Comments on McCauley's paper "Consolidating the public debt markets of Asia"

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The main arguments of the paper are as follows: dual mismatches of foreign borrowings, ie currency and maturity mismatches, were important causes of the East Asian financial crisis. Accordingly, it is necessary to develop the region's bond markets. In particular, unifying government bond markets and central bank debt markets may contribute to the development of bond markets.

The benefits of unifying government bond markets and central bank debt markets are as follows: an increase in liquidity in the secondary bond market through the development of the repo market and thereby the development of the government bond market; and advantages for monetary operations through greater influence on short-term rates with the help of a reduction in the burden of redemptions of maturing debt and interest payments.

Outstanding amounts of government, public and corporate bonds in Korea

End of period, in trillions of won

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Monetary Stabilisation Bonds	25.8	25.0	23.5	45.7	51.5	66.4	79.1	84.3	105.5
Government bonds	23.3	25.7	28.6	41.6	61.2	71.2	82.4	98.3	135.8
(Treasury bonds)	3.0	4.9	6.3	18.8	34.2	42.6	50.9	55.6	81.4
Corporate bonds	61.0	76.0	90.1	122.7	119.7	133.6	154.4	180.0	187.4
Total	164.6	190.0	234.2	343.9	376.2	429.3	501.6	544.8	574.1

Looking at the table, these suggestions seem acceptable, but there are some practical problems, which include: the difficulty of creating synergy effects from the consolidation of two markets to reduce the liquidity premium; and the possibility of reducing the efficiency and independence of monetary policy.

First, as relates to the difficulty of creating synergy effects from the consolidation, it should be taken into account that the two debts have different characteristics. In particular, government bonds have a relatively easy periodical issuance and are readily fungible, while central bank debt is issued to offset changes in bank reserves due to autonomous factors such as flows of government funds or changes in foreign exchange holdings.

1 Views expressed herein are those of the author and do not necessarily reflect those of the Bank of Korea.

Second, as relates to the possibility of reducing the efficiency and independence of monetary policy, it should be pointed out that, in fact, it is difficult to reach an agreement on the issue of government bonds for monetary stabilisation, and the practical procedures for reaching an agreement on the issue from the parliament are complicated.

As an alternative, it may be suggested that bonds be issued by the central bank and interest on them be paid by the government, as in Germany, New Zealand and Israel, etc. In Germany, an issue of three-, six- and nine-month government bonds up to DM 25 billion was decided by the Bundesbank, and in New Zealand, government bonds and central bank debt of three-month maturities for monetary operations are used together for monetary stabilisation, with the interest on the central bank debt paid by the government. More central bank independence is a prerequisite to the implementation of these policies.

As another alternative in Korea, a more feasible step-by-step approach may be considered, taking the current situation into account. As a first step, quasi-fiscal burdens of the Bank of Korea due to aggregate credit ceiling loans, and the underwriting of non-performing asset management fund bonds etc would be transferred to the government to reduce the issuance of Monetary Stabilisation Bonds (MSBs). As a second step, interest on MSBs would be paid by the government. And as a third step, Monetary Stabilisation Government Bonds (MSGBs) would be substituted for MSBs. Amounts, time and conditions of the issue of MSGBs up to a certain amount agreed on by the parliament would be decided by the BOK.

In order to introduce these approaches, it is important to have independence and coordination between government bonds and MSBs, and monetary, fiscal and foreign exchange rate policies. Step-by-step substitution of the government bonds for MSBs seems more feasible and desirable, in line with the improvement of circumstances for the independence of the central bank and of understanding about the use of government bonds for monetary policy operation.