STUDY ON MANAGING SOVEREIGN DEBT IN TIMES OF CRISIS:

Insights from the Covid-19 pandemic and lessons for the future

STUDY SUMMARY: Findings & Lessons

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from the British people

FOREWORD

The dark clouds of the COVID-19 pandemic that suddenly descended upon the global economy spared nobody and triggered one of the most devastating global health and economic crises in modern history. The pandemic placed severe strain on the public finances of all types of economies. For developing countries in particular, debt levels that were already high before the pandemic increased further, exacerbating existing debt vulnerabilities at a time when pressure to spend on health and social services became unavoidable.

The IMF noted that the impact of COVID-19 was historic and unusual in its severity as the debt stress it induced exceeded past experiences across a number of dimensions, including the dramatic increase in government borrowing needs, sharp downturn in economic activity, strain in market conditions, and disruption in operations (IMF, 2020).

The pandemic also resulted in the materialisation of a number of operational risks as governments were required to adjust. One of the main challenges of the pandemic to the environment was how to meet increased government borrowing requirements against a backdrop of volatile market conditions, both locally and globally. In addition, the adoption of remote working arrangements changed the overall control environment in which staff performed their roles, thus exacerbating the vulnerability of the Debt Management Offices to operational risks.

As part of efforts to harness a range of lessons and insights emerging from the pandemic, MEFMI, with the support of FSD Africa, commissioned a study to document debt and related policies and practices that countries adopted to manage public debt and support debt markets during the crisis. The study covered four themes: (a) macroeconomic policy interventions, (b) external financing operations, (c) local currency bond markets and (d) governance and operational risk management frameworks for public debt.

In December 2022, MEFMI and FSD Africa organised a seminar to validate the findings and recommendations from the study. The content of the study has now been finalised and has been released as separate chapters, while a study summary has also been produced.

This is the Study Summary. It brings together the findings from the four chapters and highlights the lessons learnt from the whole exercise.

We hope that the findings and lessons from this study will be useful in informing policy makers and debt practitioners of pertinent actions needed in both normal times and in times of crisis.

Readers can access the other chapters of this study here.

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ACRONYMS

BOP	-	Balance of payments
CCRT	-	Catastrophe Containment and Relief Trust
DeMPA	-	World Bank Debt Management Performance Assessment
DMO	-	Debt management office
DSSI	-	Debt Service Suspension Initiative
FSD	-	Financial Sector Deepening
G20	-	Group of Twenty
HIPC	-	Heavily Indebted Poor Country
IMF	-	International Monetary Fund
LCBM	-	Local Currency Bond Market
LCBM-M&RF	-	LCBM Monitoring and Reporting Framework
LMOs	-	Liability management operations
MDRI	-	Multilateral Debt Relief Initiative
MEFMI	-	Macroeconomic & Financial Management Institute of Eastern and Southern Africa
PRGT	-	Poverty Reduction and Growth Trust
SDR	-	Special drawing rights
SMEs	-	Small and medium enterprises

INTRODUCTION

COVID-19, believed to have emerged in China in December 2019, spread quickly across the globe and was declared a pandemic by the World Health Organization in January 2020. It triggered one of the most devastating global health and economic crises in modern history, affecting all socio-economic facets and permeating through the financial markets. The IMF (2020) estimates that the impact on developing countries was historic and unusual in severity. Among the various consequences, the pandemic in particular induced major debt stresses, while debt management proved complex and challenging, especially for countries that entered the crisis already vulnerable. Sub-Saharan African countries were more exposed, with limited room for manoeuvre given their narrow fiscal space, as compared to their situation during the 2008/09 global financial crisis. Operational challenges became frequent as the crisis unfolded, making it difficult to manage risks as working remotely became the default practice.

Globally, many countries took remedial measures to limit the socio-economic impact of the pandemic as well as cushion local financial markets. Those measures, which mainly centred on fiscal, monetary and financial polies, provide useful lessons for countries on how to prepare in advance for potential future crises.

Against this background, MEFMI, with the support of FSD Africa, commissioned a study that documents debt and related policies and practices that countries adopted to manage public debt and support debt markets during the COVID-19 crisis. The study findings and results are outlined in four chapters focused on the following important and interrelated themes: (i) Macroeconomic policy interventions; (ii) External financing operations; (iii) Local currency bond markets; and (iv) Governance and operational risk management frameworks for public debt. These chapters are available as separate documents and can be accessed here. The current paper, which also forms part of the study, provides an extensive summary of the outcome of the whole exercise.

Findings from the study come from a combination of desk reviews and feedback from questionnaires produced specifically for the exercise. A broad range of documents covering global developments as well as the performance of MEFMI countries have been consulted. The questionnaires for each aspect of the study were sent to all MEFMI member countries to solicit information on how governments and central banks responded to the pandemic.

While such responses have been described in detail in each chapter, it is important at the outset to define the various stages that countries have gone through during the pandemic and the responses they have taken at each stage. While this framework has been used specifically in Chapter Two to consider the changing nature of borrowing needs, it is also useful in a more general sense here:

- **Containment phase:** Globally, the first phase (referred to as the containment phase) coincided with the initial outbreak of COVID-19. All MEFMI countries recorded their first COVID-19 case between 13 March and 2 April 2020, except for Lesotho which recorded its first positive patient on 14 May 2020. During this stage, prompt actions and different forms of responses (health-related, financial, etc.) to contain the epidemic and minimise its impact were taken.

- **Mitigation phase:** The second phase (or mitigation phase) required governments to temper the effect of the pandemic. As an extension to the containment phase, decisive actions were taken to foster economic recovery and re-instil business confidence.

- **Reconstruction phase:** The third phase focuses on different measures to support longer-term reconstruction. This involves evaluating lessons learnt, restructuring, and investing in the health sector and building capacity in terms of the number of health workers, training etc.

Each study has put the spotlight on a series of lessons that can be learnt to help countries prepare better for possible crises in the future. These, as well as key recommendations from the study, are highlighted in this summary document.

1.

IMPACT OF COVID-19 ON ECONOMIES AND POLICY RESPONSES

Chapter one considers the impact of COVID-19 on economies and policy responses. Results from the comprehensive desk review and the survey showed that COVID-19 significantly dented the economic growth and fiscal positions of MEFMI member countries. Lockdowns, weaker domestic and external demand, and disruption in supply chains resulted in a significant slump in the region's economic growth in 2020. In that year, average real GDP growth across the MEFMI region contracted sharply, by 2.8 per cent, down from 2.7 per cent in 2019. A breakdown by country revealed that all MEFMI members experienced growth contractions in 2020, except for Tanzania and Malawi. Tanzania, it should be noted, did not lockdown its economy during the pandemic. Across the MEFMI region, service sectors such as tourism, transport, retail and wholesale were the worst affected.

Prior to the advent of COVID-19, the region was already facing significant fiscal deficits. A confluence of lower government revenues as a result of subdued economic growth and heightened expenditures to meet urgent health and economic rescue packages further worsened the fiscal positions of MEFMI countries. From -4.9 per cent of GDP in 2019, the average fiscal deficit for the region widened to -5.9 per cent in 2020. Deficits worsened in 10 MEFMI countries that year, compared to pre-pandemic forecasts. Only Lesotho, Tanzania and Zimbabwe performed better under COVID-19 than previously envisaged prior to the pandemic. The positive fiscal outcome in Zimbabwe reflected mainly the effect of high inflation in 2020, which resulted in higher nominal revenues, while Lesotho benefited from higher SACU receipts.

The disruptions to global trade, weak external demand and low commodity prices combined to negatively affect the external positions of MEFMI member countries, particularly during the first half of 2020. That inevitably created increased balance-of-payments (BOP) financing needs. A total of six MEFMI countries experienced worsening current account balances in 2020 compared to 2019. The countries that incurred improved BOP positions benefited mainly from increased remittance flows and savings from the Debt Service Suspension Initiative (DSSI). Remittances showed resilience and performed better than expected in 2020, despite the recession and higher unemployment hitting the main source countries, including the United Kingdom, France, Italy, Spain, the United States and South Africa.

Fiscal and monetary responses to COVID-19 in the MEFMI region

The sharp economic downturn in the region resulted in MEFMI countries undertaking a range of fiscal and monetary policies to cushion the impact of the pandemic. The fiscal policy responses aimed to provide lifelines to households and businesses, restore workers' incomes and preserve jobs. Monetary policy responses, on the other hand, mainly sought to guarantee appropriate market liquidity conditions to support credit markets.

The size, composition and duration of the support measures varied across countries based on their monetary and fiscal space. Whereas relatively low inflation afforded most countries the space to conduct countercyclical monetary policy, fiscal authorities generally had less room due to high debt levels in many countries. Average public debt as a share of GDP for the MEFMI region in 2019 was 63.6 per cent, more than twice the 2011 level of 28 per cent. Botswana, Eswatini, Mozambique, Rwanda and Uganda had substantial space to roll out monetary policy, as their average inflation for 2019 was below 3 per cent. Kenya, Lesotho and Tanzania had some space, while Angola, Malawi, Zambia and Zimbabwe had limited leeway. On the fiscal front, Botswana, Eswatini, Malawi, Tanzania and Uganda had substantial fiscal room to intervene. Kenya, Lesotho, Namibia and Rwanda, having debt levels between 50 and 60 per cent of GDP, had some fiscal space to intervene. Angola, Mozambique and Zambia had limited space, given that their debt-to-GDP ratio was above 60 per cent.

Tax measures

The common tax measures implemented by MEFMI member countries included VAT/duty exemptions on health equipment, pharmaceutical products, food and essential goods, and COVID-19 donations; deferment of tax filing; and fast tracking of VAT refunds. In most instances, tax filing deadlines were deferred initially for three months, although this was typically extended. Eswatini, Zambia and Zimbabwe also waived tax penalties and fees on outstanding tax liabilities resulting from COVID-19.

Expenditure measures

Reflecting the severity of the pandemic, all countries in the MEFMI region increased health expenditure to improve public health and testing capacities, establish emergency response plans, and purchase medical supplies. Most MEFMI countries introduced and expanded social protection measures including cash transfers and food assistance. Expenditure measures were also aimed at providing temporary income support to poor and vulnerable households, including workers laid off during the pandemic.

Credit guarantees were extended to save businesses and jobs in six member countries. Government guarantees and subsidised loans were used to address liquidity and preserve employment. Payment of domestic supplier arrears and prevention of the accumulation of new ones was a key policy in Botswana, Tanzania, Uganda and Namibia to avoid cash flow problems for businesses, particularly SMEs.

Monetary measures

All central banks in the MEFMI region cut policy rates in response to the pandemic-induced crisis. The countries with the largest cuts compared to their end-2019 position were Zambia (350 bps), Lesotho (300 bps), Namibia (275 bps), Eswatini and Botswana (225 bps), and Uganda (200 bps). Zimbabwe, despite having no space for countercyclical monetary policy, reduced its policy rate from 35 per cent to 15 per cent in March 2020 before revising it upward to 70 per cent within three months. Interest rate cuts were also reversed in Angola.

In addition, central banks in the region reduced statutory reserve requirements in a bid to inject additional liquidity into the market. These included the central banks of Zimbabwe and Botswana (250 bps), Mozambique (150 bps), Malawi (125 bps) and Eswatini, Kenya, Rwanda and Tanzania (100 bps). Four central banks in the MEFMI region (Rwanda, Uganda, Zambia and Angola) also put in place government bond purchase programmes as part of liquidity support measures. Several measures to boost bank lending operations were also instituted through liquidity provisions, programmes that enhanced lending and targeted lending frameworks to support credit to strategic and vulnerable sectors.

Macro-prudential responses by central banks

In addition to accommodative monetary policies, MEFMI central banks relaxed regulatory and macro-prudential standards to support the provision of credit. Measures in this regard included flexibility to banks regarding loan classifications and provisioning, loan restructuring, and grant moratoria for debt service to businesses and individuals. Other measures focused on softening the regulatory capital and liquidity requirements to allow banks to temporarily operate below required capital and liquidity levels. The central banks of Kenya, Lesotho, Malawi and Uganda also put in place measures to promote cashless transactions through the waiving or reduction of mobile money charges, while the central bank of Tanzania increased the daily transaction limits for mobile money.

International COVID-19 responses

To free up resources for poor countries to use in combating the health and economic effects of the pandemic, the G20, with the backing of the IMF and World Bank, launched the Debt Service Suspension Initiative (DSSI) in April 2020. The DSSI involved the deferment of debt service payments owed to G20 countries with the understanding that such payments would be made in the future. A total of five MEFMI countries benefited from the DSSI, amounting to between 0.89 per cent in Rwanda and 10.4 per cent of exports in Kenya in 2020. Additionally, five MEFMI countries also benefited from the IMF Catastrophe Containment and Relief Trust (CCRT), a facility that provides financial assistance to countries eligible for IMF concessional borrowing, and whose per capita income is below the International Development Association's operational cut-off. The IMF also supported MEFMI countries through loans under the Rapid Credit Facility, the Rapid Financing Instrument, the Extended Credit Facility and the Extended Fund Facility.

Impact on public debt

The comprehensive review of the debt portfolio and its evolution in the MEFMI region carried out in Chapter Two of the study and summarised in Chapter One shows that the pandemic did lead to acute acceleration in the pace of debt accumulation, which was already rising before the pandemic. That eroded debt-carrying capacity and contributed to a higher risk of debt distress. As such, the average debt-to-GDP ratio for the MEFMI region, which was only 28 per cent in 2011, rose to 63.6 per cent of GDP in 2019, before shooting up further to 70.6 per cent in 2020.

The increase in debt reflects in the main the decline in GDP growth rates and the rise in fiscal deficits to meet increased expenditures against lower revenue and partly depreciating exchange rates. Importantly, due to limited fiscal space, countries in the region had to resort to increased borrowing to acquire additional doses of coronavirus vaccines to save lives. The COVID-19 pandemic resulted in deteriorating risk ratings in the MEFMI region during 2020 and 2021.

The key lessons from the macroeconomic and financial impact of COVID-19, and from policy responses to it, are summarised at the end of the document.

2.

USE OF EXTERNAL FINANCE BY MEFMI

Chapter Two of the study focused on the use of external finance by MEFMI countries during 2020 and 2021 to fund COVID-19-related expenditure. The chapter documented and reviewed the debt management policies and practices that were adopted during that period and drew a number of conclusions and lessons that can inform public debt management, including external financing, in the future. To set the scene and put external financing in context, the chapter discussed the long-term evolution of external debt and highlighted its importance and characteristics, especially the risks that this type of funding usually entails. Historically, external finance has been a very important source of development funding, although this importance waned in the early 2000s due to a combination of factors. These included the effect of external debt reduction plans, such as the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiatives (MDRI), as well as improved domestic resource mobilisation and the development of domestic bond markets, which made domestic borrowing slightly more prominent.

In recent years, external borrowing has regained its importance due to a combination of factors. On the supply side, the emergence of so-called 'non-traditional creditors', such as China, as well as the possibility for newly emerging countries to tap into the international capital markets, have increased countries' external financing options. These developments have been a windfall for developing countries in search of funding to meet their urgent and significant developmental needs, including investment in infrastructure.

By 2019, however, external debt of low-income countries had once more become a source of worry. Both the level and cost of external borrowing had risen, and debt indicators had seriously worsened. This is also true of MEFMI countries. By November 2019, 33.3 per cent of MEFMI countries eligible for the Poverty Reduction and Growth Trust (PRGT) were classified by the IMF as either at high risk of or already in debt distress. Two years into the pandemic, this percentage had risen to 55.5 per cent. From an economic perspective, the COVID-19 crisis therefore hit at an already inopportune moment. One of the key concerns has been the increase in the share of borrowing from private sources, which could be an indirect consequence of countries graduating from low to lower middle-income status.

In analysing the debt management responses of MEFMI countries during 2020 and 2021, it is important to factor in the evolution of the pandemic over that period as both funding needs and sources rapidly evolved over time. The three broad phases introduced earlier – containment, mitigation and reconstruction – have been used to chart this evolution. Although no two countries followed the same path and there was some overlap among the three stages as countries experienced several waves of COVID-19, this approach allows us to better understand the debt management decisions taken by countries.

At the start of the pandemic, i.e. during the containment stage, funding needs primarily concerned the purchase of emergency supplies, as well as assistance measures such as cash transfers, wage subsidies and unemployment benefits. Many of the early decisions taken were therefore of a budgetary rather than a debt management nature, including the re-prioritising of government expenditure, the setting up of COVID funds, etc. However, countries did start borrowing both domestically and externally to address the pandemic. Domestic borrowing was mainly related to meeting cash management requirements. Much of the external funding was sought as budget support and, in some cases, as grants from multilateral institutions, as well as from international NGOs and philanthropic organisations.

The main preoccupation for debt managers in the initial phases of the pandemic was to manage the existing portfolio so as to prevent a massive default situation occurring. In this context, the DSSI proved useful to five of the MEFMI countries as they were able to postpone debt service payments totalling US$701.2 million, falling due between May 2020 and December 2021. Only a few MEFMI countries indicated build-ups of external debt arrears, which were dealt with on a creditor-by-creditor basis. No MEFMI country has defaulted on its external debt, except for Zambia whose debt situation requires more comprehensive treatment – a situation that is being dealt with through the G20 Common Framework for Debt Treatments.

During the mitigation phase, expenditure needs shifted to the procurement of equipment, the purchase of vaccines and the rolling out of vaccination campaigns. By then the international financial community had mobilised additional financial resources and set up or enhanced existing initiatives to combat the pandemic. MEFMI countries were able to tap into the various emergency facilities that are available, including the Rapid Credit Facility and Rapid Financing Instrument, highlighted already in Chapter One of the study.

Finally, the reconstruction phase focuses on longer-term recovery and building resilience. This involves evaluating lessons learnt, restructuring and investing in the health sector and building capacity in terms of the number of health workers, providing training, etc. Many reconstruction measures may go beyond the health sector. Some countries, like Kenya, have formally produced post-COVID-19 economic recovery strategies, to outline future economic and social policies.

The external financing policies adopted during the first two years of the pandemic were broad-based. They demonstrate a certain level of pragmatism, as debt managers used the various options that were available to manage existing debt portfolios and mobilise the additional funding required. The measures taken included postponing debt service through the DSSI; raising external grants (an estimated US$1,708 million in external grants were raised by MEFMI countries during the period under consideration); and resorting to external borrowing using both emergency facilities and usual funding sources and credit lines. MEFMI countries were also able to benefit from the 2021 allocation of special drawing rights implemented by the IMF, which totalled SDR3,795.98 for the 12 countries.

Again, the key findings and lessons learnt that can inform future debt management and external financing activities are given at the end of the document.

3.

IMPACT ON LOCAL CURRENCY BOND MARKETS

Chapter Three considered the impact of COVID-19 on local currency bons markets (LCBMs) in the MEFMI region. Specifically, the chapter analysed the impact of the pandemic on domestic debt markets and the policy responses deployed by countries to cushion LCBMs and build resilience to future crises. It also assessed how debt management offices aligned their governance practices to prioritise LCBM effectiveness and deal with other risks during a crisis. Further, the chapter also drew policy insights to help countries prepare for future crises.

Prior to COVID-19, most MEFMI countries had nascent LCBMs, characterised by narrow investor and issuer bases, less sophisticated investors, inactive secondary trading, and shallow and illiquid markets. Some countries in the region have also faced frequent macroeconomic fragilities, such as volatile and high inflation, interest rates and exchange rates. Other countries have restrictions to entry to and/or exit from their LCBMs.

As the crisis set in, MEFMI countries, like the rest of the world, instituted fiscal, monetary and financial policy measures. Such measures, described in Chapter One of the study, were aimed at mitigating the socio-economic and financial impact of the COVID-19 pandemic on households and businesses. These measures provided much-needed liquidity, which not only calmed the markets, but also ensured stability in LCBMs. As a result, interest rates were generally stable, and markets recovered from the initial shock. The establishment of the DSSI by the G20 in May 2020 further contributed to the stability of the LCBMs as it reduced pressure on debt burdens.

Lastly, institutional, legal and market reforms undertaken over the years in the region played a major role in ensuring that debt markets and debt management operations remained functional. Primary market issuances were on average fully subscribed during the pandemic, with Zimbabwe being the only exception due to reasons beyond the pandemic. Continued market engagements, investor relations and enhanced policy coordination steered the countries through the pandemic. Having a well-formulated and implementable debt management strategy with sufficient market transparency was instrumental during the crisis. The role of international bodies such as the IMF, World Bank, African Development Bank and G20 was critical in ensuring stability.

Chapter Three concludes by highlighting the key findings and lessons learnt to inform future debt management activities in LCBM-related issues. These include policies that countries can put in place, not only in case of a crisis but also during ‘good times’, as this is when countries must prepare for the future.

Based on desk research from published studies and survey feedback from questionnaires distributed to all MEFMI countries, the study findings provide insights into the performance of the LCBMs, and the policies, practices and strategies deployed during the pandemic to ensure stability and continuity. The chapter looks at policy responses and how debt management managers aligned governance practices to prioritise LCBM effectiveness. It also identifies the main policy lessons for the region.

The study shows that domestic debt increased significantly across the MEFMI region during the period 2020–2021, highlighting the important role played by LCBMs in financing crucial expenditures during the pandemic amid constrained revenues and inability to access to international capital markets. Instruments like treasury bonds, treasury bills, infrastructure bonds, central bank overdraft facility/ways and means/direct advances, central bank bills and COVID-19 bonds (Zambia only) were used to raise funds from domestic markets. Ample liquidity attributed to accommodative monetary policy and expansionary fiscal policy supported issuance of more long-term bonds, thus lengthening the overall average time to maturity of the outstanding domestic debt during the COVID-19 period. Although this has reduced the refinancing risk, long-term debt in shallow markets comes with a high interest cost, hence the need for MEFMI countries to review their strategies as the situation changes.

The pandemic impacted investor bases and market operations in the MEFMI region, but reforms undertaken over time and appropriate policy measures helped the situation. Flight to safety and quality by institutional investors saw a proportionate decline in banks' holding of domestic debt and a corresponding increase in the share of debt held by pensions and insurance companies, which reduced their exposure to equities and property markets. If the data is accurate, the increased foreign base in several countries in the region may be attributed to the search for yield as interest rates remained low in advanced countries due to accommodative monetary policies. Institutional investors generally kept the demand relatively normal, with most auctions in primary markets fully subscribed, albeit lower than the performance seen during the pre-COVID-19 period. This performance could be due to the monetary and fiscal policies that supported liquidity and continued market and institutional reforms in the region.

During crisis periods, authorities can vary the use of issuance methods to ensure minimal market distortions while also ensuring the government meets its borrowing target. The study found no significant changes in auction methods used for issuing treasury bills and bonds during the pandemic. A few countries however increased or reduced auction sizes, depending on type of securities. Most countries maintained the same issuance frequency and pricing methods for both treasury bills and bonds. Borrowing plans and issuance calendars followed already operational debt management strategies that were in place before the pandemic, save for minimal variations. Most countries review these strategies annually and they have helped enhance transparency in the marketplace. A few changes noted in issuance calendars in response to the pandemic include changes in maturities, taxation, coupon rates and frequency of calendar review.

The marketplace has improved, with investors able to enter and exit LCBMs with minimal restrictions and limited disruptions. Where secondary markets are not functioning fully, central banks offer a window to rediscount securities from holders, with imposed limits. This gives confidence to investors to participate in the primary markets and supports the growth and development of the overall LCBMs. More work however is needed to develop the secondary markets as only four of the twelve countries that completed the questionnaire reported trading activity in their secondary markets during the COVID-19 period. This provides a good pricing of the government yield curve, which is critical for guiding other issuers in the market.

As part of prudent debt management practices, countries employ various liability management operations (LMOs) to manage risks and cost, and to improve the characteristics of their debt portfolios. The most commonly used LMOs are buy-backs, switches or bond exchanges, rollovers and sinking funds. Rollovers were the most used LMO, carried out by matching new issuance to coincide with maturing securities. Other operations used include securities buy-backs, switch operations, and conversions. Two countries also reported the use of sinking funds. These methods proved effective in dealing with the risks during the pandemic as only one country reported a delay in repayment of maturing domestic debt. The DSSI, implemented in May 2020, also played a major role in easing debt pressure which had manifested in interest rates. Except for Rwanda, Botswana and Zimbabwe, all MEFMI countries participated in the DSSI and appear to have benefited in terms of maintaining market confidence and lower yields.

Lastly, communication, coordination and collaboration at the national, regional and global level proved significant in dealing with the crisis. Effective coordination and communication regarding fiscal, monetary and financial policy measures ensured adequate liquidity and certainty in the LCBMs, thus maintaining stability and overall domestic debt management practices during the pandemic. Holding virtual investor engagement forums enhanced communication and coordination among different players. All other initiatives and measures introduced to support the market were well coordinated and communicated to the market through collaborative efforts by key stakeholders. As a result, the pandemic was well managed, and the minimisation of interruptions ensured quick recovery.

The main lessons from the review of LCBMs in MEFMI countries during the pandemic period are listed at the end of the document.

4.
IMPACT ON GOVERNANCE AND OPERATIONAL RISK MANAGEMENT FOR PUBLIC DEBT

Chapter Four considered the impact of the pandemic on governance and operational risk management frameworks for public debt. The task of managing sovereign debt during the pandemic proved complex and challenging, particularly for debt managers in developing economies, as most entered the crisis with pre-existing vulnerabilities. The pandemic exposed the vulnerabilities of debt management offices, thus escalating operational challenges to unprecedented levels during the crisis. The study evaluated the mechanisms adopted by governments in the MEFMI region to safeguard good governance and mitigate the effects of the COVID-19 in the course of minimising operational risks.

The findings from the 13 MEFMI countries reviewed revealed that most countries had reported a contraction in domestic revenue and grants, amid increasing expenditure to finance the most-hit socio-economic sectors. In view of this and as described already in Chapter Two, countries increased borrowing from both domestic and external sources, which raised their nominal debt-to-GDP ratios across all countries. However, most jurisdictions in the region did not breach debt limits while responding to the impact of the pandemic. There was no change in the debt reporting content or regularity in response to the pandemic. It is worth noting that debt management audits continued to be conducted as mandated through the adoption of electronic submission and virtual meetings.

It was also found that most countries do not have quality procedure manuals to efficiently guide public debt management. This reflects weak operational risk management and business continuity in the region. Contrary to expectations, none of the countries said they had reviewed, or planned to review, existing procedure manuals, even during the pandemic. In addition, none of the countries said that their DMOs conduct regular business impact analysis of potential disruptions in business processes, through testing the suitability of operational risk management frameworks.

The findings show that most governments in the MEFMI region adopted various measures to mitigate the spread of COVID-19. These measures included remote working arrangements; leveraging technology, including virtual meetings (Zoom, MS Teams); use of mail and courier services; delegation of legal mandates, particularly those related to the signing of loan agreements; and health containment advisory measures such as work shifts, travel and gathering restrictions, social distancing, provision of sanitary facilities, mandatory wearing of face masks, compulsory temperature testing and vaccinations.

In addition, debt management strategies were revised in most countries in the region, to cope with an increase in budget deficits. The period also witnessed the materialisation of contingent liabilities and a rise in domestic interest rates. However, some of the adopted measures, particularly work shifts and strict gathering protocols, had an adverse impact on the organisation of DMOs and the segregation of duties, which increased vulnerability to operational risks.

Institutions offering capacity building pivoted from in-person to virtual classes, which enhanced flexibility, increased the number of participants and led to a more timely response to capacity building needs. However, the findings show that there was less enthusiasm and concentration by participants, partly due to unstable internet connections, inadequate working tools, preoccupation with office work and overlapping of capacity building events.

The lessons from this chapter are summarised in the next section.

LESSONS FROM THE STUDY

The lessons from the pandemic across the different themes reviewed in this study should not be forgotten as they will serve the MEFMI region well in the event of a future pandemic or another large economic shock. More importantly, COVID-19 proved that lack of preparedness would be detrimental to the extent to which countries would be able to take decisive urgently needed action. This section summarises the pertinent takeaways that should inform debt and financial management improvement plans within each MEFMI country.

1. **Macroeconomic and financial impact of COVID-19 and policy responses**

   The key lessons are as follows:
   i) Ensure that debt sustainability is maintained at all times.
   ii) Build fiscal buffers in times of high economic growth.
   iii) Build capacity in debt management.
   iv) Target low and stable inflation, which provides room for monetary policy response.
   v) Consider the importance of international cooperation in fostering rapid and effective responses to shared threats.
   vi) Ensure fiscal sustainability by enhancing domestic revenue mobilisation and reforming public financial management.

   Other lessons include: increase economic diversification; expand social protection; enhance digitalisation in the economy; and build more robust health systems.

2. **Lessons that can inform future debt management activities and external financing**

   The key lessons can be encapsulated under the following themes:
   i) The continued importance of official external finance as a dependable and countercyclical source of funding, especially in crisis situations.
   ii) The quick and effective response from the international financial community and the ability of debt management offices to tap into available initiatives.
   iii) A reminder of the importance of public debt management in enabling governments to deal with crisis situations.
   iv) The importance of strong front office capability to ensure that external funding can be sourced and negotiated quickly and at optimal terms.
   v) The need to ensure that debt management offices have in place solid operational risk management policies to ensure business continuity, especially with overseas stakeholders, should a lockdown be declared. The need to explore and put in place measures to mitigate the risks that come with external borrowing.
   vi) The need to put in place specific policies and guidelines to inform loan negotiation, commitment, and utilisation during periods of crisis and the need to consider qualitative aspects, such as ease and speed of access to funds, in addition to cost-risk indicators when making a borrowing choice.
   vii) The importance of the close interaction that exists between debt and cash management, especially during the early stages of a crisis when budget reallocation and domestic financing may be the only practicable short-term mitigation measures available.
   viii) The need to reflect on policy formulation during periods of emergency so as to safeguard existing debt policy and strategy formulation.
   ix) The importance of public debt transparency and accountability at all times so that during periods of crisis, countries can provide an accurate picture of their debt situations and borrowing needs.

3. **Impact of COVID-19 on local currency bond markets**

   The most important lessons learnt are as follows:
   i) Reforms undertaken over time built strong debt management institutions, policies and operations, which ensured quick policy responses to mitigate the effects of the pandemic.
   ii) Adequate institutional capacity, in terms of technology, infrastructure and people, provided much-needed data and information

for decision making.

iii) There is a need for further reforms to develop and deepen LCBMs in the region. This would include addressing taxation policy on debt securities, restrictions to entry or exit from LCBMs, and widening investor and issuer bases, among other reforms. Marketplace operations also need further reforms, especially to grow institutional investors, diversify instruments, encourage foreign investors and support trading of securities.

iv) Timely and coordinated policy responses accompanied by effective communication and collaboration among key stakeholders were at the forefront in managing the effects of the pandemic.

v) Fiscal, monetary and financial policy measures were useful in mitigating the socio-economic and financial impact of the pandemic on households and businesses.

vi) The role of international bodies such as the IMF, World Bank, African Development Bank and G20 was critical in ensuring LCBM stability. Well-formulated, implementable and transparent debt management strategy was a key planning tool for the achievement of debt management objectives during the COVID-19 period. The crisis provided an opportunity for countries in the MEFMI region to learn from their own challenges and solutions to ensure stability and resilience during a crisis.

vii) Communications, coordination and collaboration with local, regional and international partners were very useful in dealing with pandemic-induced instabilities and keeping LCBMs operational. They provided much-needed information and ensured access to resources to address shortfalls, as was the case under the DSSI.

viii) Countries need to have proper communication channels to ensure information flow for enhanced market confidence during a crisis.

4. Lessons learnt from operational risk management on public debt

i) The absence of business continuity plans in most countries in the MEFMI region requires intervention with a view to improving preparedness for potential future virus outbreaks. MEFMI needs to take a lead through in-country and regional capacity building activities, and where necessary field technical missions to its member states.

ii) MEFMI should consider the possibility of incorporating pandemic impacts and coping mechanisms in the design of regional and in-country capacity building activities and technical assistance to member countries. These should be included in the Annual Plans and prospectuses of MEFMI events.

iii) MEFMI should advise the World Bank to revise the DeMPA framework to incorporate mechanisms to mitigate the effects of the pandemic as part of operational risk management.

iv) Greater investment in and use of technology is required in the working environment, to allow for smooth operation of remote working. Strong safeguards should be implemented to minimise vulnerabilities to online operations.

v) Cautious escape clauses in the legislation and policies of the countries and in the regional economic blocks' convergence criteria should be adopted to provide for unforeseen circumstances.

RECOMMENDATIONS

Based on the lessons learnt, the MEFMI countries may need to consider the following to build resilience against future crises:

i) Strengthen debt management practices, policies and operations through strong and transparent institutions. This will enable quick policy responses and adequate planning and preparation to minimise the impact of future crises. The COVID-19 crisis provided an opportunity for countries in the MEFMI region to learn from their own challenges and solutions to ensure stability and resilience during a crisis. Policy measures to mitigate future crises should be customised to each country's level of market development, as different LCBMs are at different stages of market development.

ii) Enhance institutional capacity in terms of technology, tools and people to provide insightful data and information for decision making. Continue to adopt modern IT systems, equip staff with critical skillsets, and deploy effective communication channels and continuous peer and benchmarking learning for innovative solutions to challenges during future crises.

iii) Enhance policy coordination, communication and collaboration with various stakeholders and partners, and strengthen investor relations, to ensure continuity of debt management operations and maintain stability of LCBMs during future crises.

iv) Put in place well-formulated, implementable and transparent debt management strategies as an important planning tool for the achievement of debt management and market stability priorities during a crisis. There is a need to further strengthen debt management strategies, with more focus on building sinking funds and/or cash buffers to minimise market volatility and/or adverse swings during crisis times. Debt management strategies should be well planned and implemented, and monitored to ensure they meets their objectives and are backed by strong legal, institutional and administrative structures.

v) Improve the availability and quality of data on public debt and debt market performance. This will make it easier to undertake analysis for policy advice.

vi) Design and implement a clear programme for LCBM development in the MEFMI region that takes into consideration the following:
   a. Monitoring and Reporting Framework (LCBM-M&RF) across MEFMI countries.
   b. Domestic Debt Market Development Manual for MEFMI Region.
   c. Dedicated unit to handle market development exclusively and broadly.

In general, the pandemic has exposed governance and operational risk management in debt management offices in the region. Based on the findings, countries in collaboration with cooperating partners (MEFMI, IMF, World Bank, etc.) need to implement immediate and medium- to long-term measures to address governance gaps and operational risk exposures. In the short term, it is proposed that countries undertake a thorough gap analysis in business continuity plans. This would help to improve preparedness for potential future pandemics. In addition, MEFMI should consider the possibility of incorporating pandemic impacts and coping mechanisms in the design of capacity building activities and technical assistance to member countries.

In the medium to long term there should be a revision of the DeMPA framework to incorporate mechanisms to mitigate the effects of the pandemic, based on country experiences during the crisis, as part of strengthening operational risk management. There should also be greater investment in and use of technology in the working environment. Finally, cautious escape clauses in the legislation and policies of the countries and in the regional economic blocks' convergence criteria should be adopted to provide for unforeseen circumstances.

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