



Government Cash Management

Best International Practice

Based on Client Presentation
March 2004

Government Cash Management

- What is government cash management?
- Objectives – and benefits – of efficient government cash management policies
- Some policy choices and implications
- International best practice
- Different models
- Illustrative Practice

Definition of Cash Management

- The strategy and associated processes....
- for managing cost-effectively....
- the government's short-term cash flows and cash balances....
- both within government, and between government and other sectors

Objectives

- Economising on cash within government
 - Saving costs
 - Reducing risk
- Managing efficiently the government's aggregate short-term cash flow
 - Both cash deficits and cash surpluses
- In such a way as also to benefit
 - Debt management
 - Monetary policy
 - Financial markets (market liquidity and infrastructure)

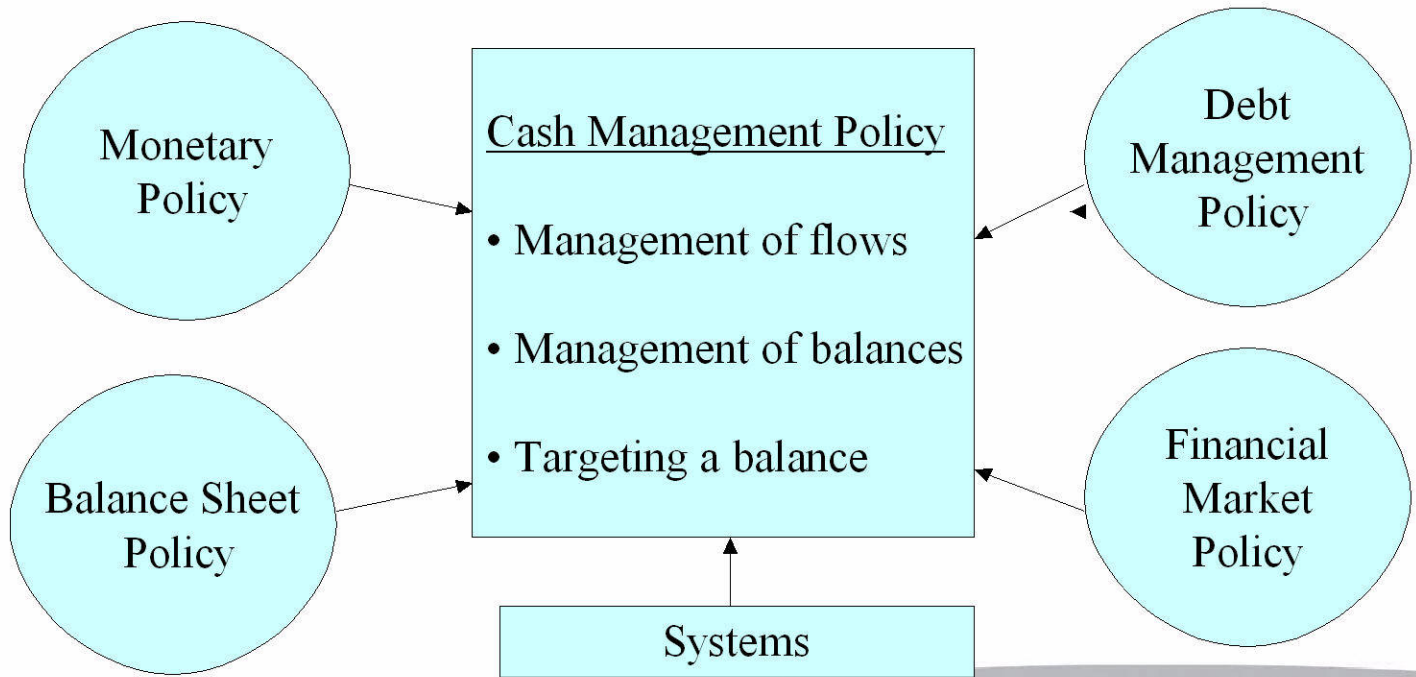
What it means in practice –within government

- Efficient cash handling and control systems
 - Help ensure payments are made properly; and that receipts are passed without delay
 - Reduce operational risk and the scope for mismanagement or fraud
- Reducing the volume of idle cash balances held by government departments with the banking system
 - Reduces government's borrowing needs
- Linking government accounts, netting balances through a single Ministry of Finance (MOF) account at central bank
 - Creates opportunities for active management
 - Reduces credit risk and moral hazard

What it means in practice – for government financing

- Increasing the range and liquidity of financing instruments – Treasury Bills and repo – adds flexibility
 - Makes sure government can fund its expenditures
 - Helps to match the timing of government cash inflows and outflows without changing the less flexible debt programme
 - Increases the options in the event of economic shocks – reduces the need for precautionary balances
- Removing (or reducing) the impact of government on short-term changes in money market liquidity
 - Makes monetary policy interventions less problematic
 - Reduces volatility of short term interest rates

Cash Management: Policy Issues



Management of Government Receipts and Payments

- Aggregate account structure – netted into single account at central bank
 - Consistent with devolution of payments and transactions responsibilities to commercial banks
 - Providing overnight balances with banks are minimal or (better) passed to a central bank account

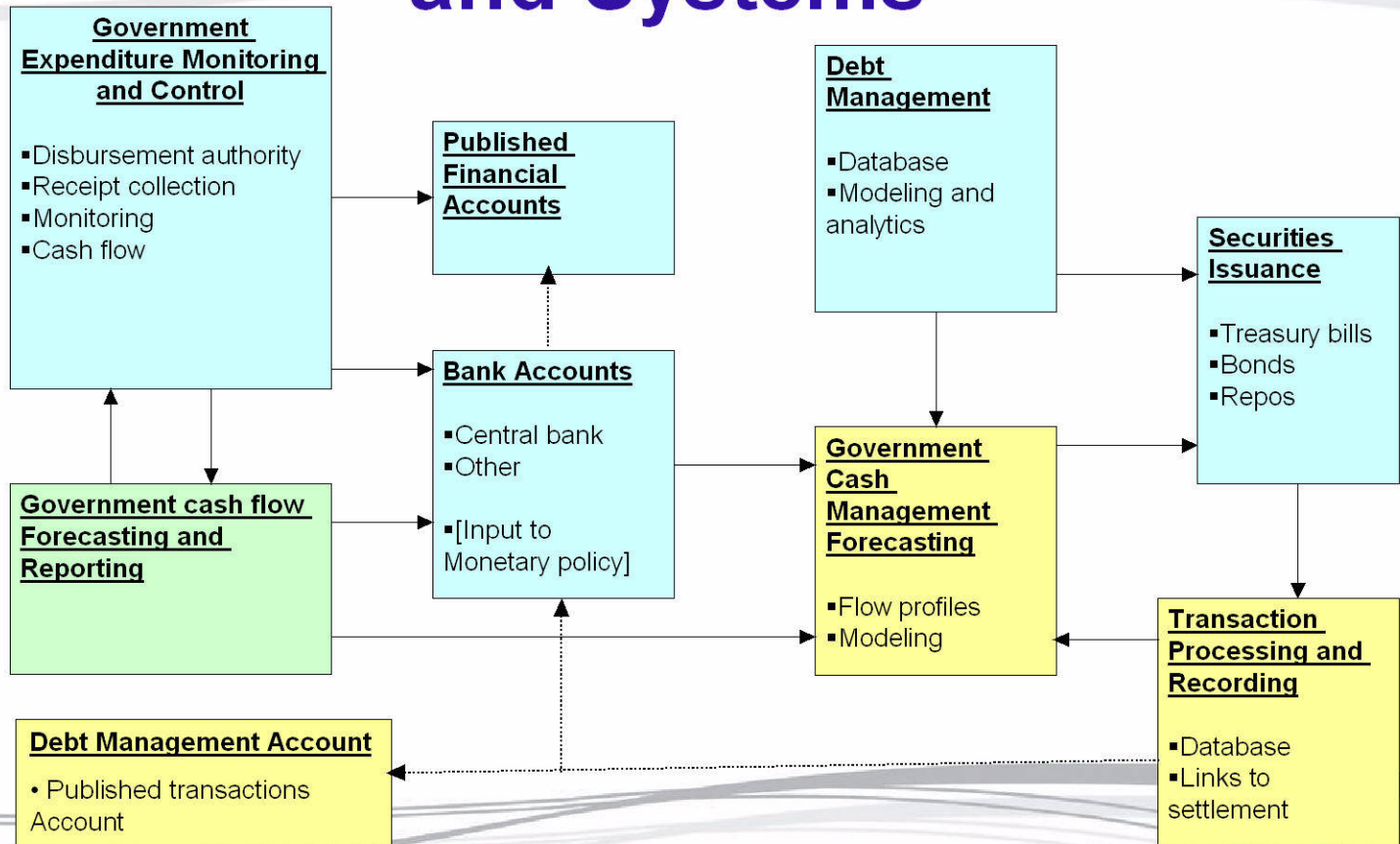
Management of Idle Balances

- Governments need access to liquidity – implies some cash balances
- Who has responsibility for their investment?
 - Central bank or MOF?
 - Who takes the risk and who has the benefit or loss?
 - Balances should be adequately and explicitly remunerated
- Investment of structural surpluses raises different issues – depends on objectives for government's balance sheet, and risk/return trade-off

Target Balances at the Central Bank

- In some countries, MOF takes responsibility for investing balances – targeting a low balance at central bank
- Associated with monetary policy independence of central bank (and helps to ensure it)
- Considerable advantages – clarity in financial markets, eases monetary policy operations – but technically demanding
- Intermediate models

Cash Management: Functions and Systems



Monetary Policy Objectives

- Whatever the model of government cash management, needs to be agreement with MOF and central bank covering
 - Flow of information from MOF on government's expected cash flows and balance at central bank
 - Flow of information to MOF on government's actual balance at central bank (in close to real time)
 - Remuneration of accounts – preferably at market rate
- Variety of mechanisms to establish co-ordination

Debt Management Policy

- Integration of debt and cash management ensures that
 - Debt issuance decisions are taken in the context of the seasonal nature of government's cash flows
 - Allows pattern of bond sales to be announced in advance, since timing of bond sales need not be linked with the timing mismatch between receipts and payments
 - MOF has overview of whole market – important when taking decisions about the future balance of short- and long-term debt, including Treasury bills.
 - Operational and risk management advantages

Financial Market Development - 1

- Development of government securities market is both effect of reform and contributes to it
- Yields on government securities serve as benchmark in pricing other assets and catalyst for growth of securities markets
- Government benefits from extra liquidity
 - reduced debt costs
 - greater flexibility to respond to economic shocks

Financial Market Development - 2

- Treasury Bills play an important role
 - Extends the yield curve
 - Use in collateral and payment systems
 - Additional risk-free assets for banks, assists balance-sheet development
 - Lower settlement and operational risk than repo
 - Suitable for non-bank investors

International Experience

- Review includes:
 - United Kingdom
 - Eurozone
 - Australia
 - United States
 - Canada
 -
- Many similarities, but some important differences

Best International Practice -1

- Processing of government transactions with few handling steps – reliance on electronic transactions, centralised systems
- “Single Treasury Account” (STA)
 - Internal accounting arrangements (and incentives) to minimise level of idle balances and reduce timing uncertainties
 - Account structures that net transactions and aggregate balances to a single account at central bank
- Internal systems to forecast daily government flows of receipts and payments

Best International Practice - 2

- Agreements between MOF and central bank on information flows and respective responsibilities (but no borrowing from central bank)
- Close interaction between government debt and cash management
- Use of Treasury Bills (and repo and reverse repo) to help manage balances and timing mismatches
- Efficient payment infrastructure

International Practice: Some Differences

- Institutional arrangements
 - Way in which debt and cash management are integrated
 - Central bank independence from MOF
- Extent to which Government balances are a ‘target’
- Central bank monetary policy operations
 - Management of fluctuations in balances
 - Determinants of Treasury Bill issuance (and potential use of Central Bank bills)

Main Models – Target Balance

- Eurozone, UK and Sweden: ministry of finance or debt office targets low and stable balance at central bank
- Differences of approach
 - Definition of target balance varies
 - Different modes of interaction with market (secured or unsecured, auctions or bilateral, issuing Treasury Bills or commercial paper, interbank or repo market)
- Difficult - some more successful than others!

Main Models – Other

- MOF or debt office maintains minimum balance at central bank – and/or rough tunes with Treasury Bills
 - Australia
- Balances left with banking sector until convenient to transfer
 - US (deposits collateralised, maintain balances at Fed of \$5-7 billion – but can be exceeded)
- Central bank takes responsibility for handling cash variations
 - Places deposits directly with banks (Canada)
 - Takes into account in own money market operations (UK pre-2000)

Typical Phases of Development

- **Phase 1: Single Treasury Account**
 - integration of government accounts
 - sweeping of overnight balances into single MOF account at central bank
- **Phase 2: Forecasting capability**
 - the development of a capability within MOF to monitor and forecast flows in and out of government – i.e. changes in MOF balances at central bank

Typical Phases of Development

- **Phase 3: Rough tuning**
 - the issue of Treasury bills (or other bills)
 - issuance pattern designed to offset liquidity impact of net daily cash flows, i.e. to smooth the change in MOF's balance at the central bank
 - some management of structural surpluses
- **Phase 4: Fine tuning**
 - more active policies, drawing on a wider range of instruments or institutional options, to smooth more fully MOF's balance at central bank

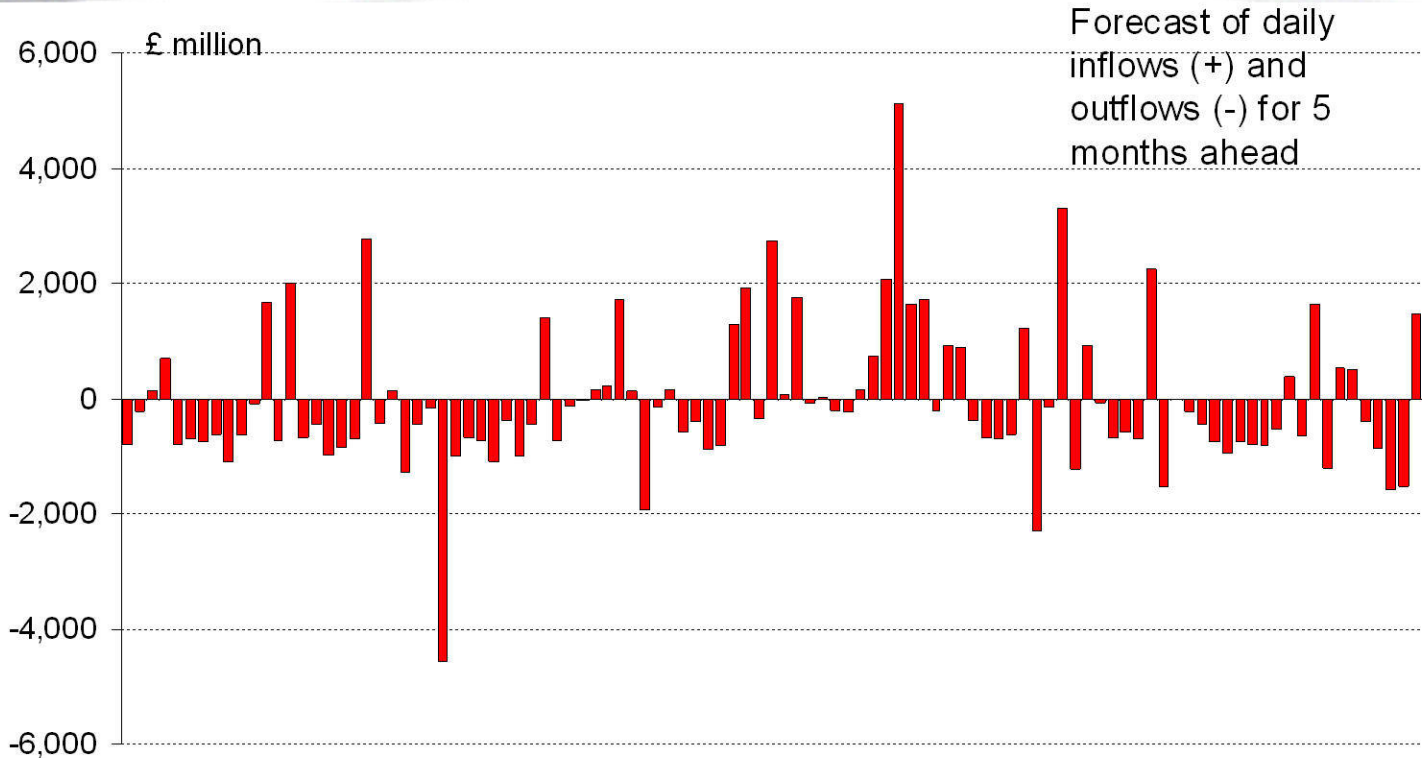
Emerging and Transition Countries

- Emphasis should be on first 3 phases
 - Set medium-term objective
 - Treasury bill example follows (illustrative data)
- Consider fine tuning in due course
 - (for some countries) will be needed for euro membership
 - operationally more demanding
 - goes hand in hand with financial market reform
- Develop capabilities incrementally – but as steps on a route to an understood objective
- Work on different phases can proceed in parallel

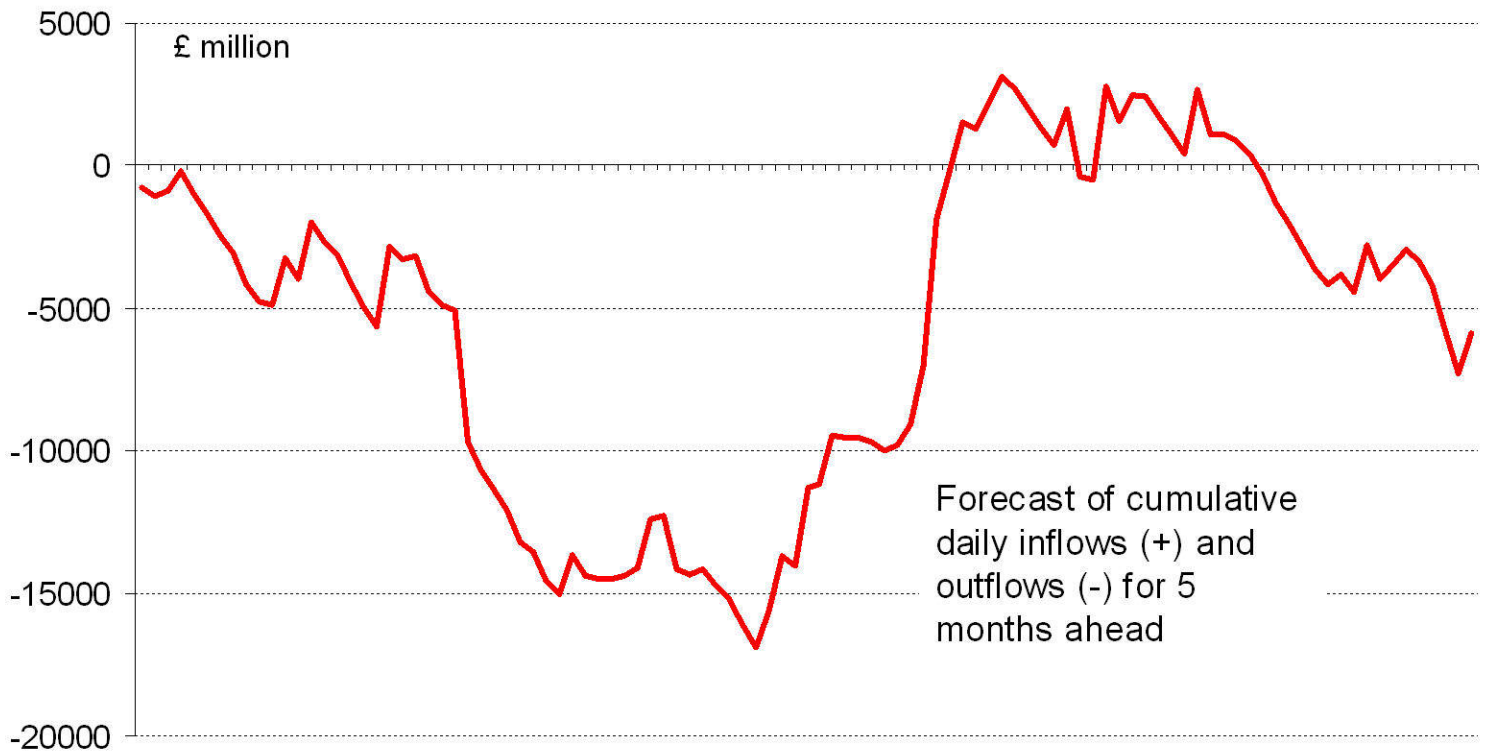
Illustrative Data

- Next 7 slides
- Slides 26-31
 - Illustrative not actual data
 - But not untypical for the time
- Slide 32
 - Published data for UK Treasury Bill issuance in 2002-03

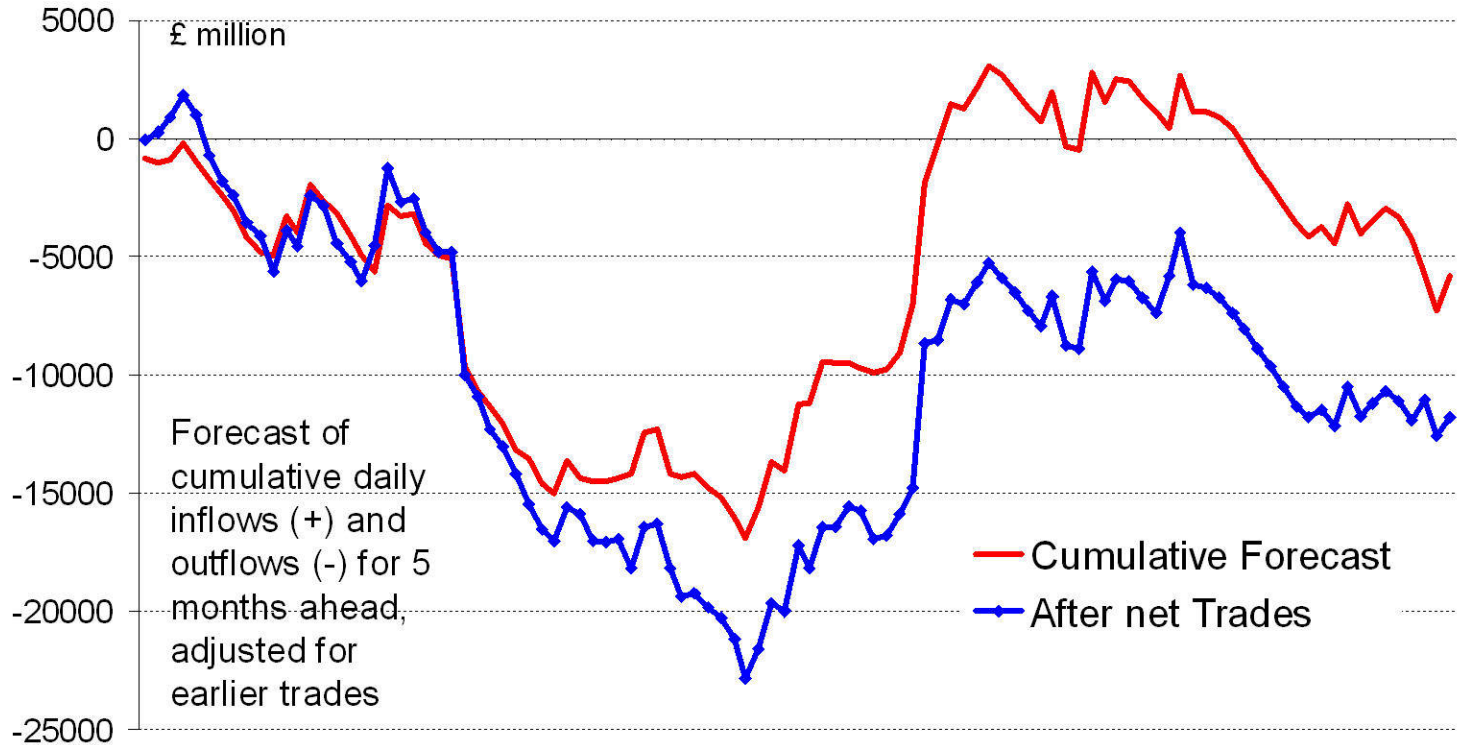
Daily Forecast of Net Cash Flows



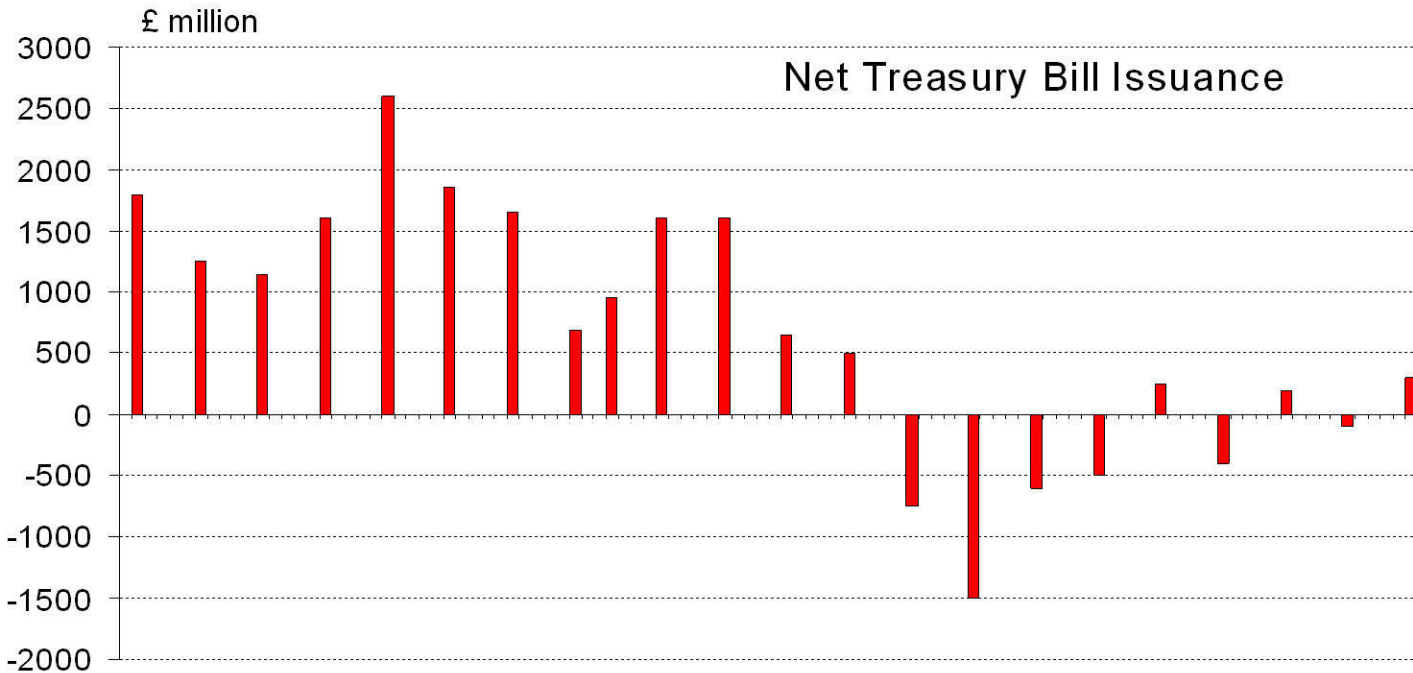
Cumulative Daily Forecast



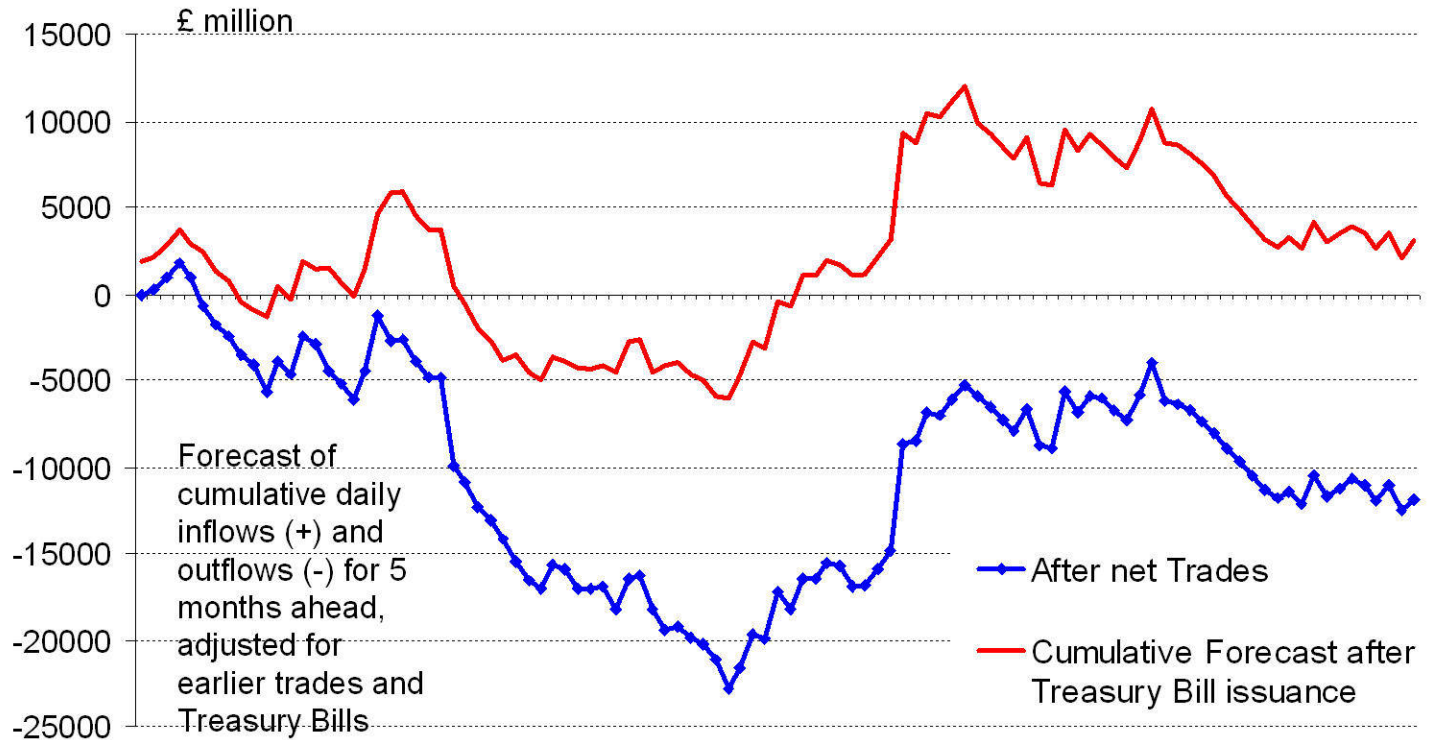
Cumulative Daily Forecast, adjusted for earlier trades



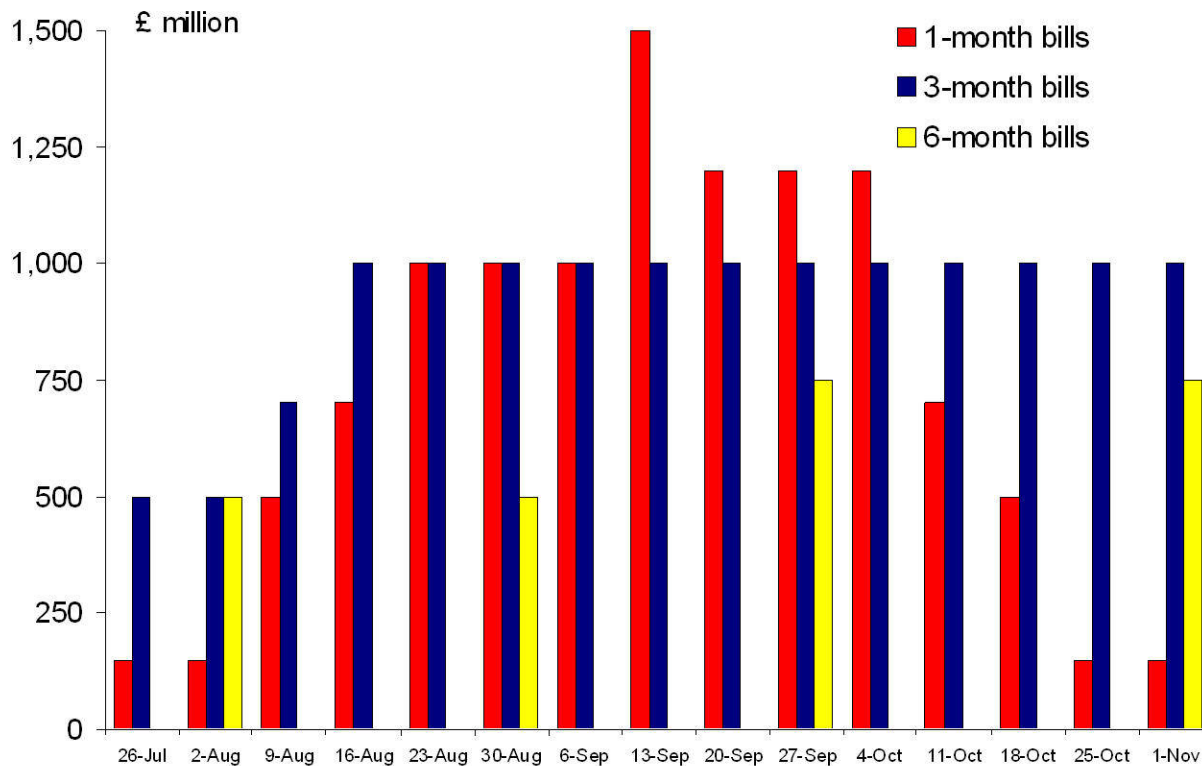
Planned Treasury Bill Issuance for Illustrative Forecast



Smoothing with Treasury Bills



Treasury Bills – Typical Issuance Pattern



Conclusion

- Substantial economic benefits from efficient cash management
- International consensus on main characteristics of efficient cash management
- But some important differences
 - How far MOF or debt office tries to meet a target of a low stable cash balance at central bank
 - Or left to central bank to balance the residual cash flow
- In emerging and transition countries, emphasise development of STA, improved forecasting and rough tuning (e.g. using Treasury Bills)