



XII OECD Workshop on “Government Securities Markets and Public Debt Management in Emerging Markets”

hosted by
the Italian Treasury Department, Ministry of the Economy and Finance
Roma, 23-24 May 2002

The annual Workshop on Government Securities Markets and Public Debt Management in Emerging Markets is organised under the aegis of the [OECD Working Party on Public Debt Management](#), whose members are Public Debt Managers and Experts from the 30 OECD Countries. The previous XI edition of the Workshop of June 2001 was held in Istanbul, Turkey.

This year, the [Italian Treasury](#) has been selected for hosting the event, to confirm its international involvement and commitment with the OECD and its activities.

The Working Party on Public Debt Management

The OECD Group of Government Debt Management Experts was set up in 1979 as a special working group of the [Committee on Financial Markets](#).

The OECD Working Party on Government Debt Management is composed of representatives of Governments and Debt Management Officials from OECD Countries. Its main aim is to discuss the issues related to Public Debt Management and to produce documents and guidelines that could serve as a benchmark experience or information tool for OECD Countries.

In 2001, the WP has produced a series of studies and a reports illustrating and evaluating the recent structural changes and trends in OECD Public Debt Markets.

Background of the Workshop

As a “non Members” oriented initiative, the Workshop brings together, around the same physical table, experts and Public Debt managers from OECD and non-OECD Countries. This year, the workshop audience has been enlarged to include also Debt Managers from Asian Countries, that usually meet the European Officials inside the ASEM Forum on Public Debt Management.

Enlarging the audience of the initiative, signals the effort of making the OECD Working Party on Public Debt a reference network for both OECD and non OECD Countries, in the field of Public Debt Management.



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**OECD Workshops on Public Debt Management in Emerging Market
1997-2001**

XI WORKSHOP: Istanbul, 28-29 July 2001

- **Rating of sovereign bonds, country risk premium and the composition of domestic vs. foreign issuance;**
- **Methods of clearing and settlement of government bonds;**
- **Organisation of the Debt Management Office (DMO).**

X WORKSHOP: Warsaw, 29-30 May 2000

- **The Role of Primary Dealer Systems in Emerging Markets;**
- **What is the future for Primary Dealer Systems?**
- **Implications of electronic trading and Communication Systems for Emerging Public Debt Markets**
- **Electronic trading and new technologies for primary markets: current practices, benefits, future changes.**

IX WORKSHOP: Prague, 9-10 June 1999

- **Organisational arrangements for public debt management;**
- **Organisation of cash management and its relationship to debt management;**
- **Reform of the primary and secondary market infrastructures for government securities.**

VIII WORKSHOP: Bratislava, 21-22 May, 1998

- **Issuance strategy and determination of debt maturity and debt duration;**
- **Design and implementation of information technology strategies.**

VII WORKSHOP: Budapest, 22-23 May 1997

- **The Role of Debt Managers in Building Secondary Market Liquidity for Government Debt;**
- **Co-ordination of Domestic and External Debt Management.**



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The issues for discussion of the XII Roma Workshop

I

The Role of Derivatives in Public Debt Markets

Needless to say, the derivatives markets have reached unprecedented highs in the last years. The market remains geographically concentrated — most of the transactions originate in London — but products are becoming more diverse as the share of the most liquid, actively traded “plain vanilla” instruments such as credit default products and total return swaps declines.

According to the statistics of BIS (*BIS Quarterly review*, March 2002), the Notional amount outstanding of OTC derivatives was, in June 2001, equal to 99.755 billions of US dollars (gross market value of 3.045 billions of USD), with an increase of 4,8% and 6,10% to, respectively, December and June 2000: 67,466 billions were due to interest rate contracts (67,6% of total) and 51.407 billions to Swaps (51,53% of Total, gross market value of 1.404 billions of USD). For a comparison, the total Central Government marketable Debt for all OECD Countries was equal to 10.941 billions of USD as reported in OECD Central Government Debt Statistical Yearbook, 2001.

Meanwhile, the Notional principal of Derivative Financial Instruments traded on organised exchanges (Futures and Options) was, in December 2001, equal to 23.539,7 billions of USD, up 65,6% with respect to the amount registered in December 2000. In particular, interest rate futures contract amounted to 9.136,8 and Interest rate Options to 12.477 billions (+139% YTY!).

The share of non-financial customers (including both Public Entities and corporations) in interest rates derivatives activity has remained stable around 8-10% throughout 1999-2001 period (see table below, Source BIS)

	june 1999		dec 1999		june 2000		dec 2000		june 2001	
	\$US bil.	%								
Notional OTC derivatives outstanding total amount	81.462		88.202		94.008		95.199		99.755	
Total Interest Rate derivatives	54.072	66,38%	60.091	68,13%	64.125	68,21%	64.668	67,93%	67.465	67,63%
Total IR Swaps	38.372	47,10%	49.936	56,62%	47.993	51,05%	48.766	51,23%	51.407	51,53%
IRS non-financial	3.828	9,98%	3.863	7,74%	4.315	8,99%	4.190	8,59%	4.463	8,68%

At present, no official or affordable data are available allowing to separate the Government and Corporate components of the total non-financial institutions category. Sovereign issuers involved in Derivatives activity mostly use interest and cross currency swaps to hedge for market and exchange rate risk. Also, swap activity could help in managing domestic Debt Duration and reduce the refinancing risk intervening on the redemption profile (see e.g. Denmark Nationalbanken, Danish Government Borrowing and Debt, 2001).



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Debt Management Issues at the Sub-National Level

Since the late '80s, many National States have been transferring function and competencies to Subnational Entities (SE) which, in turn, may have different nature, as regards territorial dimension and degree of autonomy from the Central Government. The spectrum of SE ranges from very small Metropolitan Communities (e.g. Russian “Federal Cities” of Moscow and St. Petersburg), to Quasi-States (such as German Länder or Canadian States) with their own legislative or elective bodies or representatives in a federal national Assembly.

The problems arising from decentralisation of functions to SE and in general from governing a multi-layer structure of Government can be very complex. For instance, in the case of decentralization of some social expenses and services, or health care, coupled with a balanced budget provision. On one hand, the balanced budget constraint is often necessary to avoid “soft budget” problems, usually deriving from the existence of a National State acting as a lender of last resort. On the other hand, services as health care, could not be well financed under such constraint, except for large and demographically and socially diversified communities or they may require the transfer of resources from other areas showing a budget surplus through cross financing. In sum, self financing is often not a viable alternative for public services or at least is more complicated from an actuarial and financial point of view for a SE.

This brings our discussion to the finance function for SE, and to the possibility for them of accessing national and international Capital Markets, through developed, transparent and liquid markets for their money and securities. Financing of SE expenses (especially for infrastructure investments) can be done through the bank channel (loans) or directly raising Capital on the market, via the issuance of Debt. This last option requires financial skills as well as a functioning and developed financial system.

When issuing Securities, SE must confront with the national and international Capital Markets. Direct access to the market theoretically allows for more resources at lower cost. Indeed, securities will be priced after the evaluation of the creditworthiness and patrimonial soundness of the issuer (e.g. rating), profitability of the project to be financed. Other factors, influencing the pricing and success of a SE issue could be the ability to reach a large investor base (demand), the liquidity of the security, its structure (payments, redemption, CACs) as well as global and national capital market conditions.

Two factors – affecting the investor and issuer behaviour – appear to be crucial in this field: tax collection and revenues and the role of the National Entity.

As regards taxation, it is evident that the more the fiscal independence of the SE, in terms of tax collection, the more solid appears to its patrimonial/cash situation and hence its possibility of paying interests and principal. We recall that fiscal independence can be expressed in terms of autonomy of varying tax rates or defining the tax base.

The role of the National Entity is crucial in the sense that we have already sketched before, that is in connection with moral hazard or adverse selection problems. In particular, the expectation of national government’s intervention in case of payment or roll-over difficulties, may generate fiscal indiscipline and weaken investor’s confidence.



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The Role of Securitisation of Public Assets

As reported by JP Morgan statistics, global issuance of ABSs (Asset Backed Securities) and CDOs (Collateralized Debt Obligations) has grown in 1995-2001 from \$118 to \$568 billion (Yearly avg. 31,25%). ABSs and CDOs are the most widespread type of Structured finance products, and represent two different forms of Securitisation. The largest part of this amount is due to U.S. Public activity

“Securitisation” in its widest sense implies every such process which converts a financial relation (e.g. a creditor debtor relation) into a transaction (e.g. a commercial paper). Very abstractedly, Securitisation can be defined as a reallocation of risk.

It is important to point out that the entity securitising its assets is not borrowing money, but selling a stream of cash flows that was otherwise to accrue to it. This helps the financing activity in that usually avoids confusion between the securitised obligations and all other obligations of the issuer. From the issuer’s point of view, the main advantages of Securitisation are to:

1. Lower funding costs
2. Facilitate accessing to capital markets

From the investor’s point of view this assures against default and allows to measure the effective financial capabilities of the issuer. In addition, securitised structures create custom exposures that investors desire and cannot achieve any other way. These custom exposures fit into investors various risk appetites and capital constraints.

As regards EM, asset backed Securitisation of future-flows receivables may provide a means of securing credit ratings for new issues that escape the sovereign ceiling and thereby reduce the cost of funding. Existing assets as well as currency Securitisation are also an option, but they constitute the minority of all rated Securitisations, even if the share of currency is growing. In addition, according to a World Bank study, future-flows transactions are capable of raising more capital for Emerging Countries, in periods of liquidity constraints. As a proof, we observe that the secured transactions increased as a financing mechanism after the Mexican Crisis of 1994-1995 when sovereign ratings were downgraded and borrowing costs rose in LA many Countries.

They also permit to access the market at lower interest rates and in longer maturity segments with respect to unsecured bonds.

Most of the secured transactions involve receivables from natural resources exploitation. The larger amount of such transactions come from East-Asia Middle East and CEEC Countries, that are richer in Minerals and Oil. As of 2000, the most popular future-flow backed transactions were grouped – according to S&P and Fitch – into 5 main categories, deemed the most secure:

1. Heavy crude oil receivables
2. Airline ticket receivables, telephone receivables, credit card receivables and electronic
3. Oil and Gas royalties, export receivables
4. Paper remittances
5. Tax revenue receivables