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BRIEF INTRODUCTION TO POTOMAC GROUP
KEY MEMBERS OF POTOMAC GROUP

Senior-level professionals with expertise in strategic issues facing sovereign governments, creditors and investors

AMBASSADOR FRANK WISNER, Senior Advisor

- 40+ year career as a diplomat including as US Ambassador to Zambia, Egypt, the Philippines and India

TUNDE ONITIRI, Managing Director

- Former Senior Country Manager, Singapore and Malaysia, IFC; Country Manager, Angola and Mozambique, IFC; Assistant Director AIG African Infrastructure Fund

DAVID RETCHKIMAN NIÑO DE RIVERA, Director

- 15 years’ experience in financial structuring and credit analysis in emerging markets with particular experience in Latin America

JILL OSBORN DAUCHY, Founder and CEO

- Trusted financial advisor to sovereign governments for over 20 years; Senior expert to the IMF on sovereign debt restructuring and debt management

BRUNO SILVESTRE, Media & Communications Strategist

- 35+ year career as news producer and media strategist; Former Senior Communications Advisor, IMF; Foreign Press Advisor, French Ministry of Finance; Paris bureau chief, ABC News

QUENTIN DUMONT, Associate

- Former sovereign advisory analyst, Millstein & Co; internship at the Paris Club, French Ministry of Finance
DISCUSSION OF CHAPTER FIVE: DEBT MANAGEMENT
OBJECTIVES OF DEBT MANAGEMENT

“We need to recognize the nuances between objectives of a debt manager in a developed economy vs. one in a developing (or even low income developing) country

Other considerations could include:
- Building a yield curve for the proper pricing of risk for private sector
- Extending maturities
- Creating benchmark issuances and building liquidity of secondary market
- Diversifying the country’s investor base, by attracting foreign investors or a new class of investors (i.e. sukuk), or developing new financial products for existing markets (i.e. indexed bonds, zeros, etc.)
- Supporting the development of the financial sector, and in general promoting financial stability
- Building sufficient Foreign Exchange Reserves to weather a crisis (from within or externally)

Sadly, some debt managers are motivated by other, less-noble objectives:
- “My neighbor has a Eurobond, I want one too!”
- “We may not be ready to deploy $ X million into economically productive projects, but investors are willing to lend to us now, so…. ”
UNSPOKEN OBJECTIVE

To satisfy the conditions of the IMF, including program conditionalities, borrowing limits or recommended debt thresholds

- Stark differences exist between developed and developing countries
  - IMF surveillance
  - Conditionalities and consequences

- Preoccupation with the issuance of sovereign guarantees and the accounting of related contingent liabilities

- Concerns regarding possible “hidden debts” or debts contracted by State Owned Enterprises or other government agencies that are difficult to track

- Debt managers agree that it is critical to monitor these liabilities and to quantify potential risks to financial stability, but at the same time, accounting for 100% of the risk on the balance sheet could limit future borrowing capacity
## RISKS & TRADE OFFS

A rapid increase in non-concessional domestic and international sources of financing

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<th>DOMESTIC</th>
<th>EXTERNAL</th>
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<tr>
<td><strong>SHORT-TERM</strong></td>
<td>The authors claim that governments face an inter-temporal trade-off, i.e. excessive reliance on short-term or floating rate debt to take advantage of lower short-term rates</td>
<td>Might be the only option for many LIC's that do not have sufficiently robust domestic markets or domestic sources of financing; doubtful chosen for “savings”</td>
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<td>Does that reflect reality? Or are some countries just lacking access to longer-term financing? Some countries have no other choice as they need to build their yield curve and lengthen maturities, while investor confidence grows</td>
<td>Can pose significant refinancing risk, especially for infrequent issuers or those with macroeconomic imbalances; market conditions can change radically, sudden stops</td>
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<td><strong>LONG-TERM</strong></td>
<td>Requires developed domestic investor base – banks, pension funds, insurance companies – which in turn requires a high level of financial inclusion</td>
<td>General wisdom is that governments should extend maturities, create yield curve and benchmarks for corporate issuers to price risk accurately</td>
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<td>Often the preferable source for government issuer, however, long-term domestic debt could pose greater Value at Risk (VAR) for the debt holder</td>
<td>The extreme case of the “Century Bond”: Argentina issued its century bond and 12 months later it is already asking IMF for record level bail out package</td>
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DOMESTIC & EXTERNAL DEBT

“The demand side of government debt: tracking who owns what, when and for how long can shed some light on potential risks” – the authors

- The above was mentioned in the context of advanced economies but it applies just as well to LIC’s
- By understanding the motivations of different types of creditors, the debt manager can better anticipate potential changes in sentiment, which could lead to sudden stops or investor outflows
- It is important for debt managers to understand how and why investors change their allocations
- The “original sin” of developing economies: investors’ lack of trust in the sovereign based on past transgressions
- Note that most developing countries will have a hard time convincing investors to allocate resources to “unusual” currencies – they tend to operate in a limited number of well-established major currencies
FINANCIAL MARKETS

“Well-regulated, predictable, reliable and liquid domestic debt markets can play a critical role in supporting economic growth, particularly in developing countries, at the macroeconomic and microeconomic levels” - the authors

- Benefits are clear, as are the necessary preconditions for development of domestic debt markets
- However, many preconditions are out of the control of the debt manager, such as:
  - Political stability and government credibility
  - Macroeconomic stability and relative confidence about the course of inflation
  - Prudent fiscal policy
  - Financial controls
  - Domestic savings rates (and more broadly the depth of financial inclusion)
  - Domestic institutional investor base
  - Government discipline over issuance of debt (and sovereign guarantees)
  - Functioning technical and regulatory infrastructure
- Debt managers can control the Debt Management Strategy, the issuance plan
- The key is to develop a strong sense of predictability and transparency to stakeholders