

## **RISK MANAGEMENT IN PUBLIC DEBT MANAGEMENT**

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### **Abstract**

The world economic crisis has faced public authorities with new risks for public debt management. The risks that are mainly manifested in this period are: market risk, refinancing risk, liquidity risk, credit risk and operational risk. The management of risks consists of all measures taken by the state in order to mobilize financial resources so as to achieve the goals of risk and cost, as well as other objectives such as developing and maintaining an efficient government securities market, maintaining a high loan rating as a lender.

### **Introduction**

In recent years, in Romania have been many fiscal and budgetary imbalances, the budget deficit substantially increasing from 1% of GDP in 2005 to 7.2% of GDP in 2009, representing 36.4 billion lei. However, the budget deficit in 2009 was below the target set by the International Monetary Fund, respectively 7.3% of GDP.

The issuance of treasury bills, bonds, Eurobonds, contracting loans in the foreign market, by signing a stand-by agreement with the International Monetary Fund, but also with other international financial institutions on the domestic market, imposed coverage measures for the budget deficit. Thus, at the end of February 2010, Romania's public debt was 155.027 billion lei, representing approximately 29% of GDP.

Public debt structure was as follows: state loans (39.77% GDP), Treasury bills (18.05% GDP), bonds (17.19% GDP), Eurobonds (6.11% GDP), financial leasing (0.06% GDP). The difference of 18.81% was contracted from the available GDP Treasury.

In these circumstances it is required a proper management of risks that manifest themselves in public debt management, so as to not cause a financial jam with very serious consequences on all public institutions and the overall economy.

### **Delimitation of public debt content, the first step in effective risk management**

Public debt represents all internal and external obligations of the state at a given time, contracted in the financial markets [3]. In order to evaluate Romania's public debt, any bond, denominated in currencies other than the national one, is calculated in national currency using the exchange rate announced by the National Bank of Romania for the last day of the reporting period. State Treasury represents a trustworthy institution, forced to face at any time, the funding needs established by the budget law [7].

Public debt has two components, namely:

- domestic public debt - the part of public debt, which represents all state obligations, arising from the loans contracted directly or guaranteed by the state on the international market, including amounts received temporary from Treasury sources;
- external public debt - the part of public debt which represents all state obligations, arising from loans on the foreign market, contracted directly or guaranteed by the State [6].

Public debt is established and managed separately in two forms:

- government public debt represents obligations incumbent upon the Government through the Ministry of Finances, from loans contracted or guaranteed;
- local public debt - part of the public debt which represents all internal and external obligations of local authorities.

Depending on the term public debt is of:

- short term (floating)
- medium and long term (consolidated).

Contracting financial resources in the financial markets is limited by the amount of public indebtedness. It represents all the loans that we may contract and guarantee for a period of one year, which is set annually by law. Public indebtedness includes the amount of domestic public debt and the amount of external public debt. Domestic public debt is fixed according to the approved budget deficit and the provisions of special laws. The external public debt is set as the maximum amount of foreign loans which may be contracted or guaranteed for a period of one year and is set annually by law.

For there to be a very accurate record of the level of public debt, the register of public debt was constituted, the document that highlights the debt situation in chronological order and which has two components: the register of domestic public debt and the register of external public debt.

Domestic public debt is an unconditional and irrevocable obligation of the state for the repayment of loans contracted in lei, for the payment of interest and other costs. In order to pay the interests related to the domestic public debt is granted a permanent budget authorization for making such expenditures.

State domestic debt instruments include, but are not limited to these:

- a) government securities in local currency;
- b) state loans from the National Bank of Romania, given in the conditions established by law on the status of the National Bank of Romania;
- c) state loans from commercial banks in Romania;
- d) state loans from other credit institutions in Romania and government agencies.

To the extent that it would achieve greater decentralization in use, we can accelerate the process of regional development at the regional level [5].

External public debt is an unconditional and irrevocable obligation of the state for the repayment of loans to foreign markets, for the payment of interests and other costs. For the payment of external public debt service is given a permanent budget authorization to carry out these expenditures.

The sources of payment for external debt service are, as appropriate, these:

- a) expenses provided by this destination in the state budget;
- b) reserve fund available to the Government, according to state budget law;
- c) amounts resulting from the Romanian state debt recovery;
- d) amounts received by financial institutions authorized by the Ministry of Finances to manage foreign loans contracted by it, in the name and on behalf of the state, from the final recipients of loans, for investment and imports;
- e) the amounts collected by the Ministry of Finances from the final beneficiaries of loans, based on subsidiary loan agreements, concluded under the loan agreements concluded between Romania and the international financial organizations;
- f) the amounts provided in the budgets of the beneficiaries of loans, under subsidiary loan and guarantee agreements concluded between the Ministry of Finances, county or local councils and economic agents under their authority, in the terms of loan agreements made between Romania and the international financial organizations;
- g) the amounts provided in the budgets of public or local county authorities, for external loans contracted by them, under the law;
- h) the amounts provided in the budgets of economic agents who have contracted external loans with the state guarantee;
- i) risk fund, for cases in which are executed guarantees issued by the Ministry of Finances for loans contracted by economic agents.

According to the law of public debt, external debt instruments are as follows:

- a) currency government securities, issued by foreign financial markets;
- b) loans from foreign governments, foreign government agencies, multilateral financial institutions or other international organizations;
- c) Short, medium or long term syndicated loans;
- d) direct loans from private investors, on the short, medium or long term;
- e) loans from foreign banks or foreign companies;
- f) other loans, if applicable.

In risk management, in public debt and state guarantees management, the Ministry of Finances undertakes the following:

- a) analyzes and evaluates the size of the loan, so that the level of indebtedness to meet the needs of Romania and the ability of the state to manage debt;
- b) holds the accounting of public debt contracted and statistical records of state guarantees issued;
- c) follows the development of state-guaranteed loans;
- d) supervises the liquidity of the state treasury general account for payment of obligations within the deadlines set;
- e) elaborates the annual general account of public debt.

### **Risk management and indicators for assessing public debt**

Public Debt Management consists of all measures taken by the state to mobilize financial resources so as to achieve the goals of risk and cost, as well as other objectives such as developing and maintaining an efficient government securities market, maintaining a high loan rating as a lender. In the current conditions, public decisions have a strong political nature and it is required to assume them [2].

Risks that arise in government debt management are:

- market risk refers to risks arising from market price developments (the evolution of interest rate, exchange rate increase, the oscillations in commodity prices etc.);
- refinancing risk - the risk of not being able to access financial markets in order to refinance debt or to refinance it at a higher cost;
- liquidity risk has two components:
  - the first is related to the cost borne by investors who want to close a position taken by selling their securities when the market is not attractive;
  - the second refers to the loss of liquidity due to the unforeseen obligations of state treasury and / or to meet some difficulties in order to obtain new loans;
- credit risk is the risk of non-payment of contractual obligations that comprise the public debt;
- operational risk is given by the actions of the human factor on mistakes, incompetence, legal issues and natural disasters that damage the economic activity.

Country risk is more and more manifested in these conditions of economic crisis, becoming necessary to use a more complex rating in order to quantify it [1].

Indicators for assessing public debt have been developed to determine to what extent a country's economy will experience a high level of indebtedness in the event of external, financial and economic shocks.

1. Indicators of public debt:

- the volume of public debt indicates all state obligations, contracted and outstanding;
- public debt service - payments due within one year (rates to be repaid, interests and other costs)

- ratio between public debt and the gross domestic product (it is useful in making comparisons between countries);
- ratio between domestic public debt and the gross domestic product (indicating the level of borrowing on the domestic market);
- ratio between the average interest rate and public debt (average interest rate indicated on loans contracted by the state) [4].

2. Indicators of public debt structure:

- ratio between domestic public debt and public debt (is expresses how much of the public debt is the result of borrowing on the domestic market);
- ratio between public debt and external public debt (highlights the part of public debt arising from the external market).

3. Indicators of public debt dynamics (expresses absolute or relative variation of public debt)

- the ratio between reserves and short-term external debt
- the ratio between reserves and imports
- the ratio between reserves and money supply in the wider sense.

## Conclusions

We believe that in assessing the possibility of financing the budget deficit, we should not only compare the interest of public debt with the growth rate, but we should calculate a rating based on all the above indicators.

An effective risk management in public debt management involves the following actions by the Ministry of Finance:

- direct contracting on behalf of the state, administration and repayment of state loans, including costs;
- external borrowing through bond issues launched on foreign capital markets, administration and repayment;
- examining the opportunity and the necessity of contracting external loans from foreign capital markets;
- issuance of state guarantees for foreign loans;
- analyzing the conditions for the refinancing the external debt and ensuring that new loans fit into the annual external debt limit;

Such a risk management approach is characterized by the fact that it is oriented towards the future, to the evolution of growth rate, to the specific conditions of each country and the evolution of interest rates on state loans.

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