cycle cost of the investment project(s) included with both capital and recurrent costs? Is there a year-by-year breakdown of the costs for at least the next three years, included in the budget documents?
Monitoring	Prudent project monitoring and reporting arrangements are in place both for physical and financial progress.	Are there any monitoring arrangements in the loan agreement? Will the total cost and physical progress of the investment project be monitored during implementation by the implementing government unit? Will information on the implementation of the investment project(s) be published in the budget documents or in other reports annually? ^{xiv}

XII Standard criteria refers to “a set of formal procedures adopted by government that are used for every project or group of related projects with common characteristics within and across central governmental units”.

XIII Life-cycle cost or whole of life costing includes all phases of a project lifecycle such as design, construction, management, operation and maintenance. See for example <http://documents.worldbank.org/curated/en/481791486540124454/pdf/112689-BRI-EMCompass-note-29-Infrastructure-Framework-PUBLIC.pdf>.

XIV Monitoring of loans for investment projects is covered in Chapter 7 (see oversight phase) and Chapter 8 (SOEs).

7. Parliament's Oversight Role of Public Debt in the Budget Process

The budget cycle

There are four stages associated with the budget cycle: formulation, approval, execution and ex-post oversight. The formulation and approval phases are known as *ex-ante*, which means "before the event". The executive branch is generally responsible for formulation of the budget in the ex-ante phase, while the legislative branch is responsible for approval of the budget. The government is then responsible for execution of the budget, and parliament is responsible for ex-post oversight.

According to international best practices, the government should be producing budgetary documents throughout the budget cycle. Many of these documents will include critical information regarding public debt that parliament can review as part of the approval and oversight phases of the budget cycle. The documents that are utilized through each phase of the budget cycle are represented in figure 1 below.



Photo: IMFphoto / Managing Director Kristalina Georgieva participates in a discussion with World Bank President David Malpass

Figure 1: Overview of the Budget Cycle and Key Documents

Where oversight of debt and debt management is concerned, parliament's fundamental roles are summarized in table 3, below:

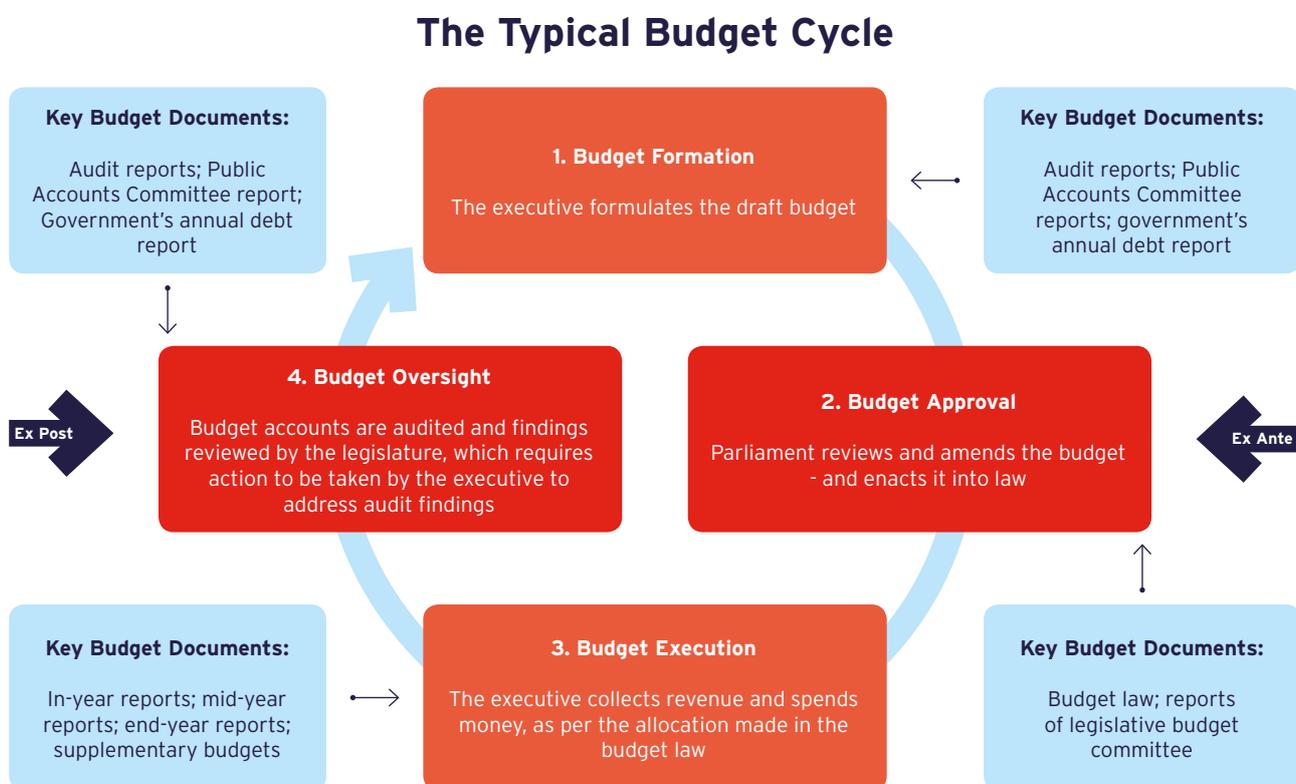


Table 3: Overview of the Budget Cycle and Role of Parliament in Debt Management

	Phase of Budget Cycle	Main Parliamentary Oversight Role
EX ANTE	Formulation	Review, debate and approval of government's MTEF and Pre-budget statement
	Approval	Scrutiny of MTDS and DSA as part of annual budget package
	Execution	While execution of the budget is the purview of the executive branch, it is important that parliamentarians understand the role of the executive branch in the execution of the debt management strategy, in order to conduct more effective ex-post oversight ^{xv}
EX POST	Oversight	PAC review of SAI reports on debt and debt management ; PAC review of government reporting on debt and debt management; and parliamentary monitoring of investment loans

XV While international best practices recommend the preparation of in-year budget reports, it is very rare and in most cases beyond the capacity of parliaments to review these reports. They are therefore not addressed in this brief.

I. Budget formulation

The minister of finance's pre-budget statement contains the "broad parameters for the executive budget proposal regarding expenditure and planned revenue, and debt".⁶⁹ It "reflects the culmination of the strategic planning phase of the budget process, in which the executive broadly aligns its policy goals with the resources available under the budget's fiscal framework – the total amount of expenditure, revenue, and debt for the upcoming budget year".⁷⁰ Not all governments provide a pre-budget statement.

The information provided in the pre-budget statement will often reflect the findings of the government's MTEF, which is the government's rolling expenditure plan that sets out medium-term expenditure priorities and hard budget constraints. In Nigeria, the Parliament is required to approve the "Medium Term Expenditure Framework and Fiscal Policy Paper" before the budget is tabled.⁷¹ Other examples related to the review of PBS can be found below in box 9.

Box 9: Debate of Pre-Budget Statements

Budget Policy Statement–New Zealand

In New Zealand, the Minister of Finance is required to present a Budget Policy Statement (BPS) to the House of Representatives by 31 March each year. The BPS is then referred to the Finance and Expenditure Committee (the committee) for detailed review. The committee must then report its findings to the House within 40 working days of receiving the BPS. In 2020 the committee's report was issued on February 20. The BPS was debated in Parliament on March 11.

The committee reported on the appearance of the Minister of Finance to discuss the BPS, with some members of the committee expressing concern that the government "may not be in a strong position to respond to COVID-19, given that it is forecast to run a deficit in the year to June 2020". The committee stated that "the minister assured the committee that he expects New Zealand's relatively low level of public debt puts the government in a good fiscal position to help alleviate some of the adverse economic effects of COVID-19"⁷²

South Africa–Debate of Medium-Term Budget Policy Statement (MTBPS)

In South Africa, the MTBPS is tabled in Parliament in October. This must be submitted to Parliament at least three months before the introduction of the national budget. The MTBPS presents a macro-economic view by highlighting key government spending priorities and the size of the spending envelope for the next MTEF period. The MTBPS also gives some indication of what the following year's budget will include. The MTBPS is divided into four sections, including: an economic overview of the global and domestic economic outlooks; an overview of fiscal policy including the financing and debt management strategy; and the government's expenditure priorities.

The MTBPS notes "Government remains committed to fiscal sustainability, but there has been significant fiscal deterioration since the tabling of the 2019 Budget. This requires substantial spending reductions to stabilise debt. Measures to manage and reduce public-sector pressures and risks will be implemented over the medium term. Fiscal policy and the debt management strategy will work to mitigate risks to the outlook". The MTBPS was presented in Parliament by the Minister of Finance on October 30, 2019.⁷³

II. Budget approval

When the draft budget and accompanying documentation is submitted to parliament by the executive branch, it is generally examined and reviewed by one or more committees. A central role is often played by the committee responsible for economy and finance, which can either carry out the majority of the budgetary review or coordinate the respective reviews of the other committees. A budget or finance committee usually takes the lead in reviewing budget documentation and questioning the underlying macroeconomic assumptions contained in the budget. Similarly, a budget or finance committee will often elicit wider societal views on the budget. A range of witnesses can be called—including senior officials in the ministry of finance, the Minister of Finance and ministers heading line ministries, as well as business groups and CSOs—that would like to provide their opinions about the impacts of the proposed budget on the economy. In smaller legislatures, parliamentary scrutiny is often undertaken by the Committee of Supply.^{XVI}

According to best practices, two key reports related to debt and debt management should be produced by the ministry of finance for inclusion in the annual budget. One of those documents is the DSA—a key fiscal and budgetary policy tool to assess the long-term sustainability of the future debt path under certain macroeconomic assumptions.^{XVII} This is distinct from the MTDS, which articulates how the government intends to implement its debt management approach over the medium term to achieve a desired composition of its debt portfolio, which captures its preferences regarding the cost-risk trade-offs.

DSAs can be helpful in identifying fiscal space, by presenting “both projected debt dynamics and the level at which debt stabilizes in a central scenario (benchmark) and in the presence of various adverse shocks”.^{XVIII} Given that it is a rolling, multi-year document, an updated version of the MTDS is supposed to appear in the annual budget document. See Annex 2 for components and suggested questions that parliamentarians can pose regarding the MTDS and DSA.

III. Execution phase

What should parliament expect from the executive branch?

While execution of the budget is the purview of the executive branch, it is crucial that parliament understands both the governance arrangements for the debt management function as well as the risks and consequences of poor debt management. This will enable parliament to conduct more effective ex-post oversight.

The IMF notes that historically, a country's poor management of its debt has been a significant factor in triggering or propagating economic crises.⁷⁴ Several debt market crises have underscored the importance of sound debt management practices and the need for an efficient and sound capital market. The magnitude of sovereign debt's impact on the country's overall economic health is reflected in the fact that debt is featured prominently in key macroeconomic indicators adopted around the world.

By prudently managing the risk and the cost of debt service, governments can control the rate of public debt growth. Governments that exercise control over public debt dynamics are better placed to ensure fundamental debt sustainability, while being able to service debt even in adverse economic circumstances.

The ministry of finance and central bank provide support and advice to the minister of finance on debt issues. Departmental officials carry out the design, execution and coordination of a debt management strategy and policy decisions. Effective and efficient administration constitutes the backbone of the ministry operations: employees' capacity and the department's managerial structure are a significant factor in the ministry's performance and ability to make informed fiscal policy decisions.

XVI Committee of Supply is a Committee of the Whole responsible for considering and approving the government's expenditure plans). See Parliament of Guyana. Glossary of Parliamentary Terms. Available online at: <http://parliament.gov.gy/publications/glossary-of-parliamentary-terms/>

XVII Macroeconomic assumptions can include the percentage change in the level of real GDP (i.e. GDP growth or reduction), percentage change in the GDP price level (i.e. inflation or deflation of prices) and a change to interest rates.

XVIII The DSA also takes into account other relevant indicators, such as a government's gross financing needs, its fiscal framework, the maturity structure of government debt, the scope for contingent liabilities, the quality of institutions and political risks.

With respect to the governance arrangements for the debt management function, the recommended best practice is that the government designate a **principal debt management entity** that is responsible for undertaking all borrowings and debt-related transactions. This entity is usually housed in the ministry of finance. See box 11. As part of this practice, other agencies, such as the central bank, can conduct debt management activities (i.e. government securities auctions in a domestic market).

It is recognized however that some countries—developing countries in particular—may have a “fragmented managerial structure”. For example:

“In some countries, one entity is responsible for external concessionary borrowing, a second entity for external borrowing on commercial terms, a third entity for domestic borrowing from institutional investors, a fourth entity for borrowing from the domestic retail sector, and so forth”.⁷⁵

A fragmented managerial structure is generally considered to be less efficient and less prone to managing the risks in the overall debt portfolio. For example, according to a report by the Caribbean Development Bank, “The actual management of the debt in some territories resides in different offices and, to the extent that quantitative limits and other constraints are embodied in legislation, responsibility and accountability are unclear”.⁷⁶

Returning to international best practice, experience demonstrates that there is a need to manage debt in a functional framework based on segregation of duties (between the Front office, Middle office and Back office). Segregation of duties is further explored in box 10, below:

Box 10: Segregation of duties in debt management^{XIX}

The rationale for the segregation of duties is to ensure that the internal organization of the principal debt management entity or entities is based on “segregation of duties between the debt managers with the authority to negotiate or contract the loan agreement and enter the contract information in the debt management system, and those responsible for (a) confirmation of contract information, and (b) initiating and processing payments”.⁷⁷

The **Front Office** is responsible for resource mobilization within the existing legal and policy frameworks. A key objective is to mobilize funding for the government in a manner that minimizes the cost of borrowing while considering the established risk parameters. The **Middle Office** performs the analytical function for debt management; while the responsibility of the **Back Office** is to record debt (settlement and payments) maintain a complete and accurate database of the debt portfolio.

Further detail on the key functions of the three offices can be found in Annex 1.^{XX}

XIX Implementing segregation of duties may prove challenging in small jurisdictions due to limited human resources.

XX Implementing segregation of duties may not be possible in all countries, particularly in small island developing states.

Box 11: Sri Lanka—Towards a DMU

Although DMUs are generally located in the ministry of finance, the Central Bank of Sri Lanka (CBSL) has historically played the primary role in the nation's management of debt. The Public Debt Department of the CBSL on behalf of the government issues debt instruments and handles all matters relating to servicing the domestic and foreign debt of the government. The Domestic Debt Management Committee, consisting of CBSL and Treasury officials, decides on the government's domestic borrowing. Also, on behalf of the government, CBSL facilitates the issuances of International Sovereign Bonds.⁷⁸ Sri Lanka's Ministry of Finance handles matters relating to obtaining loans from foreign sources. However, foreign loans obtained by the government are reviewed by the CBSL for potential monetary implications.

In October 2019, Sri Lanka initiated important debt governance reforms by clearing a path for the creation of a separate DMU in the Ministry of Finance.⁷⁹ This move towards a distinct Ministry of Finance DMU follows calls by civil society to limit CBSL authority in this area.⁸⁰

IV. Ex-post oversight

This section covers:

- SAI reporting on debt and debt management;
- The role of the PAC in reviewing the above-mentioned SAI reports;
- Government reporting on debt and debt management; and
- Parliamentary Monitoring of Investment Loans

SAI reporting on debt and debt management

Typically, as part of the ex-post oversight phase, parliament should be reviewing and holding the government to account for how it has spent and managed public funds. The SAI is a key player in this phase, auditing the government's consolidated financial statements, examining the government's compliance with rules and regulations, and conducting value-for-money or performance audits. See box 12, below, for definition of performance auditing.

Box 12: Definition of Performance Auditing

According to the International Association of Supreme Audit Institutions (INTOSAI):

"Performance auditing is an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement. Performance auditing seeks to provide new information, analysis or insights and, where appropriate, recommendations for improvement".⁸¹

Table 4, below, presents a number of SAI audit objectives covering compliance and performance audits related to debt management activities.

Table 4: Audit Objectives Covering Compliance and Performance Audits Related to Debt Management

Type of audit	Area of focus related to debt management	Audit objectives
Compliance	The government's borrowing activities	<ul style="list-style-type: none"> • "Whether⁸² the government's borrowing plan was developed in accordance with statutory requirements (for example including the borrowing plan as an Annex of the budget law)"; and • "Whether the project loans that were contracted followed the prescribed project development and financing process".
Compliance	The government's debt service activities	<ul style="list-style-type: none"> • Whether⁸³ the debt service process, budget and schedules were adhered to as required under relevant laws, rules and agreements; and • Whether repayments were made to the creditor as per the loan agreement.
Performance audit	The government's borrowing activities	<ul style="list-style-type: none"> • Actual borrowing by government was based on sound estimation process of the borrowing needs; • Whether there were reliable estimates of contingencies; and • Whether the principle of economy, namely the minimization of cost and risk was considered when borrowing.
Performance audit	The government's debt service activities	<ul style="list-style-type: none"> • Accuracy of government cash flow forecast and its impact on cost of debt servicing; • Accuracy of the debt service forecasts included in the fiscal budget and its impact on the cost of debt servicing.

Role of the PAC

The PAC, the pre-eminent oversight committee of parliament, often exercises this ex-post oversight role. Typically, the PAC reviews:

- The audited version of the financial or consolidated financial statements to establish whether the financial statements are represented fairly and in compliance with international standards;
- Whether government collected or spent the authorized amount of money for the purposes intended by Parliament; and
- Performance audit reports to determine whether the government spent funds with due regard to economy, efficiency and effectiveness.

When the PAC reviews the audited financial statements, parliamentarians can pose questions about current debt levels and the government's strategy to address the debt. According to international standards, the consolidated financial statements should contain full information on revenue, expenditure, financial and tangible assets, liabilities, guarantees, and long-term obligations, and are supported by a reconciled cash flow statement.⁸⁴ These statements should then be audited by the SAI to ensure that they are presented fairly and in accordance with international standards. As part of its financial audit, SAIs should determine whether public debt information in the financial statements:

- Is presented completely and accurately; and
- Has been accurately and adequately disclosed in a fair manner, in accordance with prevailing accounting standards.⁸⁵

Figure 2, below, maps out the stages of PAC inquiry into public debt and public debt management:

Figure 2: Sample PAC workflow related to debt management



Sample questions that could be posed by the PAC during a hearing into an SAI report on debt management can be found in table 5, below:

Table 5: Sample PAC Questions Related to Debt Management (Compliance or Performance) Audits

Area of Focus Related to Debt Management	Sample SAI Audit Conclusion	Sample PAC Questions
The government's debt service activities	The debt ⁸⁶ service process, budget and schedules were not adhered to as required under relevant laws, regulations and agreements.	How is the government addressing discrepancies between billing statements and the DMU's debt schedule? Has DMU staff identified the reasons for under-payments/over-payments reported by creditors? What is being done to rectify this situation in future? What is being done to ensure that future payments in arrears are acted upon?
The government's borrowing activities	The absence ⁸⁷ of a documented borrowing plan is undermining the government's debt management efforts.	What action is the government taking to develop a borrowing plan? How will the borrowing plan be coordinated with the monetary authority (central bank)? Do debt management officials plan to produce a report on the implementation of borrowing plans? What is the timeline for implementation? ⁸⁸

Government reporting on debt and debt management

Often the government will prepare a separate **annual debt report**, or include a debt report in its annual financial report. The PAC should also review the government's annual debt report.^{XXI} According to the DeMPA, the report should include an evaluation of the debt management operations—including borrowing, liability management operations such as debt exchanges, loan guarantees extended, and on-lending made". The report "should include enough information to enable the parliament or congress to evaluate how successful the debt management operations –including new borrowings and debt-related transactions—have been in meeting the (debt management) objectives".⁸⁹ The annual debt report should be tabled in parliament, as is presently the case in Ghana,⁹⁰ Ethiopia⁹¹ and Kenya.⁹²

Parliamentary Monitoring of Investment Loans

In addition to ratifying loan agreements (covered in Chapter 6), parliaments can play a role in monitoring the implementation of investment projects financed by loan agreements. Here are some examples of possible committee roles:

- The PAC, as part of its strategic planning process, can meet with the ministry of finance and the SAI to determine a list of high-cost, high-risk projects and monitor their implementation on a regular basis with reports from both;
- The same applies for PICs, which can monitor investment projects of SOEs. However, often the process for PIM is less established in SOEs. More rigorous monitoring and the development of a strong framework for PIM should be encouraged; and
- Depending on the number of public investment projects, sectoral committees could also monitor projects under their remit.

XXI When examining the government's annual debt report, the PAC should examine: Composition of outstanding debt at year-end including liabilities, assets and net debt; Composition of outstanding debt in terms of foreign currency debt and domestic debt; Public debt charges: whether the charges are increasing or decreasing and why; Debt-to-GDP ratio as compared to the ratio from the preceding year; Net debt-to-GDP ratio; Performance and results of public debt management; and debt financing activities.

8. Paying Special Attention to State-Owned Enterprises

Just as PACs are tasked with ex-post oversight of government agencies, many parliaments have a committee that is specifically responsible for oversight of SOEs. These committees are prevalent in many East African and South Asian countries, including Kenya, Tanzania and Uganda and Bangladesh and Sri Lanka. Where a specific committee is not charged with oversight of SOEs, this responsibility may fall to the PAC. For example, in Canada, the PAC reviews audits of SOEs prepared by the Office of the Auditor General of Canada on an annual basis.

Where a separate committee does exist, this committee will often examine the reports and accounts of SOEs, examine any relevant reports issued by the Auditor General and, as is the case in Kenya, examine whether SOEs “are being managed in accordance with sound financial or business principles and prudent commercial practices”. SOE oversight committees are generally precluded from involvement in matters of government policy as well as day-to-day administration of the SOE. Among other things, SOE oversight committees can review the process set up by the government to monitor and report debt in SOEs.

Often the public investment disclosures for central government are more rigorous than they are for SOEs. National governments should include:

- Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards; and
- Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure and mechanisms for ensuring quality of information. This should include any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships.

Box 14: Kenya: Role of the Public Investments Committee in SOE Oversight

Under the Exchequer Act, the Auditor General is required to audit public funds authorized by law (including SOEs) at least once a year. In the performance of this function, the AG is required to ascertain expenditures and withdrawals of public funds. Any unauthorized withdrawal or expenditure has to be reported to Parliament through the Ministry of Finance. Once submitted to parliament, the report of the AG is passed on to the Public Investments Committee (PIC), which analyses it and prepares a report for submission to parliament. According to the Organisation for Social Science Research in Eastern and Southern Africa, this system, however, faces several challenges, including: (1) the President may declare a state corporation to not be a state corporation for the purposes of the Exchequer and Audit Act. In fact, the Exchequer and Audit Act allowed the Treasury to exempt some corporations from audit and some of the 12 biggest offenders were exempted from time to time; and (2) the Auditor General is only required to undertake financial audits and do not have the mandate to undertake value-for-money audits covering non-financial matters.⁹³

As part of the annual reporting process, each SOE sends a report to its line ministry, which sends it to the Ministry of Finance, which, in turn, prepares a consolidated report for the PIC. The PIC then analyzes the report and presents a summary to parliament. Compared to other reporting processes, this process is long and information becomes diluted as it moves through the system.⁹⁴

In almost all the cases the PIC made recommendations that the Treasury acknowledged as 'noted' but no action was taken. The Office Attorney General indicated that without initiation of action by the Treasury it was incapable of taking any action.⁹⁵

9. Conclusion and Recommendations

The COVID-19 crisis has had dire economic consequences on the entire globe, for both developed and developing countries alike. This has prompted a series of high-level conversations between multilateral institutions and developing countries about debt relief and the suspension of debt payments during the crisis. These measures are integral to protecting the well being of populations all over the world, especially vulnerable population groups.

However, when the COVID-19 crisis eventually subsides, and the world attempts to reignite the global discussion around implementation of the SDGs, including gender equality and climate change, it should not be 'business as usual' with respect to public debt management. The role of parliament is no exception. In fact, it will be more important than ever for parliament to play a more active role in the oversight of public debt and public debt management.

Many countries that were at risk of debt distress or already in debt distress were already teetering too close to the edge of the cliff prior to the outbreak. Weak oversight of debt and debt management undoubtedly played a role. Countries have consequently seen their fiscal space for critical infrastructure and social spending further shrink as a result of the global economic shutdown, unprecedented in modern times. As the Prime Minister of Lebanon recently stated when it defaulted on its debt for the first time in its history, the country is paying for the mistakes of the past. It is not alone in this regard.

Given that necessity is often the mother of invention, there is much that parliament can and needs to do to strengthen its role in oversight of debt and debt management going forward. What follows is a series of recommendations summarized from this policy brief. Many if not all of the recommendations below are linked to increasing the transparency of the government's debt situation so that parliament is regularly informed, governments are reporting accurate and timely information to parliament and parliament has the time and the technical expertise required to effectively play its scrutiny role.

With respect to understanding the public debt situation (chapters 3 and 4):

- Prior to a parliamentary committee hearing, parliamentarians should request the time required to understand the data related to public debt and seek support from parliamentary staff, where capacity exists; and
- Parliamentarians should seek opportunities throughout the budget cycle (in particular during the approval and ex-post oversight phases) to examine public debt figures and establish whether the government is effectively managing key risks associated with public debt, including: excessive external debt at non-concessional lending rates; domestic debt with short-term maturity structure; and the level of transparency and reporting around the government's treatment of contingent liabilities.

With respect to adopting and modernizing a legislative framework for debt management (Chapter 5):

- Parliamentarians can advocate for the adoption and modernization of a legislative framework for debt management based on international best practices; and
- Parliamentarians can call for (and subsequently conduct) a review of the debt management framework. See Table 1, Key Elements of a Debt Management Law.

With respect to parliamentary ratification of loan agreements (Chapter 6):

- Parliamentarians can advocate for parliamentary ratification of loan agreements to be included in the debt management framework. Additionally, parliamentarians should advocate for the time to properly scrutinize loan agreements based on an established set of criteria. The body of literature on PIM can provide a starting point. See Table 2, Four Stages of PIM and Potential Lines of Inquiry.

With respect to integrating public debt into the entire budget process (Chapter 7):

- Consideration of public debt needs to be integrated across all stages of the budget cycle. With respect to the formulation phase, parliamentarians can advocate for the rules of procedure to include review and debate of the government's MTEF and PBS. Reference to the amount of time required and resources for proper review and debate should also be included;
- As part of the budget approval process, parliament needs to review the DSA and MTDS, in order to effectively understand the current and projected debt situation. This can be done as part of the existing committee budget hearings.
- As part of the ex-post oversight phase, PACs should review compliance and performance audit reports provided by the SAI, in addition to reviewing the debt figures provided in annual (audited) financial statements and government's annual debt report.

Finally, with respect to SOEs (Chapter 8):

- Poor management of SOEs has led to many a debt crisis in the past. Parliamentarians can advocate for a PIC to be formed to oversee the administration of SOEs, in part to ensure that they are functioning properly and not accumulating debt.

Annex 1:

Debt Management Unit: Key Functions of Front, Middle and Back Offices

Office and Function	Examples of function
Front office (Resource mobilization)	<ul style="list-style-type: none">• Managing relationships with creditors and investors;• Implementing the government's borrowing plan based on the approved strategy;• Preparing loan proposals and prospectus; and• Negotiating and contracting loans, issuing guarantees and government securities.
Middle office (Analytical function)	<ul style="list-style-type: none">• Developing a medium and long-term borrowing policy and strategy aimed at minimising cost or risk;• Undertaking portfolio and debt sustainability analysis (the latter in conjunction with the macro policy unit);• Undertaking risk analysis in coordination with the Front Office; and• Producing analytical and annual debt reports.
Back office (Recording function)	<ul style="list-style-type: none">• Registering and recording debt transactions• Settling debt service payments• Forecasting debt service payments and cash requirements• Generating debt reports required for the DMO, the government and lenders and the preparation of annual reports on public debt• Maintaining a comprehensive, accurate and up-to-date debt database• Maintaining a debt management website.

Annex 2:

MTDS and DSA--Components and Questions

	Key components	Suggested questions
MTDS	<ul style="list-style-type: none"> • The objectives and scope of debt management; • The characteristics of the existing debt portfolio and risks; • Sources of potential domestic and external financing; • The macroeconomic framework and structural factors (such as an ageing demographic); • Baseline pricing assumptions and shock scenarios; and • Comparison of alternative funding strategies based on estimates of cost and risk.⁹⁶ 	<p>The DeMPA Methodology⁹⁷ outlines several indicative questions that parliamentarians can pose to better understand the government medium-term debt strategy:</p> <ol style="list-style-type: none"> 1. Has the government written and approved an MTDS? 2. When was MTDS last updated? 3. How has the strategy been carried out? 4. How will projected changes to interest and exchange rates influence the total debt service? 5. What is the ratio of foreign currency debt to domestic debt? 6. What is the ratio of short-term to long-term debt? 7. What is the currency composition of the foreign currency debt? 8. How does the proposed strategy address key risk indicators?
DSA	<p>Two complementary components:</p> <ol style="list-style-type: none"> 9. Analysis of the sustainability of total public debt; and 10. Total external debt.⁹⁸ 	<p>Parliamentarians can pose the following questions to gain a better understanding of information contained in a country's DSA:</p> <ol style="list-style-type: none"> 1. What are the key risks that may affect the sustainability of a country's debt? 2. What are the key vulnerabilities? 3. What are the past and projected drivers of external and public debt dynamics? 4. What is the country's debt carrying capacity? 5. What are the results of the stress test? 6. Are the country's borrowing strategies in line with a country's repayment capacity?



Annex 3:

About the Author

Geoff Dubrow is a consultant with 20 years' experience strengthening the nexus between Public Financial Management (PFM) and parliamentary oversight. When Geoff conducted a strategic review of Global Affairs Canada's support to debt management units in the Eastern Caribbean Currency Union (ECCU), and an assessment of debt management capacity in Jamaica, Geoff recognized that a key (but often absent) factor in effective debt management was political leadership and political will. This has led Geoff to advocate for stronger debt management practices and for an enhanced role for parliament in oversight of public debt management. Geoff also specializes in strengthening the nexus between ministries of finance and budget committees as well as Supreme Audit Institutions (SAIs) and public accounts committees (PACs).

With respect to the latter, Geoff has worked with SAIs to improve capacity to communicate reports more effectively to key stakeholders including parliament, the media and civil society. With respect to PACs, Geoff has conducted assessments of PAC capacity and provided training for PACs on every continent as well as across Canada at the federal and provincial level.

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