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Enhancement and Adoption of Sovereign Debt Management Practices in the Advent of the Covid-19 Pandemic

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This paper discusses the evolution of sovereign debt management over the past two decades, highlights the need for its further evolution in light of the continuous efforts to build sustainable debt and growth policies, and outlines some views on its future following the ensuing challenges from the Covid-19 pandemic. The paper also outlines some key lessons and considerations for sovereign debt restructurings that might emerge as a result of Covid-19-related sovereign debt distresses and concludes by stressing the need of integrating sovereign debt management with fiscal and monetary policies.

I. Introduction

The Covid-19 pandemic has brought the field of sovereign debt management (SDM) back onto the forefront of international debate given the massive deterioration of sovereign balance sheets over the past year. Governments across the globe, regardless of their development stage and/or income levels, have been forced to implement unprecedented emergency financial measures to contain and address the impact of the pandemic on all facets of life while vital sources of tax revenue and foreign currencies earnings have all but evaporated.

The need to mobilize financial resources to address rising social needs and strengthen social safety nets is pushing public sector debts to unprecedented levels across the globe, creating significant financial stress and threatening a wave of potential sovereign defaults. Many

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governments, particularly across low-income countries, are now at high risk of debt distress as debt servicing capacities are nearing collapse. Several governments have already defaulted on their contractual debt service obligations and concerns are rapidly increasing among market participants that many other sovereigns will also need to follow suit and be forced to restructure their public sector debt positions.

As governments continue to confront complex socio-economic dislocations in the face of deteriorating fiscal space, intensifying unemployment, and shrinking national outputs, preparations are necessary to address the high levels of public debt through actions to further improve and institutionalize sovereign debt management operations. There are a variety of sovereign debt management policies that governments can enact to help strengthen sovereign balance sheets and improve the management of debt servicing obligations in the advent of the Covid-19 pandemic, including in cases where a restructuring of sovereign debt obligations becomes necessary.

The field of sovereign debt management has been undergoing a massive transformation over the past twenty years. At least four major global financial crises have positively altered our understanding and management of public debt positions through efforts to institutionalize, centralize and professionalize sovereign debt operations. Major improvements in sovereign debt management have allowed many governments to raise funds more efficiently, proactively manage risk and optimize yield curves, increase transparency through proper data dissemination and greatly improve communication with creditors and market participants. In effect, the adoption of sovereign debt management best practices has successfully allowed many governments to better contain, address, and in many cases, manage the impact of unforeseen shocks.

However, the fallout of the Covid-19 pandemic has been of a different order of magnitude to any other financial crisis of modern times. Covid-19 has become a global health calamity with devastating economic repercussions that are yet to be fully understood. As such, international actions to continue with efforts to improve sovereign debt management best practices are critically important to help deal with rising financing requirements and high public debt levels going forward. Principally among these, is the recognition that sovereign debt management must become a critical component of a country’s macroeconomic framework, fully complementing, and supporting, while maintaining independence, monetary and fiscal policies that enable a viable and sustainable economic model to foster growth and financial well being.

Over the past two decades, sovereign debt management has taken an increasingly important role in every country's macro-economic framework along-side fiscal and monetary policy management. The Asian financial crisis helped fuel a rethinking of sovereign debt management as an integral factor of sound macroeconomic policies to strengthen public credit positions and support viable long-term growth. That trend continued in 2008 and 2014, and now in the advent of the Covid-19 pandemic, the trend towards better sovereign debt management practices does not only need to be solidified but must also continue to take center stage in the international financial agenda and an even more pivotal and complimentary role in a country's overall macroeconomic framework in the years ahead.

Crises can be powerful forces for change, reform, and innovation. The Covid-19 pandemic will not be any different. In the wake of what is rapidly becoming one of the most devastating global health calamities of this century, we are beginning to see extraordinary calls for groundbreaking change and reform across all facets of life, from science to education, politics to race relations, and from economics to public finance, including sovereign debt management, among other fields. From the depths of human despair, forces for positive change are being unleashed across the globe with the potential for the formulation of progressive policies that could well foster a more balanced, equitable and just world in the aftermath of this pandemic.

Readers with a lack of familiarity in public finance may wonder why change and innovation in the field of sovereign debt management has been and will continue to be important for the promotion of a more efficient and better functioning global financial architecture. We often fail to grasp the devasting impact that a government's inability to manage its finances effectively may have on people's daily lives. Simply consider the impact that rising debt servicing costs may have on public balance sheets. Lack of fiscal capacity and the ability to raise sustainable financing often lead to painful squeezes on much needed public expenditure.

In the wake of the Covid-19 pandemic, sovereign debt management will need to take an even more important role in public finance as governments across the world seek not only to raise new financing to meet growing expenditure needs to strengthen health systems, expand social safety nets and deal with the unprecedented impact of the virus, but also to effectively manage the funds that are raised over the medium term and the related impact on public sector debt burdens.

The economic fallout of the Covid-19 crisis is likely to be of a different order of magnitude than that of the previous financial crises. The economic contraction that many countries have experienced thus far feels more like an economic depression at a truly global level given the massive market dislocations, loss of income and devasting impact on public health. And whilst, there appears to be early signs of economic recovery among developed countries capable of rolling out effective vaccine programs, for the rest of the world, the extreme uncertainty in the evolution of the pandemic itself and the inability to finance and replicate the rollout of effective vaccination programs will continue to weigh on economic activity and cripple social safety nets.

As governments across the world ascent to expand fiscal policies and raise additional resources to deal with the health and economic crises triggered by the Covid-19 pandemic, concerns are mounting about the sustainability of public debt positions. Continuing to enhance debt management best practices is critically important as governments grapple with higher and unsustainable public debt positions, massive budgetary deficits, plummeting fiscal revenues and the potential for currency depreciations.

This paper is organized as follows: Section II summarizes how sovereign debt management has evolved in the last two decades. It outlines the most important developments in the field that have led to the effective adoption of well recognized public debt management best practices. Section II looks at how sovereign debt management must continue to evolve to, and in effect, become a vital and complimentary component of a country’s overall macro-economic framework, supporting sound fiscal and monetary policies to foster viable long-term growth through the management of sustainable public sector debt positions. Section III presents some views on the future of the sovereign debt management landscape. Section IV outlines some key lessons that policy makers, and sovereign debt managers, must heed should the impact of the Covid-19 pandemic forces a sovereign to restructure their public sector liabilities. Section V offers some concluding views, highlighting that sovereign debt management operations can no longer be implemented in isolation but as a vital component of sound fiscal and monetary policies.

II. Evolution of Sovereign Debt Management

The growing importance of sovereign debt management is now well documented, with the field taking on even more importance following the Asian Financial Crisis of 1997. Since then, important developments have taken place in expanding our understanding of the scope of sovereign debt management. Public debt management practices have been redefined to empower governments to manage their public debt portfolios and financing requirements more effectively. In essence, a progressive transformation of public debt practices has enabled many governments to reorganize and prioritize debt management operations to optimize borrowing needs and proactively rationalize debt portfolios to minimize debt service whist assessing public debt sustainability.

The International Monetary Fund (IMF) and the World Bank have been at the forefront of developing a global understanding of sovereign debt management as well as codifying best practices to assist countries enhance their ability to better manage public debt positions and build necessary capacity. The public sector's debt portfolio is a nation's largest collection of liabilities containing diverse and often complex financial structures which can have wide ranging repercussions for economic activity if not managed well. Such negative repercussions include stemming growth, depressing domestic investment, disrupting credit intermediation, and increasing risk premiums among others.

Sovereign debt management is quite simply defined as the process for handling a government's financial requirements and raising funds in the most effective way at the lowest possible cost over the medium- to long-term, consistent with a prudent degree of risk (IMF, 2014). In 2004, as the global economy was finally recovering from the shock of the Asian financial crisis, the IMF and the World Bank jointly published the first version of the Guidelines for Public Debt Management.

These Guidelines were in effect the first major resource developed to assist governments formulate effective polices and strategies to manage public sector debt portfolios. It was part of coordinated international efforts, following recognition of the need to develop efficient debt management practices to strengthen the global financial architecture, promote financial stability and help governments develop tools to manage risk and reduce potential external vulnerabilities.

The objective of this paper is not to restate the findings and recommendations outlined in the Guidelines for Public Debt Management, which have been revised several times by the Bretton

Wood institutions, with the last version being published in April of 2014 to take into considerations new developments and proposals. However, this paper does aim to highlight key recommendations that have effectively advanced sovereign debt management operations and best practices. Some of these important developments include the expansion and centralization of sovereign debt management activities into dedicated and at times independent entities that have in effect institutionalized public debt activities.

In the aftermath of the Asian financial crisis, several governments moved to established independent debt management offices (DMOs) that led to the professionalization and categorization of public debt functions, and a recognition of the need to create comprehensive medium-term debt management strategies as part of efforts to proactively communicate and engage with creditors and market participants. The governments and Hungry and the United Kingdom, for instance, where the first to establish independent DMOs in effect professionalizing the role of a sovereign debt manager.

Whilst the degree and form of independence granted to DMOs has varied among countries, the trend to centralize and institutionalize sovereign debt management is now widespread and recognized. Some countries have opted to create semi-independent agencies within the Ministry of Finance or event at central banks, but still professionalising the role of debt manager given the complexity of the tasks and skills required to perform such functions. Many other nations, including Argentina, Brazil, Colombia, Indonesia, and Mexico, followed suit shortly after and have effectively gained market recognition for professionalizing debt management operations and proactively managing their public yield curves.

Over the course of the last decade, sovereign debt management has evolved to become a complex field, incorporating diverse set of policies to further promote economic and financial stability. Sovereign debt managers have emerged as key public policy makers taking on additional financial policy responsibilities well beyond raising financing needs. DMOs have delineated clear functional areas to enable responsibility of all debt management operations, including raising debt (front-office responsibilities), assessing and mitigating risk (middle-office tasks) as well as recording and reporting data (back-office procedures).

Over time, additional responsibilities have been redefined and extended to sovereign debt management including for example the establishment of creditor communication plans, managing sovereign credit ratings, formulating medium-term debt management strategies (MTDS), mitigating (and quantifying) risk, diversifying funding sources and developing liquid local capital markets to foment effective credit intermediation.

III. Future Sovereign Debt Management Landscape

In the aftermath of the Covid-19 pandemic, it is becoming clear that sovereign debt management needs to continue to evolve and be refined further, including among other important issues, to become an integral part of a country's sound macro-economic framework. Sovereign debt managers need to work independently, but in close coordination, with fiscal and monetary policy makers to jointly implement the country's economic objectives and foster sustainable long-term growth.

Without surrendering independence, debt management policy needs to be formulated in coordination with, and to complement, monetary and fiscal policies to ensure that a viable and sustainable economic model can be maintained going forward. This is particularly important to further create the capacity to address unforeseen shocks in the future, capitalising on the lessons that have been learned not only during previous financial crises, but from this current crippling shock.

The Covid-19 pandemic has crystallised the importance and benefits of enabling and promoting close coordination and shared purpose between those policy officials working on managing public debt and those implementing fiscal and monetary policies. Such coordination helps formulate clear financial objectives and define implementable tasks, while discouraging duplication of resources and reducing potential tensions between policy makers. It also ensures clarity of policies for market participants while avoiding the potential unintended consequences of an inconsistent policy mix and confusion over macro-economic policy goals.

Coordinating policy must be well managed by empowering officials to pursue their mandates effectively. Otherwise, lack of operational coordination could risk jeopardising transparency and the independence of central banks and debt management offices. Clearly defined roles and responsibilities for all key policy in officials must be established by law to ensure accountability and effectively foster cooperation.

But the role of sovereign debt managers must not stop with efforts to solely provide information and data to other key policy makers. To provide valuable data and contribute to the implementation of a shared and consistent policy mix, debt managers must continue to build capacity in their DMOs and expand their tool kits to continuously assess the sustainability of the public debt portfolio, assess risk beyond existing liabilities by quantifying existing guarantees provided by the government as well as potential contingent liabilities that may crystalize because of potential future shocks.

In addition, sovereign debt managers must commit continuously to develop and refine their MTDS, which sets all debt management goals, identifies inherent portfolio risks, and incorporates policy changes in response to developments in domestic and external markets. Incorporating tools such as liability management operations (LMOs) to proactively smoothen debt service requirements and address immediate portfolio vulnerabilities are key components of the MTDS. Pre-emptive LMOs should be formulated in consultation with stakeholders and offered to creditors as market conditions allow.

As such, enhancing communications with creditors and stake-holders going forward to foster greater transparency and investor confidence is of critical importance to achieve medium-term debt management goals. DMOs with well-established communication channels can foster effective dialogue with investors, creditors, and market participants to disseminate MTDS plans as well as respond to unforeseen shocks more rapidly. By and large, investors react positively to predictable and institutionalised access to senior policymakers, particularly when effective market feedback is solicited and reflected in policy decisions.

Finally, another important aspect that is becoming vital for debt managers to implement policy goals, is the development of strategies to promote the development of domestic capital markets. Sovereign debt managers need to take the lead in these efforts as the effective development of domestic capital markets requires adequate coordination and cooperation between government institutions, regulators, and other important stakeholders. The required infrastructure builds upon different components to support each other's legal architecture, trading and settlement systems, as well as regulatory and supervisory frameworks. Together they encourage the effective functioning of deep and competitive money, bond and equity markets.

Important features of any market include tradable goods for which demand exists, well-known times and places for issuing and trading those goods, sufficiency of supply, visible market prices and competition as well as adequate regulation. Domestic capital markets need to incorporate these characteristics to foster development and generate confidence. Deep and effective money markets depend on sound trading and settlement platforms. Bond markets depend on deep money markets and equity markets depend on strong bond markets. Each of these cannot be pursued in isolation as they are all part of a symbiotic system. Sovereign debt managers are in the optimal position to lead these efforts.

IV. Sovereign Debt Restructuring Lessons

Sovereign debt management is an important policy component to deal with unforeseen shocks. But as the Covid-19 pandemic has demonstrated, there are times when inherent risks can create liquidity or solvency situations that may be difficult to resolve without extraordinary action, including the need to restructure sovereign debt portfolios. As the pandemic has evolved, sovereign debt has increased to unprecedented high levels and the global stock of public debt is creating huge risk management challenges on sovereign debt managers. Interestingly, while massive accommodation in monetary policy among developed countries have led to record low interest rates, sovereign spreads across developing countries have continued to rise, often closing market access for many countries.

The rising levels of spreads and high public stocks are leading to a deterioration payment capacity among several developing countries. As such, the prospect for financial distress and potential sovereign defaults is increasing. For some countries, the need to restructure their public sector debt portfolios may be unavoidable to restore debt sustainability. Sovereign debt managers faced with this situation should take heed of some important lessons gleaned from the sovereign distress events of the last twenty years.

First, it is important to understand the root causes that led to the deterioration of a government's debt carrying capacity, independent of the pandemic, so that effective policy reform plans can be formulated to address the economic imbalances that worsen with Covid-19. The restructuring of sovereign debt is not to be taken lightly given the potential implications for growth and living standards. Sovereign debt managers need to consult and coordinate with other policy makers to develop plans that effectively deal with the causes of the economic imbalances, not just symptoms reflected in high interest burdens.

Sovereign Debt managers play an important role in helping assess economic imbalances and formulating policies that deal with existing financial challenges. Resources need to be pooled and well-coordinated to ensure a credible and broad-based reform plan is formulated to address those imbalances, strengthen social safety nets, and promote inclusive and sustainable growth. The importance of credible economic reforms cannot be stressed enough. Reforms cannot be implemented solely through fiscal and monetary policies, but the adoption of comprehensive debt management strategies that foster the credit rehabilitation of a country in distress and restores confidence among all stakeholders.

Second, a sovereign debt restructuring in isolation is not a panacea for resolving economic imbalances. The restructuring of sovereign debt is a process that releases resources that support and complement the implementation of a credible economic reform program. Efforts to lower interest burdens or extend maturities will not restore sustainability if economic imbalances are not credibly addressed and investor confidence restored.

Third, multilateral support during a crisis is critically important for a sovereign needing to develop credible reforms that necessitate the restructuring of sovereign debt portfolios. International financial institutions, such as the IMF, the WB and regional development institutions can provide much needed technical support, advice, and concessional financing to help support reforms. In addition, multilateral involvement is viewed favorably by creditors and market participants as their support provides independent validation of reform programs and some assurance of accountable commitment by policy makers to implement difficult reforms to address chronic imbalances.

Fourth, a sovereign debt restructuring must be anchored on a comprehensive debt sustainability analysis (DSA). The resolution of a potential default needs to be based on a transparent and comprehensive MTDS that clearly assesses inherent risks in a sovereign debt portfolio and the polices to address them. The credit rehabilitation of a sovereign goes together with transparency and credibility, which over time will help regain market access.

Fifth, a successful restructuring of a sovereign portfolio must garner widespread support from all external creditors. As such, early and transparent engagement with all stake holders is necessary. Commercial creditors should be considered and approached as important stakeholders given that over time, their continued support is necessary to regain market access as the reform program helps correct the existing imbalances. A comprehensive communication strategy is vital to engage effectively with creditors and all stakeholders in a transparent and orderly manner on the basis of credible and well-defined objectives, anchored by a DSA and grounded on fair and equitable burden sharing.

Sixth, sovereign debt managers must recognize that the restructuring of sovereign debt portfolios is a complex and protracted effort. Experienced professionals who can provide action-oriented advice to address financial challenges will be an asset. Engagement of competent financial and legal advisors should be sought early and in transparent manner to assist with the formulation of adequate solutions and strategies to engage effectively with creditors and negotiate new terms that provide sufficient debt relief to complement the economic reform program. Creditors are stakeholders and interests can and should be aligned to ensure a country in crisis emerges in a stronger credit position.

And lastly, if a sovereign debt restructuring is necessary, debt managers and policy makers should recall that the process for engagement and data dissemination matters. Consensual negotiations based on a transparent and reciprocal exchange of views as well as a policy commitments for inter-stakeholder equity (burden sharing) is necessary to build consensus and foster creditor support for the restructuring of sovereign debts and the success of critical economic reforms.

Consider the cases of Argentina and Ecuador, which were facing massive macroeconomic imbalances even before the Covid-19 pandemic appeared. Both countries found themselves needing to restructure their sovereign commercial debts at the same time during the first half of 2020. Both countries shared common bondholders, yet their approaches to engage with creditors differed and the outcomes indicate a divergent path towards restoring debt sustainability (and regaining market access in the future).

Argentina aimed to secure a restructuring agreement with bondholders without anchoring debt relief on an economic reform program designed to address imbedded imbalances and restore debt sustainability. The Argentine authorities aimed to maximize debt relief to lower fiscal pressures, not to support reforms aimed at addressing existing economic imbalances. Press reports indicate that the negotiations proved acrimonious and were not based on a transparent exchange of data and good faith dialogue.

Ecuador, in contrast, sought to restructure its sovereign commercial bonds anchoring debt relief on an IMF financed economic reform program designed to address imbalances, strengthen social safety nets, and place the public sector debt on a sustainable path. According to reports, negotiations between the Ecuadorian authorities and bondholders, while difficult, were based on transparent and consensual discussions aimed at finding common ground to support the country's reforms and restore debt sustainability.

Several countries, including Belize, Lebanon, Suriname, and Zambia, have already defaulted on their debt service obligations, and are queuing up to engage with creditors. How will they fare in their quest to restore debt sustainability? We will have to wait and see how each of these countries efforts evolve in the months ahead.

V. Conclusions

The economic impact of Covid-19 will be unprecedented. Millions of lives have already been disrupted across the globe. Thousands of jobs have been lost, entire industries are being wiped out, and numerous companies, small, medium and large, are closing down for good. In many low-income countries, the informal sector, where millions earn less than subsistence wages, will likely be devastated. The need for states to shut borders, impose lockdowns and close down economic activity will have long-lasting financial consequences. So will the extraordinary measures enacted to expand fiscal policies that are crippling sovereign balance sheets and threatening sovereign debt sustainability for many counties, particularly in developing nations.

Despite the move to ease some restrictions in developed countries as vaccine programs are being rolled out, the fact remains that the Covid-19 virus has not yet been eradicated. Countries will remain faced with uncertainty about the depth and duration of this global crisis for some time. Governments across the globe are likely to need additional measures to support health systems and ease further economic dislocation, particularly in the wake of potential new strains that are spiking infections in the developing world. More financing will be necessary, and this will come at a massive cost for low-income countries. Managing these increased debt burdens will require sovereign debt management to take on an even more important role in the post

Covid-19 environment.

The IMF and the World Bank, at the behest of the G-20 and governments worldwide, are in the process of revisiting debt management best practices and are extending additional help to assist in building debt management capacity across a spectrum of economies, including low-income countries, which often lack a depth of expertise in this area.

The economic and financial impact is likely to be even more devastating for those low-income countries with fragile health care systems and other long-standing vulnerabilities in the wake of a breakdown in global trade, low commodity prices, a collapse in tourism, and the sharp retrenchment in remittance flows, which will further lead to a surge in both public and external financing needs across these fragile economies.

Over the short term, the international community has come together to help low-income countries mobilize resources to meet some health and economic demands from the pandemic. In April of 2020, the G-20, with support from the IMF, the World Bank and other multilateral organizations, announced a Debt Service Suspension Initiative (DSSI) that allows eligible debtors to suspend external debt payments and re-channel the freed financial resources to mitigate the health, economic and social impact of the COVID-19 virus. Recognizing that many low-income countries are becoming even more vulnerable to debt distress and the likelihood of potential sovereign debt defaults in the coming months, the G-20 launched a Common Framework to help sovereigns that may need to restructure their sovereign debts.

However, these efforts are not likely to prove enough. Sovereign debt management needs to take center stage in a country's macro-economic framework to address rising financing needs and the consequences of deteriorating payment capacities. Over the long-term, and once the pandemic really starts to ease, governments will need to deal with the amounts that were borrowed to meet the crisis. Public debt burdens will increase significantly, and credit rating downgrades are likely to continue as payment capacities erode. Sovereign defaults are also likely to increase. In this environment, sovereign debt management needs to be expanded to ensure effective strategies are formulated to prioritize, redefine, and enhance debt management operations that proactively address the risks embedded in evolving public debt portfolios.

Sovereign debt management needs to become a pillar of national macroeconomic frameworks. Sovereign debt management must complement monetary and fiscal policies so that viable and sustainable economic models can be pursued going forward. Plans need to be developed to integrate effective debt management practices into overall economic policies for proper coordination with fiscal and monetary objectives and support of credible and sustainable recovery strategies after the pandemic subsides. In the advent of the Covid-19 pandemic, debt management practices must be enhanced to incorporate prudent, adaptive, and innovative strategies that complement a sound macro-economic framework.

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