# PUBLIC DEBT MANAGEMENT BILL

## POLICY BRIEF

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::::: Policy Brief :::::

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# Abbreviations and Acronyms

FCGO- Financial Comptroller General's Office

GDP- Gross Domestic Product

NNRFC- National Natural Resources and Fiscal Commission

PDMO- Public Debt Management Office

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# Introduction

The new Public Debt Management bill has been registered in the Lower House of the parliament. In the preamble, the bill has defined its objective as to properly manage public finance by maintaining co-ordination between fiscal and monetary policy, and by managing domestic and foreign loans as per the needs of the changed context. The bill has introduced Public Debt Management Office (PDMO), a separate body which will be handling all the matters related to management of public debt including estimation of borrowing required for a fiscal year, identification of the sectors for mobilization of the public loans, issuance and auctioning of the debt instruments, among others which used to be jointly handled by the central bank and Financial Comptroller General's Office (FCGO) previously. At the advent of federalism, a new act for managing public debt was of course necessary as the newly formed sub-nationals governments also have been given rights to retrieve loans for financing their expenditure needs. However, some of the aspects of the bill need reconsideration for successfully managing government finance in all three levels of government. This article will focus on some of these issues.

It comes to the observation that there are two aspects of the current Public Debt Management Bill. One aspect covers the concern regarding

1. Debt Policy in regards to debt ceiling
2. The authority structure governing the issuance and management of the Government debt instruments issued by different levels of the government in both domestic and international markets

3. Matters related to reassuring the debts undertaken by subnational governments and other organizations by the Federal Government
4. Recovering the reassured debts defaulted by the subnational governments and non-governmental organizations

This particular aspect has been comprised in the bill as the advent of Fiscal federalism has empowered subnational governments to manage their own finances regarding which, the authority of the subnational governments to access loans is provided in sections of the Constitution that covers financial procedures of both provincial and local governments.

Likewise, another aspect covers the regulation governing repayment and claim of Principal and Interest Payments by the creditors of the Government debt instruments. As such, both aspects warrant lens of analyses that are specific to each cluster of concern. The former aspect needs observation in regards to soundness of policy relating to effective Public Debt Management in advent of Federalism, and the later needs observation in regards to policy being justifiable for the creditors of the Government Debt instruments. The analysis of this brief is limited to the former aspect of the bill, and therefore critical analysis has been confined for the same.
In regards to the analysis regarding the soundness of policy for effective Public Debt Management of the country, the lens of analysis for the provision of this bill can likely be about

1. The rationale behind assigning the debt ceiling level for external debts
2. The incidence of liability during default of the Federally unassured debt instruments issued by the subnational governments

3. The centralization of debt administration after advent of Federalism in Nepal, and
4. Resolution to improve the marketability of the Federally unassured debt instruments issued by the subnational governments

# Analysis

## 1. The rationale behind assigning the debt ceiling level for \ external debts

| Section | Sub-section | Issue |
|---|---|---|
| 5 | 2 | The amount of external loan that can be retrieved by the governments is rigidly limited to NRs 1.2 Trillion |

Sub-section 2 of the Section 5 allows Nepal Government on behalf of itself or other levels of the government to retrieve external loan of no more than NRs 1.2 Trillion at once or during multiple occasions. This decision to assign external debt ceiling appears rational in terms of preventing external debt crisis that can seriously jeopardize the macroeconomic condition of the country. However, the rationale behind rigidly placing the external debt ceiling at a certain amount may not be sufficiently scientific.

Instead, the external debt ceiling should be relative to the changing size of the National economy or the foreign reserve value. As such, debt limit in terms of not surpassing certain percentage of the National Gross Domestic Production (I.e., GDP in this case) could appear rather relevant as it addresses the periods of changed macroeconomic condition of the country. Besides, Debt-to-GDP ratio is also a proven and popular method of gauging the soundness of an economy.

However, through consultation with relevant government stakeholders, it came to knowledge that the ceiling amount is revisable on every fiscal year based on the changed macroeconomic condition of the country. Regardless, the stakeholders did agree that setting external debt limit in proportion to the national GDP will definitely become more legislatively convenient.

On the same context, setting external debt limit based on proportion to GDP is not without its own challenges. As such, there still does not exist rigorous data retrieving and measurement technique to accurately project the national GDP so in order to comfortably set the percentage limit of external borrowing against the GDP. Therefore, before setting the external borrowing limit against any macroeconomic indicator, the rigorousness in calculation of the very macroeconomic indicator (i.e., GDP in this case) is pivotal. Besides, exactly recognizing the borrowing capacity of the country is also crucial before setting the external borrowing limit as a prerequisite..
As for the moment, if the set external debt limit amount is revisable in nature in every fiscal year, then such may need to be outlined in the bill.

**2. The incidence of liability during default of the Federally unassured debt instruments issued by the subnational governments**

| Section | Sub-section | Issue |
|---|---|---|
| 14 | 4 | Uncertain whether only subnational government or the entire nation shall be responsible for the Federally unassured debt defaulted by the subnational governments<br><br>Unclear regarding further consequence and resolution in case subnational governments default on Federally unassured debt |

Section 14 of the Public Debt Management Bill through its eleven sub-sections enlists the provisions for Federal Government to guarantee the loans retrieved by institution of governmental or non-governmental nature. And, sub-section 4 specifically provides the provision for the Federal Government, at its discretion, to reassure the internal loans retrieved by subnational governments. As such, the Federal Government shall ultimately be liable for the default of the debt taken by the subnational governments. And, the default is likely to be recognized as the default by the nation itself. However, in order to prevent such condition from occurring, sub-section 4 of the section 8 of the Bill allows the Federal Government to recoup the owing principal and interest payment of the loan retrieved by subnational governments by forfeiting the exact amount of revenue to be shared by the Federal Government with the defaulting subnational governments. However, in case of default by the subnational governments of the kind of debt not reassured by the Federal Government, it is unclear if it will merely be considered as default by that defaulting subnational government or shall have ramifications at national-level as well. Subsequently, the resolution after default of the debt by the defaulting subnational government of the loan not reassured by the Federal Government is not certain either. However, through consultation with the relevant government stakeholders, it came to the conclusion that regardless of the subnational borrowings being reassured by the Federal Government or not, the Federal Government is ultimately liable for the debt defaulted by the subnational government as it is already implied by the fact that the subnational government would only be borrowing funds at the approval of the Federal Government. As such, the Federal Government shall, as mentioned in Section 4(8) of the bill for Federally reassured subnational borrowings, also use the mode of revenue sharing mechanism with the subnational governments to raise the amount of debt being defaulted by the particular subnational governments.

Likewise, another issue regarding borrowing by local governments comes to be that there is not enough clarity regarding how the local Government shall be raising the public debt. As such, it is very important to be aware of the procedure for the local government to retrieve public debt before the discussion on whether the local government exclusively or the whole economy will be liable for the Federally unassured debt defaulted by the local government.

As such, since local governments in opposed to Federal and Provincial Governments are not allowed to issue their own debt instruments as per the Inter-governmental Fiscal Arrangement Act. In this regards, one of the participants of the consultative meeting recommended establishment of local government funds of trust or corporate nature to assess the viability of the purpose or the project for which the local government is seeking funds. As such, the fund company or the trust can act as the fiscally responsible mediator or facilitator of the credits for local government entities. Most importantly, such measure will also contribute towards maintaining fiscal discipline regarding debt affairs of subnational governments.

Meanwhile, if Federal Government is liable for entire debt default by the subnational governments, then such should be made explicit in the bill

### 3. Matters related to reassuring the debts undertaken by subnational governments and other organizations by the Federal Government

| Sections | Sub-sections | Issues |
|---|---|---|
| 4 | - | Management and administration of subnational debts by a Federal agency (i.e., Public Debt Management Office) centralizes the issue regarding debt management, and therefore rejects the spirit of Fiscal Federalism |

Likewise, section 4 of the bill covering the function and duties of the Public Debt Management Office (PDMO) and other areas clearly mention the function of the PDMO to manage internal loans also retrieved by provincial and local governments by limiting within the recommendation provided by the National Natural Resource Fiscal Commission (NNRFC). As such, PDMO shall be expected to administer and manage the entire work of debt issuance, auctioning, record-keeping, and other administrative work of the loan retrieved by subnational governments until it is finally deposited in the consolidated funds of the respective subnational governments. Analytically, such provision of managing and administering the entire debt management issue of subnational governments by a Federal agency rejects the spirit of Fiscal Federalism, and represents centralization in this crucial aspect of Public Finance. It tends to create a rigid hierarchical order among the level of governments in areas of debt financing and management.

Besides, it is also doubtful if it is practical for a single federal debt management agency to administer the process of debt financing for 761 units of governments at Federal, Provincial and local level. The capacity of the agency is likely to be eroded rapidly in case only one-third of the total unit of governments would choose to issue debt-instruments in a same fiscal year.

In stark contrast, an official representing the local government expressed doubt regarding capacity of the Rural Municipalities located in remote regions to be able to administer their own debt issues. As such, the official asserted that the matters related to management of the debt should be handled by the Central Government agency. The assertion comes along with the confidence of the PDMO chief regarding the technical and administrative capacity of the PDMO to handle debt administration of all levels of the governments. Meanwhile, a government official representing a constitutional commission under the Finance Ministry regarded that the centralization in the administration and management of the loans to be retrieved by subnational governments proposed in the bill is neither effective nor practical. As such, the official also doubted if Provincial Government would choose to recognize PDMO as the authority body for debt management amid advent of Federalization in Fiscal management. However, an official of the FCGO recommended sharing of the authority between PDMO and the subnational government as it appears fit.

4. **Resolution to improve the marketability of the Federally unassured debt instruments issued by the sub-national governments**

Last but not the least, it is no doubt that the marketability of the debt instruments to be issued by the subnational governments in both national and international markets is crucial for the effective functioning of this debt financing provision provided to the subnational governments. Meanwhile, the marketability of subnational government instruments can be anticipated to be low or shallow as subnational governments shall not only be issuing their debt instruments for the first time, but also their formation itself is only recent and unfamiliar to the potential creditors. As such, the potential creditors are uncertain about the debt servicing capacity of the subnational governments, and are therefore unable to assess the risk of purchasing subnational debt instruments. Alas, the potential creditors are likely to be hesitant about purchasing subnational debt instruments that does not provide adequate means of risk assessment. The issue remains relevant even though the debt issues are reassured by the Federal government. After all, even the Centrally issued debt-instruments maintain the legacy of a very poor performance in regards to market subscription due to lack of market trustworthiness and attraction.

Therefore, allowing for the provision of rating the debt instruments issued by all level of Governments in this Public Debt Bill on the basis of their serviceability can play a crucial role in improving marketability of the government securities in the future. It is because the rating of the debt instruments enables assessment of their risk and increases their marketability in both internal and external securities market. Importantly, such rating practice not only creates solid market platform for subnational debt instruments not reassured by the Federal government, but also shall improve demand of all government debt-instruments, thus also reducing the cost of debt servicing. However, during our consultations, one of the government officials revealed that the government accounting procedure does not adequately meet the criteria for standard credit gauging practice. For instance, the government either does not prepare appropriate fiscal balance sheet or mostly prepares balances sheets on cash-accounting basis. In opposed to cash-accounting basis, it requires preparing fiscal balance sheet on accrual basis in order to meet the criteria of standard credit gauging practice. As such, significant adjustments need to be done in government fiscal reporting practice before the government securities issued by different tiers of Government can be rated. Even though the significance of rating government securities is essential to improve the marketability of government securities in International and domestic market, substantial adjustments beforehand in terms of fiscal reporting practice remains crucial.

SAMRIDDHI FOUNDATION

Samriddhi, The Prosperity Foundation is an independent policy institute based in Kathmandu, Nepal. It works with a vision of creating a free and prosperous Nepal.

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i. Entrepreneurship development
ii. Improving business environment
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*(more information at www.samriddhi.org)*

Prience Shrestha reserves interest in area of Development Economics and policy research. He previously researched in policy facilitation for microenterprises. He is currently pursuing research in the subnational governance after the inception of federalism in Nepal.