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Designing Legal Frameworks for Public Debt Management

by Elsie Addo Awadzi

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I N T E R N A T I O N A L M O N E T A R Y F U N D

Legal Department

Designing Legal Frameworks for Public Debt Management

Prepared by Elsie Addo Awadzi¹

Authorized for distribution by Ross Leckow

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Abstract

Sustainable public debt has gained renewed attention as countries implement fiscal consolidation measures in the aftermath of the global financial crisis. Sound public debt policies and debt management practices require robust legal underpinnings. Complex legal issues however arise in the design of the legal framework, and tradeoffs are required in many instances. This paper analyzes key features of modern public debt management legal frameworks, drawing from examples in advanced, emerging, and frontier markets. It aims to provide guidance for countries that seek to review and strengthen their public debt management legal frameworks.

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I. INTRODUCTION

“And to preserve their independence, we must not let our rulers load us with perpetual debt. We must make our election between economy and liberty, or profusion and servitude. If we run into such debts, as that we must be taxed in our meat and in our drink, in our necessaries and our comforts, in our labors and our amusements, for our callings and our creeds, as the people of England are, our people, like them, must come to labor sixteen hours in the twenty-four, give the earnings of fifteen of these to the government for their debts and daily expenses; and the sixteenth being insufficient to afford us bread, we must live, as they now do, on oatmeal and potatoes; have no time to think, no means of calling the mismanagers to account; but be glad to obtain subsistence by hiring ourselves to rivet their chains on the necks of our fellow-sufferers.”

Thomas Jefferson, Letters of Thomas Jefferson (1743–1826)

1. **Sustainable public debt was as important a policy objective in the eighteenth century as it is today.** More recently, sovereign debt crises in developed and developing markets especially in the wake of the global financial crisis have brought renewed attention to the need to keep public debt at a sustainable level. Indeed, as has become evident, unsustainable public debt does not only affect economic and fiscal stability, but can be inextricably linked with instability of the financial sector.²
2. **Sound public debt management (PDM) helps to support sustainable debt objectives.** PDM is the process of establishing and executing a strategy for managing the government’s debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.³ Guidance for effective PDM has been provided over the years by international organizations such as the IMF and World Bank,⁴ the OECD, and the Commonwealth Secretariat,⁵ among others.
3. **A robust legal framework is critical for effective PDM, given the centrality of law to public debt.** While political and economic factors tend to influence debt policies and the quality of debt management practices, a good legal framework helps to promote discipline, transparency, and accountability, all of which are critical to achieving sustainable debt. In recognition of this, reforms to strengthen PDM legal frameworks have continued to take place in many countries, in some cases, motivated also by near sovereign debt defaults

² Existing literature suggests that banking crises often precede or accompany sovereign debt crises. Moreover, public debt levels accelerate markedly and systematically ahead of a sovereign debt crisis with often previously “hidden debt” surfacing as crises unfold—See Reinhart C., and K. Rogoff “From Financial Crash to Debt Crisis” 2010.

³ See IMF and World Bank Revised Guidelines for Public Debt Management, April 2014.

⁴ IMF and World Bank’s Revised Guidelines for Public Debt Management, April 2014. See also IMF “Government Financial Statistics Manual” (GSFM) 2014; IMF “Public Sector Debt Statistics: Guide for Compilers and Users” 2011 and 2013.

⁵ For example see Roy, Arindam, and Mike Williams, “Government Debt Management: A Guidance Note on the Legal Framework,” Commonwealth Secretariat, October 2010.

or sovereign bond market debuts. Existing literature, however, suggests that while PDM legal frameworks are generally improving, further strengthening is required.⁶

4. **The design of the PDM legal framework involves a complex set of interactions among distinct but related legal concepts.** Perhaps one of the most challenging endeavors in the design of the PDM legal framework, is striking a careful balance between flexibility in the exercise of authority on the one hand, and appropriate controls and safeguards on the other. Complexities in this regard are discussed throughout the rest of this paper.

5. **This paper analyzes a comprehensive set of issues in the design of PDM legal frameworks.** Drawing on multi-jurisdictional examples from primary and secondary sources, the paper provides an assessment of key legal issues encountered in the design of PDM legal frameworks, and where appropriate, highlights their role in supporting fiscal sustainability objectives. The key objective of this paper is to provide guidance for policy makers, debt managers, and legal drafting teams, as they contemplate PDM legal reforms.

6. **This paper is structured as follows:** Part II discusses a broad overview of the PDM legal framework. Part III explores legal framework design considerations, and Part IV deals with key elements of the PDM legal framework. Part V analyzes institutional arrangements for PDM. Part VI discusses transparency, accountability and reporting, and Part VII concludes.

II. WHAT IS THE LEGAL FRAMEWORK FOR PUBLIC DEBT MANAGEMENT?

7. **Broadly-speaking, the PDM legal framework encompasses the legal norms and institutions that govern public sector debt.** The legal framework reflects public law and private law components. Public law in this context refers to the body of law that regulates the government's authority to borrow and conduct its debt management activities, the roles and responsibilities of various players in PDM, and other substantive and procedural matters that affect public debt. Private law in relation to public debt generally comprises the body of law⁷ as may be reflected also in contractual arrangements⁸ that govern the economic interests or rights and obligations of Government and its relevant counterparties (such as creditors, and agents). The IMF and World Bank Revised PDM Guidelines (2014) recommend that debt management transactions should incorporate sound legal features, and that debt managers should ensure that they have received appropriate legal advice before undertaking transactions.

⁶ Olden Brian and John Gardner "Cash Management and Debt Management: Two Sides of the Same Coin?" in Public Financial Management and its Emerging Architecture, Eds Marco Cangiano, Teresa Curristine, and Michel Lazare, IMF 2013.

⁷ This may include the Civil Code in some jurisdictions, the law of contract, commercial, trust, and securities laws, among others.

⁸ These may include the terms and conditions for Government debt documented in loan agreements, bond indentures, prospectuses, and other issuing documents; derivatives contracts, agency agreements, among others.

8. **While this paper focuses more on public law regulating public debt, the importance of the private law component cannot be overlooked in the overall design of the PDM legal framework.**⁹ Moreover, in the particular case of public debt, the distinctions between “public law” versus “private law” tend to be blurred given the fact that Government as the main interlocutor, draws its capacity and authority to enter into debt-related contracts (private law) from public law. This makes a comprehensive approach to design of the legal framework even more critical.¹⁰

Sources of Public Debt Management Law

9. **The PDM legal framework typically comprises a complex maze of laws at various levels.** These could include all or some combination of supranational, national, and sub-national legal frameworks.

10. **Supranational frameworks could affect public debt management in a given jurisdiction.** For example, treaties signed by members of a monetary union and/or rules made pursuant to such treaties, could prescribe convergence criteria that include constraints on public debt and overall fiscal policy.¹¹ Such supranational rules may become part of the domestic law of the various member states, subject to any constitutional requirements for the formal adoption of treaties at the national level.¹²

11. **The scope of the domestic legal framework governing public debt management may vary.** These may include Constitutions, as well as primary legislation (Acts of Parliament, Laws, Decrees, as the case may be) which provide the broad legislative architecture within which public debt is contracted and managed. This is usually supplemented by a secondary legal framework (regulations, rules, guidelines, and circulars, among others)¹³ to elaborate on operational aspects of the framework.

12. **Constitutions tend to be the primary source of law for PDM, as a subset of public financial management.** Among other things:

⁹ For an exposé on private law aspects of public debt securities- a subset of public debt- see Bossu W., and Addo Awadzi E., “*Private Law Underpinnings of Public Debt Securities Markets*,” *Uniform Law Review*, 2013 Vol. 18, 2013, 564–588, Oxford Journals/Oxford University Press.

¹⁰ See Bossu and Addo Awadzi, 2013.

¹¹ Examples include the EU’s Treaty of Maastricht, and the Stability and Growth Pact (SGP); and treaties of the Eastern Caribbean Currency Union, the West African Economic and Monetary Union, and the Central African Economic and Monetary Union.

¹² E.g. a number of EU member states have enacted Stability Pact legislation adopting the EU SGP.

¹³ Some of these (e.g. guidelines or circulars) may not be legally enforceable instruments, depending on local law and practice.

- ***Political structure and powers:*** Constitutions establish the general structure of government and the allocation of political powers. The extent to which political power is allocated to national and sub-national political entities and the competencies of each level of government will have implications for management of public sector debt.
- ***Fiscal powers:*** Incidental to the establishment of political structures and powers, Constitutions typically allocate fiscal powers, including taxing and borrowing authority. It is also usual for Constitutions to set out clearly the distribution of fiscal powers among various levels of Government. For example, the Austrian constitution establishes a federal system of Government comprising the Federal State, nine States, and a number of municipalities, all of which have autonomy under the Constitution to manage their respective budgets and to borrow.¹⁴ Similarly, in Bosnia and Herzegovina, both the “Federation of Bosnia and Herzegovina” and the “Republika Srpska” have authority to regulate their respective debts.¹⁵
- ***Institutional arrangements:*** In some jurisdictions, the Constitution lays the broad foundation for institutional arrangements for public finances including debt management. The respective roles of the executive and legislature for various aspects of debt management may therefore be shaped by the Constitution.
- ***Accounting and reporting framework:*** In several jurisdictions, the Constitution provides for broad accounting and reporting requirements relating to public finances including debt. The design of public debt legislation will therefore need to reflect such constitutional requirements.

13. **In addition to the Constitution, a number of primary legislation may regulate PDM.** Examples include:

- **Public financial management (PFM) legislation in jurisdictions, tend to provide for debt management with varying levels of detail.** Broadly speaking, these include budget system laws,¹⁶ and fiscal responsibility laws,¹⁷ and others which regulate fiscal policy making, budget processes, and cash management, to mention a few. Given that public debt is an integral part of

¹⁴ By virtue however of the Austrian Stability Pact, each level of Government is required to coordinate its budget including through the surveillance of the development of budgets, public deficit and public debt. See Theis Rechtsanwälte GmbH & Co KG “The Wolf Theiss Guide to: Public Debt Management in Central, Eastern & Southeastern Europe” 2012.

¹⁵ *Ibid.* The Law on Debt, Debt Issuance and Guarantees of the Federation regulates the conditions for the creation and management of public debt by the Federation and by its lower administrative and territorial units (cantons, municipalities, cities, as well as certain public funds), while the Republika Srpska’s Law on Debt, Debt Issuance and Guarantees of sets out the rules for the creation and management of public debt within the latter.

¹⁶ Examples include Canada’s Financial Administration Act (R.S.C., 1985, c. F-11).

¹⁷ See for example, Brazil’s Fiscal Responsibility Law of 2000 as amended.

the PFM framework, PFM laws tend to contain some provisions on public debt. The level of detail however depends to a large extent on whether separate debt-specific legislation also exists or is contemplated.

- **Several jurisdictions have dedicated public debt legislation.** In such jurisdictions, legislation exists specifically for Government borrowing/public debt management, in addition to the broad provisions of PFM and other relevant legislation.¹⁸ In others¹⁹ legal provisions authorizing borrowing are scattered over a plethora of laws, with sometimes different laws governing borrowing from particular creditors, or particular borrowing instruments such as Government securities only.²⁰
- **Other relevant legislation:** Almost all jurisdictions have legislation that are not specifically public debt or PFM related laws but whose provisions may have implications for public debt management. In several jurisdictions for example, Central Bank enabling laws contain important provisions on central bank lending to Government (so-called monetary financing). Central Bank laws may also designate the central bank as Government's fiscal agent and banker, and in that regard, confer on the Central Bank a role in PDM. As a result, the Central Bank law in a given jurisdiction is often an important source of law for PDM.

14. **As mentioned earlier, many jurisdictions use subsidiary legislation to supplement their primary legal framework for public debt management.** These usually comprise a set of regulations, "ministerial orders", rules, or other instruments issued by the Minister of Finance. In some cases, the Minister may delegate power to the Central Bank in its capacity as fiscal agent of the Government to issue rules governing the market for Government securities. These may include rules for determining the method and timing of sales, and the terms and conditions on which securities are issued.

¹⁸ Examples include Sweden's Act on State Borrowing and Debt Management of 1998, the United Kingdom's National Loans Act of 1968, Thailand's Public Debt Management Act of 2005 (B.E. 2548), and Turkey's Law on Regulating Public Finance and Debt Management 2002 (Law No. 4749). Others include Ghana's Loans Act of 1970, Jamaica's Public Debt Management Act of 2012, Mauritius' Public Debt Management Act of 2009 (amended through 2012), Moldova's Organic Law No. 419 of 2006 on Public Debt, State Guarantees and State On-lending,¹⁸ Sierra Leone's Public Debt management Act of 2011.

¹⁹ Examples are Belize, Botswana, Grenada, Lesotho, and Swaziland. In these countries, the legal framework is reflected in the Constitution, PFM laws, laws regulating public debt; specific laws governing Government securities, and others regulating borrowing from specific creditors.

²⁰ For example, although Moldova has a dedicated PDM legislation, its scope excludes Government borrowing from the IMF and other non-resident lenders. Articles 1 (3) and 21 of Moldova's Organic Law No. 419 on Public Debt, State Guarantees and State On-lending, provide that external borrowing by the State or the National Bank of Moldova from the International Monetary Fund and other non-resident lenders are to be governed by separate Acts of Parliament.

Box 1: Sources of PDM Legal Framework

Supranational

- *Treaties of Monetary Union Members*

Constitutions

- Distribute political and fiscal powers and basic institutional arrangements, establish broad public finance arrangements including the authority to borrow and pay for debt related costs and expenses, and requirements for audit and reporting;

Primary Legislation

- ***PFM legislation***—Include budget laws, public financial management/administration laws, fiscal responsibility laws; and establish the framework for budget preparation and execution, cash management, public debt, accounting, auditing, and reporting;
- ***Dedicated debt legislation***—Include public debt management laws, Government loan laws, treasury securities laws, or others, which provide more specifically for mandates, institutional, and operational matters relating to public debt management; and
- ***Others***—Include other relevant laws such as Central Bank laws. Central Bank laws typically provide for Government borrowing (if any) from Central Banks, and the central bank's role as fiscal agent to Government.

Secondary Legislation

- Regulations
- Rules, Circulars (e.g. Government Securities Market Rules or Circulars, etc).

III. LEGAL FRAMEWORK DESIGN CONSIDERATIONS

Design Approaches

15. **Designing PDM legal frameworks involves several important considerations.** The approach for addressing weaknesses in the existing legal framework should be pragmatic and should be carefully calibrated to help meet reform objectives. Key considerations include the extent to which legislation may be required to codify or modify existing practices. What should be legislated and to what level of detail? Which law(s) should incorporate the framework for PDM? These and other considerations are discussed below.

16. **The legal framework for public debt may be more consolidated in some jurisdictions than in others.** In the design of PDM legal reforms, the extent of consolidation desired should be considered. While consolidation of the legal framework is not necessarily required, there could be benefits from consolidation, such as clarity, ease of reference, and consistency in the overall governance framework affecting public debt. Where multiple pieces of legislation exist, it is important to ensure that there are no overlaps, inconsistencies, or gaps, which may weaken the overall PDM framework. Together, the relevant sources of PDM law should provide a clear, comprehensive, and unambiguous framework for effective PDM.

17. **The use of the PFM or budget laws to provide comprehensively for PDM legal issues may be a preferred option in certain jurisdictions.** An overarching PFM law which covers all aspects of public finance is preferred in some advanced and developing countries. Examples include Canada’s Financial Administration Act, South Africa’s Public Finance Management Act of 1999 (amended through 2007), Kenya’s Public Finance Management Act of 2012, and Uganda’s Public Finance Management Act of 2015 which all deal extensively with public debt management as part of the broader PFM framework. Also for some jurisdictions with the civil law tradition, elevating the PDM legal framework to the level of the Organic Budget Law may help ensure that the PDM legal framework is more entrenched than would be the case with an ordinary law.²¹

18. **Furthermore, the distribution of matters provided for in primary legislation versus secondary legislation, is an important issue in the design of the legal framework.** In making the determination one way or the other, it is important to consider which matters may be appropriately left to Cabinet or the Minister to elaborate by secondary legislation, rather than specified by legislature in primary legislation. Good practices in PDM require that the legislature establishes the broad framework for PDM, while operational details and guidelines could be left to the Minister to determine. These institutional arrangements are discussed in more detail in Part V of the paper.

19. **Another key design issue relates to the range of matters to be covered in the legal framework.** More often than not, the legal framework for public debt does not only deal with Government borrowing, but also makes provision for lending and/or on-lending by Government, given that it tends to be closely related to Government debt and contingent liabilities. While not in the domain of debt management, in some jurisdictions, the legal framework may also provide for the receipt and management of grants intended for Government.²² This may be due to the fact that in some jurisdictions—particularly

²¹ In some civil law jurisdictions such as France and Spain, the Constitution recognizes the concept of “organic law”, which in some cases may enjoy a higher legal status, next only to that of the Constitution, in terms of its supremacy and entrenched provisions.

²² For example see Tanzania’s Loans, Guarantees, and Grants Act of 1974 as amended in 2004.

developing countries—Government debt may also have grant components, and in some cases, both debt and grant management are managed by the same department/team in Finance Ministries.

Relationship between PDM, PFM, and Fiscal Responsibility Laws

20. **Where they all exist, PDM laws, budget-related laws, and fiscal responsibility frameworks are often part of the same broad public finance management framework and should be viewed as such.** The PDM legal framework should therefore be well coordinated with the overall public finance management framework. Fiscal responsibility frameworks usually encompass principles, rules, and institutional arrangements which together seek to constrain Government fiscal policy making. Typically, a fiscal responsibility framework that has binding fiscal rules such as budget balance or debt rules may have implications for PDM, and will require consistency with each other.

21. **The design of the legal framework should also promote clarity in the interaction between PDM, budget execution, and cash management.** Among other things, the PDM legal framework should be consistent with budget planning and execution, cash management, and accounting and reporting requirements under the PFM framework. In particular:

- a. The legal framework should require public debt issuance to be reflected in the budget planning and execution phases, to ensure that they are well accounted for.
- b. Similarly, the PDM legal framework should support effective cash management by requiring all proceeds of debt issuance to be reflected in the consolidated fund.²³ While some jurisdictions provide for the establishment of separate accounts (e.g. special loan accounts²⁴) for proceeds of debt, these are increasingly rare, in part due to efforts of several jurisdictions to implement the treasury single account concept.
- c. The legal framework should also clarify the accounting, audit, and reporting framework for public debt, consistent with the overall framework for accountability for public finances.

²³ A genuine exception to this may be in the case where Government securities are issued for monetary policy purposes, where the proceeds of such issuance are “sterilized” into a separate account which is not accessible for Government’s general expenditures.

²⁴ For example the U.K.’s “National Loan Fund” is established under section 1 of the National Loans Act of 1968 as a Treasury account to be maintained with the Bank of England and into which loans obtained by the Government could be paid. Under section 18, any excess of liabilities of the National Loan Fund over its assets, is deemed to be a liability of the Consolidated Fund to the National Loan Fund. Also Schedule 5A of the same Act established the “Debt Management Account” whose purpose includes ensuring effective liquidity management under the National Loan Fund.

IV. KEY ELEMENTS OF SOUND PDM LEGAL FRAMEWORKS

22. **A good legal framework for public debt management should establish broad parameters, but at the same time provide sufficient clarity on several key issues.** Key elements of the legal framework are discussed in what follows.

A. Scope of Public Debt

23. **The legal framework should define what constitutes public debt.** There is no universally-accepted definition of “public debt” and various jurisdictions define this differently, with varying policy implications. Existing literature suggests that debt-to-GDP ratios for a country at any given time could range from 40 to over 100 percent depending on the definition of “public debt” used.²⁵ It is therefore critical that the legal framework for a given jurisdiction, defines the scope of public debt explicitly.

24. **From a legal perspective, the definition of “public debt” is important for a number of reasons.** It has implications for the types of public institutions and instruments that are governed by the requirements of the PDM legal framework.

Public Institutions

25. **The scope of public debt, from a legal standpoint, should reflect the public institutions whose debt liabilities are subject to the requirements of the PDM legal framework.** In this sense, “public debt” is often used to refer to debt of the general government and in some cases, the debt of the entire public sector.²⁶ Whether the broader public sector debt is included or excluded from the scope of application of the legal framework will vary from country to country, depending on the nature of the political and institutional framework.²⁷ A good example of legislation that defines public debt in terms of the entire public sector is Mauritius’ Public Debt Management Act of 2008 which includes debt incurred by (i) the central Government; (ii) the Rodrigues Regional Assembly; (iii) the local Government; (iv) public enterprises, whether or not the loans are wholly or partly guaranteed by the Government; (v) advances from the Central Bank to any entity in the public sector; and (iv) debt guaranteed wholly or partly by the State.²⁸ Also, the legal framework in Moldova defines “public debt” as “all State Debt, the Debt of the National

²⁵ See Dippelsman, Robert, Dziobek Claudia, and Gutiérrez Mangas Carlos A., “What Lies Beneath: The Statistical Definition of Public Sector Debt: An Overview of the Coverage of Public Sector Debt for 61 Countries” IMF Staff Discussion Note, 2012.

²⁶ The IMF defines “public sector” as “(...) all resident institutional units controlled directly, or indirectly by resident government units, that is, all units of the general government sector, and resident public corporations”, while the “general government sector” is defined as “... all government units and all nonmarket nonprofit institutions (NPIs) that are controlled by government units”. “Government units” refer to institutional units with legislative, judicial, or executive authority over other institutional units within a given area; See Public Sector Debt Statistics 2011/2013 paragraphs 2.17 and 2.18.

²⁷ See IMF and World Bank Revised Guidelines for Public Debt Management April 2014.

²⁸ Section 6 (1) and (2).

Bank of Moldova, of administrative-territorial units, of public institutions financed in whole or in part from State or Local budgets, and the debt from internal and external borrowings of enterprises where the State or/and administrative-territorial unit own more than 51 percent.”²⁹

26. The definition of public debt in the legal framework, should promote prudent debt management for the public sector as a whole. Sustainability of overall public sector debt is important, and the design of the PDM legal framework ought to ensure that effective constraints, risk analysis, and reporting requirements apply to all public sector entities, to the extent feasible, even though the central Government may not be liable for the debts of the entire public sector (this point is discussed in more detail below). Similarly, the legal definition adopted should support, and not impede, the compilation of public debt-related statistics in accordance with international standards including the Government Financial Statistics Manual, Public Sector Debt Statistics, or International Public sector Accounting Standards.

Public Debt Instruments

27. The scope of public debt under the legal framework should ideally cover all debt instruments representing liabilities of the public institutions contemplated in the law. From a debt management perspective, the IMF and World Bank recommend that the scope of PDM should encompass the main financial obligations over which the central government exercises control, including both marketable and non-marketable debt.³⁰ From a statistical perspective, the IMF defines total gross public debt as all liabilities that are debt instruments (i.e. financial claims that require payment of interest and/or principal by the debtor to the creditor at a date, or dates, in the future).³¹ Clarity in the legal framework in respect of which debt instruments are recognized is therefore useful. Most jurisdictions provide explicitly for direct loans, advances, overdrafts, and securities.³² Furthermore, the definition of debt may or may not include guarantees and other contingent liabilities.³³ In some cases, this may be to ensure that contingent liabilities are subject to the same safeguards including ceilings (see Part IV (E) below for more on debt ceilings). It must be noted however that from a statistical point of view specific contingent liabilities are not required to be included in the compilation of debt, but reported as a memo item in the public sector debt statistics.

28. In addition to traditional debt instruments, some jurisdictions now explicitly recognize other forms of Government debt in their legal framework. These include

²⁹ Law no.419-XVI of 22.12.2006. Art. 2.

³⁰ IMF and World Bank Public Debt Management Guidelines 2014.

³¹ Public Sector Debt Statistics (2011, reprinted 2013) debt definition is consistent with that in Government Financial Statistics Manual (2014).

³² It is also useful for the legal framework to clarify whether Government securities are to be issued in bearer, registered, or fully dematerialized form. See Bossu and Addo Awadzi, 2014 for details on these various forms in which Government securities could be issued.

³³For example, Mauritius’ Public Debt Management Act of 2008 includes in the definition of debt, “debt guaranteed wholly or partly by the State.”

payment arrears, suppliers' credit arrangements, judgment debt,³⁴ and other final compensation claims. Examples include Tanzania, where the legal framework explicitly recognizes Government's payment obligations under suppliers' credit arrangements as Government loans.³⁵ Nigeria's Fiscal Responsibility Act of 2007 recognizes unpaid judgment debts of the Government as part of Government debt,³⁶ while Brazil's Fiscal Responsibility Law of 2000, provides at Article section 7 that "judicial payments" not made during the execution of the budget in which they were included must be considered part of the consolidated debt for the purpose of application of the debt limit.

29. Alternative debt instruments such as sovereign *sukuk* are also gaining popularity, including in non-Islamic jurisdictions.³⁷ The legal framework in a number of jurisdictions provides explicit authority for the issuance of sovereign *sukuk*. Examples include the UK Finance Act 2008 and Statutory Instrument (Government Alternative Finance Regulations 2014 (S.I. 2014/1327), Luxemburg's Sukuk Law of July 2014, Turkey's Law 4749 on Regulation of Public Financing and Debt Management,³⁸ and the Mauritius PDM Act of 2008.³⁹

30. The legal framework for jurisdictions that envisage issuing sovereign *sukuk* however should be carefully designed. To be effective, the legal framework will need to be drafted to ensure compliance with relevant *Shari'ah* principles, while reflecting the idiosyncratic features of *sukuk* from a legal, accounting, and public debt management perspective. Among other things, sovereign *sukuk* tend to be issued by Governments indirectly through wholly-owned special purpose vehicles/entities (SPVs/SPEs), and are strictly-speaking "trust certificates" rather than debt instruments. Consequently, their legal status in public debt management requires clarity in the PDM legal framework. Furthermore, the framework for *sukuk* issuance should be consistent with the overall public financial management legal framework.⁴⁰ Box 2 provides more details on some legal issues that are relevant for sovereign *sukuk*.⁴¹

³⁴ "Judgment debt" is a term used in some jurisdictions to refer to claims awarded by courts or other adjudicatory bodies against a party (in this context, Government or other public sector entity).

³⁵ Section 4 of Tanzania's Government Loans, Guarantees and Grants Act 1974 (amended in 2003) provides that "where the Government with the approval of the Minister acquires any asset under an agreement which provides for payment for such asset to be made outside Tanzania subsequent to the date of the acquisition of the asset, the sum of money payable under such agreement shall, for the purposes of this section, be deemed to be a loan raised by the Minister outside Tanzania."

³⁶Section 42 (2) provides that "Outstanding judgment debts not paid shall be considered part of the consolidated debts for the purpose of application of the respective limits set in pursuance of this section."

³⁷ The UK's 2014 sovereign *sukuk* (200 million pounds sterling or US\$ 307 million) being the first non-Muslim jurisdiction sovereign *sukuk*, was followed in the same year by sovereign *sukuk* issued by Luxemburg (200 million Euros or US\$ 240 million) as the first euro zone sovereign *sukuk*, Hong Kong (US\$ 1 billion), and South Africa (US\$ 500 million).

³⁸ Article 7/A as amended in 2013.

³⁹ Section 3 (3A).

⁴⁰ See Islamic Finance: Opportunities, Challenges, and Policy Option, IMF Staff Discussion Note, April 2015 page 27.

⁴¹ See Wedderburn-Day A. Roger, "Sovereign *Sukuk*: Adaptation and Innovation ", 2010, for a good expose on the legal complexities underlying Sovereign *sukuk*. Available at <http://www.law.duke.edu/journals/lcp>.

Box 2. Stylized Legal Issues Relating to Sovereign *Sukuk*

Sovereign *sukuk* have a similar economic effect in substance as conventional sovereign bonds, although they tend to be structured differently.¹ Most *sukuk* require an underlying asset, whether in the context of an asset-based or asset-backed transaction, and tend to be structured as *murabahah*, *istisna*, or *ijara* Islamic contracts. The *sukuk ijarah* which has been used recently in many sovereign *sukuk* transactions, commonly involves the sale (asset-backed model) or a lease (asset-based model) of tangible or non-tangible assets by a Government (originator) to a special purpose vehicle or entity (SPV) established and owned by that Government. The SPV raises funding from the issuance of *sukuk* to investors, proceeds of which are made available to the Government as payment for the sale or lease of assets to the SPV.³

A clear legal basis is required for the issuance of sovereign *sukuk*. Statutory provisions typically provide for a comprehensive legal mandate for structuring the *sukuk* through an SPV and for all the underlying legal and contractual arrangements that go with it. For example:

- **U.K.:** The Finance Act of 2008 (section 157 (1)) provides broad power to Her Majesty's Treasury to make provision (by regulation) for raising money through alternative finance arrangements.⁶ The Government Alternative Finance Arrangements Regulations 2014 (GAFAR) provide more specific provisions enabling the Treasury and the Secretary of State to enter into transactions which facilitate the issuance of alternative finance arrangements for the treatment of such instruments.⁷
- **Turkey:** Law 4749 on Regulation of Public Financing and Debt Management explicitly authorizes the Minister of Finance to incorporate asset lease companies which may issue lease certificates in local and foreign markets based on movable, immovable and intangible assets.⁹
- **Luxembourg:** *Sukuk* Law of 2014⁸ provided specific authorization for the government to launch the 2014 *sukuk* issuance by selling three local buildings to an SPV under a sale, lease, and buy-back transaction.

The legal framework for sovereign *sukuk* should also clarify their legal status and treatment for purposes of public debt¹⁰ and cash management. It should clarify at the minimum, how proceeds of sovereign *sukuk* should be accounted for, what liabilities there might be for the Government in the event of a default by the SPV, and generally, the extent to which the PDM law governs *sukuk* arrangements. For example:

- **UK:** The GAFAR provides explicitly for payment of monies from *sukuk* into and out of the National Loans Fund, as is the case with other public debt instruments (such as Gilts). It also provides for modifications to the National Loans Act of 1968 such that *sukuk* (alternative financing arrangements) are treated in the same way as Gilts for the purposes of the Debt Management Account. Furthermore, to reduce the risk of default, the Treasury is empowered to give financial assistance to any company involved in the alternative finance arrangements and a permanent appropriation is established under the Regulations for this purpose.¹¹
- **Turkey:** Law 4749 provides explicitly that *sukuk* or "lease certificates" are subject to the rules and principles in the relevant legislation in respect of securities issued by the Treasury and the Law on Central Bank of the Republic of Turkey and that proceeds from their issuance are to be transferred to the Treasury.¹²

¹ This is largely due to *Shari'ah* law prohibitions against interest payment and sale of debt receivables other than for par value.

³ The SPV typically holds the acquired assets as trustee for the benefit of *sukuk* holders, leases back or rents out the assets to the Government over the life of the *sukuk*, and distributes rental receipts from those assets (calculated using a "profit rate" instead of a coupon or interest rate) to *sukuk* holders periodically. The assets are typically re-purchased from the SPV by the Government on maturity of the lease period and the proceeds paid to the SPV are repaid to *sukuk* holders on maturity of their *sukuk*. For a more detailed discussion, see Wedderburn-Day A. Roger, "Sovereign *Sukuk*: Adaptation and Innovation"

2010, <http://www.law.duke.edu/journals/lcp>

⁶ Section 157(8) of the 2008 Act defines “alternative finance arrangements” as arrangements which in the Treasury's opinion “equate in substance to a loan, deposit or other transaction of a kind that generally involves the payment of interest (including the issuance of government securities), but achieve a similar effect to such a transaction without including provision for the payment of interest.”

⁷ By virtue of the UK's Finance Act of 2008 (section 157 (1)) which provides broad power to Her Majesty's Treasury to make provision (by regulation) for raising money through alternative finance arrangements' the UK authorities promulgated the Government Alternative Finance Arrangements Regulations 2014 (S.I. 2014/1327).

⁸ Law 6631 on the sale and buy-back of real-estate assets.

⁹ Article 7/A as amended in 2013.

¹⁰ The IMF's Government Financial Statistical Manual suggests in paragraphs 2. 136–139 on “Special Purpose Entities” (SPEs) that government accounts should reflect fiscal activities of the government undertaken by the SPE including borrowing, even if no actual economic flows are recorded between the government and the SPE related to these fiscal activities.

¹¹ Regulations 7, 8, and 9.

¹² These are specified in the law as movable and immovable assets owned by unlisted public institutions as well as intangible assets such as usufruct rights, operation and other rights. See Article 7/A of Law 4749 as amended in 2013.

B. What Guides Public Debt Management?

31. **Public debt management must be guided by broad parameters set out in law.**

These include clearly stipulated objectives of public debt management, a debt management strategy, and annual borrowing plans. While some jurisdictions may be able to achieve effective debt management without stipulating such provisions in law, in a number of countries, codifying good practices in law may be desirable.

Objectives of Public Debt Management

32. **Clear articulation of medium-to long-term objectives of PDM in the primary legal framework, helps to facilitate effective debt management and to promote accountability.** Such objectives guide the conduct of debt managers, and help stakeholders measure the effectiveness of the debt management strategy. Typical objectives include: ensuring that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.⁴² Some jurisdictions include other objectives to reflect national development priorities. For example Jamaica's PDM Act of 2012 includes the following additional debt management objectives “(b) developing and maintaining an efficient market for Government Securities; (c) ensuring that the debt is managed consistent with fiscal sustainability; (d) promoting the development of the domestic debt market;⁴³ and (e) ensuring that the Medium-Term Public Debt Management Strategy is compatible with the targets of the macroeconomic objectives of the Government.” These may be set out in policy documents, although enshrining them in the primary legislation helps to improve transparency and accountability.

⁴² IMF and World Bank Revised Guidelines for Public Debt Management April 2014.

⁴³ The IMF and World Bank Guidelines on Public debt Management support including a secondary objective of promoting the development of the domestic debt market, where appropriate.

33. **Fiscal responsibility frameworks also provide for broad overarching principles that could guide PDM.** Fiscal responsibility principles such as the principle of sustainable debt management and/or prudent fiscal risk management. For example in Nigeria, the Fiscal Responsibility Act 2007 (s. 41), provides for PDM to be based on rules that ensure that borrowing at all tiers of Government is on concessional terms with low interest rates and with a reasonably long amortization period. Also, the law requires public debt as a proportion of national income to be held at a sustainable level to be prescribed by the National Assembly from time to time.⁴⁴ In the design of the legal framework, such principles should be recognized and to the extent possible, harmonized with the objectives of PDM.

Medium-Term Debt Management Strategy

34. **An increasing number of jurisdictions prepare a Medium-Term Debt Management Strategy (MTDS), and certain jurisdictions make this a mandatory requirement under law.** The MTDS is considered one of the key elements of a good debt management framework. It articulates the Government's medium-term policy for debt and its strategy (in terms of volumes, instruments, maturities, and currency mix among others) to help achieve debt management objectives approved by the legislature under the relevant legislation. A sound legal basis in law for the preparation of the MTDS is useful. To this end, some jurisdictions require preparation of the MTDS on an annual rolling basis, consistent with the medium-term budget framework.

35. **Where the legal framework provides for the preparation of the MTDS, it should clarify the scope of debt to be covered and responsibilities for developing and giving effect to the MTDS.** The scope of the MTDS should cover central Government borrowing, and exclude borrowing by local government or SOEs for example, except where they engage in quasi-fiscal activities. Furthermore, the Minister of Finance should be explicitly mandated to ensure the preparation of the MTDS. Operationally, this is typically prepared by the Debt Management Office or Department. In any event, strong coordination among relevant departments/teams within the MoF and across relevant government agencies (including the Central Bank) is required. Furthermore, the legal framework should provide explicitly for approval of the MTDS by Cabinet, and publication after such approval.

36. **While the MTDS is a policy document, some jurisdictions explicitly require all public debt-related activities to be carried out in conformity with it.** An example is Sierra Leone's Public Debt Management Act of 2011 which requires all government borrowing and public debt management activities to be undertaken in compliance with the MTDS.⁴⁵ Where the legal framework provides for adherence to the MTDS, it is important to clarify the legal consequences of non-compliance by debt managers. Some countries do this through reporting requirements under which the Minister must submit a report to Parliament evaluating the

⁴⁴ See similar examples in Belize, New Zealand and the U.K.

⁴⁵ Section 6.

extent to which debt management has conformed to the MTDS.⁴⁶ Also, some jurisdictions mandate the preparation by debt managers of annual borrowing plans to help with implementation of the MTDS over a given fiscal year, although like the MTDS, approval by the legislature is typically not required.

Debt Sustainability Analyses

37. **Debt sustainability analyses (DSAs) have become a common feature in a number of jurisdictions, although they are strictly-speaking not a core PFM function.** DSAs are part of the overall fiscal risk management framework in jurisdictions, and help to assess the sustainability of debt given macroeconomic and institutional variables. By helping in efforts to identify and prudently manage fiscal risks from debt, they provide guidance for sound debt management strategies.

38. **Providing a statutory basis for DSA could help to formalize and entrench the practice.** Where this is provided in law, there is the need to clarify responsibility for the preparation and approval of the DSA and the frequency of their preparation, such as on an annual basis, if domestic capacity makes this feasible. In particular, the Ministry of Finance should be responsible for preparation of the DSA at the technical level, with the results presented to Cabinet for consideration. The legal framework should also require the results to be laid in Parliament by the Minister of Finance, for consideration along with the budget documents. At an operational level, the macro-economic/fiscal policy department/team of the Ministry of Finance may have primary responsibility for the DSA given its macro-economic implications, although close coordination with the debt management team would be necessary.

C. Legal Mandate to Borrow

39. **A key component of the legal framework is the mandate to borrow.** Government's authority to borrow is perhaps as fundamental to sovereignty as its power to tax and spend. This may be provided for in the Constitution and/or in primary legislation such as PFM-type laws, debt management laws, and others.

While the authority to borrow may implicitly include the authority to conduct debt management operations, the legal framework should ideally provide explicit authority for this. Debt management operations include debt buy-backs, exchanges, prepayments, the reopening of existing debt issues, and hedging (derivatives such as interest rate swaps, currency swaps, and interest rate futures) transactions, if necessary or appropriate. These are often overlooked in some public debt legislation, and may in some cases be deemed to be inherent in the borrowing authority. To avoid legal arguments about the existence of this rather important authority, it may be best to clarify in law, the authority and capacity to

⁴⁶ See Paragraph 101 below.

conduct debt operations broadly (subject to the availability of relevant expertise), and to subject such activities to clear governance and transparency safeguards typically applicable to Government borrowing, to the extent applicable.

40. **Government’s authority to borrow is usually not absolute.** The authority to borrow is often subject to controls designed to promote discipline and accountability, consistent with overall fiscal policy and public financial management objectives. The types of controls reflected in the legal framework are often shaped by policy and political economy realities and may include specification of the sources from which Government may borrow, borrowing purposes, debt ceilings, and others.

Sources from which Government may borrow

41. **The legal framework should specify the sources from which Government may borrow.** Sources of borrowing could include resident and non-resident individuals, institutions, and Governments. The borrowing authority should be fairly broad to explicitly allow Government to borrow from all such sources. The legal framework should also clearly provide for the authority to borrow domestically and externally. In some countries, exchange control policies may restrict the extent to which non-residents could lend to Government.

42. **From a legal standpoint, the definition of domestic versus external debt may be of some consequence.** In some jurisdictions, different requirements may exist for domestic or external debt, for example, legislative approval for external but not domestic debt, and lack of clarity as to what is intended to be covered in each case may lead to confusion and poor compliance.⁴⁷ Also, reporting requirements under law or contract (e.g. borrowing agreements with bilateral or multilateral parties) may require clarity as to the components of the debt portfolio that is classified as domestic or external. There are at least three possible ways to define domestic or external public debt. In particular, the residence of the creditor could be a key consideration in defining debt, such that external debt would be defined as debt owed to nonresidents regardless of where the debt is contracted, the currency in which it is issued, or the governing law of the transaction. Secondly, the currency in which the debt is denominated may be the key consideration, with foreign-currency denominated debt classified as external debt. Lastly, external debt could be defined by reference to the jurisdiction in which the debt is issued and the governing law for the transaction. In such cases, transactions issued outside the sovereign’s jurisdiction and governed by foreign law are designated as external debt. Many jurisdictions however appear to use the third approach (jurisdiction of issuance and governing law) to classify debt as domestic or external.⁴⁸ For the

⁴⁷ See sections 9 (2) and 10 of Sierra Leone’s Public Debt Management Act 2011, which requires the terms and conditions of securities issued outside Sierra Leone and loans contracted from a foreign lender to be approved by Parliament. There is no requirement for the terms and conditions of domestic debt to be approved by Parliament.

⁴⁸ See Panizza, Ugo; UNCTAD “Domestic and External Public Debt in Developing Countries” Discussion Paper, No. 188, March 2008. The paper reports that while the main compilers of statistical information on public debt (e.g. BIS, Eurostat, IMF, OECD, Paris Club, UNCTAD and the World Bank) rely on the residence of the creditor in defining external debt, it may be difficult to accurately estimate the stock of external debt using this definition, given that most non-resident lenders tend to hold Government debt through intermediaries. Countries therefore tend to rely on the place of issuance/governing law as the guide post.

avoidance of doubt the legal framework should clarify the definition preferred by a given jurisdiction, but also having regard to international norms and practices.

Who Exercises Borrowing Authority?

43. **A key legal question that needs to be answered in the design of the legal framework is who exercises borrowing authority on behalf of the state.** In some jurisdictions, the authority to borrow on behalf of Government is vested in the Legislature. For example, the U.S. Congress is empowered under the U.S. Constitution “to borrow money on the credit of the United States.”⁴⁹ Similarly, Australia’s Parliament is authorized to borrow “money on the public credit of the Commonwealth.”⁵⁰

44. **In a number of jurisdictions, the Constitution mandates the Legislature to delegate borrowing authority to the Executive by an Act of Parliament, within a broad framework set out under legislation.**⁵¹ From a legal standpoint, such delegation implies authority for the Executive to borrow, subject to any constraints imposed by the Legislature. Typically, such authority is delegated to the Minister of Finance, to borrow on behalf of the State. In Canada, borrowing authority is vested in the Governor in Council (Cabinet) who may authorize the Minister to borrow money on behalf of Her Majesty in right of Canada, on specified terms and conditions.⁵² The Minister may in turn delegate his borrowing authority to other public officials or entities within boundaries permitted by law (see Part V of this paper on Institutional Arrangements).

Debt Service

45. **Creditors typically require assurances that Government debt will be repaid.** A good legal framework will therefore not only provide for the authority to borrow, but also the authority to repay debt and related costs and expenses. As with any type of Government expenditure, debt servicing will require parliamentary approval (appropriations) in one form or the other. The legal framework in many jurisdictions provides for permanent appropriations for public debt service obligations, instead of periodic appropriations. Examples include New Zealand’s “permanent legislative authority for payment of certain expenses” under its Public Finance Act 1989⁵³ which is defined among others to mean “an express authority given by or under an Act to spend public money without further authority.” In a number of jurisdictions (including Ghana and Jamaica) the permanent appropriations for

⁴⁹ U.S. Constitution, Article 1 s. 8.

⁵⁰ Australian Constitution, Article 51.

⁵¹ Swaziland’s 2005 Constitution (section 204) authorizes the Government to borrow through the Minister under the authority of an Act of Parliament.

⁵² See Canada’s Financial Administration Act (R.S.C., 1985, c. F-11) amended as of February 2014, sections 43 (1) and 44 (1) and (3).

⁵³ As amended in 2013, section 65ZH.

public debt service are provided for in the Constitution.⁵⁴ Furthermore, debt-related payments authorized by legislation should cover not only repayment of principal and debt service costs (interest/coupons), but also other expenses related to public debt. Canada's Financial Administration Act is a good example of the latter. It provides comprehensively for payment out of the Consolidated Revenue Fund for:

*“(...) (a) all money required to provide a sinking fund or other means of securing repayment of securities; (b) the remuneration and compensation of registrars and fiscal agents appointed under the Act; (c) all costs, expenses and charges incurred in the negotiation or raising of loans or issue, redemption, servicing, payment and management of any loan and any securities issued in respect thereof; and (d) all money required to be paid under contracts and agreements related to public debt.”*⁵⁵

D. Borrowing Purpose (s)

46. **In several jurisdictions, the legal framework specifies the purpose for which Government may borrow.** Historically, sovereign borrowing powers were used to borrow to fund wars, finance development, and generally to meet revenue shortfalls. Key policy choices are required including whether Government should be confined to specific borrowing purposes (e.g. to fund specific expenditures only) or whether more flexibility is required (e.g. be allowed to borrow for any reason at all). Various jurisdictions have addressed this differently. Box (2) shows examples of borrowing purposes from a number of countries.

47. **Where the law is specific on borrowing purposes, care is required in its design to ensure that Government is not unduly constrained in the event that some unforeseen financing need emerges.** As can be seen from Box 3, in some jurisdictions the legal framework authorizes Government to borrow for any lawful purpose or for any fiscal purpose, while others are more specific and narrow. Where the legal framework is so restrictive, it may be useful to provide for circumstances that require emergency borrowing for other purposes including or dealing with sudden economic shocks or for short-term smoothening of liquidity. For example, the legal frameworks in Jamaica and Sierra Leone allow some flexibility by authorizing for other grounds approved by Parliament.⁵⁶

⁵⁴ Article 119 of the Jamaican's Constitution, and Article 182 of Ghana's Constitution.

⁵⁵ Section 55, emphasis added.

Also, see Grenada's Constitution (section 81 (1) and (2)) which provides that all debt charges for which Grenada is liable to be a charge on the Consolidated Fund. Debt charges are defined to include interest sinking fund charges, the repayment or amortization of debt *and all expenditure in connection with the raising of loans* on the security of the Consolidated Fund and the service and redemption of the debt created thereby.

⁵⁶ Jamaica PDM Act Section 11 (J); Sierra Leone Public Debt Management Act 2011 –Section 3 (1).

Box 3: Selected legal provisions on Government's borrowing purposes

General fiscal purposes

- *Botswana—Section 10, Finance and Audit Act 1970 (amended as of 2007)*
“Government may borrow locally to meet current requirements.”
- *Lesotho—Section 3 (1) of the Loans and Guarantee Act 1967 as amended*
The Minister may issue government securities in each financial year and raise loans of such sums as he may require to defray expenditures which may lawfully be defrayed.
- *Tanzania—Sections 3 and 6 of Tanzania's Governments Loans, Guarantees and Grants Act, 1974 (amended as of 2003)*
Government may raise from time to time foreign and local loans “to defray expenditures which may be lawfully defrayed”.

Specific Borrowing Purposes

- *Jamaica—Section 10 of the Public Debt Management Act 2012*
“The Minister may borrow money only for the following purposes (i) to finance the fiscal deficit; (ii) to refinance any maturing or outstanding public debt; (iii) to finance investment projects approved by the House of Representatives; (iv) to finance payment of guarantees called; (v) to facilitate cash management operations; (vi) to finance activities required in the interests of national security; (vii) to reduce or eliminate the effects of a period of public disaster or a period of public emergency as defined in section 20 of the Constitution of Jamaica.”
- *Moldova—Art. 3(4), 12, 23(1) and 2710 of Law no.419-XVI*
Government may borrow for fostering development of the economy of the country and investment activities; promotion of exports; creation of new jobs and improvement of social and environmental conditions; disaster relief and other emergencies; prepayment, repayment, refinancing, restructuring of existing debt and guarantees; financing the state deficit and covering short term cash needs of the Treasury; and for on-lending to finance investment projects, programs or priority activities of the State.
- *South Africa—Section 71 of the Public Financial Management Act 1999 (amended as of 2009)*
“Government may borrow to (a) finance national budget deficits;(b)refinance maturing debt or a loan paid before the redemption date;(c) obtain foreign currency;(d)maintain credit balances on a bank account of the National Revenue Fund;(e) regulate internal monetary conditions should the necessity arise; or (f) any other purpose approved by the National Assembly by special resolution.”

Box 3: Selected legal provisions on Government's borrowing purposes (Continued)

Capital/Long-term investments only (“Golden Rule”)

- *Brazil, Federal Constitution*
Credit operations may not exceed the sum of capital expenditures in the fiscal year, except those authorized by the Legislature by absolute majority, and with a precise purpose.
- *Japan—Article IV of the Public Finance Law (Law No. 34 of 1947)*
Government may only borrow to finance public works, the scope of which is approved by the Diet.
- *Nigeria—Section 41 of the Fiscal Responsibility Act 2007*
Government borrowing by all tiers of Government (federal and state) may only be used for capital expenditures and human development.

Capitalizing Central Bank or Monetary Policy Purposes

- *Sweden—Act on State Borrowing and Debt Management 1998, section 1*
The Government is authorized to borrow also to fulfill the Central Bank's requirements of currency reserves.
- *United Kingdom—National Loans Act of 1968 section 12*
Borrowing authorization is provided for fiscal purposes, as well as to raise “any money which the Treasury considers it expedient to raise for the purpose of promoting sound monetary conditions in the United Kingdom.”
- *Lesotho—Section 3 (1) of the Loans and Guarantee Act 1967 as amended*
The Minister may issue government securities and raise loans for the purposes of conducting monetary policy in Lesotho.
- *Moldova—Article (4) of Organic Law # 419 on Public Debt, State Guarantees and State On-lending*
“The Ministry of Finance is authorized to issue State Securities for increasing National Bank of Moldova's statutory capital or for covering the debit balance of the general reserve fund of the National Bank of Moldova.”
- *Sierra Leone—Section 3 (1) of the Public Debt Management Act 2011*
“Government may borrow to “(...) meet requests by the Bank of Sierra Leone to issue Government securities for the sole purpose of supporting monetary policy objectives (...)”

E. Debt Ceilings

48. **A number of jurisdictions impose ceilings on public debt although evidence on their effectiveness appears mixed.** Debt ceilings essentially determine the maximum amount of debt that government or other public sector entities can carry. Usually designed as part of measures to promote fiscal discipline, there are widespread views that debt ceilings may be ineffective, and in some cases could increase fiscal costs.⁵⁷ In several jurisdictions however, debt ceilings are seen as useful tools to constrain fiscal policy and to promote sustainable debt. In some cases also, debt targets below the debt ceiling are imposed to help ensure a buffer between actual debt levels and the specified ceiling. Where policy favors the introduction of a debt ceiling, a number of key legal considerations should be borne in mind in the design of the PDM legal framework. These are discussed below.

Should the ceiling be specified in legislation?

49. **Debt ceilings may be established in a variety of ways, with varying implications.** For example:

- a. ***Political Commitments***: In some countries, debt ceilings are established as part of a fiscal responsibility framework based on policy commitments rather than explicit legal instruments. Debt rules have been established by political commitments in Canada and Cape Verde, and by coalition agreements in Finland.⁵⁸
- b. ***Supranational ceilings***: Debt ceilings are sometimes established as part of fiscal rules under regional treaties that bind members of monetary unions. Examples include the debt ceiling imposed on EU member states. Other monetary unions have in place debt ceilings. These include the WAEMU⁵⁹ (debt to GDP ratio of 70 percent) and the CEMAC⁶⁰ (debt to GDP ratio of 70 percent).⁶¹ In the case of the ECCU,⁶² a debt to GDP ratio of 60 percent acts

⁵⁷ See for example Government Accountability Office, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (February 2011) which analyzes the challenges of managing Government cash and debt under a statutory debt ceiling.

⁵⁸ See Budina Nina, Tidiane Kinda, Andrea Schaechter, and Anke Weber, “Fiscal Rules at a Glance: Country Details from a New Dataset” *IMF 2013 WP/12/273*. Also, Japan and Korea also have expenditure rules (ceilings) established by political commitment and internal rules OECD (2013). See “Fiscal Rules”, in *Government at a Glance 2013*, OECD Publishing, http://dx.doi.org/10.1787/gov_glance-2013-26-en.

⁵⁹ West African Economic and Monetary Union.

⁶⁰ Central African Economic and Monetary Community.

⁶¹ The Maastricht Treaty of 1992, the Stability and Growth Pact (SGP) of 1997 require EU member states to reduce their public debt-to-GDP ratios to 60 percent by 2020. The Fiscal Compact and the “six pack” also include a commitment to continuously reduce the public-debt-to GDP ratio to the 60 percent of GDP threshold. See Andrea Schaechter, Tidiane Kinda, Nina Budina, and Anke Weber, “Fiscal Rules in Response to the Crisis—Toward the “Next-Generation” Rules. A New Dataset” 2012, WP/12/187.

⁶² Eastern Caribbean Currency Union.

as a benchmark or target that member states aspire to achieve by 2020, instead of a binding ceiling,

- c. **Constitutional ceilings:** In a limited number of countries (such as Hungary⁶³ and Poland),⁶⁴ the debt ceiling is established under the Constitution. This elevates the ceiling to the level of the superior law of the jurisdiction. Also, given its inclusion in the Constitution, such a provision could make the debt ceiling rule more permanent and not subject to arbitrary changes, given that the procedures for constitutional amendments are often more stringent than for ordinary laws. This may, however, result in rigidities in the face of challenging economic outturns, leading to unintended consequences, which should be carefully considered.
- d. **Statutory ceiling:** In a number of jurisdictions that have a debt ceiling, the ceiling is established under statute such as the public debt law, fiscal responsibility law or budget/public finance management law.⁶⁵ The level of flexibility provided in the case of a statutory debt ceiling may be slightly higher than under the Constitution given that Parliament may typically amend such statutory ceilings. In some jurisdictions⁶⁶ however, amendments to statutory debt ceilings require supermajority affirmative votes in Parliament and in that sense may be similar in its rigidity to what pertains under constitutional ceilings.
- e. **Annual ceilings set by Parliament:** In a number of jurisdictions, e.g. Argentina, Brazil, Canada, Japan, Moldova, New Zealand, and Spain, Parliament is empowered to establish debt ceilings under the annual Budget/Appropriations Act. The U.S., before the coming into force of the 1974 Congressional Budget Act, required the House of Representatives to pass a resolution to approve the annual debt limit, with the budget.
- f. **Ministerial action:** Some jurisdictions provide much more flexibility by empowering the Minister of Finance to periodically set the debt ceiling by secondary legislation.⁶⁷ This may however leave too much discretion in the hands of the Minister especially where there is no requirement for Parliament to affirm such regulations.

⁶³ Hungary's Constitution/Fundamental Law of 2012 a debt ceiling of 50 per cent of the gross domestic product of the previous year.

⁶⁴ Poland has since 2004, adopted under its Constitution, a public debt/GDP ratio of 60 percent in line with the EU SGP.

⁶⁵ E.g. The U.S. Congressional Budget Act of 1974, Jamaica's Financial Administration and Audit Act, as amended.

⁶⁶ E.g. Fiscal Responsibility Laws of some jurisdictions, fiscal rules (including debt rule/ceiling) may require supermajority vote of the legislature to suspend or amend. For example, Switzerland's 2003 law requires a supermajority vote of the legislature for departure from the "balanced budget rule."

⁶⁷ See for example, section 2 of the UK's Fiscal Responsibility Act of 2010 which empowers the Treasury to issue statutory instruments to impose rules on the Treasury related to public sector net debt or general fiscal policy and framed by reference to a financial year or financial years. The Act requires drafts of such statutory instruments to be laid before Parliament and approved by a resolution of the House of Commons.

50. **As is evident from the above, the choice of one or the other legal approach to establishing a debt ceiling would require important tradeoffs.** The ultimate choice may be dictated by treaty or other legal obligations, and/or by political choice and pragmatism. It is however important to consider the legal implications of each option as discussed above, before a decision is made.

What legal type of ceiling?

51. **The legal framework should be clear in terms of the type of ceiling envisioned.** Debt ceilings could be in nominal or relative terms. Nominal ceilings are absolute numbers (e.g. value in a specific currency) which serve as the upper limit for debt. Countries that use nominal debt limits are Denmark,⁶⁸ and the U.S.⁶⁹ Australia previously had a debt ceiling which systematically increased over time to \$300 billion in May 2012 and repealed in December 2013.⁷⁰ In most jurisdictions, the debt ceiling is expressed as a percentage of GDP whether historical or forecasted. Debt ceilings could also be categorized in terms of debt stocks and flows. Many countries have introduced fiscal rules that limit the stock of debt by which the amount of debt at any point in time is limited (e.g., the Maastricht treaty ceiling of 60 percent of GDP). Flow debt ceilings are designed to limit net debt contracted within a particular period, such as on an annual basis. Where annual flow ceilings are used, it may be useful for the legal framework to ensure that debt management operations for ongoing government's liquidity management purposed are not unduly constrained.⁷¹ The legal design of the debt ceiling should therefore carefully consider the merits or otherwise of the type of ceiling provided for under the law.

Obligations covered by the ceiling

52. **In the legal design of the debt ceiling, the scope of debt to which the ceiling applies should be clarified.** Best practice suggests that where a ceiling exists, it should cover debt obligations of the general government. While as a legal matter, central Government may not be liable for the general government debt, there may be the need to ensure that the debt ceiling covers such broad scope, to help promote discipline in overall general government. A good example is Nigeria, where debt obligations (including judgment

⁶⁸ The Danish debt ceiling was last raised in 2010 from Dkr950 billion to the current Dkr 2,000 billion. In practice, the ceiling is believed to be almost three times the level of actual outstanding gross debt to help avoid any potential effect of the nominal gross debt ceiling on ongoing fiscal policies in Denmark, although as a result, it appears to be of no practical relevance for government budget making or debt management. See Jacob Funk Kirkegaard, "Can a Debt Ceiling Be Sensible?—The Case of Denmark" Peterson Institute for International Economics, July 26th, 2011, available at <http://blogs.piie.com/realtime/?p=2280>.

⁶⁹ The U.S. debt ceiling was first enacted during World War I to eliminate the need for Congress to approve each new debt issuance and provide Treasury with greater discretion over how it finances the government's day-to-day borrowing needs. The ceiling has increased from roughly \$43 billion in 1940 to more than \$17.2 trillion in 2014. Pursuant to Temporary Debt Limit Extension Act of 2014, Congress suspended the ceiling in February 2014 until March 15, 2015, after which the ceiling is expected to be increased.

⁷⁰ The ceiling was originally established under section 5 of the Commonwealth Inscribed Stock Act 1911.

⁷¹ E.g. Many countries pre-finance their borrowing requirement (which may require borrowing in a previous fiscal year to finance a portion of the following years borrowing needs) when market conditions are deemed favorable to ensure that they have adequate liquidity in the event of a downturn in market conditions.

debts) at all levels of Government are required to be subject to a single debt ceiling determined by the President.⁷² In some other jurisdictions (such as the U.S) however, the ceiling may cover only central (e.g. federal) government debt.

53. **Ideally, multiple debt ceilings should be avoided.** It is important where the introduction of a debt ceiling is found to be appropriate, the legal framework reflects a single integrated ceiling for all public debt.⁷³ The legal framework should not impose different ceilings on different types of public debt. This helps to manage fiscal risks better and mitigates arbitrage. In respect of the latter, partial or disparate debt ceilings could motivate the tendency to accumulate (or avoid) particular types of debt in order to delay reaching the ceiling or the highest ceiling (in the case of multiple ceilings). This may lead to a debt profile and fiscal risks that are not necessarily consistent with declared public debt management objectives or strategy. While not recommended, it is important to note that a number of jurisdictions impose different ceilings on different types of public sector debt obligations. For example:

- a. A single debt ceiling on consolidated debt of all levels of the general government (Nigeria);⁷⁴
- b. A single debt ceiling on all federal debt held by the public and debt held by government accounts (intra-governmental debt holdings) (U.S.);⁷⁵
- c. Different ceilings for external and domestic debt (e.g. Lesotho, Tanzania);⁷⁶
- d. Separate ceilings for Government borrowing from the Central Bank;⁷⁷
- e. Certain types of debt excluded from the debt ceiling (e.g. Moldova);⁷⁸ and

⁷² Nigeria's Fiscal Responsibility Act of 2007 S. 42.-(1) provides for a debt limit on "consolidated debt of the Federal, State and Local Governments" including unpaid judgment debts (Section 42 (2)).

⁷³ By way of illustration, conditionality on public debt in IMF arrangements for countries is established as a limit on "total" public debt and publicly guaranteed debt unless country circumstances and program objectives justify the use of more narrowly targeted conditionality. The limit may exclude debt of specific public enterprises or other official sector entities that are assessed by the IMF to be in a position to borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government. See "Guidelines on Public Debt Conditionality in Fund Arrangements" effective June 30 2015.

⁷⁴ Section 42 (2) of Nigeria's Fiscal Responsibility Act of 2007.

⁷⁵ The U.S. Treasury defines "Total Public Debt Subject to Limit" as "the Total Public Debt Outstanding less Unamortized Discount on Treasury Bills and Zero-Coupon Treasury Bonds, old debt issued prior to 1917, and old currency called United States Notes, as well as Debt held by the Federal Financing Bank and Guaranteed Debt." By this definition, some 0.5 percent of total debt is excluded from debt limit coverage. For details, see <http://www.treasurydirect.gov> and also D. Andrew Austin "The Debt Limit: History and Recent Increases," Congressional Research Service, April 27 2015.

⁷⁶ Under the now repealed Second Liberty Bond Act of 1917, the U.S. Congress imposed ceilings on specific categories of debt, which were replaced in 1939 by a single ceiling on (nearly) all public debt.

⁷⁷ In some jurisdictions that permit Government borrowing from the Central Bank—so-called monetary financing—a separate ceiling may exist specifically to discourage its use. Some jurisdictions however provide for zero monetary financing of the Government. These include the EU, and the ECCU treaties.

⁷⁸ In particular, the legal framework in Moldova excludes Government borrowing to finance the budget deficit from the debt ceiling although Government borrowing to recapitalize the Central Bank is covered under the ceiling. See Article (4) "Issuance of State Securities for increasing National Bank of Moldova's statutory capital shall be treated as state's internal debt within the limits set in the budget law for the respective year. Issuance of State Securities for covering the debit balance

(continued...)

- f. Separate ceilings for contingent liabilities (e.g. Tanzania).⁷⁹

Legal Effect of Debt Ceiling and Enforcement Mechanisms

54. **The legal framework should be explicit about the effect of the debt ceiling.** In some jurisdictions, the legal framework invalidates debt contracted in breach of the ceiling.⁸⁰ Potential unintended consequences from such provisions are however discussed in Part VI of this paper.

55. **In a number of other countries, debt ceilings may be enforced through mandatory requirements for reporting, and/or adjustment or corrective measures that are required when the ceiling is reached.** For example:

- **Brazil:** Federal, state, and municipal audit courts are each required to warn their constituents when debt and contingent liabilities reach over 90 percent of their respective limits under the Fiscal Responsibility Law.⁸¹
- **Hungary:** Hungary's 2011 Constitution establishes a public debt ceiling of 50 percent of GDP and requires Parliament to reject any budget measures which would result in the level of public debt exceeding this ceiling.
- **Moldova:** The legal framework provides that an increase in the state's internal debt limit is to be reflected in subsequent amendments of the state budget law for the respective year.⁸²
- **Poland:** The Public Finance Law imposes restrictions on public expenditures when debt exceeds 43 percent or 48 percent of GDP, although the constitutional debt limit is 60% of GDP.⁸³
- **Slovak Republic:** The 2012 Fiscal Responsibility Law imposes a set of automatic enforcement mechanisms where the 60 percent debt to GDP ceiling is close to being breached. Among other things, the Minister of Finance is required to issue an open letter when the debt ratio reaches between 50 percent and 53 percent of GDP, and an

of the general reserve fund of the National Bank of Moldova shall be treated as state's internal debt over the limits set in the budget law for the respective year.

⁷⁹ For example in Tanzania, the total net amount guaranteed by Government in any financial year cannot exceed the ceiling for guarantees set by Government for that year—See Government Loans, Guarantees, and Grants Act section 13A (3). Also, in addition to overall ceilings on guarantees, the legal framework sets a ceiling on the guarantee cover for each loan—see section 13A (1) (b) of Tanzania's Government Loans, Guarantees and Grants Act which sets the guarantee cover per loan at seventy percent of the amount borrowed, although the Minister may waive this limit on the advice of the National Committee.

⁸⁰ See for example, Suriname's National Debt Act of 2002 which provides that any agreement entered into in breach of the debt ceiling or applicable rules of law is null and void.

⁸¹ See article 59 of Brazil's Fiscal Responsibility Law (paragraph 1, subsection III), and also article 71 (subsection IV) of the 1988 Federal Constitution).

⁸² Article 4 of Moldova's Organic Law # 419 on Public Debt, State Guarantees and State On-lending.

⁸³ These debt thresholds were reduced in 2014 from 50 percent and 55 percent of GDP as a result of the changes to the pension system in Poland which affected the debt levels under the correction mechanism of the stabilizing expenditure rule.

expenditure freeze applies when it reaches between 55 percent and 57 percent of GDP. A balanced budget requirement is applicable when the debt/GDP ratio reaches between 57 percent and 60 percent, and a confidence vote is required when the debt ratio exceeds 60 percent of GDP.

- **U.S.:** Under the U.S. legal framework, the Treasury has no more authority to borrow above the statutory ceiling, although it will be able to issue additional debt in amounts equal to maturing debt.⁸⁴ Once reached, only Congress can suspend, or increase the ceiling.⁸⁵ Until suspended or increased by Congress, the Executive is required to roll-out so-called “extraordinary measures” to free up borrowing space and cash for critical spending.

F. Borrowing by Public Sector Entities

56. **In addition to providing for borrowing by the central government, the legal framework should also clarify the borrowing mandates for public sector bodies.** In particular, political and institutional arrangements within a given jurisdiction will shape the devolution of borrowing authority. In a fiscal federation for example, the legal framework will need to be clear on how borrowing authority is distributed across all levels of government including federal, state, and local governments. Also, the legal framework should clarify how borrowing authority is distributed among central government, across entities that form part of the broader general government (including local government authorities, autonomous agencies, and statutory funds), as well as the wider public sector which would include state-owned enterprises (SOEs).

57. **Jurisdictions differ in the level of borrowing authority they provide for public sector entities.** In particular:

- a. **Local government authorities:** In some jurisdictions, local government authorities (municipalities, councils, etc) have the legal authority to borrow independently from central Government. Such legal authority may be provided for in a variety of sources including the Constitution, the PFM/public debt legislation, and/or legislation establishing or governing local government authorities.⁸⁶

⁸⁴ See Congressional Budget Office “Federal Debt and The Statutory Limit”, November 2012, Government Accountability Office, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (February 2011).

⁸⁵ See for example the Temporary Debt Limit Extension Act of 2014 (by which Congress temporarily suspended enforcement of the debt ceiling until March 15, 2014).

⁸⁶ E.g. under section 88 of Ghana’s Local Government Act 1993 (Act 462) a local government authority has authority to raise local loans and overdrafts as approved “in the amounts, from the sources, in the manner, for the purposes and on the conditions approved by the Minister in consultation with the Minister responsible for Finance”, except where it does not exceed a threshold specified in the Act, or does not require a Government guarantee.

- b. *Parastatals/statutory bodies*: Most jurisdictions have autonomous public sector bodies established by special statute to provide specific governmental services. These include independent regulatory agencies, statutory funds (social security, deposit insurance, infrastructure funds, among others). Being part of the broader public service, the legal framework for public debt should clarify the extent to which they may have borrowing authority, and any controls that may relate to such authority. In Lesotho, such entities have independent borrowing authority subject to the prior written approval of the Minister of Finance.⁸⁷ Also, Jamaica’s Public Bodies Management and Accountability Act 2010 as amended,⁸⁸ prohibits public bodies from taking steps to enter into negotiations to borrow money, by way of an issue of bonds, without prior approval of the Minister.
- c. *State-owned enterprises (SOEs)*: As a general matter, SOEs—entities created either by special statute or under ordinary company law, with commercial objectives, and in which governments own shares either wholly or partly, tend to have borrowing authority. By virtue of their legal existence as corporate bodies, they typically have authority under their establishing or constituent legislation, to borrow in addition to all other powers of legal persons.⁸⁹ In some jurisdictions, broad borrowing authority is conferred on such entities in a consolidated piece of legislation. An example is New Zealand’s State-owned Enterprises (SOE) Act of 1986. Also, Tanzania’s Public Corporations Act (Cap 257) confers borrowing authority on every public corporation in which the Government is the sole shareholder. Whether such consolidated legislation exists or not, it is desirable for the overall PDM legal framework to clarify the borrowing authority of SOEs. In Lesotho, SOEs may borrow domestically or externally subject to prior written approval of such borrowing by the MoF.⁹⁰

58. Where public sector entities have borrowing authority, the legal framework should clarify liability for their borrowing. From a general legal standpoint, public sector entities should be primarily liable to their creditors for their debt obligations. This is in keeping with their separate legal persona which makes them legally distinct from Government. As a general legal matter, the central government should not be liable for the debt of a public sector entity. Conversely, the debt of the central government should not be held against other State agencies with separate legal personality.⁹¹ Governments may

⁸⁷ In respect of loans or bank overdraft of more than Rands 10,000. See Loans (Statutory Bodies) Act 1975 (Act No. 22) Section 3.

⁸⁸ As amended in 2014.

⁸⁹ Legal persons typically have powers to acquire and hold property, to sue and be sued, and to borrow, among other things.

⁹⁰ Public Financial Management and Accountability Act 2011, s. 41, section 32.

⁹¹ For example, interesting case law recognizing this principle can be found in the ruling of the Brussels Tribunal of First Instance (*Banque de la Republique du Burundi vs. Goetz et al* 19 July 2001). The Tribunal ruled that by virtue of the Central

(continued...)

however consciously assume such liabilities under explicit guarantees or indemnities for economic, political or social reasons. This is done sometimes through transfers from the central government budget to such entities,⁹² or through direct assumption of debt obligations.⁹³

59. Also in the case of SOEs, EU Statistical Office (Eurostat)⁹⁴ has ruled that EU member states may be liable for the debt of SOEs under certain circumstances.⁹⁵

Eurostat's decisions have implications for determining compliance of an EU member state under the Stability and Growth Pact among others, and may have treaty-based implications.⁹⁶

60. In any event, consistency may be required in the legal framework for debt management by the central government on the one hand, and the entire public sector on the other. Macroeconomic stability for a country depends on the overall aggregate exposure to risk including the level of overall public sector debt, and requires effective controls over borrowing of public sector entities particularly those of local government.⁹⁷ For this reason, the legal framework should subject borrowing by public sector entities to a framework that is broadly consistent with that applicable to the central government,⁹⁸ subject to relevant to fiscal powers enshrined in the constitution. For example:

Bank of Burundi's separate legal personality, it could not be held liable for the outstanding debt of the Government of Burundi. Consequently, its assets held with the Belgian Central Bank could not be attached to defray the Burundi Government's debt obligations to its creditors.

⁹²For example, in the 2013 "Chapter 9" bankruptcy filing of Detroit resulting largely from difficulties in meeting unfunded pension liabilities and health insurance benefits, the U.S. federal government offered U.S. \$300 million in combined federal and private aid to help recovery of Detroit's economy.

⁹³There is currently some speculation whether the Austrian government will assume guarantees issued by the financially-distressed southern Austrian province of Carinthia, in respect of bonds issued by Heta Asset Resolution AG (set up in 2014 by the Austrian authorities to take over assets of the failed Austrian bank Hypo-Alpe-Adria). The Austrian government has meanwhile made public statements to the effect that it will not assume liability for Carinthia's guarantees.
<http://www.bloomberg.com/news/articles/2015-03-10/carinthia-prepares-for-insolvency-seeks-credit-through-treasury>.

⁹⁴ Its mandate is to provide the European Union with statistics at the European level that enable comparisons between countries and regions and help assess compliance by EU member states with their treaty obligations.

⁹⁵ See Eurostat's letter of February 2011 on the subject "Methodological treatment of the debt of the Austrian Railway Company ÖBB), which also referred to similar decisions in earlier cases in France, Italy, Romania, and Slovakia, in relation to railway corporation debts. In respect of Austria's ÖBB, Eurostat held the view that the Austrian Government was liable for debt contracted by the Austrian railway corporation – ÖBB, subsidiary of the Government-owned ÖBB Holding AG. In reaching its opinion, Eurostat considered a number of key factors including the fact that the Federal Government was responsible for providing regular subsidies to ÖBB to cover debt service payments for 70 percent of its debt, as a result of which the former could be deemed to be indirectly responsible for the debts of the latter
<http://ec.europa.eu/eurostat/web/government-finance-statistics/methodology/advice-to-member-states>.

⁹⁶ For an expose on the legal status of Eurostat's decisions, see Alberto Vega, "Eurostat, Soft Law and the Measurement of Public Debt: The Case of Public-Private Partnerships" "European Journal of Legal Studies", Volume 6, Issue 2 (Autumn/Winter 2013/14), p 96–118.

⁹⁷ See Ahmad, Albino-War, and Raju Singh "Sub-national Public Financial Management: Institutions and Macroeconomic Considerations" IMF Working Paper 2005 WP/05/108.

⁹⁸ Some modifications may be required as far as certain public sector bodies are concerned. For example, particular care needs to be taken where Central Banks are concerned, to ensure that their ability to borrow for monetary policy purposes is not unduly constrained by any controls on public sector entities.

- a. **Public Debt Management Objectives:** The legal framework could require borrowing by public sector entities to be guided, to the extent possible, by the debt management objectives enshrined in the PDM law.
- b. **Reporting requirements:** Reporting on debt obligations of all public sector entities is sometimes required by law. While such requirements may be motivated primarily by the desire to promote fiscal oversight, there may be other objectives. For example in the case of Belgium, all foreign currency denominated borrowing by the federal and state governments are to be reported to the Central Bank (the National Bank of Belgium), which may request a discussion of any negative implications on exchange rate policy, with the Minister of Finance.⁹⁹
- c. **Constraints on Borrowing:** A number of jurisdictions impose constraints on borrowing by public sector entities. For example South Africa prohibits provincial governments or provincial public entities from borrowing or binding themselves to any future financial commitment denominated in a foreign currency or concluded on a foreign financial market.¹⁰⁰ The Minister of Finance is also authorized to approve annual borrowing plans of such entities, and impose conditions on borrowing by authorized public entities, including limits on borrowing.¹⁰¹ In some jurisdictions, constraints such as debt limits are imposed on sub-national debt through negotiations between the federal and sub-national level so government.¹⁰² Where such arrangements exist, legal underpinnings in the legal framework may usefully clarify the broad parameters for determination of controls on such entities.

61. In the absence of clarity as to which PDM requirements under the legal framework apply to the entire public sector, legal complexities could arise. In some cases, there may be ambiguity as to whether certain requirements that apply to the government are automatically applicable to SOEs and other public sector bodies. For example, Ghana’s Supreme Court has unanimously held that the constitutional requirement for parliamentary approval of all international economic (including debt-related) agreements entered into by the “Government” did not extend to agreements of Ghanaian statutory corporations given that the latter had separate legal personalities distinct from central government.¹⁰³ The court however held that:

⁹⁹ See Article 11 of Belgium’s organic law of the National Bank of Belgium.

¹⁰⁰ Public Finance Management Act 1999 as amended, Section 67.

¹⁰¹ Public Finance Management Act 1999 as amended, Section 66.

¹⁰² Examples include Austria, Belgium, and Denmark. For a full discussion, see Ahmad, Albino-War, and Singh “Sub-national Public Financial Management: Institutions and Macroeconomic Considerations” IMF Working Paper 2005 WP/05/108.

¹⁰³ See *Klomega v. Attorney General and others* (Supreme Court of Ghana, 2013) where the court held that a concession agreement entered into between the Ghana Ports and Highways Authority and a foreign counterparty did not require parliamentary approval under article 181 (5) of the 1992 Constitution which required parliamentary approval of all international economic agreements entered into by “Government.” In interpreting that provision, the Supreme Court reasoned that subjecting statutory corporations with commercial functions to the parliamentary approval process would

(continued...)

*“The court should, however, not lay down an absolute rule. If, on the facts of a particular case, central government were found to have made a particular statutory corporation its alter ego under the circumstances of that particular case, the possibility of holding that statutory corporation comes within article 181 (5) should not be ruled out (...). Whilst we do not consider that the facts of the case before us can reasonably be interpreted as falling within the notion of an agency of government constituting an alter ego for the Government, we nevertheless consider that the idea that a statutory corporation, though legally distinct from the Government, can in appropriate circumstances be held to be an alter ego of the Government is one that should serve the useful purpose of an exception to the general rule on the basis of which this case has been determined. (...) the mischief that the doctrine would be helpful in suppressing is the possibility of the central government seeking to evade parliamentary scrutiny and approval of its qualifying agreements by getting a statutory corporation to enter into international business or economic transactions that would otherwise fall within the ambit of article 181 (5)...(..).”*¹⁰⁴

G. Contingent Liabilities

62. **Contingent liabilities of the public sector are an integral part of public debt.**

Contingent liabilities, broadly-speaking, include guarantees, indemnities, and other potential liabilities that may be incurred depending on the outcome of a future event. They may be explicit or implicit¹⁰⁵ with the former referring to contingent liabilities that arise out of contractual or statutory sources¹⁰⁶ or *ex ante* policy commitments that give rise to conditional payment obligations. Implicit contingent liabilities on the other hand, are recognized after a condition or event is realized, and often arise out of political or moral obligations on public policy grounds.¹⁰⁷

63. **The PDM legal framework typically provides for Government’s authority to create contingent liabilities.** In some jurisdictions, PFM type laws, fiscal responsibility laws, and public investment management legislation may also contain provisions on contingent liabilities (including from public private partnerships). Examples include Australia’s 2003 Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties

increase the weight of Parliament’s responsibilities to an unsustainable level in a way that could not have been intended by the drafters of the Constitution.

¹⁰⁴ *Ibid*, page 17.

¹⁰⁵ For more on contingent liabilities, see Aliona Cebotari, “Contingent Liabilities: Issues and Practice” IMF Working Paper 2008 WP/08/245.

¹⁰⁶ In some jurisdictions, contingent liabilities are created by statute. These may include provisions in legislation establishing deposit insurance schemes, pension and social security schemes, that require Government to make certain payments in the event of deficiency of such schemes.

¹⁰⁷ For more on contingent liabilities, see Aliona Cebotari, “Contingent Liabilities: Issues and Practice” IMF Working Paper 2008 WP/08/245.

and Letters of Comfort¹⁰⁸ and South Africa's Treasury Regulation 16 which elaborates guidelines, approvals, and responsibilities for public-private partnerships (PPPs), pursuant to the Public Finance Management Act.

64. **A sound legal framework is required to help mitigate fiscal risks from contingent liabilities.** Among other things:

- a. **Scope:** The legal framework should clarify the types of instruments/claims that may be recognized as Government's contingent liabilities. In many jurisdictions, the public debt legal framework covers only explicit (contractual) contingent liabilities and not implicit ones. Even in the case of explicit contingent liabilities, it is quite common to see that the legal framework covers only guarantees and to a lesser extent indemnities, with no mention of how other possible contingent liabilities are to be treated. In the case of indemnities, it is important for the legal framework to specify which losses Government may indemnify, in order not to leave this wide open.¹⁰⁹ Also, it is useful for the legal framework to provide explicitly that instruments such as letters of comfort and "no objection" letters issued by Government are not binding and do not create contingent liabilities for Government.¹¹⁰
- b. **Implicit contingent liabilities:** The legal framework should specify the circumstances under which implicit contingent liabilities may become actual liabilities of Government although care must be taken in order not to create moral hazard by encouraging excessive risk taking. It should provide clearly for how such potential liabilities will be created or assumed by Government, and clearly reported to Parliament.
- c. **Reporting:** Reporting is critical to mitigating potential fiscal risks from contingent liabilities. From an accounting standpoint, contingent liabilities tend to be treated as off-balance sheet items, as a result of which information on the size of the portfolio and monitoring of its performance may be lacking. Explicit reporting requirements under the legal framework helps to promote transparency in the total quantum of contingent liabilities and the fiscal risks that emerge from them.

¹⁰⁸ See Australia's Financial Management Guidance No. 6, "Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort," September 2003 that provides for edibility for these instruments, reporting and disclosure, and risk management.

¹⁰⁹ Indemnities are guarantees to compensate a party for losses incurred.

¹¹⁰ Comfort letters and "no objections" from Government may express government's support of an activity or transaction, short of explicitly guaranteeing a third party's obligation or other undertaking. Depending on its framing, however their legal status and effect may be unclear, and it is important for the legal framework to clarify this.

Eligibility

65. **The question of eligibility for Government guarantees and indemnities is a key one which should be addressed explicitly in the legal framework.** Jurisdictions differ in how they approach this. For example:

- a. **Public sector entities:** A number of jurisdictions restrict eligibility for Government guarantees exclusively to public sector bodies (local authorities, statutory bodies and state-owned enterprises including public private partnerships. An example is Mauritius where eligibility for Government guarantees is limited to regional or local governments, and public enterprises.¹¹¹
- b. **Open-ended beneficiaries:** Other jurisdictions do not limit eligibility and provide for the possibility of guarantees to just about anyone. Examples include Lesotho where under the Loans and Guarantees Act, the government may guarantee local or foreign loans contracted by a local authority, a body corporate or individual.¹¹² Also in Kenya, Government may guarantee a loan of a county government or any other borrower.¹¹³

66. **Eligibility for Government guarantees may be justified on public policy grounds, but tradeoffs are required.** Where the scope of potential beneficiaries is widely crafted, it is imperative that a clear policy framework for determining the circumstances under which public funds would be used to guarantee liabilities is adopted, to reduce fiscal risks. On the other hand, where the scope is narrowly defined such as in jurisdictions that allow guarantees of only public sector debt, a policy decision is required as to how unforeseen occurrences which may require Government guarantees would be handled. For example, in the context of financial crisis management or in the unlikely event of severe economic contraction, Government may as a policy matter find it expedient to guarantee deposit liabilities of banks, and or to guarantee trade finance obligations of industry. In such cases, appropriate safeguards should be provided by the legal framework to ensure that such measures are well thought through and are prudently taken. It is also important that such policy measures do not become indirect government grants to private enterprises, benefiting shareholders and creditors of such institutions at the expense of tax payers.

Purposes

67. **The legal framework should provide for the purposes for which contingent liabilities could be assumed by Government.** For example:

¹¹¹ Section 8 (1) of the 2008 PDM Act.

¹¹² Loans and Guarantees Act 1976 as amended, section 6.

¹¹³ Section 58 (1). Under 58 (2), in the case of a private borrower, sufficient security for the loan is required.

- a. Moldova’s legal framework provides that government guarantees may be issued only in “exceptional cases” to guarantee loans for financing investment projects that are of major importance for the national economy, among others.¹¹⁴
- b. Kenya’s 2012 Public Finance Management Act, requires that guarantees be issued only in respect of loans for capital projects (section 58 (2) (a));
- c. Mauritius allows guarantees to be issued for any purpose except for loans to finance current expenditure; and
- d. In Tanzania, the Government may guarantee loans the proceeds of which are to be utilized in furtherance of priority areas set out in regulations made by the Minister of Finance.¹¹⁵

Who may issue guarantees?

68. **Legal authority to create contingent liabilities for the government should be clarified in law.** Generally, the Minister of Finance should be the sole authority to enter into all transactions and execute documentation on behalf of Government. The law may however provide for delegation of this authority to another person, such as a specialist government agency that issues export credit guarantees to fulfill legitimate policy objectives. For example, Austria’s Export Credit Agency (OeKB)¹¹⁶ acts on behalf the Austrian government (Federal Ministry of Finance) to examine applications and issues guarantees on behalf of the Government.

69. **Also, in some countries, the Central Bank plays a role in creating contingent liabilities by issuing guarantees on its own behalf, or on behalf of Government.** For example:

- **Ghana:** In Ghana, the Loans Act (section 13) empowers the Government to request the Bank of Ghana to issue loan guarantees on its behalf.
- **Malawi:** Under Malawi’s Reserve Bank of Malawi Act, the Reserve Bank may upon the request of Government, guarantee repayments of principle, interest, and charges under external borrowing of a statutory body.¹¹⁷

70. **This is however not typical of the modern role played by Central Banks, and where such provisions exist, the legal framework should provide for safeguards to help mitigate risks to the Central Bank’s balance sheet as well as fiscal risks.** Increasingly, Central Banks have moved away from being instruments of development policy—as part of

¹¹⁴ Organic Law No. 419, on Public Debt, State Guarantees and State On-lending, Article 27.

¹¹⁵ Tanzania’s Government Loans, Guarantees, and Grants Act section 13A (1) (a).

¹¹⁶ Oesterreichische Kontrollbank AG.

¹¹⁷ Section 41 (3).

which they provided guarantees to the private sector. They now tend to be operationally autonomous from Government, and focused on their core objective of maintaining price stability and in some cases, financial stability. Where such a role for the Central Bank still exists, however, there is the need to ensure that such guarantees are not issued outside the general governance framework applicable to Government or the wider public sector. It is important for the debt legislation to clarify whether such guarantees/contingent liabilities will be subject to the same governance framework including approvals that are required for contingent liabilities directly created by Government, in order to avoid legal/regulatory arbitrage. It should also clarify who is liable for guarantees created by the Central Bank on behalf of Government. The legal framework should help to mitigate risks to the central bank's balance sheet from any credit-related losses. Specific safeguards in this regard may include a clear requirement under the legal framework for Government indemnities for such guarantees. An example of this can be found in the Reserve Bank of Malawi Act where the Reserve Bank is entitled to demand a "counter guarantee" from Government for any guarantee it issues for statutory bodies on the request of Government.¹¹⁸

71. As in the case of direct debt obligations, it is important that the Minister exercises comprehensive oversight over fiscal risks from public sector contingent liabilities. In this regard, the legal framework should clarify whether public sector entities such as local government authorities, statutory bodies, or SOEs may themselves issue guarantees or other contingent liabilities. This is particularly relevant in the case of public-private partnerships where such guarantees tend to be used. In some countries such as Serbia, the public debt law prohibits local governments from issuing guarantees.

72. The legal framework should also clarify whether approvals from Cabinet and/or Parliament are required for specific transactions creating contingent liabilities. Parliamentary approval of contingent debts is required in many countries in OECD and non-OECD countries under budget laws, debt management laws, or constitutions (Finland and Germany).¹¹⁹ Also in Moldova, Parliamentary approval is required for government guarantees.¹²⁰

Risk Management

73. Risk management in relation to Government's contingent liabilities and the debt portfolio in general is becoming increasingly important,¹²¹ for which reason, clear legal underpinnings are essential. In particular, an operational framework is required to enable

¹¹⁸ Section 41 (3).

¹¹⁹ See Cebotari 2008; Lienert, Ian and Moo-Kyung Jung (2004); and OECD, 2007 which assert that about half of the OECD countries require parliamentary approval of loan guarantees (including Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Poland, Spain, Sweden, U.K., U.S.).

¹²⁰ Article 31 of Law 419.

¹²¹ Generally, the main risks faced by public debt portfolios relate to market risk, which includes interest rate risk and exchange rate risk, refinancing risk, liquidity risk, credit risk, and operational risk. See IMF/World Bank Revised Guidelines for Public Debt Management 2014 (Paragraph 5 "Risk Management Framework.")

debt managers to identify and mitigate risks associated with contingent liabilities (including PPPs).¹²² A clear legal framework is required for Government commitments that create explicit contingent liabilities.¹²³ The legal framework should also clarify the Minister's responsibility to ensure that the appropriate skills, processes, and systems (including internal and external controls) are in place to manage risks related to contingent liabilities.

74. A number of jurisdictions explicitly require risk assessments to be undertaken by the Executive before guarantees or other contingent liabilities are provided. The objective is to assess risks to Government from such contingent liabilities including where appropriate, market and credit risks. The legal framework should provide for initial risk assessments as well as ongoing assessments to ensure that these risks are constantly monitored and managed. While the primary legislation could provide for the broad requirements for risk assessments and management, secondary legislation should and provide for a detailed methodology for such assessments including triggers for reporting to the Minister, Cabinet and Parliament, where appropriate. An example of comprehensive provisions on guarantee risk assessments and reporting can be found in sections 58 and 59 of Kenya's Public Finance Management Act, 2012.

75. The legal framework should require the payment of guarantee fees or at least authorize the Minister to charge such fees. These could include an initial fee to reflect the credit risk undertaken by Government (i.e. the likelihood of the guarantee being called) plus administrative costs, and additional fees which could be charged over the life of the guarantee, to reflect changes in the credit risk profile. Fees could be based on a methodology to be specified by the Minister in Regulations, to provide for some flexibility in how such fees are determined. It may also be useful for the legal framework to clarify how such fees are handled by the Treasury, for example whether they should be held in a reserve fund (nominal or actual) for the purpose of paying off Government's liability under the guarantee, if called. Such provisions should however be consistent with budget execution and cash management provisions under the PFM legal framework.

H. Government Lending and On-Lending

76. Governments sometimes lend money to advance policy objectives, and to that extent, require explicit legal authority to do so. Such lending could be financed by a loan obtained by Government, which is then on-lent to another entity. The framework that governs Government lending may be spelt out in legislation (such as debt or public finance/budget laws).¹²⁴

77. The legal framework should help mitigate Government's credit risks from its lending operations. Similar to provisions requiring risks assessments and risk management

¹²² *Ibid.*

¹²³ *Ibid.*

¹²⁴ E.g. provisions on advances by Government.

for contingent liabilities, the legal framework should require due diligence and prudence in Government lending, through safeguards such as detailed credit risk analysis, market-based interest charges reflecting such risks, on-going monitoring and collections, and if deemed necessary, strong oversight by Cabinet and Parliament. Box 4 depicts common provisions in this regard.

78. Additional safeguards may be required for on-lending to help ensure that Government's own debt obligations to creditors are fulfilled. Given that on-lending transactions entail particular fiscal risks for Government in relation to the moneys borrowed (primary loan) for on-lending, it may be helpful for the legal framework to require the terms and conditions of on-lending transactions to be structured in a manner that enable Government to meet its debt service obligations under the primary loan. In particular, the quantum and timing of debt service obligations under the on-lending transaction should enable Government to meet its own obligations under the primary loan, on a timely basis, without recourse to further borrowing.

Box 4: Selected Statutory Provisions on Government Lending

Purpose of Government lending

- A requirement for the Minister of Finance to explain the public policy objective of intended Government lending.

Risk Assessment

- A requirement for risk assessment of any proposed lending by Government including the borrower's ability to repay the loan, based on a methodology to be specified by the Minister in Regulations; and
- The terms and conditions of the loan are to include market-based interest rates that reflect the borrower's risk profile as well as Government's funding costs.

Transactional Approval

- Cabinet approval is required by the Minister before a loan or advances over a threshold amount (to be specified by Regulations), and in some cases, approval from Parliament.

Record of Transactions

- A requirement for the Minister to record details of Government loans and advances, with reporting to Parliament as part of documents presented with the budget.

**Redacted from a sample of jurisdictions' legislation.*

V. INSTITUTIONAL ARRANGEMENTS FOR EFFECTIVE PUBLIC DEBT MANAGEMENT

79. **Institutional arrangements for PDM are an important component of the legal framework.** In particular, the institutional framework should be clear, and promote effective oversight over Executive actions while allowing enough flexibility for debt managers to undertake their functions.

A. The Role of the Legislature

Approval of Broad framework and Oversight

80. **As noted earlier in this paper, the role of the legislature is ideally confined to establishing the broad framework for PDM and should generally not involve transactional approval.** The framework established by the legislature, should include a clear articulation of the objectives of public debt, purposes, and other appropriate safeguards, to help promote debt sustainability. The legislature should also play an oversight role to ensure that debt management is conducted in accordance with the established framework. It can do this through reporting and accountability requirements provided in the legal framework.

81. **Delegation of borrowing authority to the Executive in some cases may not strip the legislature of its ultimate borrowing authority.** In many jurisdictions, Parliament retains a very important role in PDM and performs a number of functions in this regard. Among other things, a key role that Parliament plays in many jurisdictions is to approve borrowing transactions and their terms and conditions. In particular:

- a. **Approvals for every transaction:** In a number of jurisdictions including Austria,¹²⁵ Czech Republic,¹²⁶ Ghana,¹²⁷ and Moldova,¹²⁸ the legal framework requires the legislature to specifically approve all borrowing transactions. Strictly construing such requirements would imply that no borrowing transaction could be entered into by the Minister without prior approval from Parliament. This could prove cumbersome and costly for the Executive especially in the case of advances, overdrafts, Government securities, and others.

¹²⁵ Austria's Federal Financing Act (*Bundesfinanzierungsgesetz*) requires the authorization of the federal legislator.

¹²⁶ In addition to Act No. 190/2004 which regulated Government bonds, each specific issue of government bonds is further regulated in detail either by a specific act on a State bond program or by a specific act which empowers the Ministry of Finance to issue government bonds. See Theis Rechtsanwälte GmbH & Co KG "The Wolf Theiss Guide to: Public Debt Management in Central, Eastern & Southeastern Europe" 2012.

¹²⁷ Ghana's Constitution (Article 181 (4)) requires that "the terms and conditions of a loan shall be laid before Parliament and shall not come into operation unless they have been approved by a resolution of Parliament."

¹²⁸ Moldova's Organic Law No. 419 of 2006 on Public Debt, State Guarantees and State On-lending, Article 7.

- b. ***Specific approvals for certain transactions only:*** In other jurisdictions, legislative approval may be required for specified transactions only. For example in Belize, only Government borrowing above a specified threshold (currently the equivalent of BZD 10 million) during the fiscal year is required to be approved by the legislature. Similarly, some jurisdictions require legislative approval for external borrowing only.¹²⁹
- c. ***Approval of standard terms and conditions/Annual Approvals:*** In yet another category of jurisdictions, the legislature provides blanket approval for borrowing under certain standard terms and conditions, instead of transaction by transaction approvals. For example in Ghana, section 11 of the Loans Act allows the legislature to approve standard terms and conditions of Government loans, except that even in that event, the Minister of Finance is still required to seek *ex post* legislative approval of specific borrowing agreements after their execution.¹³⁰ The practical implementation of the *ex ante* legislative approval may however be challenging in some cases. Where such provisions exist, it is important to clarify explicitly whether such transactions have no legal validity on execution, until they receive *ex post* legislative approval. In other jurisdictions, legislative approval of Government borrowing is granted on an annual basis. For example, Grenada's Parliament passed the 2012 and 2013 Budget Loan Authorization Acts as part of the annual budget approval process, authorizing borrowing under standard terms and conditions, up to certain limits for each fiscal year. In Japan, Article IV of the Public Finance Law (Law No. 34 of 1947) requires the Diet to approve on an annual basis, the scope of public works to be financed by Government debt.¹³¹

82. Best practice however suggests that Parliament's role in approving debt transactions should be kept at a minimum. Parliamentary approval for transactions could be cumbersome, and could increase transaction costs. Parliament's role is ideally focused on delegating borrowing authority to the Executive and establishing through primary legislation, the broad framework within which such authority is to be exercised. Furthermore, through the budget process, Parliament is able to provide additional oversight over debt management. For example, Parliament may in some jurisdictions, set annual borrowing ceilings or targets which will have the effect of constraining Executive borrowing authority.

¹²⁹ For example Bosnia, where all loans obtained from foreign lenders and denominated in foreign currency require prior parliamentary approval. See Bosnia Law on Debt, Debt Issuance and Guarantees of the Federation, 2005, Official Gazette of BiH No. 52/05. Also Ghana, where Article 181 (5) requires all international business or economic transactions involving the Government to be approved by Parliament.

¹³⁰ Article 181 (3).

¹³¹ Redemption of Government bonds/borrowing is also required to be approved by the Diet.

83. **Yet for some jurisdictions, transactional approval by Parliament may continue to be regarded as a necessary component of the governance and accountability regime.** Ultimately, tradeoffs are required to balance accountability and good governance against flexibility and autonomy for debt managers. Important considerations could include the level of institutional development in the jurisdiction, and the extent to which the Executive could be relied on to police itself without transactional approvals by the legislature.

B. The Role of the Executive

84. **At the level of the executive arm of Government, institutional arrangements for debt management are also key.** As noted earlier, the legal framework should provide explicitly for debt management powers to be exercised solely by the Minister of Finance on behalf of Government and subject to the established framework. In some jurisdictions, other Ministers may play a role in debt management, but mostly in support of the Minister of Finance. For example, in Albania, the Minister of Foreign Affairs is required to counter-sign borrowing under international agreement.¹³² In other jurisdictions, there may exist legal requirements for the Minister of Finance to consult with other Ministers with relevant responsibilities including for Economic Development or Planning, local government, or SOEs.

85. **The oversight role of Cabinet in debt management should be provided for in the legal framework.** Good practices in debt management suggest that Cabinet should exercise some oversight over the public debt management function, including by approving the MTDS and reviewing debt-related reports before their submission to Parliament. Cabinet may also approve annual debt and guarantee ceilings, and in some cases, borrowing and guarantee transactions. Jurisdictions that require transitional approval for Government borrowing include Bosnia¹³³ and Ghana.¹³⁴

86. **Institutional arrangements to support the Minister of Finance in debt management are critical, given the enormity of the Minister's responsibilities.** Typical arrangements include the establishment of debt management departments or offices, and inter-departmental/agency committees, with the Minister delegating authority to officials or entities to borrow and/or manage the debt on his behalf. It may include delegated authority to approve and manage individual transactions within the limits of a defined borrowing program such as the annual program of issuance of government securities in the domestic market, or

¹³² See Theis Rechtsanwälte GmbH & Co KG "The Wolf Theiss Guide to: Public Debt Management in Central, Eastern & Southeastern Europe" 2013, who also explain that although, the term "international agreement" has not been expressly defined in Albanian law, in practice this term is invoked in relation to all agreements between Albania and foreign entities.

¹³³ In Bosnia, each individual transaction negotiated by the State Ministry of Finance and Treasury has to be approved by the Council of Ministers of the federation, on the basis of a proposal submitted by the Ministry. Bosnia's BiH Debt Law.

¹³⁴ Under Ghana's Loans Act (sections 1 and 3), Cabinet is required to approve any agreement for domestic and external loans.

the issuance of debt under mechanisms such as a medium-term note program or self-registration in foreign markets. Beyond the pragmatic benefit of enabling transactions to be undertaken in a timely manner, this provides the benefit of distancing the Minister from involvement in individual transactions and the consequent risk of undue political interference. The legal framework should provide clear statutory backing for such delegation as well as provide broad powers for the Minister to appoint agents and advisors to support him in performing his functions under the legal framework.

Debt Management Department/Office (DMO)

87. **Centralization of all debt functions in one single unit or agency reduces fragmentation and enhances coordination in debt management.**¹³⁵ In some jurisdictions, the day to day debt management functions are fragmented across more than one department or office, but increasingly jurisdictions are moving towards consolidation under a single office/department/agency. Preferably, this should be handled by a single office typically called the Debt Management Office (DMO), whether an autonomous agency or otherwise, a department or unit of the Finance Ministry. Consolidating debt management functions helps Government to maintain a holistic view on all of its debt obligations thereby promoting effective risk management of the overall debt portfolio, debt servicing, audit, evaluation, and reporting.

88. **Primary legislation in a number of jurisdictions¹³⁶ provide explicitly for the establishment of the DMO, and clarify its legal status and functions** Ideally, the legal framework should also require the involvement of the DMO in all technical analyses leading to borrowing and lending decisions, as well as those related to the creation of contingent liabilities. It should also mandate the DMO to prepare the MTDS and annual borrowing plans, as well as maintain records of all debt liabilities and exposures under contingent liabilities to facilitate reporting by the Minister. In other jurisdictions, some of these functions (particularly as they relate to Government securities) have been outsourced to the Central Bank.

89. **The legal framework should support operational autonomy of the DMO.** Operational autonomy in debt management operations from political interference is generally considered to be important for sound debt management. The legal framework should therefore support this by among other things, providing explicitly for the responsibilities of the DMO including technical analysis and decision making within boundaries established in

¹³⁵ Olden Brian and John Gardner “Cash Management and Debt Management: Two Sides of the Same Coin?” in Public Financial Management and its Emerging Architecture, Eds Marco Cangiano, Teresa Curristine, and Michel Lazare, IMF 2013.

¹³⁶ See examples in Austria, Belgium, Cyprus, Finland, Germany, Hungary, Ireland, Kenya, New Zealand, Portugal, Sierra Leone, Sweden, and the United Kingdom. For an expose on the legal framework for an autonomous debt management office, see Magnusson, Tomas (1999) “Legal Arrangements for a Debt Office. *Swedish National Debt Office*” available at: http://treasury.worldbank.org/bdm/pdf/Legal_Arrangements_for_Debt_Office_TM_1999.pdf

the MTDS and annual borrowing plans. Alternatively, the legal framework could empower the DMO to make technical recommendations to the Minister which the Minister would be required to consider before making a decision.

90. **Legal underpinnings are also required for effective coordination in overall debt management and fiscal policy.** Where, for any reason, consolidation of debt management functions is not feasible, the legal framework should help to promote coordination among the various departments or entities with day to day responsibility for debt management operations. Even in jurisdictions with consolidated debt management functions, the legal framework should mandate coordination of debt management with broader fiscal policy management, and consequently coordination between the DMO and other units of the Ministry of Finance and other relevant Agencies.

Committees

91. **A number of jurisdictions establish committees for public debt management operations.** The composition of such committees differs but they mostly comprise relevant officials of the MoF, and where applicable Planning Ministries and central banks. Their functions often include coordinating, advising on, or monitoring debt. To promote effectiveness of such committees and clarity in terms of their composition, roles, and responsibilities, statutory backing may be useful in some jurisdictions. In some countries however (see Iceland), such committees are set up pursuant to agreement between the Ministry of Finance and Central Bank. Box 5 shows examples of legal provisions for debt management committees in a number of jurisdictions.

Box 5: Selected Examples of Legal Backing for Public Debt Committees

Austria

Under the Export Guarantee Act,¹ an Advisory Council is established at the Federal Ministry of Finance to examine applications for Government guarantees exceeding a certain monetary threshold. Members are drawn from the Federal Ministry of Finance, the Federal Chancellor's Office, the Federal Ministry for Economy, the Federal Ministry of Agriculture and Forestry, Environment and Water Management, the Federal Ministry of European and International Affairs, the Austrian Federal Economic Chamber, the Federal Chamber of Labour, the Conference of the Presidents of the Austrian Chamber of Agriculture, and of the Federation of Austrian Trade Unions, and the Oesterreichische Nationalbank, among others.

Iceland

Iceland's Consultative committee on Treasury Debt Management is established pursuant to an agreement between the Ministry of Finance and Central Bank of Iceland on treasury debt management. Members are appointed by the Minister from the Ministry of Finance and others are nominated by the Central Bank of Iceland. The committee presents proposals to the Ministry on the issuing calendar for the year for Government securities, the format and arrangements for individual bond issues and their maturity and volume, market making arrangements and auction arrangements, and proposes benchmark issuances for risk management of the Treasury's domestic and foreign debt portfolio.²

Jamaica

Jamaica's 2012 Public Debt Management Act provides for the establishment of a **Public Debt Management Committee (PDMC)** and a **Public Debt Financing Committee (PDFC)**. The PDMC monitors implementation of the MTDS, and compliance with debt operations with the legal framework. The PDFC on the other hand, advises the Financial Secretary on debt transactions and applications for lending by Government, and provides periodic reports to facilitate the work of the PDMC.

Tanzania

Tanzania's Government Loans, Guarantees, and Grants Act provides for the establishment of a **National Debt Management Committee (NDMC)**³ and a **Technical Debt Management Committee (TDMC)**.⁴ The NDMC (i) advises the Minister on public debt matters (including formulation of the MTDS); (ii) coordinates and directs activities of all government departments and institutions involved in management of debt, grants and guarantees; (iii) advises on measures to be taken against a person for non-compliance with the Act.⁵ The TDMC's key responsibility is to provide technical advice to the NDMC.⁶

¹ Section 5 (2)

² See paragraph 6 of the Agreement between the Ministry of Finance and Central Bank of Iceland on Treasury debt management' dated September 2017, available at http://eng.fjarmalaraduneyti.is/media/finances/Agreement_between_MoF_and_CBoI.pdf

³ This committee is chaired by the PS Treasury and comprising Permanent Secretaries for Finance, Ministry of Finance Zanzibar, President's Office Planning and Privatization, Prime Minister's Office, Ministry of Foreign Affairs and International Cooperation, Attorney General, Governor of the Central Bank, Accountant Generals of the Ministry of Finance, and of the Ministry of Finance – Zanzibar.

⁴ This committee is chaired by the Commissioner for Policy Analysis in the Ministry of Finance with members being technical heads of units involved in debt management making up the NC.

⁵ Sections 16, 17 and 18 Government Loans, Guarantees, and Grants Act 1974 as amended (Cap 134).

⁶ Section 19 Government Loans, Guarantees, and Grants Act (Cap 134).

C. Agents, Advisors, and Dealers

92. **In many jurisdictions, debt managers outsource certain debt management services to agents and advisors.** Agents could provide services to support the issuance, registration, clearing and settlement of Government securities trades. Often the Central Bank plays the role of fiscal agent which may involve acting as issuing and registration agent. In other countries, registration and clearing of Government securities transactions are handled by a central securities depository (CSD). In some jurisdictions, the CSD is owned and operated by the Central Bank and as such, the latter's appointment as fiscal agent may cover clearing and settlement through the CSD. Where the CSD is a separate legal entity from the Central Bank, formal legal arrangements are required among the MoF, the Central Bank, and the CSD, to clarify their respective roles and responsibilities as well as rights and liabilities. In the case of Government securities issued in the international debt markets, issuing agents could include foreign investment banks.

93. **The legal framework should also clarify whether there is legal authority to appoint primary dealers and other Government securities dealers.** Depending on the structure of the Government securities market, there may be the need to provide for the appointment of dealers in government securities. In some jurisdictions, this is handled by the Central Bank as fiscal agent on behalf of the MoF under terms and conditions approved by the Minister.

Central Bank as fiscal agent

94. **Where the Central Bank is authorized under its enabling law to act as fiscal agent to Government, the PDM law and the Central Bank law should reflect this mandate.** The legal framework should clarify the scope of this agency relationship, which may include managing auctions, registry services, and cash management transactions for Government debt. In some jurisdictions, the Central Bank's fiscal agency mandate may cover borrowing by public sector entities. For example in Lesotho, the Central Bank's fiscal agency role may be in respect of loans publicly issued by the government or by public bodies.¹³⁷ In the case of Botswana, the Government, as well as statutory bodies, SOEs, and local government authorities are required to seek advice from the Central Bank concerning the timing, terms and conditions of their borrowing.¹³⁸

95. **The scope of the Central Bank's fiscal agency role should be consistent with its core central banking mandate.** While the legal framework (including the relevant central

¹³⁷ Central Bank of Lesotho Act of 2000, (section 7 (1) (m)).

¹³⁸ Section 59 of Bank of Botswana Act 1996 "Prior to any borrowing from a source other than the Bank, Government and every statutory or wholly-owned Government corporation, Government controlled corporation or local authority shall seek the advice of the Bank concerning the timing, terms and conditions of such borrowing and shall promptly notify the Bank of the terms and conditions of any such borrowing subsequently entered into: Provided that the Minister may prescribe minimum amounts below which such borrowers shall not be required to seek the advice of the Bank to proposed borrowings in Pula."

bank legal framework and/or the PDM law) should specify the scope of the central bank’s fiscal agency role as discussed above, this should be carefully crafted such as not to be inconsistent with this core mandate—typically, that of price stability. In some jurisdictions, this is provided for explicitly in the legal framework. For example, the Central Bank of Lesotho Act of 2000 provides that the role of the Central Bank as fiscal agent should be consistent with its duties and functions as a central bank.¹³⁹

96. Operational details of the fiscal agency relationship are often spelt out under a fiscal agency agreement or memorandum of understanding between the Ministry of Finance and the Central Bank.¹⁴⁰ Box 6 reflects useful provisions of fiscal agency agreements for public debt management purposes. Typically, a fiscal agency agreement or MOU sets out the respective roles and responsibilities of the Central Bank and the Finance Ministry in public debt management and related matters,¹⁴¹ and arrangements for coordination between the two institutions. In some jurisdictions, this agreement is also used to provide more broadly for the terms and conditions under which the Central Bank will act as banker and lender to Government. It is also important to provide explicitly for the terms and conditions under which the Central Bank plays the fiscal agency role, including remuneration and reimbursement for expenses related to the carrying out of its duties as fiscal agent.

97. The legal framework should clarify the Government’s role as issuer of Government securities, and provide adequate legal protection for the Central Bank as agent. Where the Central Bank acts as issuing agent for the State, it is important that its role as agent is clearly distinguished from the State’s role as principal. Legally speaking, issuance of government debt securities constitutes a contractual obligation for the Government as issuer (borrower) and a right in favor of the registered owner/holder (or bearer in the case of bearer securities) as creditor. While the Central Bank may facilitate this process, it is typically not liable for the obligations under Government debt, and consequently it is not the legal issuer of such debt.

98. The Central Bank’s fiscal agency role should not put its assets in jeopardy. It may be useful to include in legislation, legal protection for the Central Bank from attachment of its assets by creditors of the State. For example in the famous case of *Banque de la Republique du Burundi vs. Goetz et al (supra)*, creditors of the Burundi State sought an order to garnish assets of the Central Bank of Burundi held with the Belgian Central Bank, on the argument that the Burundi Central Bank was the fiscal agent of the State and held those

¹³⁹ Section 43.

¹⁴⁰ A good example of this is the “Agreement between the Ministry of Finance and Central Bank of Iceland on Treasury debt management” dated September 2007, available at http://eng.fjarmalaraduneyti.is/media/finances/Agreement_between_MoF_and_CBoI.pdf.

¹⁴¹ In some jurisdictions, this agreement is also used to provide more broadly for the terms and conditions under which the Central Bank will act as banker and lender to Government.

assets on behalf of the State. The Tribunal however rejected this argument on the basis that the Central bank was a separate legal entity from the State.¹⁴² In addition to any legal protection afforded the Central Bank under its enabling legislation, the fiscal agency agreement/MoU could also provide an indemnity by Government to the Central Bank for losses arising out of good faith performance of its duties as fiscal agent.

Box 6: Key Features of a Fiscal Agency Agreement for Public Debt Management

A fiscal agency agreement for public debt management should at a minimum provide for the following:

- ***The scope of the Central Bank's role.*** In particular, it is important to clarify whether the fiscal agent role applies only to central government or also to all public entities.¹
- ***Clear definition of responsibilities of the Minister and Debt Management Office.*** In its capacity as representative of the principal (Government), the Minister should retain responsibility for the overall PDM and in that regard oversee key activities. These include determination of the issuing calendar for the year, volumes and maturities of securities to be offered at auctions, yields and other terms and conditions. The Minister should also ensure that functions carried out by the agent conform to the overall debt management objectives, strategy and borrowing plan for the year.
- ***Clear definition of the Central Bank's responsibilities.*** In its capacity as agent, the Central Bank exercises delegated authority from the Minister and should act within the scope of that authority. It should seek the prior approval of the Minister before accepting bids at auctions, exceeding securities offering amounts, and making payments on behalf of Government, among others.
- ***Reporting.*** The fiscal agency agreement should also clearly provide for timely and comprehensive reporting by the Central Bank to the Ministry in relation to action results, future debt service requirements, and other relevant information.
- ***Remuneration and expenses.*** The agreement should provide for remuneration for the Central Bank's services as fiscal agent. This should be market-based to ensure that the true costs of the Central Bank's services in this regard are well compensated for. Also, the Central Bank should be reimbursed for direct expenses relating to the provision of its services, including costs of publication of the issuing calendar, auction announcements, and others.
- ***Cooperation and coordination.*** Arrangements could be included for cooperation and coordination between the MoF and CB including the establishment of working committees such as auction committees to facilitate cooperation, transparency, and accountability.
- ***Legal protection and Indemnity.*** The MoF should indemnify the Central Bank for any third-party claims made against it for matters within the scope of its agency authority, in the absence of negligence or bad faith.

¹ See examples in Lesotho, and Botswana, mentioned in paragraph 96 above.

¹⁴² See ruling of the Brussels Tribunal of First Instance (Banque de la Republique du Burundi vs. Goetz et al (*supra*)).

VI. TRANSPARENCY, ACCOUNTABILITY AND REPORTING

A. Transparency

99. **Transparency in public debt operations is a key tool for promoting fiscal accountability and responsibility.** A well-designed system of reporting and public disclosure should be underpinned by the legal framework. The key objective here should be to help ensure that the quantum of public debt and contingent liabilities is clearly reported on and performance under the medium-term debt strategy is monitored and evaluated.

100. **Key requirements of the transparency framework should include:**

- a. publication of the MTDS on the Government or Ministry of Finance's website, and local newspapers of wide coverage, among others;¹⁴³
- b. publication of the annual borrowing plan together with the budget;
- c. periodic public disclosure of the stock and composition of public debt (including loans guaranteed by government) disclosing details such as their currency, maturity profiles and interest rate structure financial, as well as financial assets of the state in the form of loans made by government;¹⁴⁴
- d. maintenance of public debt records including details of all government securities and a schedule of repayment obligations;
- e. periodic publication of records and accounts of borrowing by other public sector entities (including local government authorities); and
- f. annual report to Parliament evaluating whether public debt management operations conformed to the MTDS, and the reasons for any variance.¹⁴⁵

B. Enforcement and Sanctions

101. **Strong enforcement mechanisms are necessary to instill discipline in public debt management.** Violations may take various forms. For example, an official other than the

¹⁴³ For example, Mauritius' PDM Act of 2008 section 9 (3) and (5) requires the MOF to make the MTDS public no later than a month after the end of every quarter.

¹⁴⁴ E.g. Mauritius PDM Act of 2008 (s. 9 (4)) requires the MOF to prepare (no later than one month after the end of every quarter) a report on details of the outstanding public debt stock, and make it public. Sierra Leone's PDM Act of 2011 (s. 21) requires submission to Parliament annually (no later than three months after the end of the financial year), a report on details of the outstanding public debt stock. Also Lesotho's Public Finance Management and Accountability Act (section 37) requires the Minister to report on public debt annually to Parliament along with the submission of the annual budget. Details to be reported include the stock of public sector debt (including statutory bodies and SOEs), and in particular, the size and currency composition, interest rate mix and the maturity profile, contingent liabilities, and lending by Government.

¹⁴⁵ Examples include Brazil where the Federal Court of Audit is mandated by law to audit the management of federal public debt and to report to the National Congress, on the extent of compliance with requirements of the legal framework (See article 59 of Brazil's Fiscal Responsibility Law (paragraph 1, subsection III), and also article 71 (subsection IV) of the 1988 Federal Constitution).

Minister of Finance may have committed the Government to a debt transaction. The Minister may have entered into a debt transaction without the necessary approvals from Cabinet or Parliament where required, or in breach of the debt limit imposed under the law. Guarantees may have been issued in violation of the procedures set out under the law. Other examples include where public entities such as statutory bodies, SOEs, or local government authorities may have borrowed above ceilings (if any) set by the Minister of Finance.

102. Enforcement mechanisms often include reporting and sanctions. In the context of a monetary union, violations of a convergence criterion on debt may lead to mandatory corrective measures¹⁴⁶ or in extreme cases expulsion from the union.¹⁴⁷ In particular, the EU's two and six pack regulations provide for an automatic sanctioning mechanism to help promote compliance. Other currency unions such as the CFA zone in Africa and the ECCU however have no regional surveillance and enforcement mechanisms in place.¹⁴⁸

103. Sanctions for non-compliance could be personal or institutional, and civil or criminal. In some jurisdictions, the administrative law regime, the PFM legal regime, or the general legal framework applicable to public servants may provide minimum sanctions for malfeasance by officials in public debt management. Where appropriate, more specific sanctions may be provided for violations of the PDM legal framework to promote discipline. In Jamaica, the PDM Act (section 25) empowers the Minister to issue a code of conduct (including conflict of interest guidelines) for persons employed in the management of the public debt.

104. Civil sanctions for violation of the legal framework could include court action to recover payments received under any non-compliant debt transaction. For example, Suriname's legal framework specifically makes the Minister of Finance and any other responsible party, personally liable for debt obligations or guarantee commitments in violation of the debt ceiling during his term of office.¹⁴⁹

105. Criminal sanctions may involve fines and prison terms. For example, Brazil's Fiscal Responsibility Law and Fiscal Crimes Law provide for criminal sanctions for officials involved in violations of the public debt legal framework. Among other things, the Law of

¹⁴⁶ E.g. the so-called "corrective arm" of the EU's SGP.

¹⁴⁷ The ECCU has no enforcement mechanisms in place currently for non-compliance with its Debt/GDP ratio of 60 percent by 2020.

¹⁴⁸ See UN Economic Commission for Africa, "Towards a common currency in the East African Community", 2012, page 24.

¹⁴⁹ Article 5 (2) of the National Debt Act 2002 provides that "Without prejudice to the provisions Article 25(1) and (2), the Minister will directly liable for exceeding any Debt Ceiling contravention of this Act, even if his term office has ended." Also under Article 9 (3) "When the State initiates any legal proceedings as referred to in this Article, the State may claim that the party responsible for the creation of the debt obligations or guarantee commitments be held personally liable for the obligations created."

Fiscal Crimes¹⁵⁰ provides penalties (including prison terms and political office bans for specified periods) for the President of Brazil, state governors and mayors of municipalities who authorize or conduct credit operations prohibited by the Fiscal Responsibility Law or Senate resolutions. Suriname’s legal framework provides for a prison term of up to ten years and a fine for “intentional breach” of key provisions of the Act, while “accidental breach” results in a prison term of up to five years and a lower fine.¹⁵¹ In Kenya, the PFM Act of 2012 imposes a maximum prison term of two years and a fine on a public officer who borrows money, issue a guarantee, indemnity or security or enters into any other transaction that binds or may bind the national government entity or a county government entity to any future financial obligation in violation of requirements of the law (including any limits imposed).¹⁵²

106. Personal sanctions should however be designed with caution. Provisions of the law which punish officials for breach of the legal framework could inadvertently impose the burden of breach on persons who themselves may not be the real culprits. For example, debt managers may be involved in following instructions of the Minister to borrow in line with the Government’s fiscal policy, as a result of which it may be difficult to blame debt managers for this violation. Consequently, personal sanctions may be challenging to design and implement.

107. Reporting requirements following violation of the legal framework are common. Reporting may be required in the end of year debt management report, including an explanation if debt management activities deviated from the MTDS or annual borrowing plan. In addition, there may be a requirement for immediate reporting, with proposals for correction/adjustment in the course of the fiscal year.

108. In addition to sanctions and reporting requirements, the legal framework should clarify the consequences of debt contracted in violation of the law. Some jurisdictions explicitly provide that such transactions are void, voidable, or unlawful. For example in Brazil, non-compliant transactions are void and of no legal effect as though they were never contracted.¹⁵³ Others make non-compliant transactions voidable, which means that they are valid until nullified. Suriname’s National Debt Act of 2002 empowers the State to declare “(...) any unauthorized debt obligations or guarantee commitments created at the State’s expense (...)” and of any related actions, as voidable.¹⁵⁴ Under Nigeria’s Fiscal

¹⁵⁰ Federal law no 10,028 of 2000.

¹⁵¹ National Debt Act 2002 Article 25.

¹⁵² Section 196 (4) and (6).

¹⁵³ Article 33 S.1 of the Fiscal responsibility Law 2000.

¹⁵⁴ Article 9 (11) on “Voidability of obligations” empowers the State to nullify any unauthorized monetary debt obligations or guarantee commitments created at the State’s expense and of any juristic acts (performed in order to create those obligations.”

Responsibility Act of 2007, loans by banks and financial institutions to Government in contravention of the provisions of the Act are unlawful.¹⁵⁵ Box 7 summarizes experiences from a few countries.

109. **In other jurisdictions however, the legal framework may guarantee Government's liability under debt transactions in all cases.** For example in Sweden, section 4 of the Act on State Borrowing and Debt Management which provides that the State shall be liable for any and all loans entered into by the National Debt Office, is seen as guaranteeing the legal validity and enforceability of such loans by lenders, regardless of whether the Debt Office had received the necessary authorization to make a certain borrowing on behalf of the State or not, although internal sanctions may apply.¹⁵⁶ Also Moldova's Law No. 419 of 2006 on Public Debt, State Guarantees and State On-lending, provides that "The State Debt is a sovereign Debt and represents an absolute obligation of the Republic of Moldova to its commitments in accordance with signed agreements."¹⁵⁷

¹⁵⁵ Section 45 (2) provides that "Lending by banks and financial institutions in contravention of this Part shall be unlawful."

¹⁵⁶ See Magnusson, Tomas (1999) Legal Arrangements for a Debt Office. "Swedish National Debt Office" Available at http://treasury.worldbank.org/bdm/pdf/Legal_Arrangements_for_Debt_Office_TM_1999.pdf

¹⁵⁷ Article 7 (1).

Box 7: Statutory Examples of Provisions Invalidating Public Debt

Brazil

Under the Fiscal Responsibility Law 9 (Article 33, section 1 and 2) , public debt contracted in violation of the provisions of that law are null and void, and must be cancelled through the refund of the principal without payment of interests and other financial charges. If the refund is not effected during the same fiscal year in which the inflow occurred, a specific reserve must be set aside in the Annual Budgetary Law for the subsequent year.

South Africa

Under the Public Finance Management Act 1999 (section 68) amended as of 2009, any borrowing, guarantee, indemnity or security entered into by the Government or any public institution in breach of the provisions of the Act is null and void and of no effect.

Nigeria

Under Nigeria’s Fiscal Responsibility Act of 2007 (section 45 (2)), loans by banks and financial institutions to Government in contravention of the provisions of the Act are unlawful.

Suriname

The National Debt Act of 2002 (Article 4 (11) provides that any agreement entered into in breach of the debt ceiling or applicable rules of law, in particular those with regard to financial reporting and accounting is null and void.

Sierra Leone

The PDM Act of 2011 (section 27) provides that “The Government shall not be bound by the terms of any loan contracted or purported to be contracted for or on its behalf by any person other than the Minister or a public officer, authorized in writing in that behalf, by the Minister.

110. **The design of the sanctions regime should avoid unintended consequences.** For example, while a provision in the law invalidating non-compliant debt could deter unlawful behavior and promote discipline, it could also potentially create uncertainties for Government creditors who may have doubts as to whether their claims against Government will be honored. This could lead to higher borrowing costs for Government in view of increased risks perceived by investors.

111. **To reduce this risk, some jurisdictions provide comfort for potential lenders, but other jurisdictions impose the burden of due diligence on creditors.** For example :

- a. ***Tanzania:*** The legal framework in Tanzania guarantees validity of Government debt even if it is contracted in contravention of relevant requirements under law. The law provides that:

“No person lending any sum of money to the Government shall be bound to enquire whether all the conditions for raising a loan provided for in section 4 and section 7 have been complied with and for the avoidance of doubts it is hereby declared that where a loan whether a foreign loan, or local loan has

been raised by the Minister for and on behalf of the Government, the Government shall be bound by the transaction and section 16 shall apply in relation to the loan notwithstanding that any provision of the proviso to section 4 of the proviso to section 7 has been contravened.”¹⁵⁸

- ***Brazil, Nigeria:*** The legal position in other jurisdictions like Brazil and Nigeria, differs from that in Tanzania. Brazil’s Fiscal Responsibility Law requires financial institutions to request proof that their proposed lending (except for securities and external debt), to any member of the federation, complies with the established conditions and limits under the law.¹⁵⁹ In Nigeria, banks and financial institutions are required by law to request and obtain proof of compliance with the provisions of the law before lending to any Government in the Federation. It is noteworthy that these two jurisdictions impose due diligence duties only on sophisticated lenders like banks and other financial institutions, and not on others that may have no means of independently verifying compliance with the PDM legal framework.

112. **Overall, the need for provisions invalidating debt in one way or the other should be carefully examined, given possible legal and practical implications.** Alternative consequences of violations of the PDM legal framework such as requirements for reporting and for revisions to borrowing plans to conform to relevant requirements of the legal framework could be explored. For jurisdictions that find it necessary to invalidate debt for non-compliance, the design of such provisions should mitigate any unintended consequences by addressing the issues raised in the preceding paragraphs.

VII. CONCLUSION

113. **Designing PDM legal frameworks involves several important considerations.** The approach for addressing weaknesses in the existing legal framework should be pragmatic and should be carefully calibrated to help meet reform objectives. The process should involve a thorough assessment of the existing legal framework in its entirety, by reviewing the sources of law discussed above if they exist against a set of good practices that are appropriate to the political, legal, institutional and economic arrangements of the relevant jurisdiction. A good PDM legal framework will reflect an optimal balance between flexibility on the one hand and appropriate constraints. Well designed, a PMD legal framework helps to promote clarity, transparency, and discipline, which ultimately support debt sustainability objectives.

¹⁵⁸ See section 27 of Tanzania’s Governments Loans, Guarantees and Grants Act, 1974 amended as of 2003. Emphasis added.

¹⁵⁹ Supplementary law 101, of May 4, 2000, Article 33.

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