CHAPTER 2
DEVELOPMENT OF FINANCE, ACCOUNTING AND AUDITING

DEBT MANAGEMENT AGENCY IN UKRAINE: A COMPREHENSIVE APPROACH TO THE CREATION AND OPERATION

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Abstract. *The article considers a comprehensive approach to the formation and operation of a debt agency in Ukraine based on international experience. Ensuring the full functioning of the Public Debt Management Agency of Ukraine in accordance with international best practices in order to increase the effectiveness of debt policy aimed at reducing the debt burden and reducing the cost of public debt service is one of the most important tasks of Ukraine's strategic development. Analysis of international experience shows that the creation of a debt agency, as a new structure, does not automatically guarantee increased efficiency of external public debt management. It depends on the qualifications of the staff, the structure of the country's public debt and the degree of influence of the agency's staff on the change in the debt burden. Quite a wide resonance in society on the creation of a debt agency in Ukraine, incomplete regulatory support of this process necessitates the definition of approaches to the creation of a debt agency of Ukraine and justification of its functional capacity, which is associated with: creating favorable conditions for the newly created debt agencies of Ukraine; introduction of mechanisms for monitoring and control over its activities and strengthening the interaction of various government agencies within the general government sector; increasing the efficiency and productivity of the debt agency.*

Keywords: *comprehensive approach, debt agency, public debt management, monitoring, efficiency, public debt service.*

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Introduction. The decision to establish a debt agency in Ukraine was made by the Verkhovna Rada of Ukraine in November 2019 in the framework of the Law of Ukraine "On Amendments to the Budget Code of Ukraine" № 293-IX of 14.11.2019. In pursuance of this decision, the Resolution of the Cabinet of Ministers of 12.02.20020 № 127 "On the Establishment of the Public Debt Management Agency of Ukraine" (hereinafter - the Agency) approved its establishment as a central executive body implementing state budget policy in the field of public debt management and state-guaranteed debt, the activities of which are directed and coordinated by the Cabinet of Ministers of Ukraine through the Minister of Finance.. Also, the resolution approved the Statutory Regulations on the Public Debt Management Agency of Ukraine (hereinafter – the Debt Agency).

However, the full-fledged "launch" of the Debt Agency of Ukraine has been postponed by the Law of Ukraine "On Amendments to the Law of Ukraine" On the State Budget of Ukraine for 2020 "№ 553-IX of 13.04.2020. Thus, until the agency starts operating, the authority to implement the debt policy remains with the Ministry of Finance of Ukraine. We will consider further the approaches and factors that will affect the functional capacity and effective functioning of the newly created Debt Agency in Ukraine, taking into account international experience.

Literature review. Problems of public debt management in crisis and post-crisis conditions are covered in the works of M. Asha, E. Baldassi, A. Baum, N. Budina, A. Weber, S. Gupta, M. Kanjiano, F. Casselli, T. Kindi, T. Curristin, M. Lazarus, T. Lana, E. Lipper, S. Pennings, R. Pollin, W. Reinhart, K. Reinhart, K. Rogoff, F. Roser, T. Herdon and others [1–10]. The theoretical foundations of public debt and issues related to its management are covered in the works of such Ukrainian scientists as: V. Lisovenko, L. Bench and O. Betz [11], the works of T. Bogdan are devoted to macroeconomic risks that arise in the process of public debt management [12-14] and others.

Aims. The purpose of the article is to theoretically substantiate the effective organizational and economic tools to the formation and operation of a Debt Agency in Ukraine based on international experience and to develop practical recommendations for its implementation.

Methods. The authors used the methods of static and logical comparison, systematization and generalization, which made it possible to achieve the goal of the study.

Results. Below we consider the main approaches and factors that will affect the functionality and effective operations of the newly established Debt Agency in Ukraine, taking into account the results of the analysis of international experience in this area in the following areas:

- **subordination and accountability**. A study of public debt regulation systems in different countries [15-30] showed that there is no single institutional structure for debt policy. In some countries there are debt management departments within government agencies, in others there are independent agencies (Table 1), while the relative autonomy of debt agencies provides for strict accountability of such agencies to the Ministry of Finance (or Government) and coordination of their actions with other ministries and departments.

Positive arguments in favor of creating a debt agency are mainly reduced to the *independence of the agency* (including political one) from various structures that would lobby their interests. Meanwhile, the main argument in favor of the model by government agencies is high importance of coordination of external debt management policy with fiscal and monetary policies. However, the decision-making process within a multi-level bureaucratic structure in this case is often too time-consuming and may not keep pace with changes in the financial market.

In Ukraine, a comprehensive approach has been applied, according to which the functions of establishing strategic guidelines in the formation of the debt portfolio management have been transferred to the Ministry of Finance of Ukraine. Other functions related to accounting, responsible storage, technical work on debt management are transferred to an independent authoroty.

Table 1. Institutional structures for public debt management

Institutional structures	Countries
Central bank	Denmark, Iceland, Angola, Barbados, China, Jordan, Lebanon, Russia, Malawi, Uganda, Zambia, Zimbabwe.
Treasury	Australia, Belgium, Finland, France, Luxembourg, Holland, USA, Turkey, Brazil, Latvia, Malta, Papua New Guinea.
Ministry of Finance	Canada, Chile, Czech Republic, Israel. Japan. Korea, Mexico, New Zealand, Norway, Poland, Slovenia, Spain, Switzerland, Afghanistan, Albania, Argentina, Bosnia and Herzegovina, Bulgaria, Costa Rica, Croatia, Cyprus, Ecuador, Egypt, Estonia, Ethiopia, Georgia, Fiji , Ghana, Hong Kong, India, Indonesia, Kenya, Lesotho, Lithuania, Macedonia, Maldives, Mauritius, Moldova, Morocco, Nicaragua, Pakistan, Paraguay, Philippines, Romania, Rwanda, Serbia, Singapore, Solomon Islands, Sri Lanka, Tunisia, UAE, Vietnam, Uruguay.
Debt management agencies	Austria - Austrian Federal Financing Agency; Germany - German Federal Republic Finance Agency GmbH; Hungary - Hungarian Government Debt Management Agency; Ireland - National Treasury Management Agency; Portugal - Portuguese Debt Agency; Sweden - Swedish National Debt Office; Slovakia - Slovakian Debt and Liquidity Management Agency; United Kingdom - UK Debt Management Office.

Source: World Bank Group [https://data.worldbank.org/]

In this case, the public debt management body is separate, but always accountable to the Government and the Ministry of Finance of Ukraine, which determine the debt management strategy and evaluate the work of the Debt Agency;

- purpose and objectives of creation. The main purpose of creating debt agencies is to effectively manage public debt with minimal costs for its maintenance. The tasks of the functioning of debt agencies vary depending on the subordination of this body and the peculiarities of the debt situation in the country.

In Ukraine, the main tasks of the Debt Agency are:

1) implementation of state budget policy in the field of public debt management and state-guaranteed debt; 2) submission to the Minister of Finance of proposals for the formation of state budget policy in the field of public debt management and state-guaranteed debt [31].

Within the framework of these tasks, the implementation of activities that previously belonged to the sphere of competence of the Ministry of Finance of Ukraine is determined.

A novelty in the list of tasks of the Debt Agency of Ukraine, compared to its counterparts in other countries, is that the Debt Agency was determined *to be an issuer of government debt securities of Ukraine, including government bonds, treasury bonds and government derivatives of Ukraine*. The right to perform analysis, placement and active operations with government derivatives will belong to the state represented by the head of the Debt Agency in accordance with the decisions of the

Cabinet of Ministers of Ukraine. Expenditures on payments on government derivatives will be made by the Debt Agency regardless of the amount of funds provided for this purpose in the law on the state budget of the year, because according to world standards of debt accounting, derivatives are not part of debt instruments and are not included in government debt.

It should be noted that Ukraine's government derivatives currently in circulation were issued during the external debt restructuring in 2015 in the amount of USD 3.2 billion. These are GDP warrants, which are equity securities for Ukrainian creditors. Under the terms of the restructuring agreement, they were entitled to 15-40% of Ukraine's nominal GDP growth rate if economic growth rates exceed 3 and 4% per year. As of August 14, 2020, Ukraine bought about 10% of warrants (about 275 million US dollars) on the open market.

Since the conditions of issuance and servicing of government derivatives inevitably affect the welfare of all citizens of the country and the expenditures of the state budget in future periods, it is desirable to consolidate the authority to issue government derivatives by the Verkhovna Rada of Ukraine. In turn, Debt Agency has to prepare proposals on the parameters and conditions of placement of government derivatives, calculate the estimated costs of their maintenance and assess the associated fiscal risks.

Another novelty in the list of tasks of the newly created Debt Agency is its liquidity management of the single treasury account (SCR) and foreign currency accounts of the state budget, including the placement of temporarily free funds of the single treasury account and foreign currency accounts of the state budget in agreement with the Minister of Finance in line with the Strategy for reforming the public financial management system for 2017–2020, which was approved by the order of the Cabinet of Ministers of Ukraine dated 24.05.2017 № 415-r, for the first quarter of 2020.

This will integrate liquidity and debt management functions to better coordinate strategies for issuing debt instruments and investing free cash balances.

However, it is clear that this would require prior introduction of an information exchange system and the harmonization of debt issuance plans with forecasts of cash flows in the single treasury account and government currency accounts on an ongoing basis;

- **functions and structure**. In the world practice, institutional structures of public debt management include three elements: *market operations department* (front office), which ensures the implementation of agreements to attract sources of funding; *analytical department* (middle office), which provides an in-depth analysis of macroeconomic trends; *back office* with the function of external debt operational management. A more detailed division of functions between these units allows for a clear division of powers between employees and to achieve higher qualifications in individual segments of the implementation of debt policy.

At the same time, it should be noted that the management of global debt agencies includes debts that are inherently market in nature, and the management of debt obligations resembles the management of a portfolio of securities.

The functionality of the Debt Agency of Ukraine should have peculiarities due to "nuances" in the structure of public debt.

For example, the most important place in the structure of Ukraine's external public debt is played by the debts to international financial organizations and government agencies of other countries. Thus, as of July 31, 2020, the structure of Ukraine's public external debt was as follows:

- loans for securities issued on the foreign market – 56%;
- loans from MFIs, IMF and government agencies of other countries – 41%;
- loans from foreign commercial banks and other financial institutions – 3%.

Such debt structure shows that the solution to Ukraine's debt burden is in the area of intergovernmental agreements and is poorly maneuverable with the tools available to employees of other foreign agencies.

It should also be noted that Ukraine's public debt has an imbalance in instruments and the ratio of external and internal components. First of all, we are talking about:

low share of domestic debt in total public debt (in the range of 35.6-35.8%), the total amount of domestic debt as of 31.07.2020 amounted to UAH 882.62 billion (38% of the total amount of public and state-guaranteed debt), which signals the imperfection of state regulatory mechanisms and weak institutional capacity of the domestic financial market. Attempts to significantly increase domestic debt financing of the state budget by increasing the volume of foreign currency government bonds, increasing the share of non-resident investors in the portfolio of hryvnia government bonds, giving preference to short-term borrowings with very high yields on both hryvnia and foreign currency domestic debt instruments form the risk of outflow of foreign capital from the country, intensification of devaluation processes and inflation, increasing the risks of debt refinancing and dependence on external creditors;

a large share of public debt in foreign currency, which increases the sensitivity of the economy to external shocks, increases currency risks, the cost of borrowed resources and their maintenance. Formed both by borrowing on foreign capital markets and preferential financing by IFIs, and by placing foreign currency government bonds on the domestic market, the share of foreign currency debt at the end of 2017 was 70.0% of its total, at the end of 2018 – 70.9%, and at the end of 2019 – just 63.4% (according to the IMF methodology, for developing countries, the critical limit of this indicator is 60%);

the risk of making additional payments on VRI-instruments in the medium term (under the terms of the external debt restructuring conducted in 2015), the estimated total amount of which, according to experts, may be from 5 to 84 billion US dollars. This will lead either to the need to "cut" certain items of budget expenditures, or to the implementation of additional borrowings for payments on them.

The relatively high degree of autonomy of the Debt Agency in Ukraine should be based on an effective system of interaction between various public institutions within the general government sector and an effective system of control and accountability of autonomous institutions.

In the macroeconomic context, Ukraine's economy is not sufficiently diversified, so it is often affected by financial shocks, which worsen the balance of the public sector. In addition, the degree of connection of public debt management policy with the parameters of fiscal and monetary policy in Ukraine is relatively high. For example, an increase in the budget deficit or the uncontrolled accumulation of contingent liabilities may offset all the efforts of debt managers by increasing the risk of default. Thus, the issuance of debt instruments, the yield of which depends on inflation or the exchange rate, determines the sensitivity of debt service costs to the consequences of monetary policy of NBU.

The outlined macroeconomic conditions, as well as high dependence of the results of public debt management on the course of monetary and fiscal policy, complicate the task of creating a viable Debt Agency with independent status. It is difficult to require such an agency to achieve performance targets if their actual values are partly due to the work of other government bodies and partly reflect changes in the macroeconomic environment.

Disscutions. Therefore, the Debt Agency should systematize all information flows that are retransmitted from various government agencies. This would allow to quickly monitor the latest global trends in the macroeconomic sphere, especially changes in those indicators that have a direct impact on the solvency of the state in the short- and medium term.

International experience also shows that all actions of the debt agency should be subject to monitoring and control by other government agencies. Moreover, the higher the degree of independence of the agency, the more regulated should be the control system (to reduce moral hazard in the system of relations "principal-agent").

Conclusions. Analysis of the situation with the creation of the Debt Agency and the peculiarities of the current debt situation in the country makes it possible to outline the following areas of improving its functionality, taking into account the best international experience in this area:

- ***creation of favorable conditions for the functioning of the Debt Agency***, to ensure which it is necessary to finalize and approve the Medium-Term Strategy of the Ministry of Finance of Ukraine for 2021-2023, where in terms of public debt management, provide tasks regarding the following:

reducing the debt-to-GDP ratio to 55% by 2023;

successful completion of the existing IMF Stand-by Program, conclusion of an Extended Financing Agreement (EFF) with a gradual transition to fully market-based budget financing on attractive terms;

reducing the country's risk as an issuer of securities (reducing the credit spread to 300 bp in 2023) and bringing the country's international credit rating closer to investment level indicators;

reduction of currency risks due to an increase in the share of the national debt denominated in the national currency (up to 50% in 2023);

increase in the share of domestic government borrowing and government domestic debt;

complete the introduction of an information exchange system and harmonize debt issuance plans with forecasts of cash flows in the single treasury account and the government's foreign currency accounts on a permanent basis;

- ***introduction of mechanisms for monitoring and control over the activities of the newly created Debt Agency*** and strengthening the interaction of various government agencies within the general government sector by amending the Resolution of the Cabinet of Ministers of 12.02.12020 № 127 "On the establishment of the Public Debt Management Agency of Ukraine" with the following:

split of powers on issuance and placement of government derivatives between the Verkhovna Rada of Ukraine (determination of the amount of government derivatives) and the Debt Agency (should prepare proposals on parameters and conditions of placement of government derivatives, calculate estimated costs for their maintenance and assess fiscal risks);

determination of performance criteria (KPI) and targets for the work of the Debt Agency and evaluation of its activities;

definition of mechanisms for monitoring the activities of the Debt Agency, which will include: reporting on a regular basis to the Minister of Finance on a set list of indicators, preparation of annual reports of the Verkhovna Rada, internal and external audit, publication of regular reports to the public;

The Ministry of Finance of Ukraine together with the Ministry of Economic Development, Trade and Agriculture of Ukraine, the National Bank of Ukraine (NBU), the Public Debt Management Agency of Ukraine should consider the possibility of creating a unified system for detecting and overcoming macroeconomic imbalances. , planned actions of the government and the NBU in the foreign exchange market, public debt movements, etc. in terms of their likely effects on macroeconomic stability and financial stability;

- ***increasing the efficiency and productivity of the newly created Debt Agency***, which would require to:

provide for the formation of the organizational structure of the Debt Agency appropriate unit, which would implement the function of coordination and coordination of measures to implement public debt management policy with the parameters of fiscal and monetary policy by coordinating positions within the working groups, joint commissions, strategic sessions, etc.;

ensure compliance with international standards of accounting and reporting on public debt; equipment of automated workplaces for personnel, providing access to the database of public administration bodies, international news agencies and financial organizations;

form, in the Debt Agency, a single information database on debt obligations and macroeconomic parameters, on the state of world financial markets, credit ratings, new programs of international financial organizations, etc.;

take measures for training or retraining, setting the salaries of agency employees depending on the effectiveness of their public debt management activities;

form of a single information database in the agency on debt obligations and macroeconomic parameters, on the state of world financial markets, credit ratings, new programs of international financial organizations, etc.

In general, the analysis of international experience shows that in the countries where the agencies were established, it was possible to gradually softening the debt burden. If such an authority has a significant degree of autonomy from the government, it enjoys the confidence of investors in the global financial market, which expands the possibilities for the use of effective tools for public debt management.

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