

NATIONAL AUDIT OFFICE OF LITHUANIA PUBLIC AUDIT REPORT

The Government Successfully Borrows in the Domestic Market: How to Optimize this Process and to reduce Debt Management Costs

24 May 2011 No VA-P-700-1-6

Vilnius

SUMMARY

Audit started 6 January 2010

Audit completed 24 May 2011

Full audit report in Lithuanian is available at the

National Audit Office website <http://www.vkontrole.lt>

The National Audit Office of Lithuania carried out an audit of the management of the debt on behalf of the State, during which the efficiency of the management of Government securities (hereinafter – GS) issued in the domestic market was assessed. The audit covered the period between 2006-2009; in some cases data of 2010 was also used for comparison.

The Government borrows in the domestic market through issuance of bonds – GS with maturity of over one year, with maturity of 3, 5, 7 and 10 years, and Treasury bills – GS with maturity of under one year, with maturity of 1, 3, 6, 9 and 12 months.

Domestic GS comprise about 30 per cent of the debt on behalf of the State. Until the end of 2008, GS were issued in the domestic market only through auctions¹. Until February 2009, in the domestic market of Lithuania GS auctions were organized by the Bank of Lithuania, later on – AB NASDAQ OMX Vilnius. In 2008 with the start of economic crisis, the Government started to issue GS in the domestic market not only through auctions, but also through private placements concluding a contract with creditors, as well as resumed the issuance of savings bonds.

The Ministry of Finance successfully borrows in the domestic market: organization of GS auctions conforms to recommendations of the World Bank and International Monetary Fund, as well as best foreign practice.

During the audit no substantial problems related to the borrowing and debt management of the Ministry of Finance were detected; issues indicated in the report and recommendations given would allow to improve the efficiency of the GS management: i.e., to develop the domestic market, increase the demand of GS, which in the long run would help to reduce the debt management costs.

The Medium-Term Debt Management Strategy of the Government does not provide for the objective to develop and maintain the efficient domestic market; no analysis was conducted as to what is the maximum possibility to borrow in the domestic market. Establishment of the above mentioned objective and clear means to implement it would allow increasing the demand of GS issued in the domestic market, independence from foreign market and reduce the debt management costs in the future.

¹ Auction – a process in a book of assignments during which assignments to purchase and sell new issues, reopened issues and issues of GS redeemed before maturity are accumulated and automatically implemented.

GS auctions in the domestic market are insufficiently regular and predictable. In 2nd half of 2006 – 2009 the Ministry of Finance systematically cancelled previously announced auctions, which had a negative impact on auction participants and investors. Such a practice raises the distrust in auction organizers, hampers the market development, and increases the debt management costs in the long-run. The Ministry of Finance does not announce the amount of the issued GS; issuing GS in the domestic market, did not always follow the established borrowing programmes and calendars.

Appropriate planning of the borrowing need, announcement of the information about how regularly Treasury bills and bonds will be issued and about the planned amount of the GS issue would enable to attract more investors and develop the domestic market, as well as ensure the transparency of the Government plans.

The Ministry of Finance does not use auction evaluation indicators, which show the interest of investors in Government securities with various maturities. Use of Bit-to-Cover or other evaluation indicators showing the interest of investors in auctions would allow attracting more investors.

The audit pointed out that issuance and maturity dates of GS were not always closely linked to the need for public cash on respective days. The Ministry of Finance should ensure the balance between the regular nature of borrowing and need for public cash: it would enable to optimize the planning of borrowing and help to reduce the costs of interests.

In order to eliminate the possible risk of settlement between auction participants, to ensure the proper understanding of information, stability and transparency, requirements to auction participants issued by the Ministry of Finance should set the minimum and maximum amount of GS, which has to / may be purchased by one auction participant / investor in one auction, as well as to set requirements for non-competitive bids.

Seeking to attract the interest of possible new auction participants and potential investors, the Ministry of Finance should announce more information on its website related to the GS issuance process, carrying out of auctions; explain what information has to be submitted along with the bid for GS by auction participants, as well as particularities of various bids and advantages to individual groups of investors.

We want to point out that issues set out in the report and the terminology used is technical, specific and in many cases meant only for experts. (Terms used and their abbreviations may be found in Annex 1 of the Report.)