Medium-Term Debt Management Strategy (MTDS) and Medium-Term Revenue Strategy (MTRS): Synergies and Challenges

FERDI Webinar: Mobilization of Domestic Public Resources

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While fiscal policy and debt management have separate objectives …

Fiscal policy	• Achieve macroeconomic stability, equity and efficiency, and sustainable long-term growth • **Overall target** set for primary balance • **Influences the economy** through government spending and taxation
Debt management	• 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. • **Often expressed as a numerical target** for the stock composition of the debt (often referred as a strategic benchmark) • **Composition of debt is managed** through *new* debt issuance, as well as changing the composition of the *existing* debt through interest rate and exchange rate swaps, buybacks and liability management operations

Togo, Eriko (2007). "Coordinating Public Debt with Fiscal and Monetary Policies", World Bank Policy Research Paper

… they have policy interdependencies

Fiscal policy ⇄ **Debt management**

- Debt structure affects the fiscal costs of debt servicing and can jeopardize fiscal sustainability
- Tax and expenditure levels determine the amount of debt that needs to be issued

- **Poor debt management has implications for fiscal policy –** a sudden increase in the costs of debt servicing could force it to cut planned expenditures or raise revenues
- **Poor fiscal policy impacts the effectiveness of debt management** - when the debt level is excessive, investors demand higher interest rates and force debt managers to borrow for shorter periods than desired

Togo, Eriko (2007). "Coordinating Public Debt with Fiscal and Monetary Policies", World Bank Policy Research Paper

Why is the analysis of future debt profile important for fiscal policy?

These are the main reasons:

1. **A rising share of revenues devoted to debt servicing payments weakens government's ability to implement desired policies**

2. **A high debt level exacerbates an economy's vulnerability to shocks:**
   - the higher the initial debt level, the greater the impact of a given increase in interest rates or of a decline in the growth rate on the primary surplus needed to maintain debt stable
   - So, countries with high debt level are more exposed to interest and growth shocks.

3. **The composition of debt may augment vulnerabilities:**
   - the composition of the debt (e.g., short maturities, foreign currency debt)
   - investor base (e.g., a high share of externally-held debt)

"Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis" (IMF August 2011)

Why is the analysis of fiscal policy important for debt management?

These are the main reasons:

1. **Revenue and expenditure dynamics are key to project the borrowing requirement**

2. **Managing costs and risk of borrowing**
   - Strong fiscal policies can enhance investor confidence, potentially leading to lower interest rates on government bonds
   - Revenue dynamics can provide insights about the desired composition of public debt: Are revenues more in domestic currency, are they volatile?

3. **Strategic Planning**
   - Understanding the fiscal space
   - Aligning revenue, expenditure and financing policies and macro assumptions

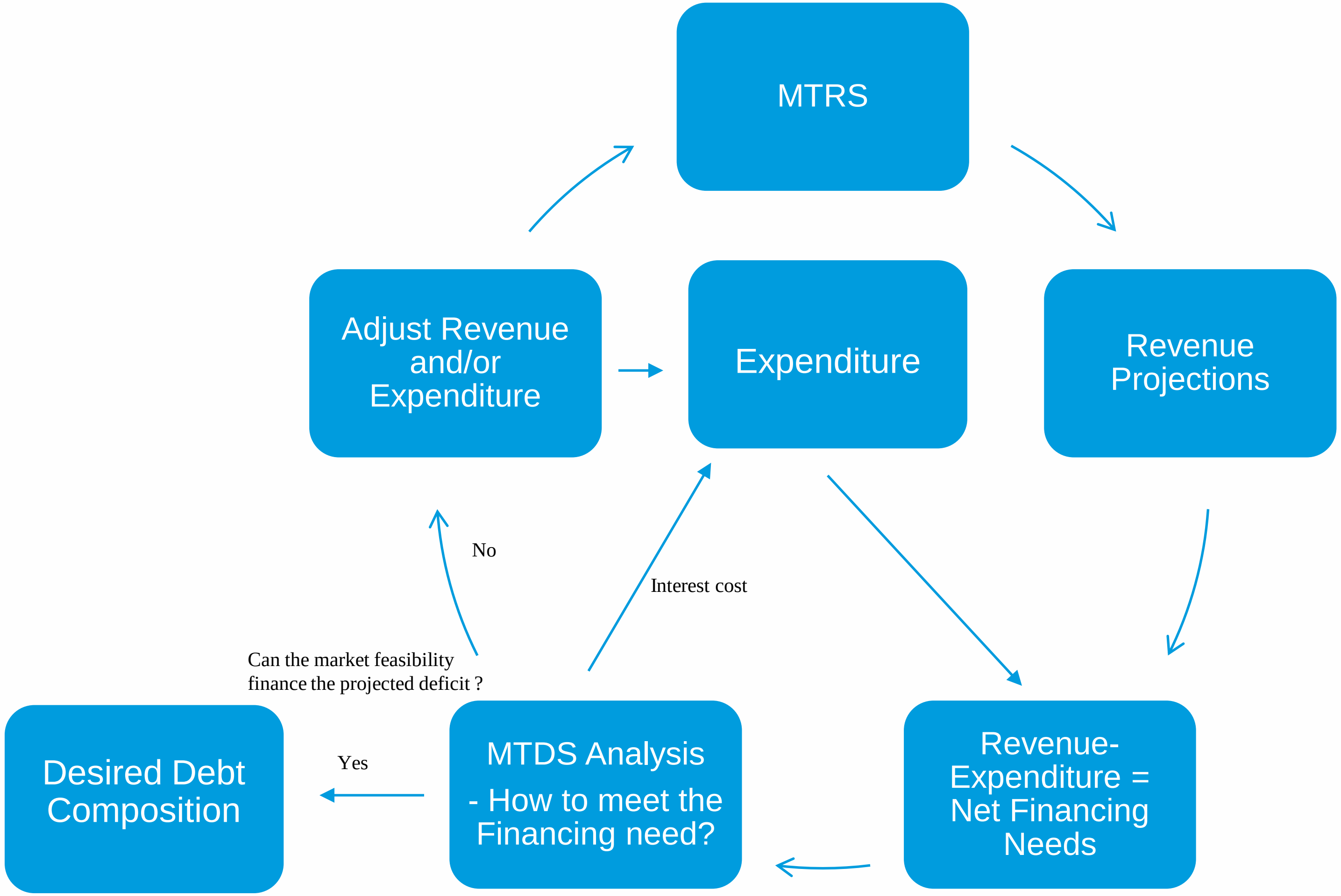
"Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis" (IMF August 2011)

Medium-Term Debt Management (MTDS)

- A framework that guides the government in achieving it’s financing goals while attaining an appropriate balance between cost and risk, and supporting secondary objectives such as development of the domestic debt market

- Debt-Management Strategy document
  - Ensures consistency in policy objectives
  - Gain commitment of key stakeholders
  - Establishes benchmark against which to evaluate outcomes → Accountability
  - Ensures market understanding of Government intent → Transparency and Predictability

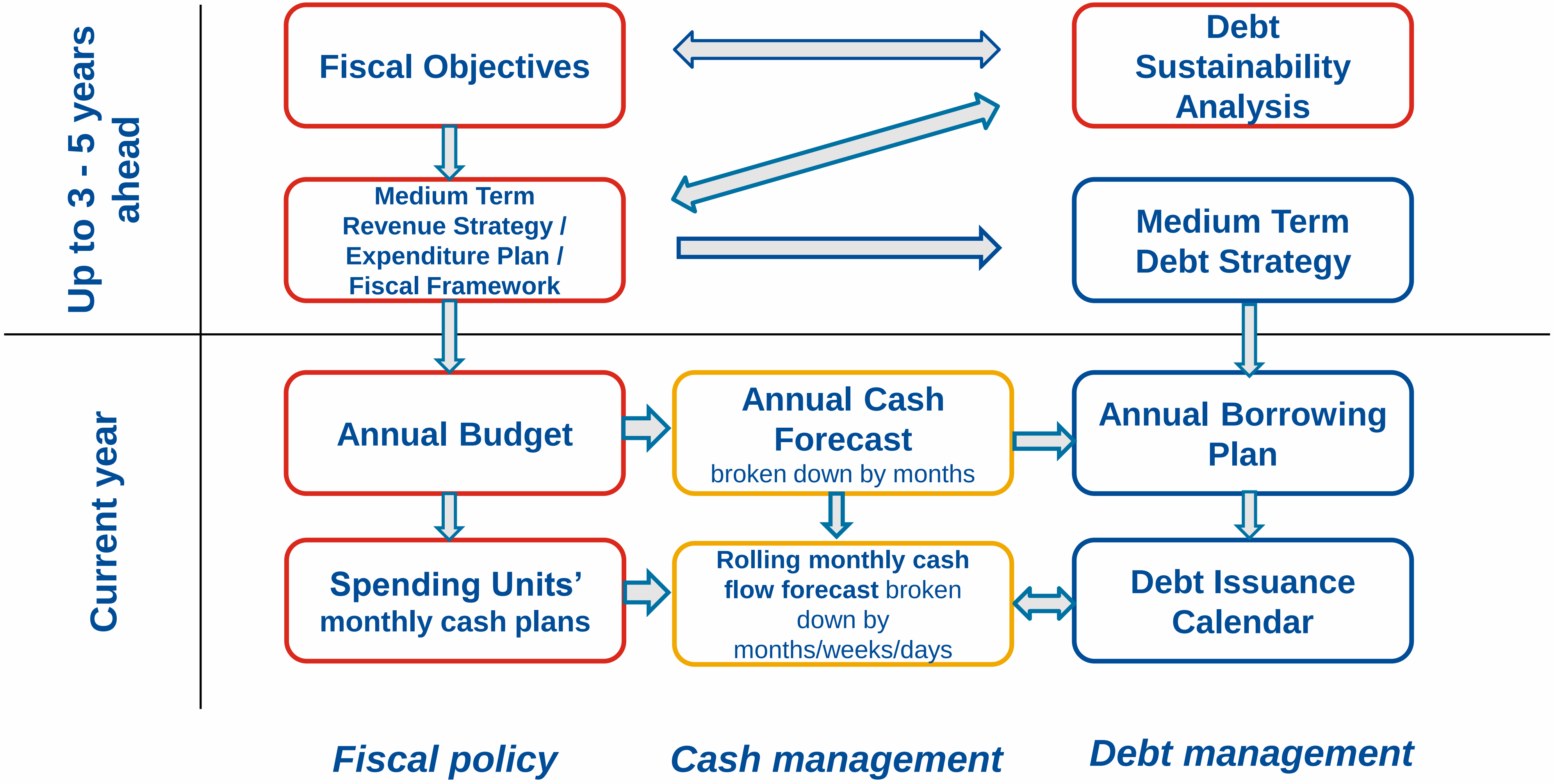
MTDS and MTRS: Analyzing the Resource Envelope



MTRS and MTDS

- Provide an overall understanding of the government's resource envelope and its potential evolution in the medium-term
- An iterative process:
  - What is the government's revenue generating capacity – how to achieve it?
  - Does the government have access to sufficient sources of financing to sustain the desired expenditure level under these revenue projections?
  - Can the resource envelope be expanded?
    - Prospects for domestic market development
    - Revising the MTRS

In practice: Designing and implementing fiscal and debt management strategies



MTDS and MTRS - Challenges

- Insufficient feedback loops in decision making

  - Flow of information may be one-sided: fiscal projections to borrowing requirement, but not always the opposite
  - Inadequate coordination mechanisms during policy formulation
  - Non-credible budget frameworks
    - → revenues do not come in as planned in budget implementation
    - → financing needs rise above planned levels
    - → market pressures (rising interest cost) and/or expenditure arrears
  - Lack of analytical capacity for planning / projections

MTDS and MTRS – In lieu of conclusion

- Decision makers should account for policy interdependencies when designing revenue, expenditure and financing policies
- Adequate coordination mechanisms should be in place to account for feedback loops
- Capacity development is needed both at the policy and technical level for better analysis, designing coherent strategic frameworks and implementation

MTRS approach to Tax System Reform

FERDI Webinar: Mobilization of Domestic Public Resources

Katherine Baer
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October 17, 2024

Outline

- **Why an MTRS?**
- **The MTRS approach, including its four interdependent components.**
- **An example of MTRS revenue proposal**
- **Status of MTRS across countries**

MTRS

- ***<u>High-level road map of the tax system reform over 4-6 years</u>***—its policy, administration, and legal components.

- Government's strategy to mobilize its own resources to finance its spending needs, while creating appropriate incentives for economic and social development.

Why an MTRS/What makes it different?

- Need to improve the quality of the tax systems, notably in the context of achieving the SDGs.
- Break with a focus on short-term measures and commit to a more comprehensive reform of the tax system.
- Visible country led – raises profile of tax system and increases accountability.
- Direct link to and driven by spending/financing needs.
- Increased certainty - clearer picture of likely revenue in the medium-term.
- Involvement of 'whole of government', civil society.
- Building tax capacity is a protracted/persistent effort.
- Better sequencing, integration of revenue reforms.
- Enhance coordination among donors/partners.

Core Elements of an MTRS

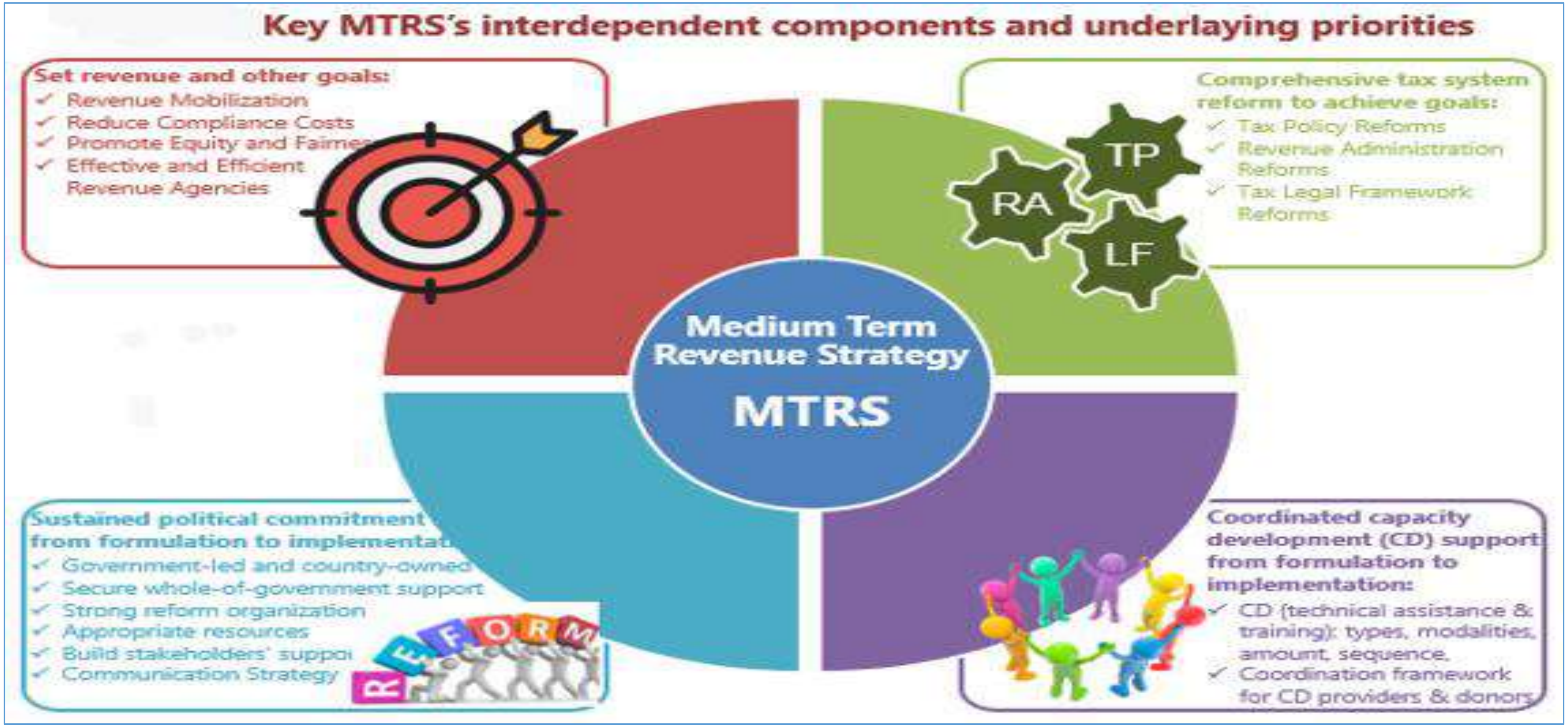
- A *broad consensus* on the level of revenue mobilization effort for the medium-term (4-6 years).

- A *comprehensive tax system* reform plan, reflecting country circumstances and the state of institutional capacity and tax reform efforts underway

- A *country's commitment* to a steady and sustained implementation, notably by securing political support and resourcing.

- A framework for *coordinated CD financing* (technical assistance and training).

MTRS – Four Interdependent Components



Designing and implementing an MTRS

- Four steps need to be undertaken in a systematic manner:

1. *Understanding the MTRS approach to tax system reform*—including its four interdependent components.

2. Taking stock of ongoing efforts—of the several tax system reform initiatives.

3. *MTRS gap analysis*—comparing ongoing reform efforts with the four interdependent components of an MTRS.

4. Addressing MTRS gaps by formulating an MTRS—building on ongoing tax system reform efforts.

Country-led effort

- Single document setting forth the country's vision of the tax system.

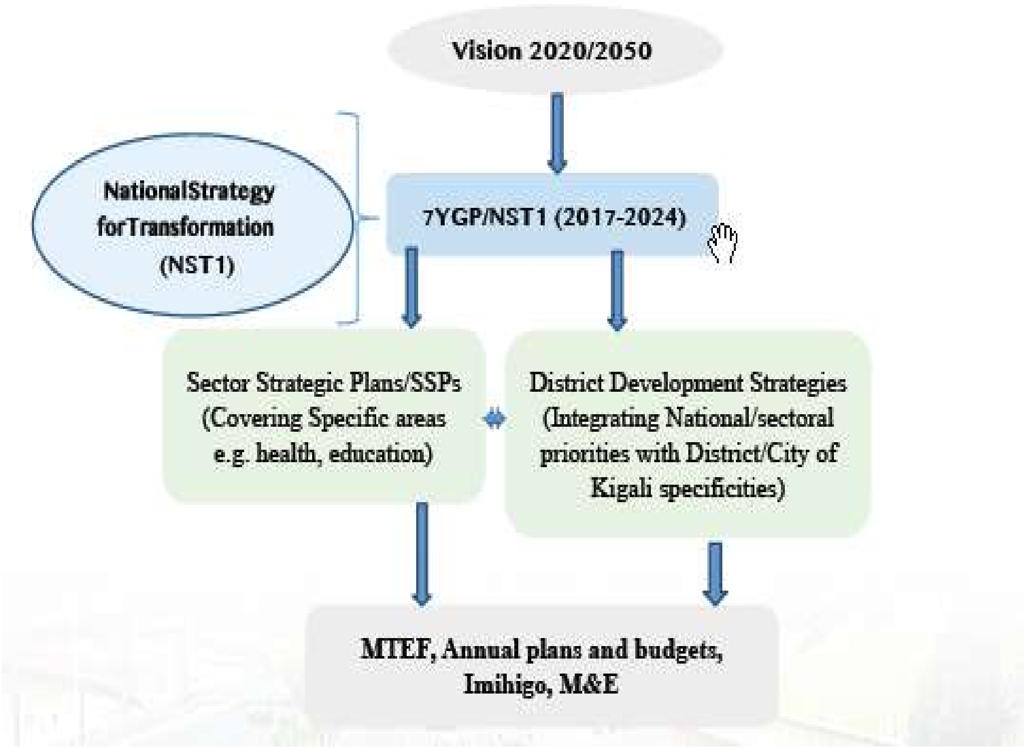
- Whole Government and inclusive approach to leading tax system reform.

- The plan supports the country's development objectives.

Builds consensus around a revenue target

- Inclusive – multiple stakeholders
- Society's expectations on public services:
  - Expenditure needs
  - SDGs agenda
- Social and economic development vision

Rwanda Development Planning Framework



Example of MTRS Summary Table: Rwanda

Table 1: Revenue Impact of the MTRS Reforms

MTRS Reform Proposal	Revenue Impact over MTRS Horizon (% of GDP)
Tax Policy Reforms	**0.46**
PIT Reforms	-0.4
CIT Reforms	0.8
VAT Reforms	-0.1
Excise Duty Reforms	0.15
Administrative Reforms	**0.54**
Shadow Economy & VAT rebate scheme	0.02
Compliance Improvement Strategies	0.46
Customs: valuation & classification	0.06

Integrates various aspects of reform

A framework for coordinating CD

- Provides framework for common understanding of government RM priorities across development partners (DPs).
- Helps identify support provided and needed (who does what).
- Helps align activities among different DPs…

Countries currently following MTRS approach

- Implementing MTRS: Cambodia, Egypt, Ethiopia, Ghana, Kenya, Liberia, Maldives, Pakistan, Papua New Guinea (PNG), Rwanda, Senegal, Sierra Leone, Tajikistan, Uganda

- Formulating MTRS: Albania, Bangladesh, Cote d'Ivoire, Indonesia, Tanzania, Thailand, Maldives, Uzbekistan, Vietnam

- Considering MTRS: Cameroon, Jordan, Lao People's Democratic Republic, Malaysia, Mongolia, Morocco, the Philippines

THANK YOU